The Senate

Standing Committee on Legal and Constitutional Affairs

Bankruptcy Legislation Amendment (Superannuation Contributions) Bill 2006

February 2007

ISBN 978-0-642-71760-3

This document was printed by the Senate Printing Unit, Department of the Senate, Parliament House, Canberra

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Canberra, Tuesday 23 January 2007

ABBREVIATIONS

ASFA	The Association of Superannuation Funds of Australia
Bankruptcy Act	*Bankruptcy Act 1966*
the Bill	Bankruptcy Legislation Amendment (Superannuation Contributions) Bill 2006
EM	Explanatory Memorandum
FPA	Financial Planning Association of Australia
IFSA	Investment & Financial Services Association
IPAA	Insolvency Practitioners Association of Australia
ITSA	Insolvency and Trustee Service Australia
Law Council	Law Council of Australia
RSA	Retirement Savings Account
Treasury	Department of the Treasury

CHAPTER 1

INTRODUCTION

Background

1.1 On 7 December 2006, the Senate referred the Bankruptcy Legislation Amendment (Superannuation Contributions) Bill 2006 (the Bill) to the Standing Committee on Legal and Constitutional Affairs, for inquiry and report by 8 February 2007.

1.2 The Bill proposes to amend the *Bankruptcy Act 1966* (Bankruptcy Act), the *Payment Systems and Netting Act 1998*, and the *Proceeds of Crime Act 2002* to:

- allow bankruptcy trustees to recover superannuation contributions made prior to bankruptcy with the intention of defeating the claims of creditors;
- provide for certain rural support grants to be exempt from the property available to pay creditors in cases of bankruptcy; and
- make minor technical amendments to clarify or improve the operation of the Bankruptcy Act.

1.3 The principal purpose of the major amendments proposed by the Bill is to allow bankruptcy trustees to recover superannuation contributions made with the intention of defeating creditors. As jointly announced by the Attorney-General and the Minister for Revenue & Assistant Treasurer on 27 July 2006, these amendments will apply to superannuation contributions made on or after 28 July 2006.[1] The effect of the amendments will be that payments to superannuation plans to defeat creditors will be recoverable in the same way as other payments or transfers to defeat creditors.

1.4 According to the Explanatory Memorandum (EM), these amendments will:

- allow a bankruptcy trustee to recover the value of contributions to an eligible superannuation plan made by a bankrupt to defeat creditors (along the lines of current section 121 of the Bankruptcy Act);
- allow the trustee to recover contributions made by a person other than the bankrupt for the benefit of the bankrupt where the bankrupt's main purpose in participating in the arrangement was to defeat creditors;
- ensure that consideration given by the superannuation trustee for the contribution will be ignored in determining whether the contribution is

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1 The Hon. Philip Ruddock MP, Attorney-General and The Hon. Peter Dutton MP, Minister for Revenue & Assistant Treasurer, 'Government Closes Superannuation Loophole in Bankruptcy', 27 July 2006, at http://assistant.treasurer.gov.au/pcd/content/pressreleases/2006/056.asp (accessed 11 December 2006).

recoverable by the bankruptcy trustee, thus overcoming the effect of the High Court's decision in *Cook v Benson*;[2]

- allow a court to consider the bankrupt's historical contributions pattern and whether any contributions were 'out of character' in determining whether they were made with the intention to defeat creditors;
- provide that a superannuation fund will not have to repay any fees and charges associated with the contributions or any taxes it has paid in relation to the contributions; and
- give the Official Receiver the power to issue a notice to the superannuation fund or funds that are holding the contributions that will put a freeze on the funds, in order to prevent the bankrupt from rolling them over into another fund or otherwise dealing with them in circumstances where the trustee is entitled to recover them.[3]

1.5 In his Second Reading Speech, the Minister for Justice and Customs stated that:

> The amendments provide an appropriate balance between the need to encourage people to save for retirement and the need to protect creditors from unscrupulous debtors who can currently attempt to avoid paying their debts by converting wealth into superannuation in the lead up to bankruptcy. They will allow superannuation contributions to be recovered only where there has been deliberate action by the bankrupt to avoid paying creditors.
>
> The amendments have been developed following extensive public consultation. The approach taken by these amendments avoids the complexity of earlier proposals and is consistent with the Government's plan to simplify and streamline superannuation.[4]

Conduct of the inquiry

1.6 The committee advertised the inquiry in *The Australian* newspaper on 12 December 2006, and invited submissions by 19 January 2007. Details of the inquiry, the Bill, and associated documents were placed on the committee's website. The committee also wrote to over 160 organisations and individuals.

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2 [2003] HCA 36. In *Cook v Benson*, the High Court ruled that superannuation entitlements rolled over to other superannuation funds by a person who subsequently became bankrupt were not subject to the bankruptcy 'clawback' provisions under sections 120 and 121 of the Bankruptcy Act. This was because Mr Benson's transfer of his superannuation entitlements was deemed to be supported by valuable consideration and therefore not subject to recovery by creditors.

3 p. 2.

4 Senator the Hon. Chris Ellison, Minister for Justice and Customs, *Senate Hansard*, 7 December 2006, p. 1.

1.7 The committee received 15 submissions which are listed at Appendix 1. Submissions were placed on the committee's website for ease of access by the public.

1.8 The committee held a public hearing in Canberra on 23 January 2007. A list of witnesses who appeared at the hearing is at Appendix 2 and copies of the Hansard transcript are available through the Internet at http://aph.gov.au/hansard.

