

# A Guide to Understanding Bankruptcy

Business Information Factsheet  
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## Introduction

Sole traders and individual members of a business partnership are personally liable for their business debts. If they have debts they cannot meet, they may consider - or be forced into - bankruptcy.

This factsheet explains what bankruptcy means and the implications it has for individual business owners. It explains the bankruptcy procedures in England and Wales and outlines the variations in Scotland and Northern Ireland. It also lists alternatives to bankruptcy in England and Wales, Scotland and Northern Ireland.

## What is bankruptcy?

Bankruptcy provides insolvent individuals with a way of dealing with overwhelming debt. A person is considered to be insolvent if either of the following conditions apply:

- They cannot pay a specific debt when it is due.
- Their assets (the things they own that could be sold to pay their debts) are worth less than the total amount they owe their creditors.

Bankruptcy is a legal procedure that arranges for creditors to be paid, in full or in part, by the sale of the debtor's assets. If the debtor has no assets, bankruptcy proceedings allow most of their unsecured debts to be written off. However, there are exceptions.

Bankruptcy proceedings cannot release an individual from:

- Debts arising from fraud.
- Debts arising from personal injury claims or family court proceedings (unless the court agrees that these should be released).
- Debts that cannot be claimed through bankruptcy proceedings - for example, student loans. Secured loans such as mortgages are also usually excluded from bankruptcy proceedings.

Becoming bankrupt can have serious implications for individuals:

- They may have to sell their personal possessions.
- They may find it difficult to obtain credit in the future.
- They will almost certainly have to close any business they run, as it will be stripped of its assets.
- They cannot be a company director while bankrupt.

- Their personal details will be published on the Individual Insolvency Register (IIR, [www.insolvencydirect.bis.gov.uk/eiir](http://www.insolvencydirect.bis.gov.uk/eiir)), which anyone can search online.

## Bankruptcy and other insolvency procedures

Bankruptcy only applies to individuals. It should not be confused with insolvency procedures that apply to limited companies or limited liability partnerships (LLPs).

More information about the insolvency procedures used for companies with debt problems can be found in BIF 199, An Introduction to Company Insolvency and Liquidation.

## Partnerships

The situation regarding ordinary partnerships is more complex. Under the Insolvent Partners Order 1994 (England and Wales), creditors can apply for a winding-up order against the partnership itself, and/or pursue bankruptcy petitions against one or more of the partners. The partners themselves can also apply to wind up an insolvent partnership. Go to [www.gov.uk/government/publications/how-to-wind-up-an-insolvent-partnership](http://www.gov.uk/government/publications/how-to-wind-up-an-insolvent-partnership) for more information.

Similar rules apply in Northern Ireland, under the Insolvent Partnerships Order 1995. Go to [www.economy-ni.gov.uk/articles/winding-your-own-partnership](http://www.economy-ni.gov.uk/articles/winding-your-own-partnership) for more information.

In Scotland, the Bankruptcy (Scotland) Act 1985, as amended by the Bankruptcy and Diligence etc. (Scotland) Act 2007, applies. For more information, contact Accountant in Bankruptcy (AiB), which is Scotland's insolvency service ([www.aib.gov.uk/publications/entity-debtor-application-pack-0](http://www.aib.gov.uk/publications/entity-debtor-application-pack-0)).

## How does an individual become bankrupt?

In England and Wales, bankruptcy proceedings start when either:

- An individual submits a petition to declare themselves bankrupt. The application can only be made online and a decision about the application is made by an adjudicator employed by the Insolvency Service rather than by a court. The fee for a bankruptcy application is £655, and it can be paid both online and by instalments.
- One or more creditors present a petition to a court to declare an individual bankrupt, if the total amount of unsecured debt is £5,000 or more (this is known as a creditor's petition). Depending on the amount of the debt, the petition may be presented to the High Court in London or to a county court.
- An insolvency practitioner applies to the court for a bankruptcy order against an individual who has broken the terms of an Individual Voluntary Arrangement (IVA). An IVA is an alternative option for paying off debts. Go to [www.gov.uk/options-for-paying-off-your-debts/individual-voluntary-arrangements](http://www.gov.uk/options-for-paying-off-your-debts/individual-voluntary-arrangements) for more information.

If an individual wants to dispute a creditor's claim, it is important for them to try and negotiate a settlement before the bankruptcy petition is due to be heard in court. It is difficult and costly to do this once a bankruptcy order has been issued.

