Chapter 6: The consequences of bankruptcy: Part 2

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Content

Summary

There are many different consequences of bankruptcy. Some of the concepts are quite complicated. It is important to have a broad understanding of the principles and to be familiar with problems that might arise so that you know what questions to ask the client and when to seek more advice on their behalf.

This section is broken up into segments. Parts 1 – 5 covers:

1. What happens to debts?
2. What property is protected?
3. What property will be taken by the Trustee?
4. Whether the client has to pay income contributions and how much.
5. What other consequences there might be.

Financial counsellors should be aware of the content of all these parts at least in broad terms as they are relevant to all clients.

Parts 6 – 9 need only be referred to if they are relevant to your client's individual circumstances. They cover in order:

6. Small Business
7. Family Law
8. Gambling and hazardous speculation
9. Death

Introduction

Your client must understand the following potential impacts of bankruptcy before making an informed decision whether to go bankrupt:

- **Debts** – will they go away?
- **Assets** (past, present and future) – will the trustee in bankruptcy ('the Trustee') take them? Can the Trustee undo past transactions and get at assets now owned by others? What about assets your client may acquire in the future?
- **Income –** will the client have to pay a portion of their income towards their debts ('income contributions') and if so, approximately how much?
- What other limitations might there be on the client's life as a result of the bankruptcy?

These are all covered in this Chapter.

> **Note:** The same consequences apply when the client has been made bankrupt on a Creditor's Petition, although in that case there is no decision for the client to make. You can refer to this Chapter to advise your client about what to expect during bankruptcy. You should also refer to the bankrupt's obligations in **Chapter 8**. If your client has very recently been made bankrupt and does not think this should have happened, refer to **Chapter 10** – A sequestration order has been made against my client – Is there anything he or she can do? Advise your client to seek urgent legal advice.

Part 2: Protected property – what can I keep?

Summary

When a person becomes bankrupt (either by filing a Debtor's Petition or by an order of the court based on a Creditor's Petition) their divisible property vests in the Trustee and becomes available to be sold and distributed among creditors. Some property is protected by the Bankruptcy Act and does not vest in the Trustee or become available for creditors. This Part explains what property is protected and therefore not divisible.

In brief, protected property includes among other things:

- Essential household property (furnishings and appliances for example with very few

exceptions).
- Tools of trade up to a prescribed value.
- A vehicle used as a primary means of transport up to a prescribed value.
- Policies of life assurance or endowment in respect of the life of the bankrupt or his or her spouse or de facto spouse.
- Superannuation that has not been withdrawn from a superannuation fund prior to bankruptcy.
- Compensation for personal injury paid to the bankrupt.
- Superannuation withdrawn on or after the date of the bankruptcy.
- Proceeds of life assurance or endowment policies received on or after the date of the bankruptcy.
- Property where substantially the whole of the purchase price was made up of funds from one or more of the last three dot points. These are collectively referred to as protected money (that is personal injury compensation paid to the bankrupt, or where received on or after the date of the bankruptcy, payments from superannuation, life assurance or endowment).

Amounts for prescribed values (or thresholds as they are often called) where shown, are included up to the date of publication. For current prescribed amounts check the AFSA website.

Of course it is not always that simple and the detail and potential complications are covered below.

Sometimes a property will be partially protected and partially divisible. For example:

- A car worth more than the prescribed value.
- A house that has been purchased with a combination of protected money and other funds.

In that case the unprotected portion will vest in the Trustee and the Trustee may sell the property and return to the bankrupt the value of the protected portion.

All other property is divisible property and is covered in Part 3 of this Chapter.

All property should be included in the statement of affairs, whether it is protected property or not!

What happens to a person’s property when they become bankrupt?

When a debtor becomes a bankrupt (on the first instant of the day on which the Debtor's Petition is accepted by the Official Receiver – s 57A), then the property of the bankrupt 'vests' in the Trustee (s 58) (that is the trustee in bankruptcy which may be the Official Trustee (AFSA), or the relevant Registered Trustee). The same occurs when a court makes a sequestration order making a person bankrupt (see **Chapter 10**).

Any property acquired by the debtor during the period of the bankruptcy also vests in the relevant Trustee. This property (along with any income contributions) makes up the bankrupt estate. This means that the debtor has no right to deal with the property anymore and the Trustee acquires extensive rights to deal with the property for the benefit of the creditors. The Trustee is then entitled to take possession of the property (s 129) and can sell the property, lease it, divide it among creditors, carry on any business of the bankrupt until such time as it can be wound up or sold, mortgage any property, make compromises with creditors and more (s 134).

