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Insolvency and Trustee Service Australia

INSPECTOR-GENERAL PRACTICE DIRECTION No 19

Provable Debts

DRAFT

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PLEASE NOTE: This draft Practice Direction is released for comment and consultation at the Registered Debt Agreement Administrators Professional Development Day on 9 September 2010. It is therefore possible that the content of this Practice Direction may change before being finalised and published to [ITSA's Policies and Practices Website](#).

This document is intended to provide general guidance only and is not intended as legal advice. Readers should not rely on this document as legal advice.

¹ Released in September 2010 for comment and consultation

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Introduction

1. It is important that personal insolvency practitioners have a good understanding of what debts are provable in bankruptcy.
2. One of the general intentions of the *Bankruptcy Act 1966* is to free an insolvent person from his or her financial obligations arising from provable debts incurred prior to entering into a bankruptcy, debt agreement or personal insolvency agreement, as the case may be. In this IGPD these administrations will be referred to as “personal insolvency administrations”. The term “provable debt” means a debt or liability that is, under the Bankruptcy Act, provable in bankruptcy. The term applies equally to debt agreements and personal insolvency agreements.
3. Knowledge of provable debts is therefore needed in order to advise insolvent debtors about their options, determine voting entitlements in all types of administrations and consider for admission, proofs of debt or claims, for dividend participation.
4. The purpose of this IGPD is to provide guidance and direction about provable debts to all personal insolvency practitioners to enable them to distinguish between provable and non-provable debts.

Categories of Debt

5. Unsecured debts can be classed into 5 main categories, as follows:
 - (i) Debts from which a debtor will be released upon discharge from bankruptcy and the creditor owed the debt can not take any further action against the bankrupt or their property when they become bankrupt. eg. goods and services obtained on credit, credit card debts, personal loans, commonly known as “provable debts”.
 - (ii) Debts which are not provable in bankruptcy eg. Court imposed fines and penalties, student loans, unliquidated damages arising from a motor vehicle accident.
 - (iii) Debts which are provable but the bankrupt is not released from the liability upon discharge from bankruptcy eg. maintenance, child support, debts incurred by fraud.
 - (iv) Debts which are provable and in respect of which the creditor can continue or commence recovery action against the debtor’s non-divisible property and/or income after the date of bankruptcy eg. maintenance, child support.
 - (v) Debts which are provable but if not paid will cause a service to be terminated for such non-payment eg. supply of electricity, gas, telephone etc or the suspension of a drivers licence and/or motor vehicle registration for non-payment of debts owing to State Debt Recovery Office eg. parking and driving infringement notices.

6. Therefore the question of what financial relief a debtor will receive upon entering into a personal insolvency administration will depend upon the nature of his or her debts. This IGPD will consider examples of the various debts.

Section 82 of the Bankruptcy Act

7. Section 82 of the Bankruptcy Act broadly sets out which debts are provable in bankruptcy.
8. The broad scope of section 82 is expressed in the first and last subsections. Subsection 82(1) of the Bankruptcy Act states:

“subject to this Division all debts and liabilities, present or future, certain or contingent, to which a bankrupt was subject at the date of bankruptcy, or to which he or she may become subject before his or her discharge by reason of an obligation incurred before the date of bankruptcy, are provable in his or her bankruptcy.”

9. Subsection 82(8) provides:

In this section, "liability" includes:

- (a) compensation for work or labour done;*
- (b) an obligation or possible obligation to pay money or money's worth on the breach of an express or implied covenant, contract, agreement or undertaking, whether or not the breach occurs, is likely to occur or is capable of occurring, before the discharge of the bankrupt; and*
- (c) an express or implied engagement, agreement or undertaking, to pay, or capable of resulting in the payment of, money or money's worth, whether the payment is:
 - (i) in respect of amount – fixed or unliquidated;*
 - (ii) in respect of time – present or future, or certain or dependent on a contingency; or*
 - (iii) in respect of the manner of valuation – capable of being ascertained by fixed rules or only as matter of opinion.**

10. When a person becomes bankrupt all provable debts owing by the debtor are converted from a right to take action against the debtor (eg. writ of execution by a sheriff, garnishee on wages) to a right to lodge a claim and share in any distribution from the bankrupt's estate.
11. Common examples of provable debts include personal loans, credit cards and the provision of goods and services obtained on credit.
12. Some examples of unusual debts which are provable in bankruptcy:
- Workers compensation payments;
 - Debts arising by breach of trust, which includes debts that arise from misappropriation of funds held by the debtor on trust or as administrator of a trust;
 - A guarantor in relation to a liability of a bankrupt is entitled to prove in the bankruptcy for participation in a dividend on two conditions, (i) that the guarantee under which the liability arose was given prior to bankruptcy, and (ii) the guarantor has paid the total liability due under the guarantee; and

- Unliquidated debts arising from breach of contract are provable and may include areas such as injuries arising from negligence or damage to goods due to negligence.
13. Interest accruing on provable debts from the date of bankruptcy to the date of dividend payment is only paid after all creditors are paid in full and there is a surplus in the bankrupt estate.²

Some debts that are not provable in bankruptcy

Unliquidated damages

14. Unliquidated damages [ss 82(2)] except those arising from breach of contract, promise or breach of trust are not provable in bankruptcy.
15. The most common situation is where a debtor has been involved in a motor vehicle accident and judgment has not been entered prior to bankruptcy, or there has been no legal acknowledgement of the liability.
16. Normally, the trustee will accept that there is a provable debt if the debtor has given a written admission/acknowledgment of liability to the other party or its solicitor/insurer and has documentary evidence that such admission has been received by the other party or its representatives.
17. As for claims for damages under tort, this is a complex area of law and it is necessary to examine the underlying transaction rather than the form of action when considering whether the claim is provable or not³.
18. The fact that a statement of claim accompanying a proof of debt quantifies damages sought does not mean the demand is not unliquidated; it is the essential nature of the demand that is relevant, not its form⁴.

Penalties and fines imposed by a Court

19. Penalties and fines imposed by a Court are not provable in bankruptcy [ss 82(3)]. However, penalties imposed by the Australian Taxation Office for late payment or late lodgement of returns are provable in bankruptcy.

