



**Australian Government**

**The Treasury**

**Attorney-General's Department**

**Insolvency and Trustee Service Australia**

# Effect of bankruptcy on superannuation contributions

Consultation Paper  
September 2005



# **Effect of bankruptcy on superannuation contributions**

Consultation Paper

September 2005

© Commonwealth of Australia 2005  
ISBN 0 642 74313 4

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration  
Attorney General's Department  
Robert Garran Offices  
National Circuit  
CANBERRA ACT 2600

Or posted at:

<http://www.ag.gov.au/cca>

Comments on this consultation paper are sought by no later than **4 November 2005**. If possible, submissions should be made via email to [superannuation@itsa.gov.au](mailto:superannuation@itsa.gov.au)

Alternatively, submissions can be mailed or faxed to:

The Manager  
Superannuation and Bankruptcy Review  
Insolvency and Trustee Service Australia  
GPO Box 821  
CANBERRA CITY ACT 2601  
Facsimile: (02) 6270 3413

### **Contacts**

Robert Patch  
Insolvency and Trustee Service Australia  
Telephone (02) 6270 3466

Fiona Spry  
Department of the Treasury  
Telephone (02) 6263 3812

### **Confidentiality**

All submissions will be treated as public unless the author clearly indicates to the contrary. Public submissions will be published on Insolvency and Trustee Service Australia's website: [www.itsa.gov.au](http://www.itsa.gov.au)

A request made under the *Freedom of Information Act 1982* for access to a submission marked confidential will be determined in accordance with that Act.

# CONTENTS

**EFFECT OF BANKRUPTCY ON SUPERANNUATION CONTRIBUTIONS** **1**

Introduction..... 1

Summary of proposed changes to the announced measure .....1

Proposed amendments and how they will work in practice.....3

The process diagrammatically.....10

The principles outlined in this paper have not received Government approval and are obviously not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.



# EFFECT OF BANKRUPTCY ON SUPERANNUATION CONTRIBUTIONS

## INTRODUCTION

1. On 16 December 2003, the Attorney-General and the then Minister for Revenue and Assistant Treasurer issued a joint press release announcing amendments to the *Bankruptcy Act 1966* so that certain superannuation contributions made prior to bankruptcy can be recovered by bankruptcy trustees, thus overcoming an anomaly in the Bankruptcy Act that allows debtors to shield their assets from creditors by making pre-bankruptcy payments to superannuation.
2. The anomaly was highlighted in the High Court decision of *Cook v Benson*<sup>1</sup> where it was held that contributions made to a superannuation fund prior to bankruptcy were settlements of property for the purposes of section 120 of the *Bankruptcy Act 1966* and that the trustees were purchasers for valuable consideration. Consequently, the bankruptcy trustee was not able to recover the contributions.
3. This paper provides information on:
  - proposed changes to the announced measure; and
  - how the measure would work in practice.

## SUMMARY OF PROPOSED CHANGES TO THE ANNOUNCED MEASURE

4. The amendments would allow bankruptcy trustees to recover certain superannuation contributions made before the date of the bankruptcy.<sup>2</sup> As announced, the measure would allow bankruptcy trustees to recover:
  - ‘excessive’ voluntary superannuation contributions and payments to retirement savings accounts (RSAs) made before bankruptcy;<sup>3</sup> and

---

<sup>1</sup> (2003) 214 CLR 370.

<sup>2</sup> The term ‘the date of the bankruptcy’ is defined in subsection 5(1) of the *Bankruptcy Act 1966*. In brief, it means the date on which a sequestration order was made against the bankrupt’s estate, or if he or she became bankrupt by virtue of the presentation of a debtor’s petition, the date on which he or she became a bankrupt.

<sup>3</sup> Retirement savings accounts (RSAs) are superannuation products that banks, building societies, credit unions, life insurance companies etc provide. Unlike superannuation funds, RSAs are not structured as trusts. RSAs are controlled by the member, must comply with the retirement income standards that apply to superannuation funds and must be capital guaranteed.

