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SUPERANNUATION AND BANKRUPTCY: IS THERE A MID-LIFE CRISIS LOOMING?

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Research suggests that Australian bankrupts are increasingly older, have professional backgrounds and generally enjoy higher levels of income than has previously been the case. Significantly, available data also indicates that the numbers of persons entering into bankruptcy hold greater levels of real property, and associated mortgage debt, than in previous decades. Given these trends, the importance of protecting superannuation funds becomes paramount to a bankrupt. However, this paper argues that there is a need to balance the protected asset status of superannuation funds with other objectives, such as achieving a fair distribution of the bankrupt's assets among creditors. This paper examines the extent to which this balance is achieved, particularly in the context of self-managed superannuation funds.

I INTRODUCTION

When the Superannuation Guarantee scheme was introduced in 1992, superannuation funds were not considered to form part of the divisible property in bankruptcy, as members of the superannuation fund, like beneficiaries in a discretionary trust, do not hold a proprietary interest in the fund. Therefore, to ensure that the bankrupt's interest in the superannuation fund did not vest in the Trustee in Bankruptcy, superannuation deeds often contained forfeiture provisions, whereby a member's interest in the fund would cease should they become bankrupt.[1] However, superannuation funds were not specifically listed as exempted property under the *Bankruptcy Act 1966* (Cth) (Bankruptcy Act) until 1994.[2] At the time of passing the *Superannuation Industry (Supervision) Consequential Act 1993* (Cth) ('SIS Consequential Act'), the government's declared intention was to extend the limitation on divisible property to include the interest of a bankrupt in, or payment from, a regulated superannuation or approved deposit fund.[3] Specifically, section 7 of the SIS Consequential Act amended section 116(2) of the Bankruptcy Act by introducing specific exemptions for:

- the interest of the bankrupt in a regulated superannuation or approved deposit fund as defined by the *Superannuation Industry (Supervision) Act 1993* (Cth) ('SIS Act');[4] and
- a payment to the bankrupt from such a fund received on or after the date of the bankruptcy, provided the payment is not a pension within the meaning of SIS Act.[5]

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[1] See Victor J Bennetts, 'Bankruptcy and Superannuation' (1995) 11 *Queensland University of Technology Law Journal* 157. However, Bennetts suggests (at 161) that the interest held by a member of a superannuation fund would vest automatically once the member became bankrupt.

[2] *Superannuation Industry (Supervision) Consequential Act 1993* (Cth) s 7, commenced 1 July 1994.

[3] Supplementary Explanatory Memorandum, Superannuation Industry (Supervision) Consequential Amendments Bill 1993 (Cth) [4].

[4] *Bankruptcy Act 1966* (Cth) s 116(2)(d)(iii).

[5] Ibid s 116(2)(d)(iv).

Thus, the Bankruptcy Act now provides that the interest of a bankrupt in a regulated superannuation fund,[6] or a lump sum payment[7] to the bankrupt from such a fund received on or after the date of bankruptcy,[8] or a split payment from such a fund where the split payment is not a pension,[9] are protected assets, being exempt property of the bankrupt. Importantly, there is no asset protection from bankruptcy unless the fund is a 'regulated superannuation fund' within the meaning of section 19 of the SIS Act.[10] Section 19 requires that the superannuation fund has a trustee; either the trustee is a constitutional corporation pursuant to a requirement in the governing rules or the governing rules provide that the sole or primary purpose of the fund is the provision of old-age pensions; and that the trustee has made a non-revocable election in writing that the SIS Act will apply to the fund. In relation to personal insolvency, the election would appear to be all but mandatory, as without the election the fund is not exempt property of the bankrupt. However, failure to comply with the SIS Act does not, by itself, result in the removal of the exempt status of the fund. Rather, failure to comply with the SIS Act imposes a 'non-complying' status upon the superannuation fund, which has the effect of removing the fund's entitlement to taxation concessions.[11] Essentially, a complying fund is one which is an Australian resident regulated superannuation fund and the trustee has not contravened any of the applicable regulatory provisions[12] and, as a result, has not received a 'notice of compliance' from the relevant regulator.[13]

This paper considers whether superannuation funds are strictly exempt property under the Bankruptcy Act, and the extent to which the balance is achieved between the objectives of a fresh start and a fair distribution of assets to creditors in personal insolvency law. The remainder of the paper is organised as follows. Part II discusses the government policy underpinning the need to provide prudential protection of superannuation savings and the increasing popularity of self-managed superannuation funds ('SMSFs'), particularly in the context of the current Australian bankrupt demographic. Part III provides a discussion of both the narrow and broad view of the 'fresh start' goal in relation to personal insolvency and the need to achieve a balance between achieving a fresh start for the bankrupt and ensuring a fair distribution of the bankrupt's assets amongst creditors. Part IV of the paper considers limitations on achieving this balance by considering the interaction of bankruptcy, superannuation and taxation laws. In that context, the paper analyses two possible areas, in which balancing the objectives of providing a fresh start with ensuring a fair distribution of the bankrupt's assets amongst creditors causes tension; namely the impact of the bankruptcy of a member of a self-managed superannuation fund ('SMSF') on the tax compliant status of the SMSF and the serving of a statutory garnishee notice on a superannuation fund by the Australian Taxation Office ('ATO').