## Who manages the bankruptcy order?

In the case of a creditor's petition, the court will appoint an Official Receiver (OR) to deal with the bankruptcy order. The OR, who is an officer of the court, is a civil servant employed by the Government's Insolvency Service.

If an individual petitions for their own bankruptcy, the case is initially dealt with by an adjudicator who is also employed by the Government's Insolvency Service. The adjudicator acts as an OR to review the petition and make decisions about the individual's bankruptcy application.

The role of an OR is to manage the bankruptcy and protect the bankrupt individual's assets until such time as a 'trustee' is appointed.

The OR will:

- Publish the bankruptcy order in the 'London Gazette' (the official publication for legal notices). They may also advertise the bankruptcy order in any other way.
- Investigate the bankrupt individual's financial affairs and report any criminal activities.
- Report on the bankrupt individual's business dealings to creditors and to the Insolvency Service.
- Give the required notice of the bankruptcy to local authorities, utility suppliers, courts, sheriffs, bailiffs, Land Registry, National Savings and Investments (premium bonds) and any relevant professional bodies.
- Make enquiries regarding other people or organisations that can provide details of any assets or liabilities that the bankrupt individual has. The OR is likely to contact banks, building societies, mortgage, pension and insurance companies, solicitors and landlords.

Once the investigations are complete, the OR may decide not to deal with the case and appoint a 'trustee in bankruptcy' (trustee). The trustee is a qualified insolvency practitioner who will be responsible for disposing of the bankrupt individual's assets and making payments to their creditors. In some cases, the OR acts as the trustee.

## What is the impact of a bankruptcy order?

A bankruptcy order transfers control of a bankrupt individual's assets and income to the OR, or to the trustee. The individual concerned is classed as an undischarged bankrupt until their debts are settled, or the time limit for the bankruptcy expires. As such, the bankrupt individual must:

- Pass on any requests for payment from their creditors to the OR.
- Provide information and attend interviews or meetings about their financial dealings as requested by the OR.
- Submit a full list of their assets and liabilities to the OR.
- Hand over all their assets, along with all account books, records, bank statements, insurance policies, other financial papers and records relating to property, to the OR.
- Inform the OR about assets acquired and income obtained (such as legacies and redundancy payments) during the bankruptcy.
- Attend court when required to explain their situation, in the case of a creditor's petition.

- Immediately cease using bank, building society, credit card and other accounts.

## Which assets can the trustee seize?

The trustee may seize and sell all of the following assets to pay the bankrupt individual's debts:

- Business assets (if the individual is self-employed).
- All personal property, including house, car and personal possessions (with some exceptions, such as items deemed 'the tools of the trade', as well as essential domestic and personal items).

If a bankrupt individual owns a home jointly with a partner, the bankrupt individual's share will still form part of their estate and must be passed to the trustee, who may have to sell it to pay the debts. It may be possible for a joint owner/third party to pay the trustee for the bankrupt individual's share of the equity in order to keep the property.

If the bankrupt individual lives with their family and a third party cannot buy out the bankrupt person's share of the property, it may be possible to delay the sale until after the end of the first year of bankruptcy. This is to allow time to make other living arrangements. The trustee can retain control of the house for three years, after which, if it has not been sold, it may be returned to the individual concerned.

The trustee also has certain powers regarding property that does not belong to the bankrupt individual. For example, if a bankrupt individual has sold property to a friend or relative for less than it is worth, the trustee can apply to the court for its seizure.

In addition to seizing property and assets, trustees can ask the court for an Income Payment Order (IPO), which deducts a proportion of any income the bankrupt individual earns to help pay off their debts.

The Enterprise Act 2002 introduced Income Payment Agreements (IPAs). An IPA is a legally binding written agreement between the bankrupt person and the OR or trustee. It requires the bankrupt individual to make payments to the trustee for a specified period. This is enforceable in the same way as an IPO. Both IPOs and IPAs can last for a maximum of three years. If an individual is discharged from bankruptcy before the IPO or IPA ends, they must still continue to make the required payments for the specified period.

Pensions from a pension scheme approved by HM Revenue & Customs (HMRC) are exempt from seizure, under the provisions of the Welfare Reforms and Pensions Act 1999. Go to [www.gov.uk/government/publications/guide-to-bankruptcy](http://www.gov.uk/government/publications/guide-to-bankruptcy) for more information about how bankruptcy affects pension arrangements.