- contributions to superannuation funds or RSAs made before bankruptcy where the transfer was made with the intention of defeating creditors.
5. To keep the measure as simple as possible, minimise compliance costs and complexity, while at the same time balance the interests of creditors with those of the bankrupt in retirement, the ‘excessive’ contribution limb would be modified. In brief, it is proposed that, subject to a number of exceptions, bankruptcy trustees would be able to recover from a bankrupt’s superannuation plan contributions above a certain annual threshold amount that were made during the period beginning on the day five years before the commencement of the bankruptcy and ending on the date of the bankruptcy.<sup>4</sup>
  6. ‘Excessive’ contributions would also include contributions made by the bankrupt for the benefit of a third party up to five years before the commencement of the bankruptcy, apart from an amount equal to the market value of any consideration paid by the third party to the bankrupt or to another on the bankrupt’s behalf for that contribution. Third parties would not have the benefit of the threshold, but would have the benefit of the solvency test for contributions made more than two years before the commencement of the bankruptcy.
  7. Further, for both ‘excessive’ contributions and those made with an intention to defeat creditors, a bankruptcy trustee would be able to recover earnings on the moneys recovered.
  8. The following contributions would not be recoverable:
    - those made more than two years before the commencement of the bankruptcy where it can be shown that the bankrupt was solvent when the contributions were made;<sup>5</sup>
    - eligible termination payment rollover amounts;<sup>6</sup>
    - government co-contributions; and
    - employer contributions to a defined benefit fund with more than four members.<sup>7</sup>

---

<sup>4</sup> The term ‘the commencement of bankruptcy’ is defined in subsection 5(1) and section 115 of the *Bankruptcy Act 1966*. In brief, if a person becomes a bankrupt on a creditor’s petition, the bankruptcy is taken to have commenced at the earliest act of bankruptcy committed by the person within the period of six months immediately before the date on which the creditor’s petition was presented. In relation to a debtor’s petition, the commencement of the bankruptcy depends on the circumstances in which the debtor’s petition was presented or accepted. For example, if a debtor’s petition is presented when no creditor’s petition is pending but the debtor has committed at least one act of bankruptcy in the past six months (and accepted by the Official Receiver without a direction from a court), the bankruptcy will be taken to have commenced at the time of commission of the earliest act of bankruptcy within those six months.

<sup>5</sup> This is in keeping with subsection 120(3) of the *Bankruptcy Act 1966*. The Government announced on 11 August 2005 that it proposes to amend the *Bankruptcy Act 1966* to allow bankruptcy trustees to recover property transferred to related parties at less than market value in the four years before the commencement of the bankruptcy. The period would, however, remain at two years before the commencement of the bankruptcy for the recovery of ‘excessive’ superannuation contributions made for the benefit of the bankrupt or third party.

<sup>6</sup> This exclusion would ensure that an amount rolled over or transferred from one fund to another is not counted as a new contribution for the purposes of these amendments.

## PROPOSED AMENDMENTS AND HOW THEY WILL WORK IN PRACTICE

### What superannuation contributions are recoverable

9. The approach for recovering contributions made to superannuation plans would be based on the existing provisions of the *Bankruptcy Act 1966* providing for the recovery of transfers of property by a bankrupt. Consequently, a bankruptcy trustee would be able to recover:
  - ‘excessive’ contributions – these being certain contributions that have been made either to a bankrupt’s superannuation plan or to a third party’s superannuation plan;<sup>8</sup> and
  - contributions made to the bankrupt’s superannuation plan that were intended to defeat creditors.<sup>9</sup>
10. Superannuation plans are regulated superannuation funds, approved deposit funds, RSAs, accounts within the meaning of the *Small Superannuation Account Act 1995* and any public sector superannuation scheme designated by the regulations.
11. Bankruptcy trustees would not be able to recover amounts that exceed the value of the member’s withdrawal benefits (this is the amount of the member’s superannuation interest should they voluntarily leave the superannuation plan). This exclusion helps to ensure that the amendments would not infringe the Constitutional prohibition on the acquisition of property otherwise than on just terms, by limiting recoveries to superannuation benefits that have a relevant connection with the bankrupt.