None of this, however, affects the right of a secured creditor to repossess and sell the secured asset. Dealing with secured debts in bankruptcy can be quite tricky and the most common scenarios, houses and motor vehicles are dealt with separately later in **Chapter 6 Part 3.**

The property that has vested in the Trustee can then be dealt with as the Trustee sees fit in order to meet the demands of creditors with provable debts and to cover the costs of administering the estate. However, there are some types of property which are not available to creditors. Property which is available for creditors is known as divisible property and property which is protected is referred to as protected property.

Protected property

Importantly, some property is protected by the Bankruptcy Act from division among the creditors including (Section 116):

- Property held in trust for another person (the trust must be properly documented and comply with any relevant laws to be valid);
- Household property (see **Protected household property** below);
- Tools of trade used to earn a living (property used to earn income by personal exertion) up to the prescribed value ($4,450 as at August 2025. For current indexed amounts check the AFSA website).

  Remember: The value is garage/auction value not replacement or insurance value.

- A vehicle used primarily as a means of transport up to the prescribed value ($9,600 as at August 2025. For current indexed amounts check the AFSA website). Where the vehicle is secured the critical amount is the equity level (value of vehicle less any loan secured over the vehicle);

- Policies of life assurance or endowment assurance in respect of the life of the bankrupt or the spouse or de facto partner of the bankrupt (that is the policy itself, not any money paid out or withdrawn from it prior to bankruptcy);
- The proceeds of a life assurance (or life insurance) or endowment assurance policy referred to in the previous point received on or after the date of the bankruptcy;
- The interest of a bankrupt in a superannuation fund (except where it can be shown that funds or property were transferred to the superannuation fund for the purpose of depriving the creditors of that property or otherwise or delaying their access to it);
- A payment from a superannuation fund received on or after the date of the bankruptcy (provided it is not a pension within the meaning of the *Superannuation Industry (Supervision) Act* 1993). The issue of Total & Permanent Disability (TPD) payouts linked to superannuation and life policies is a difficult issue and your client should seek legal advice before proceeding with bankruptcy (more information is included in below in the section titled Superannuation and Bankruptcy and in Chapter 8 in the section titled Insurance Claims);
- Money held in a Retirement Savings Account (under the *Retirement Savings Act* 1997);
- A payment from a Retirement Savings Account (provided it is not a pension within the meaning of the *Retirement Savings Act* 1997);
- Any right of the bankrupt to recover damages or compensation for:
    - personal injury or wrong done (for example defamation) to the bankrupt, their spouse or de facto partner, or a member of their family
    - the death of the bankrupt's spouse or de facto partner, or family member.
- Any compensation received by the bankrupt for personal injury, wrong or death in the previous point, whether received before or after the bankruptcy (NOTE – compensation paid to others as opposed to the bankrupt is not protected if it has been given to the bankrupt, nor is any divisible property – such as a house – purchased with compensation received by, for example, a spouse of the bankrupt and placed in the name of the bankrupt);
- mounts originating from a Rural Support Scheme in prescribed circumstances;
- Money required to be transferred to a spouse or de facto partner under the *Family Law Act 1975 (Parts VIII and VIIIAB)*
- Payments made under the *National Redress Scheme for Institutional Child Sexual Abuse Ac*t 2018 (Cth) to the bankrupt
- Awards of a sporting, cultural, military or academic nature made to the bankrupt, such as trophies & medals, that are claimed as having sentimental value, may be exempted by a vote of creditors (in practice this issue rarely arises as most such awards have no monetary value). Money paid as prize money is not protected.

Note: Defence Service Home Loans: Where the client has a home that is being purchased with a Defence Services Home Loan, the home is protected unless the Secretary of the Department waives the protection due to fraudulent behaviour of the borrower (which would be most unusual). Also, the protection ceases if the borrower re-finances and the Defence Services Loan is paid out in the process. Accordingly, clients should be advised to maintain the Defence Services Home Loan when they are re-financing by way of a second mortgage.

Protected household property

A full description of household property that is NOT divisible among creditors is found in Bankruptcy Regulation 27.

Generally, ‘household property (including recreational and sports equipment) that is reasonably necessary for the domestic use of the bankrupt’s household, having regard to current social standards’ is not available for distribution among creditors and can be retained by the bankrupt.

Specifically:

a. In the case of kitchen equipment, cutlery, crockery, foodstuffs, heating equipment, cooling equipment, telephone equipment, fire detectors and extinguishers, anti-burglar devices, bedding, linen, towels and other household effects (to the extent consistent with the above definition);

b. Sufficient household furniture;

c. Sufficient beds for the members of the household; and

d. Educational, sporting or recreational items (including books) that are wholly or mainly for the use of children or students in the household;

e. 1 television set;

f. 1 set of stereo equipment;

g. 1 radio;

h. Either:

- 1 washing machine and 1 clothes dryer; or
- 1 combined washing machine and clothes dryer;

i. either:

- 1 refrigerator and 1 freezer; or
- 1 combination refrigerator/freezer;

j. 1 generator, if relied on to supply electrical power to the household;

k. 1 telephone appliance;

l. 1 video recorder (or equivalent technology).

