



January 2021

# The bankruptcy system and the impacts of coronavirus

## About the discussion paper

The *Bankruptcy Act 1966* regulates Australia's personal insolvency system. It creates a framework to allow people in severe financial stress to discharge unmanageable debts while providing for the realisation of a debtor's available assets for distribution to affected creditors.

The Attorney-General's Department is seeking stakeholder submissions on possible changes to the personal insolvency system to inform the Government's ongoing response to address the impacts of the coronavirus.

The coronavirus pandemic has had wide reaching personal, employment and economic impacts across Australian communities, businesses, and industry sectors. The Australian Government made significant temporary amendments to the Bankruptcy Act and Regulations as part of the Coronavirus Economic Response Package in March 2020. In summary, the temporary amendments increased the:

- minimum amount of debt that can trigger bankruptcy ('the bankruptcy threshold') from \$5,000 to \$20,000
- amount of time to respond to a Bankruptcy Notice from 21 days to six months, and
- temporary debt protection from 21 days to six months.

The temporary measures, which were initially scheduled to cease on 24 September 2020, were extended until the end of 31 December 2020.<sup>1</sup> On 1 January 2021, the bankruptcy threshold permanently changed to \$10,000, doubling the pre-coronavirus threshold of \$5000.<sup>2</sup> The period of temporary debt protection and the amount of time to respond to a Bankruptcy Notice, reverted back to 21 days following the cessation of the temporary measures.

This paper provides an overview of four elements of the Bankruptcy Act to guide stakeholder consideration:

1. the default period of bankruptcy
2. debt agreements,
3. personal insolvency agreements, and
4. offence provisions.

The department also welcomes views on any other areas that stakeholders consider may address the impact of the coronavirus, including the impact that it has had on businesses (e.g. sole traders and partnerships).

# Request for submissions

The Department is seeking written submissions from stakeholders on possible changes to the personal insolvency system to address the impacts of coronavirus. The discussion paper includes questions to guide feedback. However, stakeholders are welcome to provide further information and suggestions relevant to the topic.

Submissions can be made by email to [Bankruptcy@ag.gov.au](mailto:Bankruptcy@ag.gov.au)

Please:

- provide submissions as either a Word or RTF document – you can provide an additional PDF version of your submission if you would like, and
- clearly mark any parts of your submission that you would like to remain confidential – provide confidential parts in a separate attachment.

If you have any questions about the consultation process, email [Bankruptcy@ag.gov.au](mailto:Bankruptcy@ag.gov.au)

## 1. Default period of bankruptcy

### Discussion questions

**Question 1:** How do current economic circumstances impact the policy setting for a default period of one year bankruptcy?

**Question 2:** Have stakeholder views about the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 changed due to the impacts of coronavirus?

**Question 3:** How might a default period of one year benefit debtors with business related debts such as sole traders?

**Question 4:** Do stakeholders have views on how the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 could be amended to respond to concerns about the one-year default period being made available to bankrupts for whom such a concession is not a desirable or justifiable outcome?

### Background

The default period of bankruptcy is the time that must pass before a bankrupt is discharged from bankruptcy. The current default period for a bankruptcy is three years. Ordinarily, the three-year period starts from the date on which the bankrupt filed his or her statement of affairs.

### Bankruptcy Amendment (Enterprise Incentives) Bill 2017

On 7 December 2015, the Government announced that it would reduce the default bankruptcy period from three years to one year. Reducing the automatic discharge period to one year is intended to reduce stigma, encourage entrepreneurs to re-engage in business sooner and encourage people, previously deterred by punitive bankruptcy laws, to pursue their own business ventures.<sup>3</sup>

Public consultation on the proposal occurred between 29 April 2016 and 27 May 2016 as part of the National Innovation and Science Agenda.<sup>4</sup> On 19 October 2017, the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 was introduced to Parliament.