Proceeds of Crime debts

20. Amounts payable under both State and Commonwealth Proceeds of Crime laws are not provable in bankruptcy. e.g Pecuniary Penalty Orders.

HECS debts

21. A debt incurred under the Higher Education Support Act 2003 are not provable in bankruptcy.
22. Originally, there were three stages in the formulation of HECS debts:

² See subsection 82(3B) and s.153A

³ *Auto Group Ltd v England* [2008] NSWSC 402,

⁴ *Cornelius v Barewa Oil & Mining NL (in liq)* [1982] WAR 311; 64 FLR 287

- (i) HECS Semester Debts - the fee for the provision of higher education each semester to the student.
 - (ii) Accumulated HECS Debts - the accumulated semester debts for the year (normally two semesters);
 - (iii) HECS Debts which have become repayable and have been notified by way of a Notice of Assessment issued by the Australian Taxation Office (ATO).
23. HECS debts were incurred under the *Higher Education Funding Act 1988* (Cth) (the HE Funding Act). Section 106J of the HE Funding Act provided for a “HEC Semester Debt” in respect of study undertaken in a particular semester.
 24. With effect from 1 June the following year, the HECS Semester Debt became an “Accumulated HECS Debt” pursuant to section 106N of the HE Funding Act. In effect, the Accumulated HECS debt replaced the HECS Semester Debt.
 25. An Accumulated HECS Debt became repayable when the person’s taxable income exceeded the prescribed threshold amount. Section 160T of the HE Funding Act provided that the Commissioner of Taxation may make assessments of the amount of Accumulated HECS debts and the amount required to be repaid.
 26. Up until 1 June 2006, in respect of an accumulated HECS debt that was incurred prior to 1 January 2005, and /or a HELP debt incurred between 1 January 2005 and 31 May 2006, when a student or ex-student became bankrupt:
 - (i) The total accumulated HECS debt was provable in bankruptcy. However, the bankrupt was released from only that part of the accumulated HECS debt which has been assessed by the Commissioner of Taxation prior to the date of bankruptcy as being payable in the particular income year that a person became bankrupt. In most cases the former bankrupt would not be released from the major portion (if not all) of the accumulated HECS debt.
 - (ii) The bankrupt was liable to continue repayments when his or her income was above the minimum threshold for ATO-assessed HECS repayments in respect of the accumulated HECS debt, or in the case of a student, the ongoing HEC Semester debts that accumulate.
 27. On 1 January 2005, the HELP (Higher Education Loan Programme), which incorporated HECS, PELS, BOTPLS and OLDPS schemes, came into operation.
 28. HELP debts comprise HECS-HELP, FEE-HELP and OS-HELP debts, and are incurred under Part 4-1 of the *Higher Education Support Act 2003*, and any HELP debt that was incurred after 1 January 2005, is not provable in bankruptcy.
 29. Existing accumulated HECS debts are converted into HELP debts, and any new accumulated HELP debt are provable in bankruptcy as from 1 June 2006.
 30. However, any existing semester debt incurred prior to 1 January 2005, or an accumulated HELP debt incurred prior to 1 June 2006 is provable in bankruptcy. Furthermore, all HELP debts which have been assessed as being payable by way of a Notice of Assessment issued by the ATO, are provable in bankruptcy.

Student Loans

31. A Student Loan made pursuant to the *Student and Youth Assistance Act 1973* and as from 1st July 1998, the Youth Allowance and Austudy Payment Schemes covered by the *Social Security Act 1991*, is a debt not provable in bankruptcy, pursuant to section 12ZW of that Act.

Debts barred by the Limitation Act 1969

32. Debts barred by the *Limitation Act 1969* (in NSW) or equivalent legislation in another State or Territory⁵ are not provable in bankruptcy. Most debts incurred more than six years prior to bankruptcy under a simple contract are not provable unless the debt has been 'revived' within that period, ie. the debt has been part-paid in that period, the debt has been acknowledged in writing or a judgment has been obtained. The period for suing under a Deed is 12 years from the breach and for enforcing a judgment 12 years from the date of judgment. It should be noted that time for the purposes of the Limitations Act ceases to run at the date of bankruptcy.

Creditors legal costs

33. Creditors' legal costs are not provable in bankruptcy unless:
- (i) they are allowed on a judgment obtained prior to bankruptcy; or
 - (ii) were allowed as part of the contractual obligation incurred prior to bankruptcy.

Collection agents' expenses

34. Costs of abortive writs are not provable nor are collection agents' expenses unless the debtor is liable under the terms of the contract.

Unenforceable debts

35. If a debt is not enforceable at law owing to a prohibition contained in a statute, the debt cannot be proved, eg a debt due to an unlicensed bookmaker or a debt related to illegal purchases.

Costs of proceedings

36. Should a bankrupt unsuccessfully bring an action in which judgment or a decision is given prior to bankruptcy, the costs are a debt provable in the bankruptcy only if the costs order is made prior to bankruptcy.⁶

⁵*Limitations of Actions Act 1974*: QLD
Limitation Act 1974:TAS
Limitation of Actions Act 1958: VIC
Limitation Acts 1935 & 2005: WA
Limitation Act 1985: ACT
Limitation of Actions Act 1936: SA
Limitation Act: NT

⁶*Foots v Southern Cross Mine Management Pty Ltd* [2007] HCA 56 (7 December 2007)

Council rates

37. Local councils who are owed rates are secured creditors as the rates attach to the property on which the rates have been levied, and the council is empowered to sell the property after a certain number of years to recover outstanding rates. However, strata levies are unsecured and will often form the basis of a bankruptcy notice/ creditor's petition.

Debt incurred after bankruptcy

38. Debts incurred by the bankrupt after he/she becomes bankrupt are not provable in bankruptcy and the bankrupt remains liable for those debts.
39. Creditors with post bankruptcy debts may exercise their usual civil remedies for the collection of outstanding debts. For example, a writ of execution may be enforced against property that does not vest in the trustee.