Acknowledgement

1.9 The committee thanks those organisations and individuals who made submissions and gave evidence at the public hearing.

Note on references

1.10 References in this report are to individual submissions as received by the committee, not to a bound volume. References to the committee Hansard are to the proof Hansard: page numbers may vary between the proof and the official Hansard transcript.

CHAPTER 2

OVERVIEW OF THE BILL

2.1 Schedule 1 of the Bill contains amendments relating to recovery of superannuation contributions made with the intention to defeat creditors. Schedule 1 is divided into two Parts: Part 1 contains the substantive amendments which have the effect of rendering certain contributions void; Part 2 is concerned with the recovery of void contributions.

2.2 Part 1 of Schedule 1 will commence on 28 July 2006. Part 2 of Schedule 1 will commence on a single day to be fixed by Proclamation. However, if any of the provisions in Part 2 of Schedule 1 do not commence within six months of Royal Assent, they will commence on the first day after the end of that six-month period.

2.3 Schedule 2 contains the amendments relating to the treatment of rural support grants and minor technical amendments to clarify or improve the operation of the Bankruptcy Act.

Schedule 1 – amendments relating to superannuation contributions

Part 1 – Amendments commencing on 28 July 2006

Amendments to Bankruptcy Act 1966

2.4 Item 6 of the Bill inserts new 'Subdivision B – Superannuation contributions' into the Bankruptcy Act. This subdivision contains the substantive provisions which outline when a superannuation contribution made prior to bankruptcy will be void against a trustee in bankruptcy. The purpose of the provisions is to enable the recovery of superannuation contributions made to defeat the bankrupt's creditors. There will be two types of recoverable contributions:

- contributions made by a person who later becomes a bankrupt (see section 128B); and
- contributions made by a third party for the benefit of a person who later becomes a bankrupt (see section 128C).

2.5 These are discussed further below.

Superannuation contributions made to defeat creditors – contributor is a person who later becomes a bankrupt

2.6 New section 128B describes when a superannuation contribution made by the person who later becomes bankrupt is void against the bankruptcy trustee. This section is based on existing section 121 (transfers to defeat creditors).

2.7 Subsection 128B(1) sets out the conditions which must be satisfied for a superannuation contribution to be void. This subsection is essentially the same as subsection 121(1) with modifications to apply it only to superannuation contributions. Those modifications are the limitations in paragraph 128B(1)(a) that it applies only to a transfer which is made by way of a contribution to an eligible superannuation plan and paragraph 128B(1)(d) that the transfer occurs on or after 28 July 2006. The term 'eligible superannuation plan' is defined in new section 128N.[1]

2.8 Subsections 128B(2), (3) and (4) deal with ways of showing that the transferor's main purpose in making the contribution was to defeat creditors. Subsection 128B(2) allows that purpose to be inferred if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent. This replicates existing subsection 121(2). Subsection 128B(3) provides that, in determining whether the transferor had the requisite purpose in making the contribution, regard must be had to that person's pattern of contributions and whether, in light of any such pattern, the contribution in question is out of character.

2.9 According to the EM, it is not intended that an 'out of character' contribution will automatically be assumed to have been made with the intention to defeat creditors. Rather, an 'out of character' contribution could indicate that the transferor was aware of impending insolvency and, as such, the transferor should be put on notice that they may be required to explain the purpose to a court's satisfaction.[2]

2.10 Subsection 128B(6) is designed to protect the rights of another person who acquires property from the transferee in good faith and for at least market value consideration. This is in line with existing subsection 121(8).

Superannuation contributions made to defeat creditors – contributor is a third party

2.11 New section 128C describes when a superannuation contribution made by a third party for the benefit of a person who later becomes bankrupt is void against a trustee in bankruptcy. This provision is designed largely to cover arrangements under which a person who later becomes bankrupt agrees that money which would ordinarily be paid directly to them should instead be paid to a superannuation plan for that person's benefit. The EM states that the most common example would be payments made by that person's employer, such as under a salary sacrifice arrangement.[3]

2.12 Subsection 128C(1) will provide the circumstances in which such a contribution is void against the bankruptcy trustee. In particular, the transfer will be void only:

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1 See the discussion of section 128N below.

2 p. 5.

3 p. 6.

- where the bankrupt was a party to the arrangements which resulted in the transfer (paragraph 128C(1)(c); and
- if the money or property transferred would probably have been available as part of the bankrupt's divisible property in the event of bankruptcy (paragraph 128C(1)(d)).

2.13 Subsections 128C(2) and (5) will provide that a benefit that is payable in the event of the death of a person is to be disregarded. The EM explains that this is designed to address two situations:

- The bankrupt's employer makes a contribution to a super fund for the benefit of the bankrupt's spouse. Under the governing rules of the fund, the bankrupt is a reversionary beneficiary in the event of the spouse's death. This provides a contingent benefit to the bankrupt at the time the contribution is made. The effect of the subsections is that this contingent benefit is disregarded for the purposes of subsection 128C(1) – this means there is effectively no benefit to the bankrupt and the bankruptcy trustee cannot recover the contributions made for the benefit of the spouse. It would be inappropriate to recover contributions made by a third party for the benefit of someone other than the bankrupt under these provisions.
- The bankrupt's employer makes a contribution to a super fund for the benefit of the bankrupt. The bankrupt's spouse/children become beneficiaries in the event of the bankrupt's death. Without subsection (2), it may be open to the bankrupt to argue that the contribution was made not only for his/her benefit and, as a result, escape the operation of the provision (even though the contribution was made principally for his/her benefit). The effect of subsection (2) is that the contingent benefit to the spouse/children is disregarded and the trustee is entitled to rely on the fact that the contribution was made to provide a benefit to the bankrupt only.[4]

2.14 Subsections 128C(3), (4), (5) and (6) deal with ways of showing that the transferor's main purpose in making the contribution was to defeat creditors. Subsection 128C(3) allows that purpose to be inferred if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent. This replicates existing subsection 121(2) of the Bankruptcy Act.