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[6] Ibid s 116(2)(d)(iii), which also applies exempt property status to an approved deposit fund or an exempt public-sector superannuation scheme within the meaning of the SIS Act.
[7] Meaning a payment which is not a pension within meaning of the SIS Act.
[8] Where a person becomes bankrupt by virtue of a creditor's petition, the date of bankruptcy is the date on which a sequestration order is made: *Bankruptcy Act 1966* (Cth) s 43(2); whereas if the bankrupt presents a debtor's petition, the date of bankruptcy is the date on which the Official Receiver accepts the debtor's petition: *Bankruptcy Act* s 55A(4A).
[9] *Family Law Act 1975* (Cth) Part VIIIB.
[10] *Bankruptcy Act 1966* (Cth) s 116(2)(d)(iii)(D).
[11] SIS Act s 45.
[12] Ibid s 38A, which defines the regulatory provisions to include the SIS Act, the *Superannuation Industry (Supervision) Regulations 1994* (Cth), as well as certain provisions of the *Taxation Administration Act 1953* (Cth) and the *Corporations Act 2001* (Cth).
[13] SIS Act s 42A (in relation to self-managed superannuation funds), and s 42 (for all other superannuation funds).

II PROTECTION OF SUPERANNUATION FUNDS IN BANKRUPTCY: IS THERE A MIDDLE-AGED PROBLEM?

The compulsory superannuation guarantee scheme was introduced in 1992 as a response to Australia's expanding aged population. The aim of the scheme was to compel superannuation contributions by employers to strengthen the retirement savings, thus reducing the reliance on the government's aged pension and increasing Australia's national savings.[14] Twenty five years later, the Australian government introduced the Superannuation (Objective) Bill 2016 with the intended purpose of ensuring that the primary objective of the superannuation system, being to 'provide income in retirement to substitute or supplement the age pension', is enshrined in all future legislation and associated regulations that relate to superannuation.[15] If enacted, the primary objective would be supported by subsidiary objectives to be prescribed in regulations.[16] While the subsidiary objectives have not, as yet, been prescribed, it is expected that they will be able:

- To facilitate consumption smoothing over the course of an individual's life;
- To manage risks in retirement;
- To be invested in the interests of superannuation fund members;
- To alleviate fiscal pressures on government from the retirement income system; and
- To be simple, efficient and provide safeguards.[17]

The Bill was ultimately referred to the Senate Economics Legislation Committee, which indicated while there was general in-principle support for defining an overall policy objective among stakeholders,[18] there were numerous concerns about the primary objective as stated. These included the generic wording of the objective,[19] a lack of specificity around what level of income could be considered 'adequate',[20] ensuring that the subsidiary objectives are compatible with the primary objective,[21] and other matters. It is not clear how the primary objective, if legislated, will operate in relation in relation to other laws which may relate to superannuation, such as the Bankruptcy Act, though it is clear that primary and subsidiary objectives are not intended to affect the meaning of any other Commonwealth laws.[22]

In the context of the overall objectives of the superannuation scheme, there are particular risks that face the middle-aged investor.[23] For example, the Australian Competition and Consumer

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[14] The Treasury (Aust), *Charter of Superannuation Adequacy and Sustainability and Council of Superannuation Custodians* (2013) ch 4 <http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/supercharter/Report/Chapter-4>. See also Australia's Future Tax System Review, *Australia's Future Tax System: The Retirement Income System: Report on Strategic Issues* (2009) ch 2 <https://taxreview.treasury.gov.au/content/downloads/retirement_income_report_stategic_issues/retirement_income_report_20090515.pdf>.

[15] Superannuation (Objective) Bill 2016 (Cth) cll 5–7. See generally Explanatory Memorandum, Superannuation (Objective) Bill 2016 (Cth) [1.16]–[1.18].

[16] Superannuation (Objective) Bill 2016 (Cth) cl 5(2).

[17] Commonwealth, *Parliamentary Debates*, House of Representatives, 9 November 2016, 3378–3380 (Scott Morrison), 3379.