### Earnings

12. For both ‘excessive’ contributions and those made with an intention to defeat creditors, a bankruptcy trustee would be able to recover earnings on the contributions recovered. Earnings would be calculated at the long-term bond rate between the date the contribution was made and:
  - in the case of a creditor’s petition – the date the bankrupt’s statement of affairs is given to the bankruptcy trustee; or
  - in the case of a debtor’s petition – the date of bankruptcy.
13. However, a court would be able to declare a different amount (including a negative amount) where the actual fund earnings are different from the long-term bond rate (e.g., after taking into account fund earnings and losses, fees, charges and taxes).

### Interaction with the *Family Law Act 1975*

---

<sup>7</sup> A defined benefit fund is one in which the member receives on retirement a defined amount determined by a formula (usually worked out by the number of years of membership in the fund and the average salary leading up to retirement). This exclusion is required because of the difficulty in determining the value of employer contributions to these funds.

<sup>8</sup> This limb is analogous to section 120 of the *Bankruptcy Act 1966*.

<sup>9</sup> This limb is analogous to section 121 of the *Bankruptcy Act 1966*.

## Bankruptcy and superannuation

14. For both 'excessive' contributions and those made with an intention to defeat creditors, a bankruptcy trustee would not be able to recover contributions from a superannuation interest that has been established for a spouse under the superannuation-splitting arrangements in the *Family Law Act 1975*.

### 'Excessive' contributions

15. As mentioned above, 'excessive' contributions comprise certain contributions that have been made either to a bankrupt's superannuation plan or to a third party's superannuation plan.

### Contributions that have been made to a bankrupt's superannuation plan

16. Where a bankrupt or a third party makes a contribution to the bankrupt's superannuation plan, a bankruptcy trustee would be able to recover, from the bankrupt's superannuation plan, contributions above a certain annual threshold.
17. There are complexities in determining the annual threshold amount because of the Government's need to balance the interests of creditors with those of the bankrupt in retirement.
18. A higher threshold amount would promote the retirement income policy objective of encouraging individuals to have sufficient superannuation savings to fund an adequate retirement income, whereas a lower or no threshold amount would promote the bankruptcy policy objective of ensuring creditors are not denied moneys they are owed. In determining an appropriate threshold the Government is also aware that compliance costs must be kept to a minimum.
19. The annual threshold amount would be 9 per cent of the annual superannuation guarantee maximum contribution base in each of the five years before the commencement of the bankruptcy. A pro-rata amount would apply for any part of a year before the date of the bankruptcy. The superannuation guarantee maximum contribution base for 2005-06 is \$134,880.<sup>10</sup> Nine per cent of this amount is \$12,139.20.
20. Setting the annual threshold amount at 9 per cent of the annual superannuation guarantee maximum contribution base will protect employee's superannuation guarantee entitlements, and equivalent contributions by the self-employed. It will also protect some additional contributions made by those whose annual income for superannuation guarantee purposes is less than \$134,880 (in 2005-06).
21. The following 'excessive' contributions would not be recoverable and would not count towards the annual threshold amount:
  - eligible termination payment rollover amounts;
  - government co-contributions; and
  - employer contributions to a defined benefit fund with more than four members.
22. In working out the contributions that count towards the annual threshold amount, all contributions made to the bankrupt's superannuation plan within the year would be

---

<sup>10</sup> Section 15 of the *Superannuation Guarantee (Administration) Act 1992* explains how the maximum contribution base is worked out.

added together (including amounts received from third parties such as sacrificed amounts, but not including those mentioned in the preceding paragraph). Where more than one contribution has been made for the benefit of a person (including contributions made to different plans), then all the contributions would be considered as a whole.

