How bankruptcies can be annulled

By David Hurt, WA Insolvency Solutions Partner and Bankruptcy Trustee

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Personal insolvencies, including bankruptcies, are on the rise. But while bankruptcies aren't forever, there are ways to have them annulled before the usual time period is over.

In June 2022, the Australian Financial Security Authority found there were 852 new formal personal insolvencies – up from 751 in May. Of these, 503 were bankruptcies, with construction and healthcare being the most common industries affected.

While the usual bankruptcy term is three years, it is possible to get a bankruptcy annulled if the right conditions are met. When something is annulled – such as a marriage – it is considered void and legally to never have existed or occurred. If a bankruptcy is annulled, the bankrupt estate is brought to an end and legally taken not to have occurred.

During FY21, 11,399 bankrupt estates were finalised, and 359 bankruptcies were annulled. There are, however, different types of annulments in bankruptcy and each has a different process. Even if a bankruptcy is annulled, the bankrupt's name will still appear forever on the National Personal Insolvency Index and on the bankrupt's credit report for up to five years.

There are three ways a bankruptcy annulment can occur:

By proposal

- s73 Composition *(Section 73 of the Bankruptcy Act 1966 [the Act]) has been a part of the bankruptcy system for some time; it allows bankrupts to make formal proposals to their creditors to settle debts and have the bankruptcy annulled)*
- A settlement proposal is put to creditors (with a recommendation from the Trustee)
- The proposal put to creditors is on the basis it puts creditors in a better position than in bankruptcy
- The proposal requires acceptance by the passing of a special resolution by the creditors

By payment of debts

- s153A of the Act applies
- It's allowed on the basis the Trustee is satisfied all the debts of the bankrupt have been paid (including interest) together with all the fees and costs of the estate and the Trustee's remuneration

By the Court

- s153B of the Act applies
- The Court needs to be satisfied that a sequestration order should not have been made or that a debtor's petition ought not to have been accepted by the Official Receiver

In my experience, annulment by payment of all debts is a rare occurrence. However, our office has recently been involved in two such bankruptcies that were annulled through the payment of all debts, as highlighted in the following two scenarios.

Annulment by paying off debts

The first scenario concerns a bankruptcy that commenced in 2019, where the bankrupt was required to make minimal income contributions. The only asset was residential property in country WA. The property was heavily encumbered ($850,000) to the bank, being security provided in respect of a guarantee given for a related company debt. The value of the property at the time of bankruptcy was $230,000.

In 2020, the bank reached a settlement with the related company and released the guarantor, which resulted in the mortgage being discharged. The unencumbered property was consequently revalued in 2021 at between $280,000 to $320,000 and subsequently sold for $300,000, with net proceeds of $284,000.

The estimated debts due to the ATO were $186,000, but ultimately its claim was $66,000.

The conclusion is that all debts were paid in full, the bankruptcy was annulled, and the surplus funds of around $141,000 were returned to the former bankrupt.

The second scenario concerns a bankruptcy that commenced in 2020 and concluded in 2022. The principal asset of the bankrupt was a residence in south-west WA. Following the increase in real estate values, the residence was revalued and sold in January 2022. The net proceeds of around $83,000 were received into the bankrupt estate.

The debts owed by the bankrupt will be less than $20,000, which allowed an annulment to occur soon thereafter, with surplus funds remaining.