[18] Senate Economics Legislation Committee, Parliament of Australia, *Superannuation (Objective) Bill 2016* (2017) [2.2].

[19] Ibid [2.11]–[2.20].

[20] Ibid [2.21]–[2.30].

[21] Ibid [2.41]–[2.48].

[22] Superannuation (Objective) Bill 2016 (Cth) cl 5(2).

[23] 'Middle-aged', defined as '... commonly from about 45 to 60 years old': *Macquarie Dictionary* (online ed, 2017) <http://gateway.library.qut.edu.au/login?url=http://www.macquariedictionary.com.au/login>.

Commission ('ACCC') reported in its 2015 Scam Watch report that $24 million was lost by Australians in investment scams.[24] The 2015 Scam Watch Report further identified that do-it-yourself ('DIY') SMSF operators have been reported as prime targets for Australian investment scammers.[25] The ACCC has highlighted the risks of exploitation, particular to the middle-aged investor, stating:

> Australians approaching retirement or recently retired will naturally be looking for opportunities to invest or increase their investments. This mix of available funds through superannuation payouts and a desire to maximise wealth for retirement, leaves the over 55s open to exploitation by investment scammers who offer false promises of high returns and phoney assurances of low risks.[26]

Thus, such scams pose a significant investment risk for middle-aged investors, especially in the context of the current demographic of the average Australian bankrupt. For example, within Australia, approximately 40 per cent of bankrupts are aged 45 years or older and are more likely to have been made bankrupt due to non-business related circumstances, including being subject to a scam, than business-related circumstances.[27] More detailed analysis of the average Australian bankrupt's demographic, as carried out by Ramsay and Sim[28] and Morrison and Lee,[29] indicates an increase in the number of bankrupts with professional occupations, and consequently higher levels of personal income and household income. In noting this continuing trend, Morrison and Lee have also suggested a continuing increase in the level of personal insolvents' unsecured debt. This has led some commentators to suggest that bankruptcy is a 'middle class' phenomenon.[30]

The investment in superannuation in Australia is significant, with $2.1 trillion invested in superannuation industry assets as at 30 June 2016 ($2.0 trillion in 2015).[31] Of this amount, $1292.2 billion ($1246.0 billion in 2015) in assets were held by APRA-regulated superannuation entities and $621.7 billion ($589.9 billion in 2015) were held by SMSFs, which

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[24] Australian Competition and Consumer Commission, *Targeting Scams: Report of the ACCC on Scam Activity 2015* (2016), 1 <https://www.accc.gov.au/publications/targeting-scams-report-on-scam-activity/targeting-scams-report-of-the-accc-on-scam-activity-2015>.

[25] Ibid 16–17, 29. See also Emma Koehn, 'How to Identify and Beat Investment Scams' *The Australian* (online), 18 June 2016 <http://www.theaustralian.com.au/business/wealth/how-to-identify-and-beat-investment-scams/news-story/afeaf78c08c4ef216fa8df50fce6208b>.

[26] Australian Competition and Consumer Commission, above n 24, 10.

[27] See Australian Financial Security Association, *Business and Non-Business Statistics: Time Series* <https://www.afsa.gov.au/statistics/time-series-0>. It should be noted that the available data on personal insolvency is on documentation completed by persons becoming bankrupt, which in turn is premised on the bankrupt's understanding of the various social factors being reported on. As such, the reliability of the data may be limited. See Ian Ramsay and Cameron Sim, 'Trends in Personal Insolvency in Australia' (Research Paper No 390, Centre for Corporate Law and Securities Regulation, University of Melbourne, 23 March 2009) <http://dx.doi.org/10.2139/ssrn.1367445>. However, it is worth noting that similar age and gender demographics appear to apply in relation to the average New Zealand bankrupt: New Zealand Ministry of Business, Innovation and Employment, *New Zealand Insolvency and Trustee Service: Insolvency Statistics and Debtor Profile Report*: *1 July 2015–30 June 2016* (2016) <https://www.insolvency.govt.nz/assets/pdf/Statistical-Data-Reports/Insolvency-statistics-full-report-2015-16.pdf>.

[28] Ian Ramsay and Cameron Sim, 'Personal Insolvency in Australia: An Increasingly Middle Class Phenomenon' (2010) 38 *Federal Law Review* 283, 291–298.

[29] David Morrison and Rachel Lee, 'Trends in Personal Insolvency in Australia: An Update' (2012) 20 *Insolvency Law Journal* 18.

[30] Ramsay and Sim, above n 28, 283. See also Teresa A Sullivan, Elizabeth Warren and Jay Lawrence Westbrook, *The Fragile Middle Class: Americans in Debt* (Yale University Press, 2000).