Types of Provable Debts

Income Tax

40. Generally, the ATO lodges a claim in a bankrupt estate for unpaid income tax for the period up to the end of the financial year (i.e. 30th June) prior to the date of bankruptcy, viz. if a debtor went bankrupt on say the 24th May 2007, the ATO would claim for unpaid tax up to 30th June 2006, and consequently as the unpaid income tax for the period from 1st July 2006 to 23rd May 2007 (the day before bankruptcy) would not be provable, the bankrupt will be liable for the tax payable on earnings derived in that period.
41. However, a debtor who was operating a business up to the date of bankruptcy or shortly beforehand, is able to lodge 2 tax returns for the one financial year. ie. the first return for the period starting on the 1 July prior to the date of bankruptcy, and ending on the day before bankruptcy, and the second return for the period from the date of bankruptcy to the following 30 June.
42. In the matter of **Dr Graham v Deputy Commissioner of Taxation**, the ATO contended that a taxpayer could not lodge 2 returns for the one financial year. However, the Federal Court determined that a taxpayer could do so, and held that:-
 - a) the obligation to pay tax is an obligation derived from the (*Income Tax Assessment Act 1936*) statute.
 - b) the obligation commences at the beginning of each financial year (i.e. 1 July), even though the amount of tax cannot be ascertained until its end (i.e. 30 June). Ascertainment is merely an accounting exercise which fixes the obligation to pay such tax as due and then makes the tax itself due and payable.
 - c) the obligation which commences at the beginning of the tax year is a contingent debt liability which matures into an actual liability when the amount of the debt is ascertained.

- d) the Income Tax Assessment Act permits the lodgement and assessment of tax returns for part of a financial year. (i.e. two tax returns can be lodged to cover the one financial year.)
43. Therefore, using the above dates, the bankrupt can lodge a tax return for the period from 1 July 2006 to 23 May 2007 (the day before bankruptcy) and income tax assessed as payable on the income earned up to 23 May 2007 would be a provable debt in the bankrupt estate. Of course, the bankrupt would also be required to lodge a return for the remainder of the year i.e. 24 May to 30 June 2007 and the tax assessed payable on that return would not be provable.
44. There is no benefit for a salary or wage earner to lodge 2 tax returns for the one year assuming the employer is remitting tax instalment deductions.
45. Penalties imposed by the ATO for late payment or late lodgement of returns, are provable in bankruptcy as they have not been imposed by a Court.
46. The ATO is entitled by statute to retain any refunds more appropriately described as “credits” due to the bankrupt during the period of bankruptcy and apply such credits to the bankrupt’s liability for unpaid income tax and/or any other amounts owing to the Commonwealth eg Child Support, HEC debts, Centrelink overpayments.

Unpaid Superannuation deductions

Superannuation Guarantee Charge

47. Since 1992, employers generally have been required by the *Superannuation Guarantee (Administration) Act 1992* (“the SGA”), which is administered by the ATO, to contribute to the superannuation savings of their employees.
48. Furthermore, the payment of superannuation contributions for employees by their employers is now a standard condition in contracts of employment, workplace agreements and/or under an award provision.
49. Should the employer fail to make the superannuation contributions, the ATO imposes a tax known as the Superannuation Guarantee Shortfall (“the SGS”), which is comprised of the unpaid superannuation contributions up to the minimum amount (currently 9%) plus interest (currently 10%) plus, an administration charge (currently \$20 per employee with a shortfall, per quarter).
50. Under section 36 of the SGA the ATO is empowered to raise assessments for the SGC.
51. Accordingly, the ATO is entitled to lodge a proof of debt in the estate of a bankrupt employer for the SGC. Where the ATO receives or recovers the SGC, the ATO is then required to pay the shortfall component to a superannuation fund nominated by the employee.
52. Conversely, the SGC is not a debt owing to the employee, therefore the employee is precluded from suing the employer for the debt, but the employee can seek an order for specific performance of the term of employment contract i.e. an order that the employer pay the required superannuation contributions to the employee’s superannuation fund.

Employer Contributions Pursuant to an Employment Contract

53. However, if under the contract of employment the employer is required to make superannuation contributions for the employee, the employee would be entitled to claim in the estate of the bankrupt employer for the unpaid contributions. (If there was no contractual obligation on the employer, the employee would be unable to lodge a claim).
54. Likewise, if the employer became bankrupt, the trustee would be required to pay any dividend in respect of the employee's claim to the employee's superannuation fund ie not the employee. Similarly, with any dividend paid to the ATO, the shortfall component would then be paid into the employee's nominated superannuation fund.
55. Therefore, it is possible for both the ATO and the employee to lodge a claim for the same unpaid superannuation contributions. However the trustee would apply the rule against "double proof", as there can only be one dividend in respect of the same debt.

Unpaid wages, salary etc ..

56. Subsection 109(1)(e) of the Bankruptcy Act currently provides a priority up to \$3,950.00⁷ in respect of unpaid income and allowances (other than in respect of leave entitlements) in respect of a contract of employment, award, agreement or the Australian Fair Pay and Conditions Standard in respect to an employee of the bankrupt whether the remuneration is by salary, wages, commission or otherwise in respect to services rendered to or for the bankrupt before the date of the bankruptcy.

57. Furthermore, ss 109(1B) and (1C) state:

“(1B) The reference in paragraph (1)(e) to amounts due in respect of an employee of the bankrupt includes a reference to amounts due as contributions to a fund for the purposes of making provision for, or obtaining, superannuation benefits for the employee, or for dependants of the employee.

(1C) The reference in paragraph (1)(e) to amounts due to or in respect of any employee of the bankrupt also includes a reference to amounts due as superannuation guarantee charge (within the meaning of the Superannuation Guarantee (Administration) Act 1992), or general interest charge in respect of non-payment of the superannuation guarantee charge.”

58. The sum claimed in excess of \$3,950.00 would rank equally with ordinary unsecured creditors.

Maintenance Debts

59. Whilst a debt for unpaid maintenance is provable in bankruptcy, the bankrupt is not relieved of the ongoing liability for maintenance. Therefore, the creditor spouse can share in a dividend (if any) and continue to look to the bankrupt for maintenance.
60. Furthermore, it should be noted that on obtaining a discharge, unless an order from the Court is obtained pursuant to ss153(2A) of the Bankruptcy Act to release the former bankrupt from liability to pay arrears due under a maintenance agreement or maintenance

⁷ This amount is indexed – see indexed amounts at ITSA's website www.itsa.gov.au (Menu: Trustees/Current Amounts)

order, a discharge from bankruptcy will not release the former bankrupt from any liability under such an order and the bankrupt will still be liable.