## What about the creditors?

The OR or the trustee will contact all the individual's creditors to inform them about the bankruptcy.

Creditors must make a formal claim for the amount they are owed. The trustee may place an advertisement in the local newspaper asking creditors to submit claims. There is a strict order of precedence for payments to creditors:

- The OR's costs.

- If the bankruptcy order was made on a creditor's petition, the petitioner's costs and expenses in making the bankruptcy order.
- Trustees' fees and expenses.
- Preferential creditors, for example employees.
- Unsecured creditors, for example firms that have supplied goods and services to the failed business, financial institutions that have made unsecured loans or given credit, and any other individuals to whom the bankrupt person owes money. This also includes HMRC.

Secured creditors, for example banks and other lending institutions with a legal interest (called a charge) in a debtor's property, do not have to rely on the trustee for repayment of the debt. They can realise the asset that was provided as security for the debt to release the money they are owed.

For example, if business premises were provided as security on a loan, the secured creditor can sell the premises to realise the money owed. If insufficient money is raised from the sale, the secured creditor will have to claim the balance from the trustee as an unsecured creditor. If more money is raised than is required to clear the debt, the balance goes to the trustee for distribution among the other creditors.

If there is any money left over after all the debts are paid, it will be returned to the bankrupt individual, who may apply for the bankruptcy to be annulled (cancelled).

## **What are the restrictions during bankruptcy?**

A bankrupt individual must not:

- Trade under any name other than that under which they were made bankrupt.
- Act as a company director or promote, manage or form a limited company without the court's permission.
- Hold certain public offices.
- Act as a trustee of any charity or pension fund.
- Write cheques, knowing they will be dishonoured.
- Obtain an overdraft or open a new bank or building society account without declaring their bankruptcy.
- Obtain credit for more than £500 (for example, hire-purchase agreements), either alone or jointly with another person, without first disclosing that they are bankrupt.
- Make direct payments to their creditors.

A bankrupt individual may, however, carry on a business as a sole trader, providing they comply with all the restrictions above. Failure to co-operate or comply with the above could result in their arrest or delay their discharge from bankruptcy.

## When does bankruptcy end?

Bankruptcy ends when the individual is 'discharged' from bankruptcy. This normally happens automatically one year after the date of the bankruptcy order, provided that the individual has fully co-operated with the OR and/or trustee.

However, the OR can apply to the court to have a discharge suspended if the individual has not co-operated or carried out their duties during their period of bankruptcy.

## What happens after discharge?

Once a person is discharged, the restrictions during bankruptcy no longer apply. Provided the individual is not subject to an additional court order, they may borrow money and carry on a business as before.

However, bankruptcy can remain on a person's credit record for six years, so, in practice, they may find it difficult to get a loan. Credit reference agencies do not always update their records automatically, so the individual may have to ask them to remove this information once the six-year period has elapsed.

An individual's details will remain on the Insolvency Register for three months after they have been discharged from bankruptcy.

If the individual still owns any properties after paying their debts, details of the bankruptcy will be held by both Land Charges and Land Registry. The individual will have to apply to them directly to remove these details and will need to provide proof of discharge from bankruptcy.

Once discharged, the individual may become a company director unless they are disqualified from doing so by a court order (such as a bankruptcy restrictions order, debt relief restrictions order or disqualification order).

## What are the rules in Scotland?

The insolvency procedure for individuals in Scotland is very similar to that in England and Wales. Insolvency in Scotland is governed by the Bankruptcy and Diligence etc. (Scotland) Act 2007, the Bankruptcy (Scotland) Regulations 2008, the Bankruptcy (Scotland) Act 1985, the Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008 and the Bankruptcy and Debt Advice (Scotland) Act 2014.

In Scotland, bankruptcy is often referred to as 'sequestration'. There are some key differences in Scotland's bankruptcy procedures:

- A debtor must owe at least £1,500 to apply for their own bankruptcy. They can do so through Accountant in Bankruptcy (AiB), Scotland's insolvency service. People on a low income with few assets or savings can apply for bankruptcy under the Minimal Asset Process (MAP), in which case they may be discharged from bankruptcy after only six months.
- A creditor must be owed at least £3,000 and must petition the Sheriff Court in order to make someone bankrupt.
- The Sheriff Court or the AiB will appoint a trustee to manage the bankruptcy.
- The trustee can either be the AiB or a private insolvency practitioner.