The Enterprise Incentives Bill proposed to amend the Bankruptcy Act to:

- reduce the default period of bankruptcy from three years to one year
- reduce other time periods associated with bankruptcy to one year including for:
  - disclosing bankrupt status when applying for credit
  - seeking permission for overseas travel, and
  - the attainment of certain licences and entering into certain professions.
- extend income contribution obligations for discharged bankrupts for a minimum period of two years following discharge or, in the event that a bankruptcy is extended due to non-compliance, to five to eight years.<sup>5</sup>

The Enterprise Incentives Bill 2017 lapsed when the 45th Parliament was prorogued on 11 April 2019.

## Consideration of the Enterprise Incentives Bill

Whilst before the Parliament, the Enterprise Incentives Bill was considered by the Senate Legal and Constitutional Affairs Legislation Committee (the Committee). The Committee received a number of submissions raising concerns over the possible exploitation of the reforms proposed in the Enterprise Incentives Bill. The Committee recommended that the Senate pass the Enterprise Incentives Bill subject to consideration of how to ameliorate the risk of the one-year default period being made available to bankrupts for whom such a concession is not a desirable or justifiable outcome.<sup>6</sup>

## Concerns about the Enterprise Incentives Bill

Some stakeholders raised concerns about the Enterprise Incentives Bill with the Committee and with the department. Specifically, concerns that the default period of one year would be abused by rogue, reckless and repeat bankrupts. As a result, the department undertook targeted stakeholder consultation on additional amendments to the Enterprise Incentives Bill to strengthen the objection to discharge regime to address these concerns.

In view of the mixed feedback this consultation received, the department has continued to review the Enterprise Incentives Bill with a view to addressing concerns raised by stakeholders.

In addition to a strengthened objection to discharge regime, the department has considered the following refinements to the Enterprise Incentives Bill:

- implementation of an early discharge application process
- criteria that would exclude a bankrupt from the default period of one year, and
- strengthened offence provisions (**see below** – 4. Offence provisions).

The department notes that early discharge was available to certain bankrupts in Australia up until 2002. However, it was discontinued for reasons including the perception that it made bankruptcy too easy, was unfair on bankrupts that did not qualify for early discharge and operated in discriminatory ways.<sup>7</sup>

In relation to criteria that would exclude bankrupts from a default period of one year, the department notes that the Bankruptcy Act currently provides for this type of approach. For example, the Official Receiver has the discretion to reject a debtor's petition under certain circumstances.<sup>8</sup>

## 2. Debt agreements

### Discussion questions

**Question 1:** What reforms, if any— either on a temporary basis or more permanently – should be made to the debt agreement system to respond to coronavirus?

**Question 2:** Are there changes that could be made to the debt agreement system to make it more useable for those with business related debts such as sole traders?

**Question 3:** Should the income, debt, and/or asset threshold amounts for debt agreements be increased? For example, the income and/or debt threshold could be increased to match the current asset threshold of \$236,126.80.

**Question 4:** Does the impact of the coronavirus give rise to the need to re-consider the term limit of a debt agreement?

**Question 5:** What are the possible consequences (unintended or adverse) to making reforms to the debt agreement system in response to the impacts of the coronavirus?

**Question 6:** If you support reforms to the debt agreement, should there be a transition period before any reforms take effect?

### Background

Debt agreements are regulated under Part IX of the Bankruptcy Act and offer an alternative to bankruptcy to debtors, provided certain threshold requirements are met.

Debt agreements were introduced into the Bankruptcy Act in 1996 to provide low income debtors and their creditors with an informal and inexpensive alternative to bankruptcy or a personal insolvency agreement (provided under Part X of the Bankruptcy Act).<sup>9</sup> Substantial reforms to debt agreements were made by the *Bankruptcy Legislation Amendment (Debt Agreements) Act 2007* and the *Bankruptcy Amendment (Debt Agreement Reform) Act 2018*.