[31] Australian Prudential Regulation Authority, *Annual Superannuation Bulletin June 2016* (2017) 6, <http://www.apra.gov.au/Super/Publications/Documents/2017ASBEXCEL201606%20-%20PDF.pdf>.

are regulated by the ATO.[32] The comparatively higher rate of growth of investments in SMSFs between 2015 and 2016 (5.39 per cent, compared to 3.7 per cent growth in APRA-regulated superannuation entities), suggests that SMSFs are the fastest growing superannuation sector in Australia. The popularity of SMSFs is attributed to their ability to provide not only taxation and estate planning opportunities to their members, who must also be trustees of the fund, but also an increased control over investment decisions.[33] Regardless of the reasons underpinning their popularity, what is apparent from the available data is that the likelihood of insolvent persons holding an interest in an SMSF on becoming bankrupt is increasing. In the context of these trends, some consideration of the impact of becoming bankrupt on SMSF investments is warranted.

III BALANCING FRESH START FOR DEBTORS WITH A FAIR DISTRIBUTION AMONG CREDITORS

In Anglo-American legal systems such as Australia, the notion of 'fresh start' is said to be one of the main, if not the most important, objectives of bankruptcy legislation.[34] Despite its importance, what is meant by the term 'fresh start' is by no means clear. Howell[35] argues that the discourse on the fresh start concept ranges from the narrow view, focusing on the discharge of debts, to the broader notion of a 'rehabilitation-focused' fresh start, a view which encompasses the more holistic financial well-being of the debtor.

Proponents of the broader rehabilitation focus acknowledge that reliance solely on the bankruptcy legislation to achieve the fresh start objective is not sufficient and that other laws, policies and programs will impact the ability of a debtor to obtain a fresh start.[36] Thus, it is argued that adopting a rehabilitation focus to the fresh start objective requires consideration of the bankrupt's finances as a whole. In that regard, protection of the bankrupt's investments in superannuation funds plays a significant role in providing a discharged bankrupt with a fresh start. Howell provides support for this view, stating:

> Certain property is also exempt from realisation and distribution to creditors. This includes … superannuation interests. These exemptions facilitate the bankrupt maintaining at least a basic standard of living and opportunity for employment and social engagement … following discharge from bankruptcy. They therefore facilitate the wider, rehabilitation sense of the fresh start goal.[37]

Given the age of the average bankrupt, as discussed above, he or she may have only a limited number of full-time working years left before retirement. This shortened period of post-bankruptcy employment can be supplemented, however, by the availability of superannuation funds in retirement. By providing such income the bankrupt's superannuation fund assists the discharged bankrupt in enjoying a basic standard of living and, to that end, is considered to fall within the broader definition of fresh start. The provision of a fresh start is, however, not the only goal of bankruptcy law. A competing and equally important aim is the equal and equitable

[32] Ibid.
[33] See generally George Mihaylov et al, 'Tax Compliance Behaviour in Australian Self-Managed Superannuation Funds' (2015) 13(3) *EJournal of Tax Research* 740; Ron Bird et al, 'Who Starts a Self-Managed Superannuation Fund and Why?' (Working Paper No 127, Centre for International Finance and Regulation, September 2016).
[34] Nicola Howell, 'The Fresh Start Goal of the Bankruptcy Act: Giving a Temporary Reprieve or Facilitating Debtor Rehabilitation?' (2014) 14 *QUT Law Review* 29, 29.
[35] Ibid 33–34.
[36] Ibid 34.
[37] Ibid 36.

distribution of the bankrupt's assets amongst his or her creditors.[38] Given the tension that exists between such goals, a balance must be struck for both goals to be achieved.

The need to balance a fresh start for debtors and a fair distribution of the bankrupt's assets amongst creditors was recently affirmed by Logan J, in the *Trustees of the Property of Morris (Bankrupt) v Morris (Bankrupt)*[39] ('*Morris*') in which the balance favoured providing a fresh start to the bankrupt. The issue in *Morris* was whether two separate payments received by the bankrupt (Ms Morris) from her deceased husband's regulated superannuation funds after Ms Morris was declared bankrupt were after-acquired property, and therefore divisible among her creditors,[40] or exempt property.[41] In deciding that both payments were exempt property, Logan J considered the meaning and effect of the exemption of the bankrupt's 'interest in a regulated superannuation fund', stating:

> That interest was not proprietary but, upon the favourable exercise of the discretion, a proprietary interest was created, and that interest was, quite literally, an interest in a regulated superannuation fund, for there is no dispute between the parties that each of the [husband's superannuation funds] is a regulated superannuation fund within the meaning of the SIS Act.[42]

Logan J arguably adopted a broad view of the fresh start goal, noting earlier statements of parliamentary intention throughout Australia.