2.15 Subsection 128C(4) provides that, in determining whether the transferor had the requisite purpose in making the contribution, regard must be had to that person's pattern of contributions and whether, in light of any such pattern, the contribution in question is out of character. According to the EM, it is not intended that an 'out of character' contribution will automatically be assumed to have been made with the intention to defeat creditors. Rather, an 'out of character' contribution could indicate that the transferor was aware of impending insolvency and, as such, the transferor

4 pp 6-7.

should be put on notice that they may be required to explain the purpose to a court's satisfaction.[5]

Time for making claims by trustee

2.16 New subsection 128D(1) will provide that an action under section 128B or 128C may be commenced by the bankruptcy trustee at any time. This is in line with existing subsection 127(4) of the Bankruptcy Act.[6]

Definitions

2.17 Section 128N will provide a number of definitions for the purposes of the new Subdivision B. The EM states that these definitions are largely to clarify that certain terms used in the new Subdivision will be interpreted consistently with superannuation and related legislation.[7]

2.18 The key definition is that of 'eligible superannuation plan' which is defined to mean any of the following:

(a) a regulated superannuation fund (which has the same meaning as in the *Superannuation Industry (Supervision) Act 1993*);

(b) an approved deposit fund (which has the same meaning as in the *Superannuation Industry (Supervision) Act 1993*);

(c) a Retirement Savings Account (RSA);

(d) a public sector superannuation scheme (which has the same meaning as in the *Superannuation Industry (Supervision) Act 1993*).

2.19 Section 128N will also include a definition of 'scheme'. The EM states that the term is defined very widely and is deliberately intended to cover any type of arrangement which a person enters into to convert money or property which would have been available to creditors in the event of bankruptcy into an interest in superannuation.[8]

Other amendments

2.20 Item 3 will make it clear that superannuation contributions which are void under the new sections 128B or 128C form part of the property available for distribution among the bankrupt's creditors.

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5 p. 7.

6 Note that subsections 128D(2) and (3) clarify transitional arrangements in relation to the commencement of certain provisions.

7 p. 8.

8 p. 7.

2.21 Item 4 will make it clear that superannuation contributions which are void under the new sections 128B or 128C are not protected from the doctrine of relation-back.[9] Section 123 currently provides that, subject to sections 118 to 122 (inclusive), payments, transfers, assignments and contracts made prior to bankruptcy in good faith and in the ordinary course of business remain valid where the other party to the transaction was not aware at the time that a petition had been presented against the debtor. The amendment made by Item 4 will make that protection also subject to the new sections 128B and 128C.

2.22 Item 5 will make it clear that a superannuation contribution made with the intention to defeat creditors is void, notwithstanding that it was made pursuant to a maintenance agreement or maintenance order. This is consistent with existing subsection 123(6).

2.23 Items 7 and 8 will amend provisions relating to objections to discharge. A superannuation contribution which is void under new section 128B or 128C has the same character as a transfer which is void under section 121, having been made with the intention to defeat creditors, and should give rise to equivalent grounds for objecting to the bankrupt's discharge.

2.24 Item 10 amends section 302A of the Bankruptcy Act.[10] Section 302A provides that a provision in a provident, benefit, superannuation, retirement or approved deposit fund that has the effect that:

(a) any part of the beneficial interest of a member or depositor is cancelled, forfeited, reduced or qualified; or

(b) the trustee or another person is empowered to exercise a discretion relating to such a beneficial interest to the detriment of a member or depositor;

is void if the member or depositor becomes a bankrupt, commits an act of bankruptcy or executes a personal insolvency agreement under the Bankruptcy Act.

2.25 The EM states that this (and similar) provisions are designed to prevent debtors from arranging their affairs so that certain rights that they may hold cease upon bankruptcy and do not become available for the benefit of their creditors.[11]

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9 The doctrine of relation-back is an expression of the retrospective operation of bankruptcy. According to the doctrine, bankruptcy starts earlier than the actual date that a debtor or creditor applied for bankruptcy. The bankruptcy is taken to have 'related back to' the time of the earliest act of bankruptcy, up to six months before the petition was presented (s 115, Bankruptcy Act). From that time on, transactions involving the debtor can later be set aside. Some transactions are protected from relation-back under the Bankruptcy Act (ss 123 & 124): Butterworths Australian Legal Dictionary, p. 1004.

10 Items 11, 12 and 13 make similar provisions in respect of equivalent terms and conditions of an RSA as defined by the *Retirement Savings Accounts Act 1997*; and equivalent provisions in a trust deed.

2.26 According to the EM, the effect of the amendment to be made by Item 10 is to provide that such a provision is not void pursuant to section 302A if it does so in order to facilitate compliance with the new sections that void certain contributions to superannuation plans that have been made to defeat creditors. A provision in a fund that provides for payment of monies to a bankruptcy trustee pursuant to the new recovery provisions would be expected to cancel that part of the bankrupt's interest in the fund that corresponds to the amount paid to the trustee. If this did not occur other members of the fund would be unfairly disadvantaged.[12]

Part 2 – Amendments commencing on Proclamation

2.27 The amendments contained in Part 2 deal with processes relating to the recovery of superannuation contributions which are void against the trustee under new sections 128B and 128C. These amendments will commence on a single day to be fixed by Proclamation to allow time for necessary supporting regulations to be made.