Child Support Debts

61. The Child Support Registrar may prove in a bankrupt estate for the entire amount outstanding at the date of bankruptcy, including late payment penalties (i.e. interest charged on the unpaid child support.)
62. The Registrar can also (and usually does) continue to recover the child support portion of the debt, however, the Registrar is prevented from pursuing the bankrupt for late payment penalties owing at the date of bankruptcy, as the bankrupt is released from the penalty portion at the date of bankruptcy. Note, interest re-starts accruing on the child support owing at the date of bankruptcy.
63. The Registrar can continue to take action against non-divisible property of the bankrupt.
64. Upon discharge from bankruptcy, the former bankrupt remains liable for the amounts due to the Registrar for Child Support [s153(2)(c)], unless an order from the Court is obtained pursuant to ss153(2A) of the Bankruptcy Act to release the former bankrupt from liability to pay arrears due under a Child Support Order or maintenance order.
65. Therefore, if the major portion of the debtor's liabilities comprises maintenance or child support debts, bankruptcy will not provide much relief.

Centrelink debts

(formerly debts of Department of Social Security)

66. If the debt to Centrelink (or any creditor) was incurred by fraud, the bankrupt is not released from the debt on discharge from bankruptcy [ss153(2)(b) of the Bankruptcy Act].
67. Centrelink is precluded from taking any recovery action against the bankrupt after he/she has been discharged, unless the bankrupt has either been convicted of fraud in relation to the debt or has admitted the fraud.

Restitution orders

68. Restitution Orders are normally associated with criminal proceedings eg a person has been convicted of larceny, embezzlement, fraud. As part of the sentence imposed, an order is made that the convicted person pays a specific sum (usually the amount stolen, embezzled, fraudulently appropriated etc) to the particular affected party by way of restitution. (Note. does not apply to compensation for pain and suffering on the part of the victim of the crime.)
69. In the case where the convicted person has been sentenced to a term of imprisonment or periodic detention, and has been ordered to pay a specific sum to a specified party (via the Court), the restitution order usually contains a 'default clause' ie. if the money is not paid the defendant is to be imprisoned for a specified period.
70. In many cases the term of imprisonment is suspended if the defendant enters into a recognisance to be of good behaviour for a specified period (usually the same period as the term of imprisonment) and to repay the subject monies to the victim. In these cases if the

defendant does not repay the money as required, the recognisance is breached and the prison sentence applies to the defendant.

71. In either scenario the amount the defendant is ordered to pay by way of restitution is a provable debt if the defendant becomes bankrupt. However if the bankrupt does not pay he breaches the order and is liable to be imprisoned.
72. The bankrupt can avoid imprisonment by obtaining an order of the Federal Court of Australia under ss 60(1) of the Bankruptcy Act which states:

“The Court may, at any time after the presentation of a petition, upon such terms and conditions as it sees fit:

(a) discharge an order made, whether before or after the commencement of this subsection, against the person or property of a debtor under any law relating to the imprisonment of fraudulent debtors and, in a case where the debtor is imprisoned or otherwise held in custody under such law, discharge the debtor out of custody; or

(b) stay any legal process, whether civil or criminal and whether instituted before or after the commencement of this subsection, against the person or property of the debtor:

(i) in respect of the non-payment of a provable debt or of a pecuniary penalty payable in consequence of the non-payment of a provable debt; or

(ii) in consequence of his or her refusal or failure to comply with an order of a court, whether made in civil or criminal proceedings, for the payment of a provable debt;

and in the case where the debtor is imprisoned or otherwise held in custody in consequence of the non-payment of a provable debt or of a pecuniary penalty referred to in subparagraph (i) or in consequence of his or her refusal or failure to comply with an order referred to in subparagraph (ii), discharge the debtor out of custody.”

73. An order pursuant to ss60(1) of the Bankruptcy Act discharges or stays the order of imprisonment made by the Local, Supreme or District Court which also made the restitution order.
74. The lead case in respect of the operation of this section is *Storey v Lane* (1981) 147 CLR 549 wherein Gibbs CJ held that the effect of s60 of the Bankruptcy Act is to empower the Court to relieve a debtor against whom a petition has been presented, from a process (civil or criminal) instituted against him because of his failure to pay a provable debt.
75. Orders can be made under ss60(1) of the Bankruptcy Act even after discharge from bankruptcy as was the case in *Re Rooney; Ex parte Rooney* (1986) 68 ALR 487 wherein a former bankrupt was released from custody.
76. The sentencing process, following the failure to pay compensation as ordered, is “a legal process in respect of the non-payment of a provable debt”, ss60(1)(b)(i) of the Bankruptcy Act *Re Sutherland-Cropper* (1985) 61 ALR 713.
77. It should be noted that it is a matter for the bankrupt to make the application under ss60(1) of the Bankruptcy Act to the Federal Court (i.e. the trustee does not make the application) and that such orders only relate to provable debts.

Victim's Compensation

78. In NSW, the *Victims Support and Rehabilitation Act 1996* provides for the payment to victims of crime, compensation for physical and/or psychological injuries suffered during the commission of a crime and the recovery from the offender, of the amount paid (or part thereof) to the victim. There is similar legislation in the other States.
79. The process is conducted in two separate stages.
- (i). The victim of the crime applies to the Victims' Compensation Tribunal for an award of compensation and if the claim is accepted, an award is paid to the victim from the Victims Compensation Fund, a fund created by statute. The amount of the award is relative to the extent of the injury sustained by the victim (maximum of \$50,000).
- (ii) The Tribunal then makes a Provisional Order for Restitution against the offender in the amount paid to the victim and if the debtor subsequently becomes bankrupt, that amount becomes a debt provable in bankruptcy from which the offender will be released when they are discharged from bankruptcy.
80. The offender has the opportunity, either by a hearing before the Tribunal or by conference with the Registrar, to put their case forward as to why the order should not have been made or seeking a reduction of the amount of the order.
81. The Tribunal is empowered to make restraining orders against the property of an offender against whom a Provisional Order for Restitution has been made or about to be made. However, the Tribunal does not have the power to imprison the offender for non-payment of the order.