> When one looks at the progressive amendment, not just of s 116(2)(d), but elsewhere of s 116(2), one sees particular progressive value judgments by Parliament reflecting changes in Australian society and provision in that society in respect of benefits for retirement, either by age, invalidity or death, or alternatively, the division of such benefits in the course of resolving a property dispute in a matrimonial cause.[43]

However, there are limits to the extent to which a bankrupt's superannuation investment is protected. This point was highlighted by Edmonds, Gordon and Beach JJ in *Di Cioccio v Official Trustee in Bankruptcy (as Trustee of the Bankrupt Estate of Di Cioccio)*, who stated in relation to the proper construction of sections 58 and 116(2) of the Bankruptcy Act: 'The [Bankruptcy] Act may be read as encouraging a bankrupt to commence re-establishing themselves but, until discharged, the Act does not permit a bankrupt to commence acquiring all kinds of assets to the detriment of a bankrupt's creditors.'[44]

A regulated superannuation fund's asset protection only applies 'on or after the date of bankruptcy'[45] such that if an individual were to withdraw a lump sum cash payment from their superannuation fund prior to being declared bankrupt, those monies or any property purchased with those monies would not be protected. The bankruptcy trustee would be entitled to all or

[38] Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988) vol 1 [33].
[39] [2016] FCA 846.
[40] *Bankruptcy Act 1966* (Cth) s 58(1).
[41] Ibid ss 116(2)(d)(iii)(A), 116(2)(d)(iv), 116(2)(a).
[42] *Trustees of the Property of Morris (Bankrupt) v Morris (Bankrupt)* [2016] FCA 846, [27]. Note, that this will not extend to moneys paid from a regulated superannuation fund to a deceased estate as the payment will no longer retain the character of superannuation fund payments. See *Cunningham (Trustee) v Gapes, in the matter of Gapes (Bankrupt)* [2017] FCA 787, [22]-[23] (Collier J).
[43] Ibid [24]
[44] [2015] FCAFC 30, [32].
[45] *Bankruptcy Act 1966* (Cth) s 116(2)(d)(iv).

any of those remaining monies, or property purchased with those monies, at the date of bankruptcy for the benefit of creditors.[46]

The legislation governing both the APRA-regulated superannuation entities and ATO-regulated SMSFs is the SIS Act, the purpose of which is 'to substantially increase the level of prudential protection provided to the superannuation industry, to substantially strengthen the security of superannuation savings, and protect the rights of superannuation fund members'.[47] To achieve these objectives, the SIS Act provides:

- a clear delineation of the basic duties and responsibilities of trustees, and indicates that trustees have primary responsibility for the operation of funds; and
- that trustees and investment managers must be suitable to act as fund trustees and to manage fund moneys respectively.[48]

General anti-avoidance provisions, such as sections 120 and 121 of the Bankruptcy Act, along with the more specific anti-avoidance provisions provided for by sections 128B, 128C and 139ZU of the Bankruptcy Act, prevent the bankrupt's regulated superannuation fund being used as a repository for hiding the bankrupt's property from his or her creditors. For example, sections 128B and 128C are aimed at voiding transfers made by the debtor or third parties on the debtor's behalf where the intention of the transfer was to defeat creditors. This intention need not be the only purpose, but must be a main purpose of the transaction. Such an intention is subjective, and is usually inferred from the circumstances of the transaction, the debtor's financial position at the time, and the result of the transaction.

IV LIMITS TO ACHIEVING THE BALANCE

The protected asset status given to a regulated superannuation fund under the Bankruptcy Act is consistent with Australia's classification as a liberal bankruptcy jurisdiction, prioritising the notions of 'fresh start' for debtors and fair distribution of the bankrupt's assets amongst the bankrupt's creditors.[49] In the circumstances discussed above, such as the operation of the anti-avoidance provisions, it is argued that there is equilibrium between the fresh start and fair and equitable distribution of the bankrupt's assets amongst creditors. However, there are several factors which may affect the existing balance, including the operation of Australian taxation laws, thus causing tensions between the bankruptcy law objectives.