23. Contributions made more than two years before the commencement of the bankruptcy would not be recoverable as 'excessive' where it can be shown that the bankrupt was solvent when the contributions were made. This is in keeping with the current bankruptcy provisions that allow for the recovery of undervalue transfers from a person who becomes bankrupt.<sup>11</sup> Consistent with the existing relationship between sections 120 and 121 of the *Bankruptcy Act 1966*, contributions that are not recoverable as 'excessive' would be recoverable if they were made with an intention to defeat creditors (discussed below).

#### Contributions that have been made to a third party's superannuation plan

24. A bankruptcy trustee would be able to recover all the contributions that the bankrupt has made to a third party's superannuation plan up to five years before the commencement of the bankruptcy, apart from an amount that is equal to the market value of any consideration given by the third party. Where the bankrupt has made contributions for the benefit of an employee, the amounts for which market value consideration had been provided would include contributions made under the superannuation guarantee arrangements or under a salary sacrifice arrangement. The bankruptcy trustee would not be able to recover superannuation contributions made more than two years before the commencement of the bankruptcy where it can be shown that the bankrupt was solvent when he or she made the superannuation contribution. This is in keeping with the current bankruptcy provisions that allow for the recovery of undervalue transfers from a person who becomes bankrupt.<sup>12</sup>

#### Contributions made with an intention to defeat creditors

25. In keeping with section 121 of the *Bankruptcy Act 1966*, a bankruptcy trustee would be able to recover contributions (including via salary sacrifice) made by the bankrupt in order to defeat creditors. The principal difference with section 121 would be that the consideration provided by the superannuation trustee for the contribution would be ignored in determining whether the contribution is recoverable by the bankruptcy trustee, thus overcoming the effect of the High Court decision of *Cook v Benson*. (Otherwise the provision would be couched in similar terms to that found in section 121.)

#### The process of recovering superannuation contributions

26. The process for recovering superannuation contributions would be modelled on those applying to the recovery of other assets by bankruptcy trustees.
27. A bankruptcy trustee would use information disclosed in the bankrupt's statement of affairs prepared under section 54 of the *Bankruptcy Act 1966*. The trustee also would be

---

<sup>11</sup> See section 120 of the *Bankruptcy Act 1966*.

<sup>12</sup> See section 120 of the *Bankruptcy Act 1966*.

- able to obtain further information from the bankrupt via the provisions that are already available in the *Bankruptcy Act 1966*, for example section 77.
28. It is proposed that the Official Receiver would be able to give a **cashing notice** to a superannuation trustee requiring it to pay a recoverable amount to the bankruptcy trustee.
29. The recoverable amount would be the lesser of the amount specified in the notice and the member's withdrawal benefit in the superannuation plan. The amount specified in the notice would not be greater than the amount of the member's interest in the superannuation plan that is attributable to recoverable contributions. The amount attributable to the recoverable contributions would be the amount of the recoverable contribution adjusted to allow for fund earnings.
30. The cashing notice would need to:
- identify the recoverable contributions and set out how the recoverable amount was calculated;
  - specify the date on which the member's withdrawal benefit is to be calculated (the date of effect);
  - specify the date on which the payment must be made (the payment date). This must be at least 28 days after the later of the day on which the cashing notice is given to the superannuation trustee and the day on which the copy is given to the member of the superannuation plan;<sup>13</sup> and
  - be accompanied by an extract from the National Personal Insolvency Index that includes the name and contact details for the bankruptcy trustee.
31. The Official Receiver would also give a copy of the cashing notice (and accompanying documents) to the bankrupt, the member of the superannuation plan, and the bankruptcy trustee.<sup>14</sup> Attached to the copy would be a document that sets out the facts and circumstances on which the Official Receiver relies.<sup>15</sup> If it is believed that the facts and circumstances do not provide sufficient reason, an application could be made to the court to have the cashing notice set aside.<sup>16</sup>
32. As well, the Official Receiver would advise the superannuation trustee of the date on which the copy and accompanying documents were given to the member of the superannuation plan.
33. The Official Receiver would not be able to give a cashing notice (and must revoke a notice that has already been given) if he or she had reasonable grounds to believe that the property divisible among the bankrupt's creditors, apart from superannuation, would probably be sufficient to meet the bankrupt's debts and the cost of the administration. Similarly, the amount specified in the cashing notice may not be more

---

<sup>13</sup> This is intended to give the parties time to consider the validity of the cashing notice and, if necessary, to initiate court proceedings challenging its validity.

