***BANKRUPTCY AND THE FAMILY HOME***

It is important to remember that if a person becomes bankrupt, all their assets “vest in”, or become controlled by, their trustee in bankruptcy, who can then sell those assets to pay out the creditors of the bankrupt.

Such assets include the family home of the bankrupt whether the home is registered in the sole name of the bankrupt or the joint names of the bankrupt and their spouse or other family member.

**Joint assets**

The vast majority of family homes in Australia are held in joint names of spouses. While this is sometimes necessary because this is the only way in which lenders will lend spouses the money to buy their first or subsequent family home, it is important to review your situation if you feel that the family home may be subject to attack by creditors at some stage, for example if you are running a business in your own name or you are concerned that you may be subject to a claim as a director of a company.

Let’s be very clear about this: the family home is not a protected asset under the Bankruptcy Act. If there is equity in the asset, as there often is, the trustee in bankruptcy must take action by enforcing the sale of the asset and netting the proceeds on behalf of creditors.

**The powers of the trustee in bankruptcy**

If the asset is held in the joint names of the bankrupt and his or her spouse, the trustee in bankruptcy can still force the sale of the asset even though the non-bankrupt spouse is debt-free, knows nothing about the debts and has done nothing wrong. This applies whether the asset is held as joint tenants or tenants in common.

Once the family home becomes “vested in” the trustee, the law says that the joint ownership in the asset becomes “severed”, in other words, the bankrupt’s “half” in the asset is separated from the joint tenancy and is able to be realised to pay creditors, whereas the non-bankrupt’s “half” is not prejudiced.

However, in order to realise the bankrupt’s “half” it will be necessary to sell the entire asset, unless the non-bankrupt spouse is able to pay one half of the market value of the asset to the trustee in bankruptcy.

**The rights of the mortgagee**

Frequently, an act of bankruptcy will trigger a serious default under the terms of the mortgage, which will entitle the mortgagee to “call in” or exercise their rights under the mortgage, even if the bankrupt continues to make payments on the mortgage.

However,usually, the mortgagee bank will step aside and allow the trustee to deal with the family home along with the bankrupt’s other assets, unless the trustee determines that there is no equity in the asset, in which case the mortgagee will invariably take possession of the property and sell the property to enable it to clear the debt.

**The rights of the non-bankrupt spouse**

Despite what appears to be “one way” legal traffic in favour of the trustee in bankruptcy and the mortgagee bank, the non-bankrupt spouse still has some rights apart from the right to “buy out” the trustee in bankruptcy.

An example is if the bankrupt spouse takes out a loan secured by a mortgage against the family home which is ostensibly for the bankrupt's benefit (for example, a second mortgage to buy a car or fund a business), then it may be possible for that loan to "come off" the bankrupt's share in the property, rather than the non-bankrupt's share in the property, which essentially then means the non-bankrupt's share in the property is left intact.

**DIY Asset Protection**

Bankruptcy and how assets are dealt with as a result of bankruptcy can be a fairly complex area of law. Extremely emotional, too, when it comes to the family home. If you are faced with this situation, please do not simply throw up your hands, go bankrupt and allow a trustee in bankruptcy to dictate what happens to your prized asset. There may be other options, especially for your non-bankrupt spouse.

However, as with all asset protection, prior planning and prevention is much more preferable to the last minute salvage operation.

If you feel that you may be at risk of bankruptcy or other creditor's claim at some future time in the future, you may wish to consider taking one of the following steps:

- Putting the asset in the sole name of the non-at-risk spouse or another entity (eg a family trust);
- If the above is not possible because the non-at-risk spouse is unable to secure a mortgage on their own, then you should consider putting, say 1% of the asset in your name, and 99% of the asset in the name of your non-at-risk spouse. Your bank will not care about how the legal ownership of the asset is divided, provided that both your names are on the mortgage;
- The cost of taking one of the above steps is almost negligible given that any such transfer between spouses (where the asset is the family home) is exempt from stamp duty – only conveyancing fees apply.

Timing is critical in bankruptcy law. If you take the above steps within six months of the commencement of bankruptcy then it is likely that the trustee in bankruptcy will seek to set aside or reverse the transfer. However, if you take the above steps now, and become faced with bankruptcy at some future date (eg a year or two) then the transfer will be valid and result in the protection of the asset.