A *Disqualification of SMSF Trustees Due to Bankruptcy*

One area which affects the ability of the bankrupt to achieve a 'fresh start' in the broad sense is the approach taken by the legislature to waiving the disqualification of SMSF trustees who are 'insolvents under administration' ('IUA').[50] Section 17A of the SIS Act requires that all members of a SMSF must be trustees of the super fund, or, if the trustee is a company, directors of the corporate trustee. Section 120(1)(b) of the SIS Act provides that an IUA, which by definition includes an undischarged bankrupt or a person who has executed a Part X

[46] See *Zylvain Stanley Jemielita ex parte: Official Trustee in Bankruptcy* [1966] FCA 1208 and *Klewer v Official Trustee in Bankruptcy (No 2)* [2008] FCA 1788 in which similar circumstances existed.
[47] Explanatory Memorandum, Superannuation Industry (Supervision) Bill 1993, 1.
[48] Ibid.
[49] Rafael Efrat, 'Global Trends in Personal Bankruptcy' (2002) 76 *American Bankruptcy Law Journal* 81, 87–91.
[50] SIS Act s 120(1)(b).

agreement,[51] is disqualified from acting as a trustee of a SMSF. Similarly, section 206B(3) of the *Corporations Act 2001* (Cth) disqualifies an IUA from acting as a director of a company. Section 126K of the SIS Act requires a trustee who becomes a disqualified person to immediately resign as trustee of the super fund. Severe penalties are imposed on the IUA member if he or she does not resign immediately, including two years' imprisonment and a penalty of up to $10 800 if he or she fails to resign.[52]

To remain a complying superannuation fund, entitled to concessional tax treatment, the disqualified trustee needs to cease acting as trustee or director of the corporate trustee immediately. The remaining trustees of the SMSF must notify the ATO in writing within 28 days of the trustee's disqualification.[53] The SMSF then has six months[54] to:

- Roll-over or transfer the disqualified person's superannuation interest into another complying fund or, if the disqualified person can meet a condition of release, pay the interest to the person as a benefit and cease that person's membership of the fund;
- Appoint a small fund trustee who is licensed by APRA; or
- Wind up the fund.[55]

If none of the above options is actioned, the fund automatically becomes non-complying and loses its concessional tax status, which means a loss of benefits equal to the value of the additional tax levied on the fund, by all of the fund's members, not just the member/trustee who has been disqualified.

Maintaining the SMSF's status as a complying fund by achieving any of the options listed above would also seriously affect the bankrupt members' fresh start, given the costs involved and/or the loss of superannuation benefits. For example, rolling over the disqualified person's benefit entitlement into a larger APRA-regulated fund within the six-month limitation period may not be achievable, particularly where the SMSF holds assets that are not quickly realisable, such as real estate. Retaining complying superannuation status by appointing a small APRA licensed fund may also be challenging. Insolvency practitioners advise that the annual fees set by the two available bankruptcy trustees — Australian Executor Trustees and Perpetual Limited — for services as a small fund trustee may be prohibitive.[56] Furthermore, this may not be the most cost effective approach to SMSFs with smaller investment balances, for example where the sole asset of the fund is a negatively geared residential rental property, as the ongoing costs are proportionately greater than those with larger balances.[57] Finally, winding up the SMSF in circumstances where there is no roll over of members' benefits into another complying SMSF would mean a loss of benefits to each member of the SMSF and certainly would affect the fresh start capability of the insolvent member.

The imposition of disqualification status on a SMSF trustee due to bankruptcy is particularly severe as there is no ability to waive the SMSF trustee's disqualification. By contrast, if a

[51] Ibid sub-s 10(1).
[52] Ibid sub-ss 126K(1)–(2).
[53] Ibid s 42A.
[54] Ibid sub-s 17A(4).
[55] See generally Australian Taxation Office, *Disqualified Trustee as a Result of Dishonesty Conviction: Case Study Scenario* (SMSF Case Studies, 14 October 2016) <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-case-studies/Disqualified-trustee-as-a-result-of-dishonesty-conviction/>.
[56] See John Wasiliev, 'The Nitty-Gritty of Small APRA Funds', *The Australian Financial Review* (online), 11 October 2014.
[57] Ibid.

member of a SMSF is disqualified due to being convicted of an offence under section 126B of the SIS Act, the member may apply within 14 days of the conviction to have the disqualification waived.[58] The policy justifications for the introduction of this provision were clearly aimed at addressing the severity of the disqualification provisions, the Explanatory Memorandum stating that:

> These sections have been inserted to allow the Commissioner to waive the disqualified person requirements for trustees, and responsible officers of trustees, investment managers and custodians of superannuation entities, if the Commissioner believes, given the information provided, that the person is highly unlikely to be a prudential risk to a superannuation entity. Currently the impact of the disqualified person provisions means, for example, that even persons whose only offence was a minor offence involving dishonesty 20 years ago, for example shoplifting, are disqualified persons and cannot act as a trustee, or as responsible officers of trustees, investment managers or custodians. These new sections will enable the Commissioner to waive the disqualified person status of such an individual.[59]