In the case of household property not included above, the following should be considered in determining whether or not a particular item is protected household property:

a. The number and ages of members of the bankrupt's household;

b. Any special health or medical needs of any of those members;

c. Any special climatic or other factors (including geographical isolation) of the place where the household residence is located;

d. Whether the property is reasonably necessary for the functioning or servicing of the household as a viable and properly run household;

e. Whether the costs of seizure, storage and sale of the property would be likely to exceed the sale price of the property;

f. If paragraph (e) does not apply – whether for any other reason (for example, costs of transport) the sale of the property would be likely to be uneconomical.

Antiques may be divisible property (that is 'not protected'). An item is considered antique only if a substantial part of its market value is attributable to its age or historical significance (Regulation 27 (5)-(6)).

Note: This regulation also forms the definition of property that cannot be taken as security for a loan under the *National Credit Code*.

Tools of trade

Tools of trade used to earn a living worth up to the prescribed value are protected in bankruptcy and cannot be taken by the Trustee (the prescribed value is $4,450 as at August 2025. For the current indexed amounts check the AFSA website.

Remember: The value is garage/auction value not replacement or insurance value.

The Act no longer refers to 'tools of trade' since the 1996 amendments. Instead, the phrase is property 'for use by the bankrupt in earning income by personal exertion' (s 116(2)(c)). This reflects a general trend to widen the scope of the provision from being restricted to men who earned their living by manual labour using the implements or tools of their trade to encompass a broader range of occupations. Therefore it could include a pianoforte (for a music teacher), or a computer for a home-based consultant or law books up the threshold value for a lawyer. However, there are some restrictions:

- The person must have the capacity to use the property to earn an income by personal exertion – that is the bankrupt must have the requisite skills and ability. If the property relates to a trade that the bankrupt is not trained in or the bankrupt is too ill (permanently) or disabled to continue in, then the property will not be protected;
- The property must have a readily identifiable connection with income producing activities carried out by the bankrupt – although it could arguably be a different activity to the primary income generating activity of the bankrupt prior to the bankruptcy.

Bottles of wine used for wine tasting were found by the court not to be protected because they were consumables and therefore did not fit in the ordinary concept of a 'tool'. However, it is not clear whether this case was referring to the current s 116(2)(c) which uses the broader term 'property' or the former version of the Act which referred specifically to tools of trade etc.

Property in excess of the threshold amount can be protected where:

- There is a resolution passed by the creditors to allow this (presumably because they are convinced that they are better off allowing the bankrupt to use the property to earn income than by selling and dividing the proceeds); or
- A higher amount is ordered by the court upon the application of the bankrupt.

These exceptions are clearly intended to address the somewhat arbitrary nature of the setting of the threshold amount.

Motor vehicles

A vehicle used primarily as a means of transport up to the prescribed value is protected and cannot be taken by the Trustee (the prescribed value is $9,600 as at August 2025. For the current indexed amounts check the AFSA website. Where the vehicle is secured, and the bankrupt can afford the payments, the critical issue is the equity level.

If your client owns one or more motor vehicles you need to ask the following questions:

- What is the total value of the vehicle(s)?
- Is/are the vehicle(s) security for a loan?

Unencumbered motor vehicles (no secured loan)

> **Note:** All of the following assumes that the vehicle is not protected for another reason, such as that it was wholly or substantially purchased with money received for compensation for personal injury – see next section below.

Where there is no loan, then whether or not your client can keep the car will depend entirely on the market value of the car. Your client will be able to retain one vehicle as a primary means of transport if it is valued at less than the prescribed amount (in reality a bankrupt can usually retain more than one vehicle provided their combined value does not exceed the threshold). If your client's vehicle is worth this amount or less, then he or she will definitely be able to retain it. If it is worth more than $2,000 **over** this amount, then the Trustee may sell the vehicle. There is a grey area in the middle where the Trustee is highly unlikely to take the vehicle because the costs of selling it will not make it worthwhile. If there is a question over the protection of the vehicle the client should be advised to discuss the situation with AFSA. Clearly the closer the value to the prescribed amount, then the less likely it will be sold.

