Superannuation Entitlements are not always Protected in Bankruptcy

By Jon Broadley, Director

When an individual becomes bankrupt, the bankrupt's property vests in the bankruptcy Trustee with a number of exceptions. One exception is in respect of the bankrupt's interest in a regulated superannuation fund, an approved deposit fund or an exempt public sector superannuation scheme.

Superannuation benefits of a bankrupt as at the date of bankruptcy and payments of superannuation benefits to a bankrupt after bankruptcy are generally protected from being attacked by the bankruptcy Trustee. However, such protection does not apply to payments received from their superannuation fund before the date of bankruptcy because they are no longer funds in the regulated superannuation fund. If such payment was simply kept in the bankrupt's bank account when bankruptcy occurred, the Trustee is entitled to seize those funds for the benefit of creditors. There is also Court authority to the effect that property purchased with superannuation moneys before bankruptcy is also available to the bankruptcy Trustee.

Attacking Pre-Bankruptcy Superannuation Contributions

Before 28 July 2006, payments and property transfers to eligible superannuation funds were not subject to challenge. However a change to the Bankruptcy Act 1966 (Cth) provided that transfers made by a debtor were void if:

a. they were made to eligible superannuation funds of the Bankrupt;
b. the property formed part of the bankrupt estate if the transfer had not been made; and
c. the main purpose of the transaction was to stop or delay the asset from being available to creditors.

On a similar note to the above, transfers made to a superannuation fund of the bankrupt by third parties on a bankrupt's behalf may also be attacked by the Trustee. The transfer must have occurred pursuant to a scheme to which the debtor was a party. The intention to defeat the creditors' interest in the relevant property can be inferred from all the circumstances of the transaction, whether the debtor was or was about to become insolvent and the result of the transaction.

If there is a history of personal contributions to eligible superannuation funds over a lengthy period of time, it may be difficult to argue that the relevant intention to defeat creditors existed.

Deeming provisions in the legislation regarding actual or likely insolvency, to prove the intention of the debtor, also relate to transfers by third parties.

The Bankruptcy Act provides for a rebuttable presumption of insolvency if the debtor did not keep proper financial records during the relevant period.

The Bankruptcy Act also gives certain powers to Trustees including the power to issue a superannuation notice freezing the relevant superannuation account. A Trustee must satisfy the Official Receiver that there are reasonable grounds to suggest that a superannuation contribution is void. This notice can be given to the Trustees of an eligible superannuation plan. Superannuation fund Trustees have certain civil and criminal protection for acts done in good

faith. In addition, certain taxes and charges would apply to the relevant contribution and must be paid to the superannuation fund to ensure that Trustees are not left out of pocket in circumstances where they may have no idea of the background to the payment or payments.

Accordingly, the freezing notices affect superannuation Trustees' abilities to deal with superannuation funds except in specified circumstances. Possible void transactions need to be resolved before funds can be paid out.

Income Contributions from Bankrupt

During the period of bankruptcy, a bankrupt can be assessed for contributions based upon income received by the bankrupt during that time. Although the actual funds received from the superannuation fund after the date of the bankruptcy are protected from actual seizure by the Trustee, the Bankruptcy Act extends the definition of "income" to include any annuity or pension paid to the bankrupt from a superannuation fund. Therefore, in an indirect way, the bankrupt is penalised in respect of superannuation payments received. A Trustee can add those superannuation payments to any other income received by the Bankrupt during bankruptcy to determine whether the bankrupt has a liability to pay income contributions.

It should be noted that there is some uncertainty between payments from superannuation received by an income stream as distinct from a lump sum payment and whether the latter (such as a lump sum employment termination payment) is able to be considered as income under Section 139L of the Bankruptcy Act. It may depend upon the provisions of the superannuation trust deed or generally the circumstances in which such lump sum payment or payments may be made. Compulsory superannuation payments are not considered income for contribution calculation purposes but voluntary contributions, e.g. salary sacrificed by the bankrupt are considered to be income.

Australian Taxation Office Garnishee Notices

The Taxation Administration Act 1953 (TAA) gives the Australian Taxation Office (ATO) the power to recover tax liabilities and other debts payable to the Commonwealth from third parties who may owe money to, or hold money on behalf of, a tax debtor. The ATO can issue a Garnishee Notice to a superannuation fund but it is not usually effective until the debtor's benefits are payable under the rules of the fund, e.g. if the debtor retires or dies.

There is some case authority to suggest that money due by an employee for future salary payments can be the subject of a valid garnishee notice. However there is an uncertain issue to be considered regarding superannuation benefits if the debtor is unlikely to retire or die for thirty or forty years into the future, well after the bankrupt is discharged.

Apart from paying your taxes, there may be some available ways to avoid superannuation funds being garnisheed by the ATO. We are happy to discuss these with you.

Should you wish to discuss any matters arising out of this article, please contact the author:

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