<sup>14</sup> This is in keeping with subsection 139ZQ(5) of the *Bankruptcy Act 1966*.

<sup>15</sup> This is in keeping with subsection 139ZQ(5) of the *Bankruptcy Act 1966*. This additional information is not given to superannuation trustees for privacy reasons.

<sup>16</sup> This is in keeping with section 139ZS of the *Bankruptcy Act 1966*.

than the amount that the Official Receiver reasonably believes would probably be sufficient to meet the bankrupt's debts and the cost of the administration. In making this assessment, the Official Receiver would be required to have regard to the value of the other property that is or probably will be divisible among the bankrupt's creditors. A decision to issue, amend or revoke a cashing notice (or not to do so) would be reviewable by the Administrative Appeals Tribunal (for example, because there are reasonable grounds to believe that sufficient other assets will probably become available to meet the bankrupt's debts).

34. If need be, the bankruptcy trustee would be able to seek a court order requiring the superannuation trustee to comply with the cashing notice. The court would also be able to, amongst other things, set aside or amend the cashing notice.
35. An amendment or revocation of a cashing notice (including an extension of the date of effect or the payment date) by a court or the Official Receiver would have no effect unless a copy of the order or notice is served on the superannuation trustee before the date of effect. A copy of the court order or Official Receiver's notice would be given to any person to whom a copy of the cashing notice was also given.

#### Roll-overs

36. The bankruptcy trustee would be able to recover a contribution from a superannuation plan that has been rolled over into another plan (including through one or more roll-overs). Provisions seeking to trace precise amounts through successive roll-overs have proved to be very complex. In order to reduce compliance costs and to keep the provisions simple, the amount that can be recovered from a superannuation plan to which benefits have been rolled over would not be limited by the amount that was rolled over to the plan.
37. However, the Official Receiver would only be able to issue a cashing notice in relation to a downstream plan if he or she is satisfied that the amount that may be recovered from the upstream fund would probably be insufficient to allow all of the recoverable contribution (including fund earnings) to be recovered.

#### The cashing of benefits

38. If a bankrupt cashes recoverable contributions as a commutable pension before being discharged from bankruptcy, any amount that is commuted from the pension would vest in the bankruptcy trustee.<sup>17</sup> If the commutable pension is held by a person other than the bankrupt, that person would be taken to hold the commuted amount on trust for the bankruptcy trustee. The amount that the bankruptcy trustee may recover from the superannuation trustee would be reduced by the amount that the bankruptcy trustee recovers under these provisions.
39. The cashing of a superannuation benefit as a non-commutable pension would not affect the amount that may be recovered by the bankruptcy trustee.
40. Currently, a payment from a superannuation plan that is not a pension does not vest in the bankruptcy trustee.<sup>18</sup> A bankrupt may therefore cash his or her recoverable superannuation benefits as a lump sum, rather than risk the bankruptcy trustee recovering it from the superannuation plan. To address this, a superannuation benefit

---

<sup>17</sup> A commutable pension is one that can be converted into a lump sum.

<sup>18</sup> Subparagraph 116(2)(d)(iv) of the *Bankruptcy Act 1966*.

## Bankruptcy and superannuation

cashed otherwise than as a pension from benefits attributable to recoverable contributions would vest in the bankruptcy trustee. Similarly, if the superannuation benefit is held by a person other than the bankrupt, a superannuation benefit cashed otherwise than as a pension from benefits attributable to recoverable contributions would be taken to be held on trust for the bankruptcy trustee.