If your client has more than one vehicle, then any additional vehicle will be sold unless their **combined value** is worth **less** than the threshold amount. Where your client has one car worth a significant amount of money (say $25,000) and another worth very little (say $2,500) then the Trustee will take and sell the more expensive car and there is no requirement to return the difference between the value of the cheaper car and the threshold amount. If the client has a good relationship with the Trustee they may be able to come to another arrangement but strictly speaking the bankrupt is entitled to a (singular) primary means of transport. Your client may want to consider selling both (for market value) prior to bankruptcy and purchasing a car valued closer to the threshold amount. Keep in mind that the Trustee may seek to recover any proceeds received above the value of the car eventually retained if this transaction occurred close to the date of the bankruptcy. It is most unusual for a client to a have an unsecured motor vehicle that has an auction value well in excess of the threshold, as high value vehicles will usually be subject to a lease, hire purchase or other secured credit agreement.

If your client has only one vehicle valued at well above the threshold amount, then it will be sold, and the threshold amount returned to the bankrupt to allow them to purchase a cheaper vehicle as a primary means of transport**.** However, the Trustee will usually accept an offer from a friend or relative of the bankrupt to pay the difference between the auction value of the vehicle and the threshold amount, to enable the bankrupt to retain the vehicle. If your client and his or her partner are both bankrupt, they can usually retain one vehicle each valued up to the threshold amount. AFSA (where the Official Trustee is the Trustee) may allow a couple who are both bankrupt to retain one vehicle worth twice the threshold amount, but it is unclear whether private registered trustees will interpret the law in this same way.

Case study

A client and his wife have a car worth approximately $19,000. They still owe about $4,000 on a secured loan. The husband is considering going bankrupt but the wife is not. Although there is $15,000 equity in the car, the husband's share is only $7,500 which is close to the threshold amount. In these circumstances the Trustee is very unlikely to take the car. If the car was worth closer to $26,000 the

Trustee may request the wife to make an offer to purchase the husband's share less the threshold amount – in this case about $2,900.

The Trustee cannot take a car that does not belong to the bankrupt. Proving ownership of a vehicle may not always be straightforward. Registration is only an indicator of ownership. Who paid for the vehicle is also very important, as is any evidence of the purchaser's intentions in relation to ownership (was the car intended as a gift?). Who predominantly uses and maintains the car may also be important. Even if it can be established that the vehicle belongs to someone other than the bankrupt, then the bankrupt will be asked to supply details of their ongoing use of the vehicle in the statement of affairs as this benefit could be deemed as income for the purpose of establishing whether income contributions are payable and how much. Often, clients under 25 will have their vehicle registered in a parent's name to reduce the insurance premiums.

Remember: Putting a car in another person's name, such a spouse or family member, in anticipation of bankruptcy could be found to be an undervalue transaction or transfer to defeat creditors as with any other asset. These are known as *antecedent transactions* and more information on the trustee's powers in relation to *antecedent transactions* is found in **Chapter 6 Part 3**.

Where a vehicle has been specially modified for a person with a disability, AND is necessary for their transport, AND is worth more than the prescribed value, then there *may* be a way of protecting the vehicle:

- Was it paid for with compensation funds? – if so, it may be protected (see below in relation to compensation for personal injury);
- Is the trustee willing to seek a resolution from creditors under s 116(2)(ca) that a greater amount than the prescribed value should apply in the circumstances?
- Apply to the court (it is not clear whether this is possible – it is not mentioned as an option in the relevant section of the Act, as it is with property used for personal exertion, but there are broad powers under the Act to apply to the court on a range of issues (s 30) and your client should seek legal advice);
- Have a relative or other interested party negotiate to pay the Trustee the difference in value.

As there is always some discretion involved in deciding whether to sell a vehicle for the benefit of the creditors it is always worth making a case to the Trustee on behalf of a client with special needs (their own or their dependents) where the value of the vehicle is not too far above the threshold.

Tip If your client is unsure of the value of their vehicle, you can find out by using the Redbook website. You will need the following details:

- Make
- Model
- Year
- Kilometres travelled (odometer reading)
- Condition (well maintained/poorly maintained etc)

This service cost $33 (as at May 2024).

Where there is a loan secured over the vehicle

Where the car is security for a loan (whether by mortgage, bill of sale or other means) then what will happen to it depends on the amount of the client's equity in the vehicle. This is simply the market value of the vehicle less the amount outstanding on the loan. If the equity equals the prescribed amount or less, the Trustee will not be interested in the vehicle and the client may retain it provided they can keep up the repayments on the loan. Should the client fail to make the repayments then the lender can repossess the car in accordance with their contractual rights. In most cases the market value of the car will be less than the loan because cars depreciate in value quite quickly.