Business owners in Scotland can get more information and guidance from the AiB website at [www.aib.gov.uk](http://www.aib.gov.uk).

## What are the rules in Northern Ireland?

Bankruptcy in Northern Ireland is covered mainly by the Insolvency (Northern Ireland) Order 1989.

- Creditors can make a bankruptcy petition to the High Court if they are owed £750 or more. An individual can also petition the court for bankruptcy on their own behalf.
- Government departments such as HMRC are classed as preferential debtors and can make a claim on any assets before unsecured creditors.
- Bankrupts are usually discharged after 12 months, but exceptions apply.

Contact the Insolvency Service in Northern Ireland ([www.economy-ni.gov.uk/topics/insolvency-service](http://www.economy-ni.gov.uk/topics/insolvency-service)) for more information.

## Alternatives to bankruptcy

There are alternative ways of dealing with personal debt, and business owners should only consider bankruptcy as a last resort.

### Informal arrangements

An individual business owner could write to their creditors with a proposal to repay some of the debt initially, or all of the debt over an extended period. Informal arrangements are not legally binding, so creditors may agree at first, but later pursue the individual business owner for all the debt.

### Formal schemes

Depending on where in the UK an individual is based, there are other arrangements and procedures that provide alternatives to bankruptcy:

#### *England and Wales*

- **Debt management plan (DMP).** This is an agreement with creditors to pay off 'non-priority' debts in full. The arrangement is managed by an authorised debt management company that takes a regular monthly payment from the debtor and shares it among their creditors. A DMP is not legally binding. Go to [www.citizensadvice.org.uk/debt-and-money/debt-solutions/debt-management-plans/debt-management-plans-explained/debt-management-plans-what-you-need-to-know/](http://www.citizensadvice.org.uk/debt-and-money/debt-solutions/debt-management-plans/debt-management-plans-explained/debt-management-plans-what-you-need-to-know/) and [www.nationaldebtline.org](http://www.nationaldebtline.org) for more information.
- **Individual voluntary arrangement (IVA).** This is a formal agreement with creditors to pay off debts in full or in part. The agreement is arranged by an insolvency practitioner and must be approved by the court. Go to [www.gov.uk/options-for-paying-off-your-debts/individual-voluntary-arrangements](http://www.gov.uk/options-for-paying-off-your-debts/individual-voluntary-arrangements) and [www.citizensadvice.org.uk/debt-and-money/debt-solutions/individual-voluntary-arrangements/](http://www.citizensadvice.org.uk/debt-and-money/debt-solutions/individual-voluntary-arrangements/) for more information.
- **Debt relief order (DRO).** DROs are for people with debts below £20,000, who do not own a home, have few assets and little surplus income. DROs are issued by the OR, but individuals

must apply through an authorised debt advisor. A DRO lasts for 12 months. During this time, named creditors cannot take action to recover their money without permission from the court. After 12 months, if there has been no change in the debtor's circumstances, the debts specified in the Order are written off. Go to [www.gov.uk/options-for-paying-off-your-debts/debt-relief-orders](http://www.gov.uk/options-for-paying-off-your-debts/debt-relief-orders) and [www.citizensadvice.org.uk/debt-and-money/debt-solutions/debt-relief-orders/](http://www.citizensadvice.org.uk/debt-and-money/debt-solutions/debt-relief-orders/) for more information.

- **Administration order.** If an individual is taken to court by one or more creditors, owes less than £5,000 and is deemed able to pay, the court may make an administration order. This will require the debtor to make weekly or monthly payments through the court. If they stop paying, the court may apply the same conditions as applied to a bankrupt individual. Go to [www.gov.uk/options-for-paying-off-your-debts/administration-orders](http://www.gov.uk/options-for-paying-off-your-debts/administration-orders) for more information.

#### *Scotland*

- **Debt management plan (DMP).** Go to [www.aib.gov.uk/guidance/publications/information-guides-and-booklets/bankruptcy-1-april-2008/introduction-aib-4](http://www.aib.gov.uk/guidance/publications/information-guides-and-booklets/bankruptcy-1-april-2008/introduction-aib-4) for more information about DMPs in Scotland.
- **Debt Payment Programme (DPP).** Individuals can apply for a DPP under the Scottish Government's Debt Arrangement Scheme (DAS). This freezes the interest and fees on the debt, and allows the debtor to pay off what they owe over a period of time. Go to [www.dasscotland.gov.uk](http://www.dasscotland.gov.uk) for more information.
- **Trust deed.** This is a formal voluntary arrangement between a debtor and their creditors. It must be set up and managed by an insolvency practitioner who becomes the trustee. While setting up a trust deed is an alternative to bankruptcy, it is still a very serious step. Go to [www.aib.gov.uk/trust-deed-guide-effective-01-april-2008](http://www.aib.gov.uk/trust-deed-guide-effective-01-april-2008) for more information.

