



Australian Government

Attorney-General's Department

Senate Economics Legislation Committee
Inquiry into the Bankruptcy Amendment (Exceptional Circumstances Exit
Package) Bill 2011

Submission from the Commonwealth
Attorney-General's Department

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1. Introduction

The Attorney-General's Department (the Department) is responsible for Bankruptcy Policy. We hope that this submission will be of assistance to the Committee.

How is property treated under the *Bankruptcy Act 1966*?

When a person becomes bankrupt the property of the bankrupt vests in the trustee who is administering the debtor's bankruptcy on the date of the bankruptcy (paragraph 58(1)(b) of the *Bankruptcy Act 1966* (the Act)). The property of the bankrupt which is divisible among the bankrupt's creditors is specified in s 116(1) of the Act.

Property acquired by the bankrupt after the date of bankruptcy but before the date of discharge is also available to the trustee (s 116(1)). This type of property is referred to as 'after-acquired property'. Section 116(2) of the Act provides that certain types of property are not available to the trustee. Property that is covered by s 116(2) of the Act is often described as exempt or indivisible property.

Existing provisions relating to rural support schemes

Paragraphs 116(2)(k)-(m) of the Act provide that amounts paid to the bankrupt under a rural support scheme prescribed for the purposes of those paragraphs are exempt property. Regulation 6.04A the *Bankruptcy Regulations 1996* (the Regulations) provide that the following rural support schemes are prescribed for the purposes of paragraph 116(2)(k):

- Dairy Exit Payment
- Farm Help reestablishment scheme

Regulation 6.04B of the Regulations provide that the following payments made under rural support schemes in the circumstances specified in Regulation 6.04B are prescribed for the purposes of paragraph 116(2)(l):

- 1985 Rural Adjustment Grant Scheme
- 1988 Rural Adjustment Grant Scheme
- Rural Adjustment Grant Scheme
- Rural Adjustment Scheme
- Rural Reconstruction Grant Scheme
- Sugar Industry Reform Program
- Tobacco Grower Adjustment Assistance Package

The Department of Agriculture, Fisheries and Forestry (DAFF) advises that no payments have been made under any of the programs listed in Regulation 6.04A or Regulation 6.04B since 30 June 2009.

The Bankruptcy Amendment (Exceptional Circumstances Exit Package) Bill 2011

The Bankruptcy Amendment (Exceptional Circumstances Exit Package) Bill 2011 (the Bill) would amend the Regulations in order to provide that payments made under the 'Exceptional Circumstances Exit Package' are prescribed for the purposes of paragraph 116(2)(k).

The Bill would also amend the Regulations in order to provide that payments made under the Exceptional Circumstances Exit Package (and to which the circumstances outlined in Item 3 of the Bill apply) are prescribed for the purposes of paragraph 116(2)(1). In other words payments made under the Exceptional Circumstances Exit Package would not be divided amongst the creditors of a bankrupt and as such would be exempt property.

2. The application clause of the Bill (Item 4 of Schedule 1)

The Department believes that there may be an issue with the drafting of the application clause of the Bill (Item 4 of Schedule 1). Item 4 of Schedule 1 provides (emphasis added):

The amendments made by items 1, 2 and 3 apply in relation to any grant under the Exceptional Circumstances Exit Package made on or after 1 July 2010, where a *final order in bankruptcy* has not been made before the commencement of this item.

In relation to this item the Explanatory Memorandum for the Bill states:

Item 4 provides that these amendments apply only to grants made on or after 1 July 2010 where a final order in bankruptcy has not been made, that is, the orders have not been finalised by the courts or the debts paid.

The current wording of Item 4 of Schedule 1 may create some confusion and not achieve the desired outcome. A person can become bankrupt either by the Court making a sequestration order against them (involuntary bankruptcy) or through the submission of a debtor's petition to the Insolvency and Trustee Service Australia (voluntary bankruptcy). While the reference to a "final order in bankruptcy" may cover those cases where a Court makes a sequestration order it probably would not cover those cases where a debtor becomes voluntarily bankrupt through the submission of a debtor's petition. The reference to "final orders" could also lead to confusion as the term "final order" is used in a different context in the Act (see s 40(1)(g)).

3. How would the exemption operate?

This section of the submission will discuss how an exemption of payments made under the Exceptional Circumstances Exit Package scheme (the Scheme) would operate in practice if the Bill became law.

As outlined above broadly speaking property can become part of the estate of a bankrupt in one of two ways. Firstly any property belonging to the bankrupt on the date of bankruptcy will vest in the trustee. Second if the bankrupt acquires property after the date of bankruptcy but prior to discharge the property will also vest in the trustee.

We will deal firstly with what would happen if a bankrupt receives a payment under the Scheme prior to the date of bankruptcy (and the payment is exempt property). If none of the monies received have been spent and the grant money is readily

identifiable the bankrupt would retain the payment. If some of the monies received have been spent and/or the money has been commingled with other money the bankrupt would have to provide evidence to the trustee regarding the source of the money.

If the bankrupt has spent the money on some form of property they may be entitled to retain the property by virtue of paragraph 116(2)(n) and s 116(3). The effect of paragraph 116(2)(n) and s 116(3) is that if the “whole, or substantially the whole” of the money used for the purpose of a particular property is “protected money” the bankrupt will be entitled to retain that property. The definition of “protected money” includes amounts covered by paragraph 116(2)(k) and paragraph 116(2)(l).

We will turn now to what would happen if a bankrupt receives a payment under the Scheme after the date of bankruptcy (and the payment is exempt property). Given the criteria for assessing applications for assistance under the Scheme that are set out in the *Exceptional Circumstances Exit Package Policy Guidelines* (EC Exit Package Guidelines) it is unlikely that a person would receive a payment under the Scheme if they are an undischarged bankrupt. However if an undischarged bankrupt did receive such a payment it would be exempt property (under the Bill) and the bankrupt would be able to retain the payment.

4. General policy considerations and exempt property

We understand that it is generally undesirable for Government grant money to be paid to a recipient only to have the grant money become part of their bankrupt estate. However from a Bankruptcy Policy perspective prescribing certain payments as exempt property under the Act or Regulations may not be the best solution to this problem.

Firstly adding to the types of property that constitute exempt property complicates the bankruptcy process (which can result in the costs of administering bankrupt estates increasing) and increases uncertainty among creditors. Secondly as there are many types of Government payments to individuals and there is no blanket exemption the selection of which Government payments to exempt will always be somewhat arbitrary. For example Government payments made to persons who have been victims of a natural disaster are not exempt property.

Generally speaking it may be better for the criteria for receiving Government payments to include criteria that seeks (to the extent possible) to avoid giving grants to people who are insolvent or to people who are at real risk of becoming insolvent. Of course as recipients of Government payments often receive them because they are in financial distress it can be difficult to craft criteria for receiving Government grants that exclude people who are at risk of becoming bankrupt.

It should be noted that under the EC Exit Package Guidelines an applicant must be “effectively in control” of the farm enterprise in order to receive an exit grant. This means an applicant cannot:

- be involved in bankruptcy proceedings,
- have been issued an eviction order,

- have been threatened with foreclosure; or
- have in any other way lost management control of the farm.

This helps to minimise the risk that an applicant who receives a grant will subsequently become bankrupt.