> **Note:** In some cases, creditors will seek to rely on a provision of the contract to repossess the vehicle just because the debtor is bankrupt, even though he or she is up to date with their repayments. Such clauses are void by virtue of s 301 (or s 302) of the Bankruptcy Act. This means that the creditor cannot take action on this basis alone (the fact of the bankruptcy) – the client needs to have otherwise breached the contract, such as not meeting the repayments or failing to the keep the vehicle insured. More information on what do if the creditor tries to repossess the car or vary the contract as a result of the bankruptcy is included in **Chapter 8.**

Where the secured vehicle's value is substantially less than the secured loan balance and the bankrupt cannot maintain payments on the secured loan, the bankrupt may be able to negotiate a pay out with the secured creditor to release the security. If the subsequent value is then below the AFSA threshold the vehicle should be protected from recovery action by the Trustee.

Where the equity in the vehicle is higher than the prescribed limit plus the likely costs of organising a sale, then the Trustee may require the vehicle to be sold. When the vehicle is sold the amount of the loan would be repaid to the secured creditor; the amount equivalent to the prescribed limit would be returned to the bankrupt for the purchase of another vehicle; and the Trustee would retain the balance (less the cost of the sale) for distribution to the creditors (and to meet the costs of administering the estate).

Example

Bankrupt has one car worth $40,000.

There is a loan secured over the vehicle with $20,000 owing.

The Trustee can sell the vehicle and:

- $20,000 will go to the lender to pay out the loan
- $9,600 (indexed amount at August 2025) will go to the bankrupt to cover the cost of a vehicle as primary means of transport (the threshold amount)
- $10,400, less the costs of the sale, will go to the *bankrupt estate* for the benefit of creditors and the costs of administering the estate.

The Trustee can elect to do this at any time during the bankruptcy or afterwards (see **How long does the Trustee have to make a claim on property** in **Chapter 6 Part 3**). It is important to note that the property which vests in the Trustee is that which is 'acquired' before or during the period of the bankruptcy. This means that if your client keeps paying the loan and building up equity, then the Trustee may opt to sell the vehicle later in the bankruptcy or even afterwards. Due to the rate at which most vehicles depreciate, this is far less likely to be a problem with cars than it is with houses and other real estate.

If your client is paying off a fairly expensive vehicle but has little equity, you need to:

- Warn the client that continuing to pay off the vehicle could lead to the risk of the Trustee opting to sell it at a later date;
- When the client is interested in retaining the vehicle, assist him or her to assess whether he or she will have the capacity to meet the repayments on the vehicle once other provable debts no longer need to be paid – if he or she does not have the capacity to repay the loan, then the vehicle should be surrendered or the client will risk losing the vehicle plus the benefit of any repayments made. It is also important that the client can afford to keep the vehicle comprehensively insured;
- When the client is interested in retaining the vehicle, **and** has the capacity to meet the repayments, determine whether there is a relative (or other appropriate person) who would be interested in purchasing the Trustee's interest in the vehicle and allowing the bankrupt to keep it (the client should be aware that use of the vehicle may then constitute a benefit for the purposes of calculating income contributions);
- When the client is interested in keeping the vehicle and can afford the repayments but has no interested 'buyer' to help out, then the client will need to be aware of the need to try to buy out the equity in the vehicle from the Trustee upon discharge (if there is any);
- In any event the loan should be listed in the statement of affairs. This is not only required but will make it easier in the event that the vehicle is repossessed or otherwise damaged or destroyed, and the client needs to be released from the liability

for any shortfall by the bankruptcy.

What if my client has sold a vehicle that is security under a loan contract?

This is not an uncommon occurrence among the clients of financial counsellors. Where your client has sold a vehicle over which there is a mortgage or bill of sale securing a loan, he or she is in breach of contract and may potentially face criminal proceedings if the creditor refers the matter to the police. This is not a likely outcome, but it is a possible one.

By selling or otherwise disposing of the vehicle (i.e., the security), the underlying loan is no longer a secured debt (regardless as to whether the Personal Property Security Reregister is removed or not) and becomes an unsecured debt. The creditor has a right to claim for the shortfall and lodge a proof of debt in the estate to receive any dividends. The trustee will investigate if any portion of the sale proceeds are still available for recovery.

Any deliberate omission of the above information may potentially enable enforcement action against the debtor (by the trustee).

It is recommended advice is sought about how to proceed and this issue is considered prior to filing for bankruptcy.

If the creditor threatens to go to the police, or the police wish to question the client, or lay charges, the client will need criminal law advice.

If the creditor claims the debt has been incurred by fraud and that the client will not be released at the end of the bankruptcy – refer the client for legal advice.

Superannuation and bankruptcy

Generally speaking, funds in a superannuation fund are protected in bankruptcy (s 116 (2)(d)(iv)). This means they are not available to the Trustee unless they have been withdrawn from the fund prior to bankruptcy. Funds withdrawn by the bankrupt on or after the date of the bankruptcy are also protected.