The Debt Agreement Reform Act 2018 amended the Bankruptcy Act to introduce new qualification and registration requirements for administrators, new provisions relating to the content, length, variation, termination and voiding of debt agreements, and new offences and functions and powers of the Inspector General. Relevant to this discussion paper, the reform measures changed the debt agreement system by:

- imposing a default limit of three years on the length of debt agreements (unless the homeownership exception applies) to allow debtors to manage their debts in the short term while providing greater protections to financially vulnerable people<sup>10</sup>, and
- doubling the asset threshold amount (from \$113,350 to \$226,700 at the time of commencement of the reforms) to ensure a greater proportion of debtors have access to the debt agreement system.<sup>11</sup>

The key reforms commenced on 27 June 2019 and applied to debt agreement proposals given to the Official Receiver on or after that date.

There is a low uptake of debt agreements by debtors who are in business. For example, data published by the Australian Financial Security Authority (AFSA) shows that in the September quarter 2020, 8% of debt agreement debtors were in business, while 39% of bankrupts were in business.<sup>12</sup>

# Threshold requirements for debt agreements

Section 185 of the Bankruptcy Act sets out threshold requirements for a debtor to propose a debt agreement to the Official Receiver.

## Term of a debt agreement

Subsection 185C(2AA) of the Bankruptcy Act specifies a three year limit on a debt agreement proposal from the day the agreement is made, unless the home ownership exception applies. That exception allows a debtor to propose a five year debt agreement to the Official Receiver if the debtor has an interest in real property in Australia as defined under subsection 185C(2AB) of the Bankruptcy Act.

## Debt agreement eligibility requirements

A debtor must meet certain eligibility requirements in order to propose a debt agreement. Specifically, a debtor may not make a proposal if:

- at any time within the previous 10 years, a debtor has been bankrupt, a party to a debt agreement or given an authority under section 188 of the Bankruptcy Act,
- the debtor has unsecured debts that exceed the 'threshold amount',
- the value of the debtor's property which would be divisible among creditors in a bankruptcy exceeds the 'threshold amount'; or
- the debtor's after-tax income in the year beginning at the time of the proposal is likely to be more than half of the 'threshold amount.'<sup>13</sup>

Subsection 185C(4) of the Bankruptcy Act defines the 'threshold amount' as a formula<sup>14</sup> similar to the one used to determine the 'base income threshold amount' which is needed to calculate income contributions of bankrupts.<sup>15</sup> The 'threshold amount' formula applies to the income, unsecured debt and asset threshold amounts required to make a debt agreement proposal. If these threshold amounts are exceeded, the Official Receiver must refuse the proposal.<sup>16</sup>

The dollar amounts in the bankruptcy laws are indexed. The AFSA maintains a table of the current income, unsecured debt and asset thresholds, largely reproduced below.

**Table 1 - Part IX Debt Agreement eligibility requirements<sup>17</sup>**

Part IX Debt Agreement Eligibility	Amount	Bankruptcy Act
<b>Debts:</b> A debtor cannot propose a debt agreement if their unsecured debts add up to more than this limit.	\$118,063.40	s185C(4)(b), (c) and (5)
<b>Assets:</b> A debtor cannot propose a debt agreement if their divisible assets (assets or property that could legally be sold by the trustee if you were bankrupt) add up to more than this limit.	\$236,126.80	s185C(4)(b), (c) and (5)
<b>Income:</b> A debtor cannot propose a debt agreement if their after-tax income for the year is over this limit.	\$88,547.55	s185C(4)(d) and (5)

## Consequences of entering into a debt agreement

A debt agreement releases a debtor from most unsecured debt when the debtor has completed all obligations and payments. One of the consequences for a debtor to propose a debt agreement to the Official Receiver is that it constitutes an 'act of bankruptcy'<sup>18</sup>. A debtor also commits an 'act of bankruptcy' in relation to debt agreements if:

- a debt agreement proposal is accepted by creditors,
- the debtor breaches a debt agreement; or
- a debt agreement is terminated under section 185P, 185Q or 185QA of the Bankruptcy Act.<sup>19</sup>