However, if the trustee of the SMSF is disqualified due to being an IUA, it appears that disqualification cannot be waived, regardless of the underlying reason for the trustee's insolvency.[60] Furthermore, such a trustee is disqualified for the duration of their insolvency administration. The basis for not waiving disqualification for IUAs is difficult to discern. It suggests that an IUA is considered more reprehensible and unfit to manage the SMSF than a SMSF trustee convicted of a dishonesty offence, even where there is no dishonesty or *mala fides* associated with the bankrupt's insolvency.[61] Furthermore, the failure to provide a waiver of disqualification of the SMSF trustee is inconsistent with the latitude granted by section 206G(1) of the *Corporations Act 2001* (Cth) which permits a person disqualified from managing a company to apply to the court for leave to manage a particular company or companies.[62] The considerations taken into account when hearing an application for leave to manage a corporation while disqualified were considered in *Adams v ASIC*.[63] They included, among other things, that:

- The legislative policy is one of protecting the public, not one of punishing the offender.
- The aim of the legislation is generally to deter others from engaging in conduct of the particular kind in question and abusing the corporate structure to the disadvantage of stakeholders.
- The court in exercising its discretion should have regard to the nature of the offence that the person was convicted of, as well as the risks involved to other persons if the disqualification was waived.

By analogy to the justifications for waiver in relation to those persons disqualified from being a SMSF trustee or managing companies due to an offence being committed, it is argued that

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[58] SIS Act s 126B(4).

[59] Explanatory Memorandum, Superannuation Industry (Supervision) Legislation Amendment Bill 1995, [87]–[88].

[60] SIS Act s 126B(1), which provides that the waiver is only applicable to persons disqualified solely because of the operation of s 120(1)(a)(i).

[61] Statistics consistently show that the majority of bankruptcy cases are caused by factors such as unemployment and excessive use of credit, rather than carrying on a business. Since 2007–08 consumer debt has accounted for 75 per cent (lowest: 2012–13) to 85 per cent (highest: 2008–09) of debtors entering bankruptcy, with the latest available figures in 2014–15 showing 78 per cent. See Australian Financial Security Association, above n 27.

[62] If permission is granted, the court order may allow full unrestricted access or impose limiting conditions on the disqualified person's right to direct the company.

[63] (2003) 46 ACSR 68, [8] (Lindgren J).

there may be circumstances which warrant the waiver of the SMSF trustee's disqualification due to bankruptcy.

Firstly, the impact of disqualification on the SMSF trustee may be particularly burdensome given the current demographic of the average Australian bankrupt and the recent popularity of DIY SMSF operators, particularly middle-aged operators, to be prime targets for Australian investment scammers.[64] As previously noted, this burden is not necessarily borne only by the disqualified trustee, but also by the remaining SMSF members, if the SMSF remains non-complying. Secondly, the inability of an IUA SMSF trustee to obtain a disqualification waiver, along with the consequential loss of concessional taxation treatment by the SMSF, invariably impacts upon the availability of fresh start opportunities for the IUA trustee. This loss may be tolerated where the need to substantially strengthen the security of superannuation savings and protect the rights of superannuation fund members[65] is at risk from such an IUA SMSF trustee. However, as is the case with section 206G(1) of the *Corporations Act 2001* (Cth), consideration should be given to the need to strengthen the security of superannuation savings as a determining factor in the decision to waive the disqualification,[66] rather than a justification for a blanket disqualification for every SMSF trustee who is an IUA. This would be consistent with the policy objectives of the superannuation system, discussed above. Thirdly, it may be considered in certain circumstances that the refusal to waive the disqualification is discriminatory in the sense that it has the effect of penalising not only the offending IUA SMSF trustee but also the remaining members of the SMSF, and imposes more than a short-term hardship on the trustee when the assessed risk to the remaining members of the SMSF and the public is relatively small.

SMSF trustees who are disqualified on the basis of being an IUA should be entitled to apply for a waiver of their disqualification. The current approach negatively affects the IUA member's ability to achieve a fresh start without a corresponding positive impact being spread amongst the IUA member's creditors. Where it is considered in the circumstances that the SMSF and the public are not at risk by allowing the IUA to retain his or her trusteeship, then disqualification should be waived. Doing so would mean the maximisation of a fresh start opportunity for the IUA SMSF trustee, as well as the maintenance of concessional tax treatment for the SMSF, for the benefit of remaining members.