Superannuation withdrawn prior to the bankruptcy is not protected. If this money has been spent on living expenses (or medical expenses, for example) the client should inform the trustee and provide evidence such as receipts where possible. If the money is still in the client's bank account, it will vest in the trustee. If it has been used to pay someone else (for example, given to adult children to assist with the purchase of their home) the Trustee is likely to require the money to be repaid. There are a number of possibilities for the Trustee to void the transaction including as a preferential payment, undervalue transaction or transfer to defeat creditors – see **Chapter 6 Part 3.**

Case examples

1. A client obtained early release of some of her superannuation to repay a debt to her mother prior to going bankrupt. The mother was in receipt of the Aged Pension. After the client went bankrupt, the Trustee considered the payment was a preferential payment and required the mother to repay it to the *bankrupt estate*. The mother had already spent the money and was asked to enter into a repayment arrangement with the Trustee. The amount was ultimately waived after representations were made by a financial counsellor on behalf of the mother, but this outcome cannot be guaranteed. If the mother had owned significant assets or had a good income the amount would have been more determinedly pursued by the Trustee.
2. A man in his fifties who was bankrupt sought advice from a legal centre. He had withdrawn $90,000 in superannuation a couple of years previously and had given it to his daughter to assist her to purchase an apartment. The trustee was now demanding the daughter repay the money to the *bankrupt estate* or join with the Trustee in the sale of the apartment. The man was advised that the Trustee was entitled to do this as it was an *undervalue transaction* under the Bankruptcy Act (see **Chapter 6 Part 3**).

While superannuation that has not been withdrawn prior to bankruptcy is generally protected, there is an exception for superannuation contributions 'made to defeat creditors' (s 128B). The contribution(s) will be found to be made to defeat creditors if the now bankrupt person's main purpose in making the contribution(s) was:

- To prevent the transferred property from becoming divisible among his or her creditors; or
- To hinder or delay the process of making property available for division among his or her creditors.

However, the Act also provides that the main purpose will be taken to be one or both of (i) or (ii) above if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the now bankrupt person was, or was about to become, insolvent. Other evidence may also be used to establish the main purpose of the contributions (instead of or in addition to imminent insolvency). Of course the compulsory contributions made by a person's employer would not be relevant – it would only be additional, voluntary contributions that would be vulnerable to this allegation.

In deciding what the main purpose was regard must also be had to whether the nowbankrupt person had established a pattern of making contributions to one or more eligible superannuation plans, and whether, in the light of that pattern, the contribution(s) in question were out of character. This means that if a person can demonstrate a long history of contributions of a similar amount and regularity predating their insolvency, they can use this to combat the inference that the contributions were made to defeat creditors.

Contributions by third parties to the bankrupt's superannuation fund may also be challenged applying the same principles (Section 128C).

Self-managed superannuation funds

The same rules apply to self-managed superannuation funds, but only if they are found to comply with the definition of a regulated superannuation fund (within the meaning of the *Superannuation Industry (Supervision) Act 1993)*. The Trustee may review the underlying trust deeds establishing the fund to determine if this is the case.

Also, a bankrupt is not permitted to remain as the Trustee of a self-managed superannuation fund. He or she has 6 months from the date of the bankruptcy to cease to perform this role.

More information on this is available from the ATO.

Total and Permanent Disability Payouts

Whether payments under Total and Permanent Disability (TPD) claims paid out under an insurance policy attached to a bankrupt's superannuation are protected is currently a vexed issue. Advice from AFSA suggests amounts paid by superannuation funds under total and permanent disability insurance policies vest in the trustee if paid before bankruptcy. However, if paid on or after the date of bankruptcy, such amounts do not vest. There is judicial authority that lump sum TPD payments (whether attached to superannuation or not) will be protected where the amount of compensation is determined by reference to personal injury (as opposed to illness) suffered by the bankrupt (see **Chapter 6 Part 2**). Another view is that a TPD payment should be treated as a payment from a superannuation fund under s 116(2)(d)(iv) and is protected regardless of the cause of the disability but only if it is paid on or after the date of the bankruptcy See also the section on **Insurance Claims in Chapter 8** for more information.

Claims made during the period of the bankruptcy will only vest in the Trustee once a decision has been made to accept the claim. If that decision is made after discharge the funds will not vest in the Trustee. The surest solution is to wait until after discharge to make a claim, but this will not always be practical or desirable. Another option may be to have the amount paid into the superannuation fund's allocated pension fund (if it has one) and paid as income – this would then count towards income contributions but would not vest in the trustee. If your client is in a position where they have no choice but to proceed with a TPD claim during bankruptcy, or they have already received such a payment and the Trustee is seeking to claim the amount, they should get legal advice.