2.28 Item 16 will amend subsection 116(1) to add to the list of types of property which are divisible among the bankrupt's creditors. That divisible property will include amounts paid to the bankruptcy trustee under the new provisions relating to the recovery of void superannuation contributions.

2.29 Item 17 will amend paragraph 116(2)(d) to make it clear that amounts paid to the trustee pursuant to a court order under the new section 139ZU (order relating to roll-over of superannuation interests etc) form part of the property available for distribution among the bankrupt's creditors.

2.30 Items 19 and 20 will insert subsections 128B(5A) and 128C(7A) respectively to ensure that, where a superannuation contribution is void, the trustee of the superannuation fund does not bear any loss resulting from fees, charges and taxes paid in respect of that contribution.

Superannuation account-freezing notice

2.31 Item 21 will insert new section 128E which will allow the Official Receiver to issue a superannuation account-freezing notice under certain conditions. This notice is designed to prevent the member of the superannuation fund dealing with their interest in the fund which could result in the void contribution not being recovered by the bankruptcy trustee. The power to issue this notice is in line with existing powers exercised by the Official Receiver to assist trustees.[13]

2.32 Subsection 128E(2) will provide that the Official Receiver may, by written notice, direct the trustee of an eligible superannuation plan not to cash or debit or

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11 p. 9.

12 p. 9.

13 For example, under sections 77C, 139ZL and 139ZQ.

permit the cashing, debiting, roll-over, transfer or forfeiture of the whole or part of the superannuation interest other than where this is necessary to comply with provisions of the Bankruptcy Act or for the purposes of charging costs against, or debiting costs from, the superannuation interest or for the purposes of giving effect to a family law payment split.

2.33 Section 128F will provide for the revocation of superannuation account-freezing notices in various circumstances.

2.34 Section 128G will provide that a copy of any superannuation account-freezing notice or revocation notice must be given to the trustee of the bankrupt's estate and to the member of the eligible superannuation plan.

Consent of Official Receiver to the cashing of a superannuation interest

2.35 Section 128H will provide a mechanism for a member of an eligible superannuation plan to request consent from the Official Receiver to the cashing, debiting, roll-over, transfer or forfeiture of all or part of the member's interest where a superannuation account-freezing notice is in force in relation to that member's interest.

2.36 Note that before giving consent under this section, the Official Receiver must consult the trustee of the bankrupt's estate (subsection 128H(6)). According to the EM, the purpose of consultation is to ensure the Official Receiver is informed about any recovery risk which may arise if consent is given. The Official Receiver would normally be expected to give consent where the value of the member's interest which the member is seeking consent to deal with exceeds the amount the bankruptcy trustee would expect to recover. The Official Receiver may also give consent where the member wishes to roll-over the amount for investment reasons and advises the Official Receiver of the details of the new fund(s) – this will allow the Official Receiver to issue a new superannuation account-freezing notice in relation to the interest in the receiving fund(s). Another matter which may be relevant to the Official Receiver's decision is the likelihood that the trustee will be able to pay all creditors' claims relying on assets other than superannuation.[14]

2.37 Certain decisions by the Official Receiver relating to consent is subject to review by the Administrative Appeals Tribunal in certain circumstances (see subsections 128H(7) and 128H(8)).

Power of court to set aside superannuation account-freezing notice

2.38 Section 128J will allow a court to set aside a superannuation account-freezing notice where it is satisfied that the Official Receiver did not have reasonable grounds to believe that the conditions upon which a notice may be issued existed.

Judicial enforcement of superannuation account-freezing notices

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14 p. 13.

2.39 Section 128K will provide a mechanism for judicial enforcement of a superannuation account-freezing notice. This enforcement mechanism can apply either to a potential or actual breach of a notice and remedies are available for both situations.

Protection of trustee of eligible superannuation plan

2.40 Section 128L is designed to protect the trustee of an eligible superannuation plan who complies with their obligations under these amendments. In particular:

- a trustee of an eligible superannuation plan who complies in good faith cannot be exposed to civil or criminal liability as a result of that compliance; (subsection 128L(1));
- anything done (or not done) by the trustee of a regulated superannuation fund or the trustee of an approved deposit fund to comply in good faith is taken not to be in breach of the *Superannuation Industry (Supervision) Act 1993* (subsection 128L(2)).[15]

Rolled-over superannuation interests

2.41 New section 139ZU will deal with the situation where there is a void superannuation contribution under section 128B or 128C but the member has rolled over that contribution to one or more other eligible superannuation plans.

2.42 The EM states that it would be inappropriate to require the trustee of an eligible superannuation plan to pay money to the bankruptcy trustee where the contribution in question is no longer in that plan. Section 139ZU will provide a court with a broad discretion to make orders in relation to other superannuation interests held by the member. It will not be necessary for the trustee to trace the original void contribution. However, there must be a void contribution under section 128B or 128C to trigger a court's discretion under section 139ZU. In addition, the court can make an order in relation to another superannuation interest only where it finds that all or part of that interest can be attributed to the original void contribution which has been rolled-over or transferred by the member.[16]

2.43 Subsection 139ZU(1) sets out the conditions that must be met before a court can make an order for the payment of money by the trustee of an eligible superannuation plan. Where a court is satisfied that these conditions are met, it can make an order directing the trustee of the other eligible superannuation plan (that is, the one to which money or property has been transferred) to pay to the bankruptcy trustee a specified amount. The EM states that, in determining the specified amount to be repaid, the court should consider whether the trustee of the other eligible superannuation plan has debited any fees, charges and taxes and ensure that the trustee

15 Subsection 128L(3) will provide equivalent protection to the provider of an RSA.

16 pp 14-15.

of that plan does not suffer any loss by ensuring the specified amount does not include such amounts.[17]

2.44 Subsection 139ZU(2) will provide that the court must not make an order unless it is satisfied that it is in the interests of the bankrupt's creditors to do so.