During the life of a debt agreement, there is a moratorium on a creditor being able to commence or continue with proceedings for the recovery of its debt (with some exceptions, such as liability from a child maintenance order). However, a creditor may apply for a sequestration order from the court if the terms of the debt agreement have not been met.<sup>20</sup>

There are other consequences of entering into a debt agreement that may impact a debtor. For instance, a debtor's name will appear on the National Personal Insolvency Index (NPII) and can be used by a credit reporting agency. The length of time this information is publically available on the NPII will vary depending on a debtor's circumstances, such as the point in time a debt agreement is completed.<sup>21</sup>

## 3. Personal insolvency agreements

### Discussion questions

**Question 1:** Could personal insolvency agreements play a greater role – either on a temporary basis or more permanently – in settling debts for individuals, including those who have business-related debt (e.g. sole traders), who are in financial distress due to the impacts of coronavirus?

**Question 2:** Are there barriers to the uptake of personal insolvency agreements?

**Question 3:** Could the processes for establishing personal insolvency agreements be streamlined to make them more attractive or more accessible, particularly for individuals with business-related debt?

A personal insolvency agreement (PIA), also known as a Part X (10), is a legally binding agreement between a debtor and creditors. A PIA can be a flexible way to come to an arrangement to settle debts without becoming bankrupt.

A personal insolvency agreement involves:

- The appointment of a trustee to take control of the debtor's property and make an offer to the debtor's creditors.
- The offer may be to pay part or all of the debts by instalments or a lump sum.

Unlike debt agreements, there are no debt, asset or income limits to be eligible for a PIA and the length of a PIA is dependent on what is negotiated with the trustee and creditors. The average length PIAs is shorter than the default period of bankruptcy and the default maximum length of debt agreements prescribed in the Bankruptcy Act (both 3 years). Between the 2014 and 2019 financial years the mean length of PIAs was 560 days, whilst the median length of PIAs was 301 days.

There are fees to propose, lodge and manage a PIA. The fees between trustees vary. We note that the debtor may retain their assets (such as house or car) if the terms of the agreement allow.

The uptake of PIAs is low compared to bankruptcy and debt agreements. PIAs have made up just 0.8% of personal insolvencies under the Bankruptcy Act between the 2013 and 2019 financial years. Just over half of PIAs made in this period were business related.

## 4. Offence provisions

### Discussion questions

**Question 1:** What new or expanded offence provisions could respond to concerns about the abuse of a one year default period of bankruptcy?

**Question 2:** What new or expanded offence provisions could respond to concerns about the behaviour of untrustworthy advisors, including pre-insolvency advisors?

### Background

The abuse of the personal insolvency system to avoid paying debts is a concern that is frequently raised by stakeholders. A 2018 report estimated the annual direct impact of illegal phoenix activity to be between \$2.85 billion and \$5.13 billion.<sup>22</sup> While illegal phoenix activity is generally associated with corporate insolvency, analogous behaviour in the personal insolvency system by debtors as well as their advisors is the subject of the department's ongoing consideration.

Stakeholder concerns over the Enterprise Incentives Bill centre on its possible abuse by serial, non-compliant bankrupts to avoid debts. Similarly, stakeholders consistently raise concerns over the harm to the economy and the personal insolvency system caused by untrustworthy advisors, including so called 'pre-insolvency advisors', who advise people under financial stress how to defeat the legitimate interests of creditors, generally through the creation and/or use of false information.

### Offences under the Bankruptcy Act

The Bankruptcy Act contains offences, including offences punishable by imprisonment. Part XIV of the Bankruptcy Act prescribes a number of offences targeting creditor defeating behaviour. For example, it is an offence punishable by up to five years imprisonment to conceal property with the intent to defraud creditors under paragraph 263(1) of the Bankruptcy Act. However, these types of provisions are generally aimed at the behaviour of the bankrupt rather than at the behaviour of those who advise them to take certain actions.