Compensation for personal injury

What part of compensation money is protected?

Lawyers often divide compensation claims into heads of damage such as pain and suffering, expenses paid, economic loss etc. In bankruptcy it is not the head of damage that matters but the essential nature of the loss that is being compensated. So, compensation from a personal injury claim resulting from a car accident will be completely protected. On the other hand, if the essential nature of the loss being compensated is economic for example, negligent advice in relation to money or property) then the money will not be protected, unless there is a separate and divisible cause of action relating to a wrong done to the person rather than their property. When your client is unsure about what their compensation was for, they will need to obtain records from the relevant proceedings or negotiations, and possibly seek legal advice.

> ***Berryman v Zurich Australia Ltd* [2016] WASC 196**
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> Mr Berryman was self-employed as a carpenter. He had taken out a life insurance policy with Zurich which provided for a lump sum payment in the event of total and permanent disablement. In 2009, Mr Berryman's right foot was crushed while at work. He made a claim under his policy, which was refused, and he commenced proceedings for breach of contract. He later became bankrupt. Zurich applied to have the proceedings dismissed on the basis that they had been abandoned as the trustee had not made an election to continue.
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> The court found that Mr Berryman's right to compensation was protected under section 116(2)(g) and that he was entitled to continue proceedings in his own name under section 60(4). This was so even though the action was for breach of contract. Importantly, the amount of benefit payable under the policy, and therefore claimable as damages, was determined by reference to the personal injury.
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> This approach has been approved in the recent decision of ***Lee v The State of Western Australia (No 2)* [2023] WASC 247.**

Protected money and property purchased with protected money

Where your client has purchased property using entirely protected money, or almost entirely protected money (substantially the whole of the purchase price), then that property does not vest in the Trustee and is not divisible among creditors. Protected money includes:

- Compensation received by the bankrupt (at any time, before or during bankruptcy) for personal injury to him or herself or a member of his or her family, or the death of a person in his or her family. This does **NOT** extend to compensation received by the bankrupt's spouse or other family member that has been given to the bankrupt or used to purchase property in the bankrupt's name, jointly or solely – see example below.
- The proceeds of a life assurance or endowment assurance policy over the life of the bankrupt or his or her spouse or de facto spouse received on or after the date of bankruptcy.
- A payment from a superannuation fund that was received on or after the date of the bankruptcy.
- Any loan repaid with money from one of the above sources.

Where property has been purchased almost entirely with money from one of the above sources it will be protected and cannot be taken and sold by the trustee. Similarly, if the property was purchased with a loan for almost 100% of the property and that loan was repaid entirely by one of the above sources, that property will be protected and will not vest in the trustee (ss 116(2D) and 116(3)).

What if the house purchased with protected money is in more than one name?

Where the property purchased with personal injury compensation or other protected money is in more than one name, it gets more complicated.

> **Examples**
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> A man receives compensation money for personal injury. He uses the money to buy a house for himself and his wife and puts the house in both names. The house is paid for entirely from the compensation funds.
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> Where he later becomes a bankrupt (and his wife does not), the man's half interest in the house will be protected because it was acquired with 'protected money'- that is compensation for personal injury paid to the bankrupt. Further the wife is not bankrupt in any event and can retain her 50% share.
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> On the other hand, where she becomes a bankrupt and he does not, then her share of the house will **not** be protected because the compensation was not paid to '*the bankrupt*'. This is a very important distinction.
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> If they both become bankrupt, then his share will be protected, but hers will not.

The last point above is very important. It is not uncommon for couples to purchase property in both names regardless of the source of the purchase funds. If a couple purchase a house in both names with compensation paid to one of them, then it is always possible that the court will interpret the transaction as a gift from the party receiving the compensation to their spouse/ de facto partner unless there is very clear evidence that this is not the case. This means that the money that has been gifted is no longer protected under the Bankruptcy Act. As shown in the example above, this won't matter if the member of the couple who did not receive the compensation does not go bankrupt (as his or her share of the asset does not vest in the Trustee anyway). It is a disaster, on the other hand, if the person who did not receive the compensation is the bankrupt party, or where both members of the couple end up bankrupt, because half the compensation money may no longer be protected.

> **Note:** If you have a client who has received a compensation payout and is contemplating buying property with another person, you should strongly recommend that they get legal advice about the best way to organise their affairs to make sure the compensation funds remain protected in the event of the bankruptcy of either the client or the other person.

What if property has been only partially paid for by compensation or other protected money?