2.45 Subsection 139ZU(4) will provide that, for the purposes of paragraph (1)(b), a benefit that is payable in the event of the death of a person is to be disregarded.[18]

2.46 Subsection 139ZU(6) will provide that it is immaterial whether the roll-over or transfer occurred directly or indirectly through one or more interposed eligible superannuation plans. According to the EM, this reinforces the notion that the trustee does not have to trace the original void contribution through a number of transfers or roll-overs. It will be sufficient for the trustee to establish that there were transfers or roll-overs and request the court to exercise its discretion in relation to another interest or interests held by the beneficiary.[19]

2.47 Subsection 139ZU(8) will provide that, at the hearing of the application, the trustee of the other eligible superannuation plan and the beneficiary may appear, adduce evidence and make submissions. The EM states that the trustee of the other eligible superannuation plan will also be able to make submissions about the effect of any proposed order on other members of that plan. That trustee can also request the court to consider whether the payment of any fees, charges and taxes in relation to the member's interest should affect the amount it may be required to pay to the bankruptcy trustee.[20]

Schedule 2 – other amendments

Payments made under rural support schemes

2.48 Items 5 to 7 of Schedule 2 will implement a regime to protect certain payments made under certain rural support schemes from seizure under the Bankruptcy Act

2.49 The EM explains that a number of rural grants are currently afforded the status of non-divisible property under the Bankruptcy Act. For example, grants pursuant to the Dairy Exit Program ('Dairy Exit') and the Farm Help Re-establishment Grant Scheme ('Farm Help').

2.50 The Bankruptcy Act does not currently explicitly provide that classes of rural grants may be prescribed by regulation as non-divisible property. The current

17 p. 15.

18 The discussion of subsection 128C(2) above explains the rationale for this provision.

19 p. 16.

20 p. 16.

non-divisible property status of Farm Help, Dairy Exit and other grants is provided for in the Bankruptcy Act and therefore can only be modified by primary legislation.

2.51 The EM explains that amendments to existing rural grant schemes may necessitate changes to the provisions providing for their protection in bankruptcy. Existing rural grant schemes may be modified without the passage of fresh primary legislation which might be used as a vehicle to modify the Bankruptcy Act. Future rural grant schemes may also come into existence without the passage of fresh primary legislation which might be used to insert protective provisions into the Bankruptcy Act.[21]

2.52 Grant schemes may be introduced (or amended) and payments to primary producers commenced within a short period. Rapid introduction (or amendment) of schemes may be necessitated by the circumstances giving rise to the creation (or amendment) of the schemes. Accompanying protections under the Bankruptcy Act for those payments must therefore also be capable of being introduced rapidly.

2.53 The EM states that it is desirable that any appropriate protections can be put in place or take effect before payments are made under the relevant grant schemes. This will assist in ensuring that all of those recipients whose financial circumstances are most dire (those who are already in bankruptcy or whose bankruptcy is imminent) will receive the benefit of the financial assistance provided by the Federal Government. This will also provide certainty to persons dealing with the recipients of these payments as to whether any grant funds will be available to creditors upon bankruptcy.[22]

2.54 The EM states that in such circumstances, a regulation-making power is required to put in place or to amend, in a timely manner, adequate and appropriate protections for certain kinds of rural grants.[23]

Inspector-General's role and functions

2.55 Items 2 and 3 of Schedule 2 will amend subsection 20H(5) of the Bankruptcy Act to ensure it accurately reflects the Inspector-General's role in relation to payments into the Consolidated Revenue Fund.[24]

2.56 Items 11 to 18 of Schedule 2 will amend section 299 of the *Proceeds of Crime Act 2002* to ensure it accurately reflects the Inspector-General's role in relation to Confiscated Asset Accounts determinations.[25]

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21 p. 18.

22 p. 18.

23 p. 18.

24 See EM, p. 17, for further explanation.

25 See EM, p. 19, for further explanation.

CHAPTER 3

KEY ISSUES

3.1 The majority of submissions and witnesses expressed strong in-principle support for the Bill and its objectives. However, submissions and witnesses drew to the committee's attention a number of technical matters raised by the Bill which, they argued, require further consideration prior to implementation. This chapter examines the main issues and concerns raised in the course of the committee's inquiry.

In-principle support

3.2 Submissions and witnesses welcomed the Bill as a means of removing the potential loophole highlighted by the decision of *Cook v Benson* by enabling the recovery of superannuation contributions made prior to bankruptcy with the intention of defeating creditors. The general view was that the Bill represents a workable and balanced approach between the interests of bankrupts and the interests of creditors, at the same time minimising any active role for superannuation fund trustees.[1]

3.3 Some submissions and witnesses also commented that the Bill represents a simpler, less costly and preferable approach to earlier Federal Government proposals for reform in this area.[2]

Consultation

3.4 Many of those who provided evidence to the committee commended the extensive nature of the Federal Government's consultation process in relation to the Bill.