The department notes the possibility that the offence provisions prescribed in the Bankruptcy Act could be enhanced by the inclusion of new provisions and the expansion of current offence provisions to target the provision of untrustworthy advice. We note that new phoenixing offences to prohibit creditor-defeating dispositions commenced in the corporate insolvency system in February 2020.<sup>23</sup>

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## Endnotes

- <sup>1</sup>The temporary bankruptcy measures were extended by *Corporations and Bankruptcy Legislation Amendment (Extending Temporary Relief for Financially Distressed Businesses and Individuals) Regulations 2020*.
- <sup>2</sup> The *Bankruptcy Amendment (Bankruptcy Threshold) Regulations 2020* amended the *Bankruptcy Regulation 1996* to prescribe a \$10,000 bankruptcy threshold.
- <sup>3</sup> Bankruptcy Amendment (Enterprise Incentives) Bill 2017, *Explanatory Memorandum*, page 2.
- <sup>4</sup> National Innovation and Science Agenda, *Proposals Paper: Improving bankruptcy and insolvency laws*, [https://treasury.gov.au/sites/default/files/2019-03/C2016-017\\_pp\\_NIS\\_insolvency\\_measures.pdf](https://treasury.gov.au/sites/default/files/2019-03/C2016-017_pp_NIS_insolvency_measures.pdf)
- <sup>5</sup> Bankruptcy Amendment (Enterprise Incentives) Bill 2017, *Explanatory Memorandum*, page 2.
- <sup>6</sup> Senate Legal and Constitutional Affairs Legislation Committee, *Report on the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 and the Bankruptcy Amendment (Debt Agreement Reform) Bill 2018 [Provisions]*, Recommendations 1.
- <sup>7</sup> Bankruptcy Legislation Amendment Bill 2002, *Explanatory Memorandum*, pages 9-10.
- <sup>8</sup> *Bankruptcy Act 1966*, subsection 55(3AA).
- <sup>9</sup> Bankruptcy Legislation Amendment Bill 1996, *Explanatory Memorandum*, paragraph 45.
- <sup>10</sup> See Debt Agreement Reform Bill 2018, Replacement Explanatory Memorandum, paragraphs 113-116.
- <sup>11</sup> See Debt Agreement Reform Bill 2018, Replacement Explanatory Memorandum, paragraphs 68-69.
- <sup>12</sup> Australian Financial Security Authority, *Business and non-business statistics*, <https://www.afsa.gov.au/statistics/business-and-non-business-statistics>.
- <sup>13</sup> See *Bankruptcy Act 1966*, section 185C(5) for the definition of 'After tax income'.
- <sup>14</sup> The formula for 'threshold amount' is seven times the amount that, at that time, is specified in column 3, item 2, Table B, point 1064-B1, Pension Calculator A in the *Social Security Act 1991*.
- <sup>15</sup> See *Bankruptcy Act 1966*, section 139K for the definition of 'base income threshold amount'.
- <sup>16</sup> *Bankruptcy Act 1966*, paragraph 185E(2)(a).
- <sup>17</sup> Australian Financial Security Authority, *Indexed amounts*: <https://www.afsa.gov.au/insolvency/how-we-can-help/indexed-amounts-0>.
- <sup>18</sup> *Bankruptcy Act*, paragraph 40(1)(h)(a).
- <sup>19</sup> See *Bankruptcy Act 1966*, paragraphs 40(1)(hb),(hc) and (hd), respectively.
- <sup>20</sup> See *Bankruptcy Act 1966*, subsection 185Q(2) and subsection 185T(4).
- <sup>21</sup> For further information see Australian Financial Security Authority, *Consequences of a Debt Agreement*: <https://www.afsa.gov.au/insolvency/cant-pay-my-debts/consequences-debt-agreement>.
- <sup>22</sup> The Phoenix Taskforce, *The economic impact of potential illegal phoenix activity*, <https://www.ato.gov.au/General/The-fight-against-tax-crime/In-detail/The-economic-impacts-of-potential-illegal-phoenix-activity-report/>
- <sup>23</sup> *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020*, Schedule 1.