Quite often a property will have been purchased partly with protected money and partly with other funds. Alternatively, the property may have been purchased with other funds and then improved with protected money or the property may have been initially purchased with protected money and the client has subsequently taken out a mortgage over the property which he or she has been repaying from other funds. In such cases the property itself is not protected (because protected money did not make up substantially the whole of the purchase price) – it will still vest in the Trustee – but when the Trustee sells the property, the Trustee must pay the bankrupt 'so much of the proceeds of realising the property as can be fairly attributed to that protected money' (s 116(4)).

Sometimes there will be a quite complicated chain of purchases, improvements, sales and further purchases since the protected money was expended. Provided there is sufficient evidence to the trace the money, then the Trustee should still account to the bankrupt for the protected amount. Further, the amount to be repaid is not simply the amount of protected money used, but the proportion of the proceeds of the sale as is attributed to the protected money. This means that if the property has increased in value, the amount of the protected portion will increase accordingly. Of course, the downside is that if the property has decreased in value, then so will the protected portion meaning that the bankrupt may receive back less than their original compensation. Of course, the costs of the sale will be deducted to determine the amount of the proceeds of the sale.

> **Examples**
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> - Where a bankrupt had purchased her home with 50% protected money (say a personal injury pay out) and the other half had since been paid off

using regular income, then the trustee should return half the proceeds of the sale to the bankrupt (assuming there is no co-owner to complicate matters).

- Where a bankrupt had already owned his home and then received compensation money, which was used to improve and modify the home, the current value of those modifications would have to be repaid by the Trustee. This would usually be worked out by establishing the percentage increase in value in the property as a result of the improvements at the time they were done, and then applying this percentage to the proceeds of sale. Clearly, this will not be an easy or non-controversial calculation.
- Where a non-bankrupt spouse or de-facto (or other co-owner) is involved, the calculation will become very complicated. The court will first have to determine the amount of the respective shares of the bankrupt and non-bankrupt parties and then work out the appropriate percentage of *protected money* used in the purchase and apply this to the bankrupt's share of the equity. This may be further complicated if the Court finds that part of the compensation money was actually a gift to the spouse and is therefore no longer protected (see below).

Stankovic v Van Der Velde **[2012] FCA 1436**

The parties in this case were a married couple. The couple already owned one block of land when the male member of the couple received personal injury compensation of $250,000. They then purchased the property next door, mostly with the compensation funds, but also with a small mortgage. This transaction was complicated slightly by the fact that the couple set up a company with both of them as directors and equal shareholders to execute the purchase. This was in the late eighties or early nineties. In 1994 they sold both properties and bought another one for $850,000. $255,826 of this amount was financed by the sale of the property purchased largely with compensation money.

By the time the matter came before the Court in 2012 there were both family law proceedings and a dispute between the Trustees in the husband's bankruptcy and the husband about the amount of protected money involved as a result of the personal injury compensation.

The Federal Court determined the matter as follows:

- The purchase of the house by a company owned equally by both parties meant that the husband had effectively given 50% of the money to his wife (there being no evidence to the contrary);
- This meant that the contribution of the compensation money had to be reduced by half from $255,826 to $127,913. This represented only 15.05% of the purchase price or 30.1% of the husband's half share in the equity of

the new $850,000 property.
- After payment of mortgages and expenses the proceeds of the sale of the above property amounted to $6,229,795. The Court said that 50% or $3,114,898 should be paid to the wife.
- The Trustees then conceded that 30.1% of the remainder should be returned to the bankrupt as representing the portion of the proceeds attributable to protected money.

The court also ordered that the Trustees were entitled to deduct the costs of the proceedings before calculating the bankrupt's share (but after deducting the wife's full 50%) as a result of his failure to provide the information to justify this protected amount to the Trustees earlier when they requested it. The court said that the proceedings would not have been necessary had the bankrupt complied with his obligations to provide adequate information to the Trustees. Despite this the bankrupt is likely to have received in excess of $900,000.

Where it appears that there may have been protected money involved in the purchase of an asset the bankrupt will need to provide as much evidence as possible to the Trustee to establish the status of the money as protected, and where necessary, to trace the transactions that have occurred since the purchase in order to justify the amount of the protected portion claimed. It is not sufficient to simply claim the property or funds are protected. Further, it is vital that all assets are disclosed in the statement of affairs, regardless of whether they are allegedly fully or partially protected.

Note: Do not attach original documents to the statement of affairs – provide copies or a list of documents the client holds and tell the client to retain the originals unless requested to produce them by the Trustee.

More information on the treatment of co-owners of property generally is included in **Chapter 6 Part 3** in relation to **Divisible Assets**

Protected Property

- Must be disclosed in the statement of affairs AND
- Protected status must be established by evidence.

Where there has been a complicated chain of events with property being bought, sold and/or refinanced, there must be sufficient evidence of all relevant transactions to conduct a tracing exercise back to the protected money.