3.5 For example, the Australian Finance Conference noted that it has had 'a good opportunity to participate in discussion on the policy in this Bill along with a range of other policy proposals related to personal insolvency over recent years'.[3]

3.6 Dr Brad Pragnell from the Association of Superannuation Funds of Australia (ASFA) told the committee that:

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1 For example, see The Institute of Chartered Accountants, *Submission 1*, p. 1; ANZ Banking Group, *Submission 3*, p. 1; Mr Paul Cook, Insolvency Practitioners Association of Australia, *Committee Hansard*, 23 January 2007, pp 7 & 8; Dr Brad Pragnell, Association of Superannuation Funds of Australia, *Committee Hansard*, 23 January 2007, p. 2.

2 For example, see Dr Brad Pragnell, Association of Superannuation Funds of Australia, *Committee Hansard*, 23 January 2007, p. 2; Mr Paul Cook, Insolvency Practitioners Association of Australia, *Committee Hansard*, 23 January 2007, p. 7; Mr Michael Lhuede, Law Council of Australia, *Committee Hansard*, 23 January 2007, p. 11.

3 *Submission 9*, p. 1.

> We were quite involved in discussions with [the Department of the] Treasury and [the] I[nsolvency] T[rust] S[ervice] A[ustralia] in earlier consultations back in 2003, 2005 and more recently around this bill. I think generally we have found the process has been quite good. Those agencies have been very open to listening to industry concerns. In respect of cost and complexity we were quite pleased, as I mentioned in our opening remarks, to see that there was a rethink around the 2005 proposals, which would have imposed considerable cost and complexity. Other than maybe finessing certain aspects of this bill, we think that the regime is definitely a significant improvement and definitely achieves the policy objectives that were set out back in 2003.[4]

3.7 The committee acknowledges the comprehensive and wide-ranging consultation undertaken by the Federal Government in relation to the Bill.

Technical issues

3.8 Some submissions and witnesses submitted that, despite the overall soundness of the approach taken in the Bill, certain provisions may warrant minor technical amendment to improve their practical operation or to avoid unintended consequences. Some of these issues are discussed below.

Delay in commencement

3.9 The committee received some evidence suggesting that the commencement date of the substantive provisions of the Bill should be delayed until 1 January 2008 to allow implementation of the necessary changes to administration systems, processes and procedures.

3.10 As Dr Pragnell from ASFA told the committee:

> ASFA does have concerns about the capacity of the [superannuation] industry to implement the necessary changes to administration systems, processes and procedures to deal with processing payments and freezing notices within a relatively short time frame. Superannuation funds have limited resources. Simplified superannuation proposals and the anti-money laundering counterterrorism financing changes both come into force during 2007 and represent significant administrative challenges to be faced by funds and administrators. ASFA therefore requests, in consideration of these other changes, that the substantive proposals contained in this bill commence on 1 January 2008. We do recognise, however, that the regime must apply to contributions that were made on or after 28 July 2006.[5]

3.11 AXA Superannuation and the Investment & Financial Services Association (ISFA) also argued that commencement of the Bill should be no earlier than 1 January

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4 *Committee Hansard*, 23 January 2007, p. 3.

5 *Committee Hansard*, 23 January 2007, p. 3.

2008 to give the superannuation industry the necessary time to implement the required changes.[6]

3.12 When questioned at the hearing about the cost to industry and the scale of setting up any relevant systems and procedures, representatives from ASFA were unable to provide the committee with detailed information to support their arguments for a delayed commencement date. However, the representatives articulated some general concerns:

> Our members really would appreciate some additional time from when this bill becomes an act to be able to work through what is required. Even at this point I think they are going to need to work through what these notices are going to look like, how they are going to receive the notices, how they are going to be dealt with, what processes they are going to put in place to deal with them, how the moneys are going to be paid out and how they are going to record that data. So coming out of this are a number of systems issues that will require some level of at least one-off activity from the trustees. I think that is what this kind of regime actually does. Once you set it up, it kind of rumbles along in the background, like everything else. But the start-up of it does require a reasonable burst of resources. I wish I could provide you with some more detailed costings or scale …[7]

3.13 Conversely, Mr Paul Cook from the Insolvency Practitioners Association of Australia (IPAA) informed the committee that his organisation is 'happy to begin as soon as possible'. Mr Cook elaborated:

> Our view is that, since the Cook v Benson statement came down on 16 September 2003, it is fair to say that the industry has been on notice for quite some time that there are changes in this area. Trustees at the moment write to the superannuation funds about information because, if you do something to fool creditors, those funds are available. This change is about affecting something where an anomaly popped up. That is not to say that trustees do not already write to trustees who receive the funds at the moment.[8]

3.14 In response to the superannuation fund industry's concern that there may not be adequate time for implementation, representatives from the Insolvency and Trustee Service Australia (ITSA) noted that the onus is on the bankruptcy trustee, through the Official Receiver Notice, to provide the evidence in support of the claim for payment. That is, the only positive obligation on the superannuation fund is to pay the relevant monies. Notwithstanding this, the representatives acknowledged that there will be some implementation issues for superannuation funds:

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6 *Submission 8*, p. 5; *Submission 13*, p. 7.

7 Dr Brad Pragnell, Association of Superannuation Funds of Australia, *Committee Hansard*, 23 January 2007, p. 5.

8 *Committee Hansard*, 23 January 2007, p. 8.