Rent

82. Rent debts are provable in bankruptcy. However, this does not prevent the landlord from evicting a tenant for non-payment of rent.
83. A landlord is entitled to prove for any rent outstanding at the time of the appointment of the trustee and for any rent that becomes due for payment after the appointment and that cannot be collected from the bankrupt.
84. Future rental that would have been paid under the lease is a provable debt. The landlord can also prove for any other amounts that are owing under the provisions of or breach of the lease.
85. A landlord must attempt to mitigate their loss by taking reasonable steps to find a new tenant. The claim will have to be adjusted for the amount paid by any subsequent lessee. At times, these amounts will have to be estimated as the landlord will not be able to determine the exact debt when they will need to lodge a proof.

Debts of Uncertain Value

86. Section 82 of the Bankruptcy Act provides,

“The trustee shall make an estimate of the value of a debt or liability provable in the bankruptcy which, by reason of its being subject to a contingency, or for any other reason, does not bear a certain value.”

87. It is commonplace for creditors to obtain default judgment against a debtor. It should be noted that the trustee is not bound to accept a judgment debt as being a true reflection of the debt, that is, the trustee is able to inquire into the debt and is not obliged to accept a judgment at face value (commonly referred to as “going behind the judgment”). There have been numerous instances where a debt has been admitted for considerably less than a default judgment amount, as portions of the judgment were considered to be not provable in the bankruptcy. Loss of profit components on breach of contract proofs for example need to be carefully considered.

Claims by Secured Creditors

88. A secured creditor in bankruptcy is a creditor who holds either a mortgage, a lien or a Bill of Sale over the bankrupt’s property i.e. if the creditor holds a mortgage over a property owned by a relative or friend of the bankrupt, as security for the loan made to the bankrupt, for bankruptcy purposes, the creditor is unsecured.
89. A secured creditor has the following three options in relation to its debt:
- (i) Surrender its security and prove in the estate for the entire debt;
 - (ii) Realise its security and prove for the deficiency after the proceeds of sale have been applied to the principal of the debt;
 - (iii) Estimate the value of the security and prove in the estate for the estimated deficiency.
90. A deficiency arising from the sale of an asset (eg house, motor vehicle) by a secured creditor in respect of a contract (eg mortgage, hire purchase, lease) entered into before the date of bankruptcy, is a provable debt, irrespective of when the asset is sold, i.e. before, during or after bankruptcy.
91. The general rule is that in the absence of a surplus there is no ability to prove for interest for any period subsequent to the bankruptcy and the rule applies whether the interest is on a secured or unsecured debt⁸.
92. A creditor with a primary debt owing by a bankrupt with security over another person’s property, say a relative, can prove in the bankruptcy for the full amount.
93. The bankrupt can make payments from their income to the creditor to prevent the creditor from selling the relative’s property. However, such payments will not excuse “a contributor” from making their assessed income contributions to their trustee.

Claims by Partners of the Bankrupt

94. Where one partner of a firm becomes bankrupt, a creditor to whom the bankrupt is indebted jointly with the other partners of the firm or any of them shall not receive a dividend out of the separate property of the bankrupt until all the separate creditors have received the full amount of their respective debts⁹.

⁸ See *Re Vellnagel; Whiteman v Hanson* (1975) 6 ALR 80 per Burt J. at p 81. The rule is now expressly stated in sub-s.82(3B) See also *Re Westpac Banking Corporation v GV Morton* [1988] FCA 140; 1987 Bankruptcy 79 ALR 206 (29 April 1988)

⁹ Section 141 of the Bankruptcy Act

Judgment Debts 10

95. Generally speaking, debts that arise from judgments issued prior to the date of bankruptcy will be provable debts: *Wentworth v Rogers* (2009) 7 ABC(NS) 391 ; [2009] NSWSC 1038 at [22].
96. Nevertheless ‘The trustee's right and duty when examining a proof for the purpose of admitting or rejecting it is to require some satisfactory evidence that the debt on which the proof is founded is a real debt. No judgment recovered against the bankrupt, no covenant given by or account stated with him, can deprive the trustee of this right. He is entitled to go behind such forms to get at the truth, and the estoppel to which the bankrupt may have subjected himself will not avail against him’: *Re Van Laun; Ex parte Pattullo* [1907] 1 KB 155 at 162–163 (Bigham J); *Re Van Laun; Ex parte Chatterton* [1907] 2 KB 23 (CA); *Re Quatrovision Pty Ltd (in liq)* [1982] 1 NSWLR 95.

Debts for Essential Services

97. Debts for unpaid electricity, gas, telephone etc at the date of bankruptcy are provable. However, to maintain the provision of the particular service, the bankrupt will most probably be required to pay the accounts i.e. if the account is not paid, the service will be disconnected. Bankruptcy will not prevent such disconnection.
98. If the bankrupt seeks an essential service at another address and has a debt to the service provider for a previous address, they may be required to pay a higher than normal security deposit.
99. Note, there is nothing to prevent a bankrupt from paying any provable debt although this should be subject to their obligation to make mandatory income contributions if their income exceeds the prescribed threshold. Likewise, a bankrupt can maintain the payments on a leased vehicle.

Traffic and Parking Fines

100. Subsection 82(3) of the Bankruptcy Act states that “penalties or fines imposed by a Court in respect of an offence against a law, whether a law of the Commonwealth or not, are not provable in bankruptcy”.
101. Therefore, all fines and penalties except those imposed by a Court are provable in bankruptcy.
102. Traffic Infringement Penalties imposed under the PERIN system in Victoria are not provable in bankruptcy because they are deemed to be an order of the Court aptly characterised as giving rise to a penalty or fine.¹¹
103. Each State and Territory in Australia has passed legislation that governs the registration and enforcement of fines and penalties¹². However, there are some significant differences

¹⁰ This passage is a section taken from Australian Bankruptcy Law & Practice’s commentary on Section 82 – Judgement debts

between the legislation in each State and Territory. The relevance of the *Mansfield* decision for each State and Territory therefore depends on whether the legislation in that State or Territory deems an infringement notice to be an order of a court.