#### *Northern Ireland*

- **Individual voluntary arrangement (IVA).** Go to [www.economy-ni.gov.uk/publications/sip-31-individual-voluntary-arrangements](http://www.economy-ni.gov.uk/publications/sip-31-individual-voluntary-arrangements) for information about IVAs in Northern Ireland.
- **Administration order.** In Northern Ireland, administration orders are issued by the Enforcement of Judgements Office. Go to [www.economy-ni.gov.uk/articles/alternatives-bankruptcy](http://www.economy-ni.gov.uk/articles/alternatives-bankruptcy) for more information.
- **Debt relief order.** Go to [www.economy-ni.gov.uk/publications/debt-relief-order-information-debtors](http://www.economy-ni.gov.uk/publications/debt-relief-order-information-debtors) for information about DROs in Northern Ireland.

## Hints and tips

- If a business is in financial difficulty, it is important to seek professional advice before deciding if bankruptcy is the right option.
- Some business owners may be in a position to consider alternatives to bankruptcy, such as DROs, IVAs, debt management plans or administration orders.
- A qualified insolvency practitioner can provide professional advice and guidance. Professional associations such as the Insolvency Practitioners Association ([www.insolvency-practitioners.org.uk](http://www.insolvency-practitioners.org.uk)) and the Association of Business Recovery Professionals ([www.r3.org.uk/get-advice/find-a-practitioner](http://www.r3.org.uk/get-advice/find-a-practitioner)) provide online directories of their members.

## Further information

BIF 37 An Introduction to Making a Small Claim to Recover an Unpaid Debt  
BIF 115 A Guide to Recovering an Unpaid Debt  
BIF 150 An Introduction to Selling Your Business  
BIF 192 A Guide to Dissolving a Partnership  
BIF 199 An Introduction to Company Insolvency and Liquidation  
BIF 294 An Introduction to Administration and Company Voluntary Arrangements

## Useful contacts

The Insolvency Service is a statutory body that provides information on insolvency, redundancy and related matters in England and Wales.

Tel: (020) 7637 1110

Website: [www.gov.uk/government/organisations/insolvency-service](http://www.gov.uk/government/organisations/insolvency-service)

Accountant in Bankruptcy (AiB) administers bankruptcy and insolvency processes in Scotland. It publishes information about bankruptcy.

Tel: 0300 200 2600

Website: [www.aib.gov.uk](http://www.aib.gov.uk)

The Insolvency Service for Northern Ireland is part of the Department for the Economy. It is responsible for administering bankruptcy and corporate insolvency in Northern Ireland. It provides information about bankruptcy and liquidation.

Tel: (028) 9025 1441

Website: [www.economy-ni.gov.uk/contacts/insolvency-service](http://www.economy-ni.gov.uk/contacts/insolvency-service)

Business Debtline provides free advice and information about debt problems. It covers England, Wales and Scotland.

Tel: 0800 197 6026

Website: [www.businessdebtline.org](http://www.businessdebtline.org)

Citizen's Advice Bureau provides free advice and information on managing debt.

Website: [www.citizensadvice.org.uk](http://www.citizensadvice.org.uk)

National Debtline is an independent debt advice service.

Tel: 0808 808 4000

Website: [www.nationaldebtline.org](http://www.nationaldebtline.org)

StepChange Debt Charity provides advice and debt management plans.

Tel: 0800 138 1111

Website: [www.stepchange.org](http://www.stepchange.org)

The Insolvency Practitioners Association (IPA) is a membership body for practitioners of insolvency-related work in the UK. It has an online directory of insolvency practitioners.

Tel: (020) 7623 5108

Website: [www.insolvency-practitioners.org.uk](http://www.insolvency-practitioners.org.uk)

The Association of Business Recovery Professionals (R3) is a professional association for turnaround specialists in the UK. It has an online 'Find a Practitioner' search facility.

Tel: (020) 7566 4200

Website: [www.r3.org.uk](http://www.r3.org.uk)

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