> … we have, in the course of consulting with the super industry on this, been very cognisant of the implementation issues. They have taken the opportunity to raise those with us early. But there is a bit of a trade-off between reducing the complexity that would have been apparent from earlier proposals and having a system which is more limited in its application and does not introduce great complexity for the super funds to have to administer it. We have spoken to them about things like the way that they could build on systems they already have in place to make payments for other purposes. Depending on the final form of this legislation when it is enacted, we would more than happy to be talking to them further about those implementation issues. The examples [given by superannuation funds in the course of the committee's inquiry] about things like what the notices will look like, how they will recognise them and how they will know exactly how to comply with them are all issues that we can deal with … relatively quickly.[9]

3.15 The committee is satisfied that a delay in commencement of the Bill's substantive provisions is not warranted in the circumstances. However, the committee encourages ITSA to assist industry groups as much as possible with respect to implementation.

'Out of character' contributions and proof of intent

3.16 The committee engaged in some discussion at the hearing about the need for greater certainty in the Bill, particularly in relation to the meaning of the phrase 'out of character' in proposed subsections 128B(3) and 128C(4) and how proof of intention to defeat creditors would be ascertained in practice.

3.17 Witnesses told the committee that there does not yet appear to be any judicial guidance in relation to the phrase 'out of character'. However, witnesses agreed that the courts would play an important role in determining the meaning of this phrase. As Mr Cook from the IPAA told the committee:

> We would have to go to case law to find out, though, because of the term 'pattern of behaviour out of character'. We need a case that says, 'This is out of character,' and is more definitive. We will have to run cases. Those cases may have to be funded by the Commonwealth, and they may be prepared to do that.
>
> …
>
> My view is that trustees will be keen to take these cases on. It is pretty obvious what is out of character in one respect—you can see the elephant in the room. Then you have to go through the process of recovering. If you have a litigious bankrupt on the other side, you will take advantage of all the processes along the way. But I do not think it is that hard to spot an inappropriate pattern, I have to say.[10]

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9 *Committee Hansard*, 23 January 2007, pp 20-21.

10 *Committee Hansard*, 23 January 2007, pp 9 & 10.

3.18 Mr Michael Lhuede from the Law Council of Australia (Law Council) expressed a similar view, noting a preference for guidance from case law as opposed to the provision of greater certainty in the legislation itself:

> … I am loath to start bringing in examples. As a lawyer, I do not think it makes for good legislation. People tend to get tied down by that and courts tend to start interpreting from those examples.
>
> …
>
> The question you put to Mr Cook was: do we need to start defining the criteria? Courts can work it out, but the primary test of a trustee is not going to be those criteria. I think Mr Cook said that if you see the elephant in the room you can usually identify it. You can. The courts can and do. The primary question is one of proof of intent. You probably do not even need that section in there because there are a series of cases already on the books which say that the courts are to have regard to the surrounding circumstances in proof of intent. But you do not even need to go there if you can prove the person is insolvent. That is probably the primary means by which trustees will run a 121 case. Similarly, they will now run a 128B case.[11]

Ability of superannuation fund trustee to pay bankruptcy trustee an amount net of fees and charges

3.19 Some superannuation industry groups argued that, despite being strongly supportive of the policy objective set out in proposed subsections 128B(5A) and 128C(7A) (to ensure that, where a superannuation contribution is void, the trustee of the superannuation fund does not bear any loss resulting from fees, charges and taxes paid in respect of that contribution), the process involved is cumbersome and inefficient.[12]

3.20 Dr Pragnell from ASFA explained the process to the committee:

> First, the official receiver provides a notice of payment to the superannuation fund. Second, the superannuation fund pays the total amount of the contribution as specified in the notice to the trustee in bankruptcy. Finally, the trustee in bankruptcy is then required to pay back to the superannuation fund an amount equal to the fees, taxes and charges debited in respect of the contribution.[13]

3.21 This effectively means that the superannuation fund trustee is required to pay out a certain amount, only to then receive part of that amount back again.[14]

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11 *Committee Hansard*, 23 January 2007, p. 14.

12 For example, see ANZ Banking Group, *Submission 3*, pp 1-2; Superpartners, *Submission 5*, p. 2; Association of Superannuation Funds of Australia, *Submission 6*, pp2-3; AXA Australia, *Submission 8*, p. 3.

13 *Committee Hansard*, 23 January 2007, pp 2-3.

14 Association of Superannuation Funds of Australia, *Submission 6*, p. 3.

3.22 ASFA and the ANZ Banking Group suggested that it would be simpler and would avoid 'double handling' of payments if the superannuation fund trustee paid the net amount to the bankruptcy trustee:

> As it is only the superannuation fund trustee that is aware of the fees, taxes and charges debited in respect of those contributions, it would be far simpler if the law permitted the superannuation fund trustee to pay only the net amount and to advise the trustee in bankruptcy of the reason for the reduction in the payment.[15]

3.23 In their response to a question on notice, ITSA and the Department of the Treasury (Treasury) noted that in practice this is what currently occurs in relation to sections 120 and 121 of the Bankruptcy Act. ITSA and Treasury explained that the rationale for the process set out in the Bill is that the bankruptcy trustee will not know how to calculate these amounts and that it would be impractical to require the bankruptcy trustee to determine the net amount and limit recovery to that amount. However, the trustee/Official Receiver will accept the net amount as complying with the notice.[16]

Ongoing deduction of fees and charges for insurance

3.24 Some superannuation industry groups asserted that a definition of 'costs' should be inserted in section 128N of the Bankruptcy Act to permit the ongoing deduction of fees and charges associated with the provision of insurance cover so that a bankrupt continues to benefit from insurance cover in the event of death or disability.[17]