104. In South Australia, it appears that fines are not provable in bankruptcy. The *Expiation of Offences Act 1996* states that once an enforcement order is made, 'the order will be taken to be an order of the Court, and ... is enforceable under the Criminal Law (Sentencing) Act 1998 accordingly'.¹³
105. Similarly, in Tasmania, the *Justices Amendment (Infringement Notices) Act 1997* states that 'an enforcement order is taken to be an order of a court of summary jurisdiction'.¹⁴
106. A similar provision is included in Queensland's *State Penalties Enforcement Act 1999*.¹⁵
107. The Federal Court's decision probably does not change the situation in New South Wales which has a purely administrative process to enforce infringement penalties. That is, these are not 'orders of the Court' within the meaning of ss82(3) of the Bankruptcy Act.

Insolvent Trading

108. In certain circumstances, a director (including former director) of a company can become personally liable for debts of a company of which they were a director, under either the *Corporations Act 2001* and/or the Income Tax Assessment Act.
109. If held liable, the debt is provable in bankruptcy, with the liability normally being to the Liquidator of the company on behalf of the creditors of the company.
110. Even though the liability may not be quantified at the date of bankruptcy, it is an obligation incurred before bankruptcy for which the bankrupt may become liable before discharge {ss82(1) of the Bankruptcy Act}. It is a claim for money under a statute made independently of a wrong which is a tort or breach of contract.¹⁶

Rule Against Double Proof

111. It is a well established rule of bankruptcy law that there cannot be two claims in respect of the same debt and there is much case law on the subject.¹⁷
112. This issue may arise for example if a guarantor of a debt owed by a bankrupt to a creditor seeks to claim in the bankrupt estate before the creditor has had its debt paid in full. The basis for the rule against double proof is that until paid in full, a creditor is entitled to prove for the whole debt even if part of it has been paid by the surety. That is established

¹¹ State of Victoria v Mansfield [2003] FCAFC 154 (18 July 2003)

¹²] Fines, Penalties and Infringement Notices Enforcement Act 1994 (WA), Fines and Penalties (Recovery) Act 2001 (NT), Magistrates Court Act 1930 (ACT); State Penalties Enforcement Act 1999 (QLD), Fines Act 1996 (NSW), Expiation of Offences Act 1996 (SA), Justices Amendment (Infringement) Act 1997 (TAS).

¹³ Expiation of Offences Act 1996 (SA) s 13(6)(b)

¹⁴ Justices Amendment (Infringement Notices) Act 1997 s 92I(1)

¹⁵ Section 147

¹⁶ Official Trustee in Bankruptcy v CS & GJ Handby Pty Ltd (1989) 21 FCR 19^l; 87 ALR 734

¹⁷ See for example *State of Western Australia v Bond Corporation Holdings Ltd* (1992) 37 FCR 150

by *Re Fenton and by In re Oriental Commercial Bank* (1871) LR 7 Ch App 99 per Mellish LJ at 103-4. The rule is designed to prevent two dividends being paid for the same debt.

113. However the Full Federal Court has held that the rule against double proof does not prevent two creditors exercising voting entitlements in respect to the same debt. In *Neville Loeskow v Avokah Irrigation Pty Ltd (Receiver and Manager Appointed) and Commonwealth Bank of Australia* [1996] FCA 1420 (24 April 1996) Foster J said,

“I have, however, come to the conclusion that it was not appropriate to apply the rule in the circumstances of the case. Despite its reference to “proof”, I am of the view that the rule really relates to entitlement to receive payment from a debtor or his insolvent estate. It does not operate to prevent the creation of a debtor/creditor relationship between a guarantor and a principal debtor. In the present case, of course, the payment by Avokah Irrigation to the Bank under the guarantee created a debt between Loeskow and Avokah Irrigation of the amount of the payment, namely \$403,310.95. The rule against double proof operated only to prevent payment of that debt or any rateable dividend in respect of it until the Bank's debt was paid in full. It had no effect upon the existence of the debt or upon Avokah Irrigation's status as a creditor of Loeskow.”

Deceased creditor's estates

114. An executor of a deceased creditor's estate may prove in the bankruptcy in place of the deceased creditor.

Disclosure of debts by the debtor/bankrupt

115. A debtor (or a bankrupt) is required to disclose all their liabilities in their statement of affairs irrespective of whether the debts are provable or not.
116. In the case of a debt owing to a relative or a friend where the relative or friend has said words to the effect “Don't worry about it”, unless the debtor has obtained a written release of the debt from the creditor, the debt should be included in the debtor's statement of affairs. It will be for the trustee to determine if the debtor and the relative or friend intended to create legal relations and, as a result, a legally enforceable debt.

Guarantors

117. It appears to be a settled rule of bankruptcy law that where a creditor proves in the bankruptcy of a guarantor and the guarantor is only responsible for the amount in fact owing by the principal debtor, any payment by or on behalf of the principal debtor received by the creditor before proof must be taken into account by the trustees in valuing the creditor's proof; a creditor claiming in a guarantor's bankruptcy is not, however, obliged to bring into account, in reduction of the amount of the debt sought to be proved, payments received from the principal debtor after submission of proof, let alone an estimate of what it may be able to obtain by realising the principal debtor's security¹⁸.
118. This rule is subject only to the qualification that the creditor is not entitled to recover more than 100 cents in the dollar. If the creditor who has proved in the guarantor's bankruptcy ends up with more than 100 cents in the dollar, it must account to the bankrupt guarantor or, more accurately, to his trustee, for the excess.

¹⁸ As the creditor is not a secured creditor of the bankrupt. A secured creditor holds security over the property of the bankrupt

Debts Payable in Foreign Currency

119. Where a debt is payable in foreign currency, the creditor is entitled for the purposes of his or her proof to convert into its Australian equivalent the amount of his debt in foreign currency at the rates of exchange at the date of bankruptcy.¹⁹

Trustee's Role in Disputed Debts

120. The Bankruptcy Act provides a mechanism for both creditors and bankrupts to appeal the trustee's decisions to admit or reject a creditor's proof of debt [ss104 and 178 of the Bankruptcy Act].
121. In the instance where both the bankrupt and the creditor dispute the admission by the trustee of a particular proof of debt, the trustee's role should be limited to that of a submitting party in the legal proceedings.
122. In the matter of *Wilson and Or v Official Trustee in Bankruptcy and Or* (122 ALR 585-603) in the Full Federal Court, their Honours stated that because "at all material times there was to be a contradictor other than the trustee which would take an active part in the proceedings", the dispute would be fully ventilated and the trustee should have only played a submitting appearance role.
123. In other words, where both the bankrupt and the creditor are challenging the quantum of a proof of debt, the trustee should step back and let the Court decide between the parties.
124. Likewise, where the bankrupt has made the creditor a party to the proceedings (or visa versa), the trustee should "step back and let the bankrupt and the creditor do battle". However, it may be that the Court requires the trustee's participation in the proceedings in which case, the trustee could seek an order for costs to be payable by the "losing party".
125. Note, "proving a debt" refers to the process of establishing the existence of a debt owing by a bankrupt debtor to a creditor plus quantifying owing, and the onus of proof is on the creditor to prove that the debt is owing, to the satisfaction of the trustee. However, the costs of "proving the debt" are not provable.