### Investment options within the one fund

41. If a superannuation interest is apportioned among two or more investment options, the regulations would provide for how the superannuation trustee is to apportion the recoverable amount.

### Supervision notices

42. The Official Receiver would be able to give a superannuation trustee a **supervision notice** in relation to an interest in the superannuation plan. This notice would advise a superannuation trustee that it is not able to deal with certain moneys in the plan or undertake certain transactions, for example, to cash benefits from the plan or roll over or transfer benefits to another plan. However, it would still be able to deduct from such an interest its fees, charges and taxes.
43. By issuing a supervision notice on a superannuation trustee the Official Receiver is ensuring that the member of the plan does not attempt to frustrate the recovery process, for example by dividing a recoverable superannuation contribution among several plans.
44. The Official Receiver would only be able to issue a supervision notice if he or she were satisfied that there were reasonable grounds to believe that a cashing notice may be given in relation to those contributions.
45. A supervision notice would operate for 12 months from the date of effect, but the Official Receiver would be able to issue successive notices. The Administrative Appeals Tribunal would be able to review a decision to issue (or not to issue) a supervision notice.

### Death

46. The death of a bankrupt would not affect the recovery of superannuation contributions made by the bankrupt for the benefit of another person.
47. Part X of the *Bankruptcy Act 1966* allows a creditor to bankrupt the estate of a deceased person. It provides for the appointment of a bankruptcy trustee to administer the estate for the benefit of the deceased's creditors. This administration takes precedence over the administration by the deceased's legal personal representative. Consistent with this approach, the amendments would allow a bankruptcy trustee to recover contributions made for the benefit of the deceased bankrupt by any person, and by the bankrupt for the benefit of a deceased person, as though the person had not died. This would be subject to the qualification that the bankruptcy trustee would not be able to recover amounts that have already been paid out by the superannuation trustee, for example, as a result of the bankrupt's death.
48. The potential to recover the superannuation benefits of a deceased person should not unduly impede the payment of superannuation benefits to the deceased's estate or beneficiaries. For example, a bankruptcy trustee may seek to use a supervision notice

to prevent the payment of benefits from a superannuation interest of a deceased person. In order to prevent this, a supervision notice would have no effect more than six months after the death of the member of the superannuation plan. This means that a bankruptcy trustee would be able to defer payment of superannuation benefits to the deceased's estate or beneficiaries for no more than six months. While the primary application of this rule is expected to be in relation to superannuation interests held on behalf of the deceased bankrupt, the rule would also apply where the bankruptcy trustee is seeking to recover superannuation contributions made by the bankrupt for the benefit of another person who has died.

### Limitation periods

49. A cashing notice seeking recovery of contributions under the 'excessive' contributions limb would have no effect if it is given more than six years after the date of the bankruptcy,<sup>19</sup> while there would be no time limit where a contribution has been made and it can be shown there is an intention to defeat creditors.<sup>20</sup> Consistent with the existing provisions for the recovery of other assets, the fact that the bankrupt has been discharged from bankruptcy would not affect the recovery of contributions.<sup>21</sup>

### Protection of superannuation trustees

50. Civil proceedings would not lie against a superannuation trustee for anything done (or not done) in good faith in reliance on, or in connection with, a cashing or supervision notice.

---

<sup>19</sup> This is in keeping with subsection 127(3) of the *Bankruptcy Act 1966*.

<sup>20</sup> This is in keeping with subsection 127(4) of the *Bankruptcy Act 1966*.

<sup>21</sup> A bankrupt can prima facie be discharged from bankruptcy three years from the date on which the bankrupt filed his or her statement of affairs: section 149 of the *Bankruptcy Act 1966*.

**THE PROCESS DIAGRAMMATICALLY**

**Abbreviations**  
B - bankrupt  
BT - bankruptcy trustee  
M - member  
OR - Official Receiver  
ST - superannuation trustee