3.25 ITSA and Treasury provided the following response to this argument:

> The definition of 'costs' includes charges relating to the management or investment of fund assets or R[etirement] S[avings] A[ccount] assets. It is considered that this definition clearly includes normal administration fees associated with management of the account.
>
> Insurance premiums may relate to a range of products. It would not be appropriate to provide a general carve-out for all such premiums as some may be considered discretionary spending which is not directly related to the provision of the superannuation product. The definition of 'costs' in section 128N includes a power to make regulations to extend the definition and the Government will consider more detailed representations from the superannuation industry when they are made.[18]

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15 Dr Brad Pragnell, Association of Superannuation Funds of Australia, *Committee Hansard*, 23 January 2007, p. 3.

16 *Submission 14*, p. 3.

17 For example, see Association of Superannuation Funds of Australia, *Submission 6*, p. 4; Investment and Financial Services Association, *Submission 13*, pp 3-4.

18 *Submission 14*, p. 2.

3.26 The committee is satisfied with the response from ITSA and Treasury and would encourage the Federal Government to consult further with the superannuation industry in relation to this issue.

Interaction between abolition of Reasonable Benefit Limits and the Bankruptcy Act

3.27 Some submissions and witnesses commented on the apparent inconsistency between section 116 of the Bankruptcy Act and the abolition of the pension Reasonable Benefit Limit (RBL) from 1 July 2007 under the Federal Government's Simplifying Superannuation reforms. Currently, under paragraph 116(2)(d) and subsection 116(5), superannuation and life insurance assets are protected in the event of bankruptcy up to a limit of the RBL, with only amounts above the superannuation RBL being available for redistribution.[19]

3.28 The Financial Planning Association of Australia (FPA) and Mr Lhuede from the Law Council submitted that the application of the removal of the pension RBL in the context of the Bill will need to be resolved.[20]

3.29 The committee notes advice from ITSA and Treasury indicating that the Federal Government is considering this issue but has not yet announced a response.[21] However, a representative from Treasury told the committee that there is an opportunity for legislative amendments in this regard in the bill currently before Parliament dealing with the simplification of superannuation.[22]

3.30 The committee also notes that the Institute of Chartered Accountants in Australia and Mr Lhuede from the Law Council expressed the view that some threshold limit for protection of superannuation from creditors would be appropriate.[23]

Committee view

3.31 The committee acknowledges the widespread support for the Bill in its attempt to overcome the potential loophole highlighted by the decision of *Cook v Benson*. The committee agrees that the Bill represents a balanced approach between the interests of bankrupts and the interests of creditors and, in this context, applauds the extent and nature of the Federal Government's consultation with relevant stakeholders.

3.32 The committee is satisfied by ITSA and Treasury's responses to some of the technical issues raised by submissions and witnesses. The committee considers that

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19 The current level of the pension RBL for the 2006-07 financial year is $1,356, 291: The Institute of Chartered Accountants, *Submission 1*, p. 1.

20 *Submission 12*, p 1; *Committee Hansard*, 23 January 2007, p. 12.

21 *Submission 14*, p. 1; *Committee Hansard*, 23 January 2007, p. 17.

22 *Committee Hansard*, 23 January 2007, p. 17.

23 *Submission 1*, p. 1; *Committee Hansard*, 23 January 2007, p. 12.

many of these issues are of a relatively minor nature and will be resolved once the Bill is implemented and its measures applied in practice. In particular, the committee notes evidence suggesting the importance of the role of the courts in developing the law and providing greater certainty in this area. The committee also commends the willingness of ITSA to assist and support industry throughout the implementation process. Accordingly, the committee recommends that the Senate pass the Bill.

Recommendation 1

3.33 The committee recommends that the Senate pass the Bill.

Senator Marise Payne
Chair

APPENDIX 1

SUBMISSIONS RECEIVED

1	The Institute of Chartered Accountants in Australia
2	Trustee Corporations Association of Australia
3	ANZ Banking Group
4	Superannuation Australia
5	Superpartners
6	The Association of Superannuation Funds of Australia
6A	The Association of Superannuation Funds of Australia
7	Law Council of Australia
8	AXA Australia
9	Australian Finance Conference
10	Taxation Institute of Australia
11	Mr Michael Lhuede
12	Financial Planning Association of Australia
13	Investment & Financial Services Association
14	Insolvency and Trustee Service Australia
14A	Insolvency and Trustee Service Australia
15	CPA Australia

APPENDIX 2

WITNESSES WHO APPEARED BEFORE THE COMMITTEE

Canberra, Tuesday 23 January 2007

Association of Superannuation Funds of Australia
Dr Brad Pragnell, Director, Policy & Best Practice
Dr Michaela Anderson, Director, Policy & Research

Insolvency Practitioners Association of Australia
Mr Paul Cook, Deputy President
Mr Mike Lotzof, Chief Executive Officer
Ms Kim Arnold, Technical Director

Law Council of Australia
Mr Michael Lhuede, Chair, Bankruptcy Subcommittee

Insolvency and Trustee Service Australia
Mr Terry Gallagher, Chief Executive and Inspector-General in Bankruptcy
Mr David Bergman, Adviser, Policy and Legislation

Attorney-General's Department
Mr Richard Glenn, Acting Assistant Secretary, Office of Legal Services Coordination

Department of the Treasury
Mr Antony Coles, Manager, Superannuation, Retirement and Savings Division