Release from Provable Debts in Bankruptcy

126. Section 153 of the Bankruptcy Act sets out the effect of discharge:

(1) Subject to this section, where a bankrupt is discharged from a bankruptcy, the discharge operates to release him or her from all debts (including secured debts) provable in the bankruptcy, whether or not, in the case of a secured debt, the secured creditor has surrendered his or her security for the benefit of creditors generally.

Note: The operation of this section in relation to accumulated HEC debts and semester debts under the Higher Education Funding Act 1988 is affected by section 106YA of that Act.

(2) The discharge of a bankrupt from a bankruptcy does not:

¹⁹ *Re Griffiths; In the Matter of the Bankrupt Estate of Griffiths* (2004) 139 FCR 185

(a) *release the bankrupt from:*

(i) *a debt on a recognizance; or*

(ii) *a debt with which the bankrupt is chargeable at the suit of the sheriff or other public officer on a bail bond entered into for the appearance of a person prosecuted for an offence against a law of the Commonwealth or of a State or Territory of the Commonwealth; or*

(aa) *release the bankrupt from liability to pay an amount to the trustee under subsection 139ZG(1); or*

(b) *release the bankrupt from a debt incurred by means of fraud or a fraudulent breach of trust to which he or she was a party or a debt of which he or she has obtained forbearance by fraud; or*

(c) *subject to any order of the Court made under subsection (2A), release the bankrupt from any liability under a maintenance agreement or maintenance order;*

Note: A discharged bankrupt remains liable under any pecuniary penalty order because such liabilities are not provable in bankruptcy, see subsection 82(3A).

(2A) *The Court may order that the discharge of a bankrupt from bankruptcy shall operate to release the bankrupt, to such extent and subject to such conditions as the Court thinks fit, from liability to pay arrears due under a maintenance agreement or maintenance order.*

(3) *The discharge of a bankrupt from a bankruptcy does not affect the right of a secured creditor, or any person claiming through or under him or her, to realize or otherwise deal with his or her security:*

(a) *if the secured creditor has not proved in the bankruptcy for any part of the secured debt--for the purpose of obtaining payment of the secured debt; or*

(b) *if the secured creditor has proved in the bankruptcy for part of the secured debt--for the purpose of obtaining payment of the part of the secured debt for which he or she has not proved in the bankruptcy;*

and, for the purposes of enabling the secured creditor or a person claiming through or under him or her so to realize or deal with his or her security, but not otherwise, the secured debt, or the part of the secured debt, as the case may be, shall be deemed not to have been released by the discharge of the bankrupt.

(4) *The discharge of a bankrupt from a bankruptcy does not release from any liability a person who, at the date on which the bankrupt became a bankrupt:*

(a) *was a partner or a co-trustee with the bankrupt or was jointly bound or had made a joint contract with the bankrupt; or*

(b) *was surety or in the nature of a surety for the bankrupt.*

(5) *Where a bankrupt has been discharged from a bankruptcy, all proceedings taken in or in respect of the bankruptcy shall be deemed to have been validly taken.*

Release from Provable Debts in a Personal Insolvency Agreement

127. Section 230 of the Bankruptcy Act provides:

Release of provable debts

- (1) *If a personal insolvency agreement provides for a debtor to be released from a provable debt, the agreement operates to release the debtor from that provable debt unless the agreement is set aside or terminated under this Part.*
- (2) *Subsection (1) has effect subject to subsections (3), (4) and (5).*

Exceptions

- (3) *Subsection (1) does not operate to release the debtor from a debt that would not be released by his or her discharge from bankruptcy if he or she had become a bankrupt on the day on which he or she executed the personal insolvency agreement.*
- (4) *Subsection (1) does not affect the right of a secured creditor, or a person claiming through or under a secured creditor, to realise or otherwise deal with the creditor's security:*
 - (a) *if the secured creditor has not proved under the agreement for any part of the secured debt--for the purpose of obtaining payment of the secured debt; or*
 - (b) *if the secured creditor has proved under the agreement for part of the secured debt--for the purpose of obtaining payment of the part of the secured debt for which the creditor has not proved under the agreement;*

and, for the purposes of enabling the secured creditor, or a person claiming through or under a secured creditor, so to realise or deal with the creditor's security, but not otherwise, the secured debt, or the part of the secured debt, as the case may be, is taken not to have been released.

- (5) *A personal insolvency agreement does not release from any liability a person who, at the date on which the debtor executed the agreement, was:*
 - (a) *a partner or a co-trustee with the debtor; or*
 - (b) *jointly bound or had made a joint contract with the debtor; or*
 - (c) *surety or in the nature of a surety for the debtor.*

Release from Provable Debts in a Debt Agreement

128. Section 185NA of the Bankruptcy Act provides:

Release of debtor from debts

Time and effect of release

- (1) *When a debt agreement ends under subsection 185N(1), the debtor is released from provable debts from which the debtor would have been released if the debtor had been discharged from bankruptcy immediately after the acceptance of the relevant debt agreement proposal for processing was recorded on the National Personal Insolvency Index.*

Limits on release

- (2) *The release ceases to operate if the debt agreement is declared void by the Court.*

(3) *The release does not:*

- (a) *release anyone else from a debt that he or she owes jointly with the debtor; or*
- (b) *release a guarantor from the guarantee that the guarantor gave for the debtor's debt.*

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Appendix 1 - Treatment of Certain Liabilities

Item	Provable/ extinguishable	Provable/not extinguishable	Not provable	Reason/Comments
Restitution	No-Fraud	Fraud		<p>The amount the defendant is ordered to pay by way of restitution is a provable debt if the defendant becomes bankrupt. However if the bankrupt does not pay he may breach the order and may be liable to be imprisoned.</p> <p>In the case where the convicted person has been sentenced to a term of imprisonment or periodic detention, and has been ordered to pay a specific sum to a specified party, the restitution order usually contains a 'default clause' i.e. if the money is not paid the defendant is to be imprisoned for a specified period.</p> <p>In many cases the term of imprisonment is suspended if the defendant enters into a recognisance to be of good behaviour for a specified period (usually the same period as the term of imprisonment) and to repay the subject monies to the victim. In these cases if the defendant does not repay the money as required, the recognisance is breached and the prison sentence applies to the defendant.</p> <p>The bankrupt can avoid imprisonment by obtaining an order of the Federal Court of Australia under Section 60(1) of the <i>Bankruptcy Act 1966</i>.</p>
Pecuniary Penalty Orders			√	Covers both State and Federal Proceeds of Crime
Income Tax	√		√	<p>The bankrupt can lodge a return for the period from the commencement of the financial year to the date of bankruptcy and income tax assessed as payable on the income earned up to the date of bankruptcy would be a provable debt in the bankrupt estate.</p> <p>The bankrupt would also be required to lodge a return for the remainder of the</p>

Item	Provable/ extinguishable	Provable/not extinguishable	Not provable	Reason/Comments
				<p>year and the tax assessed payable on that return would not be provable.</p> <p>Penalties imposed by the Australian Taxation Office for late payment or late lodgement of returns are provable in bankruptcy.</p>
HECs/HELP debts	√		√	<p>HECS-HELP, FEE-HELP or OS-HELP debts (which only arise after 1 January 2005) are not provable. However, any part of a HECS-HELP debt which has been assessed as payable on a notice of assessment will be provable.</p> <p>The <i>Higher Education Support (Transitional Provisions and Consequential Amendments) Act 2003</i> provides for the conversion of existing accumulated HECS debts to new accumulated HELP debts. The new accumulated HELP debt will not be provable from 1 June 2006.</p>
Student supplementation loans			√	Section 12ZW of the <i>Student Assistance Act 1973</i> provide that student loans provided pursuant to that Act are not provable in bankruptcy.
Claims in tort (eg. most car accidents)	If no longer an unliquidated claim for damages.		If merely unliquidated claim for damages.	To be provable liability and quantum need to have been determined.
Victims compensation	No-Fraud	Fraud		<p>Liabilities for victim's compensation are afforded no special treatment in bankruptcy. They are provable debts.</p> <p>The legislation pursuant to which the liability to pay compensation arises will determine the date at which the debtor becomes liable (or contingently liable) and therefore when the amount becomes provable.</p>
Centrelink overpayment	No-Fraud	Fraud		Centrelink guidelines below describe its approach to making determinations in

Item	Provable/ extinguishable	Provable/not extinguishable	Not provable	Reason/Comments
				<p>relation to fraud:</p> <p>For fraud to be present there must be two elements in existence:</p> <ul style="list-style-type: none"> • a guilty act; and • a guilty intention (an act committed with reckless indifference can also be fraud). <p>In making an allegation of fraud, it is necessary for Centrelink to be satisfied that the material known provides a reasonable basis for the allegation. A recovery fee does not necessarily indicate fraud.</p> <p>Examples of fraud may include where the customer has:</p> <ul style="list-style-type: none"> • been successfully prosecuted for Centrelink debts incurred through fraud; • made a deliberately false claim; • multiple identities; or • never advised employment and/or wages. <p>Fraud has not been committed merely because a customer has:</p> <ul style="list-style-type: none"> • a partner who failed to declare income, or • debts from advance payments.
Foreign Debts			Except for foreign revenue claims	The Act does not discriminate against foreign creditors. Note however common law rules regarding enforceability of foreign revenue claims.

Item	Provable/ extinguishable	Provable/not extinguishable	Not provable	Reason/Comments
Liability for costs of immigration detention - a person becomes liable for the costs of their detention in accordance with Part 2, Division 10 of <i>Migration Act 1958</i>	√			<p>Detention costs would appear to accrue daily (they do not even appear to be a contingent liability that arises only upon the raising of an assessment).</p> <p>Costs with respect to pre-bankruptcy detention therefore appear to be provable, irrespective of the date that any claim is made against the detainee.</p>
Fines & penalties imposed by a Court			√	Administratively issued fines (such as parking fines) are also considered to be ‘court imposed fines’ and not provable when orders for enforcement are made by the court or legislation deems them to be orders of the court. (See <i>Vic v Mansfield</i> [2003] FCAFC 154). Prior to this any liability is provable.
Debts barred by statute			√	However, if leave is obtained to enforce an otherwise statute barred debt, the debt will become provable.
Council/shire rates			√	<p>Council rates are secured by statutory liens over the property to which they relate. Only the unsecured portion of any outstanding rates is provable in bankruptcy.</p> <p>NB: Post bankruptcy rates are never provable. However, these are still secured upon the property (which may have vested in the trustee). Generally, liability for post bankruptcy rates falls upon the registered owner (who may still be the bankrupt, if the trustee has not transmitted title into its own name). Provisions</p>

Item	Provable/ extinguishable	Provable/not extinguishable	Not provable	Reason/Comments
				exist to enable a trustee to avoid liability for rates other than out of the sale proceeds of the relevant property.
Costs orders	√		√	<p>A costs order made after bankruptcy is generally not provable, with some exceptions. eg. The liability for costs also arises as a part of a contract entered into prior to bankruptcy.</p> <p>There is some old case law that indicates that if a plaintiff commences an action; the defendant then becomes bankrupt; and the plaintiff is then successful, then, provided that the judgement sum itself is provable, the costs will also be considered to be provable. There is also some case law that indicates the opposite.</p>
Insolvent Trading	√			A claim against a director in respect of liabilities of a company incurred whilst the company was insolvent is provable in the bankruptcy of the director. This is the case irrespective of whether judgement is obtained against the bankrupt before or after bankruptcy, provided that the acts giving rise to the liability occurred prior to bankruptcy.