B *The Impact of Servicing Garnishee Notices on Superannuation Funds*

As a general rule, a garnishee order requires a judgement creditor to obtain a court order against a third party who owes money to or holds money on behalf of the debtor, to pay those monies to the judgement creditor. Despite the ATO being an unsecured creditor in relation to a debtor's tax debts, the Commissioner of Taxation (Commissioner) has a number of collection and enforcement powers,[67] including a 'statutory garnishee power' pursuant to section 260-5 of schedule 1 of the *Taxation Administration Act 1953* (Cth). This statutory garnishee power provides the Commissioner with the power to recover tax related liabilities from third parties owing money to, or holding money for, a tax debtor.[68]

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[64] Australian Competition and Consumer Commission, above n 24.
[65] See earlier discussion regarding the purpose of the SIS Act.
[66] The court gives consideration to such circumstances under s 206G(1) of the *Corporations Act 2001* (Cth) when granting leave to a disqualified person to continue to manage a corporation.
[67] See generally, Australian Taxation Office, *Enforcement Measures Used for the Collection and Recovery of Tax-related Liabilities and Other Amounts*, PS LA 2011/18, 3 July 2014, <http://law.ato.gov.au/atolaw/view.htm?Docid=PSR/PS201118/NAT/ATO/00001>.
[68] Ibid [97].

The Commissioner considers the 'serving of garnishee notices is an efficient and cost-effective way of obtaining payment of outstanding debt'.[69] If effective, the power to serve a statutory garnishee notice upon a superannuation fund would provide the Commissioner with effective priority of payment in insolvency, which would affect the fresh start objective of personal insolvency without a counter-balancing distribution of the proceeds of such a garnishee notice amongst the debtor's creditors. However, the Commissioner's ability to serve a statutory garnishee notice validly is subject to certain limitations.

The first limitation is that unless the tax debtor–member's superannuation benefits are payable under the superannuation fund rules, meaning that the superannuation fund trustees are under a presently existing obligation to pay such funds to the tax debtor–member who is legally and beneficially entitled to such funds, the serving of the statutory garnishee notice on the superannuation fund will be unsuccessful. ATO Practice Statement, *Enforcement Measures Used for the Collection and Recovery of Tax-related Liabilities and Other Amounts* states:

> A garnishee notice in respect of any tax-related liabilities may be served on a superannuation fund but it will not be effective until the tax debtor's (member's) benefits are payable under the rules of the fund (for example, the tax debtor retires or dies). A notice served on the fund will generally request payment as a lump sum unless the anticipated retirement income stream can guarantee repayment within a satisfactory period of time.[70]

In the recent case of *Commissioner of State Revenue v Can Barz Pty Ltd & Anor*[71] ('*Can Barz'*), the Queensland Court of Appeal considered the ability of the Queensland Commissioner of State Revenue to recover a payroll tax debt incurred under the *Payroll Tax Act 1971* (Qld) pursuant to section 50 of the *Taxation Administration Act 2001* (Qld) ('TAA Qld'). Section 50 of the TAA Qld, like its Commonwealth equivalent,[72] provides that where a debt is payable by a taxpayer, the Commissioner is empowered to issue a garnishee notice to a person who is 'liable or may become liable to pay an amount to the taxpayer'. In the *Can Barz* case, Can Barz Pty Ltd contracted to sell real estate which was held on trust for the benefit of Bird and Scott, as trustees of the Mewcastle Superannuation Fund ('the SMSF Fund'), which was a SMSF as defined by section 17A of the SIS Act. In the ordinary course of events, Can Barz Pty Ltd would have received the settlement monies from the real estate agent and purchasers and, on receiving instructions, paid those monies to Bird and Scott, who would then have held the sale proceeds as trustees of the SMSF Fund. However, before settlement, the Commissioner of State Revenue issued garnishee notices pursuant to section 50 of the TAA Qld to:

1. Real estate agents and purchasers, requesting them to pay the settlement monies to the Commissioner rather than Can Barz Pty Ltd; and
2. Can Barz Pty Ltd, requesting the company to pay to the Commissioner monies which it would otherwise have paid to Bird and Scott.[73]

In the circumstances before the court, it was clear that neither Scott nor Bird, as trustees of the Fund, held any beneficial interest in the assets of the SMSF Fund. In their capacity as trustees, they were obliged to comply with SIS Act and superannuation laws, as defined by the Mewcastle Trust Deed ('the Trust Deed'), which included an obligation to pay out to members

[69] Ibid [100].
[70] Ibid [118].
[71] [2016] QCA 323.
[72] *Taxation Administration Act 1953* (Cth) sch 1, s 260-5, previously *Income Tax Assessment Act 1936* (Cth) s 218.
[73] *Can Barz Pty Ltd & Anor v Commissioner of State Revenue & Ors* [2016] QSC 59, [6].

or dependants only when the circumstances provided for in the Trust Deed or relevant law had occurred.[74] In their capacity as members of the Fund, the Trust Deed provided that the fund was vested in the trustees and no other person had any legal or beneficial interest in any asset of the fund.[75]

The issue before the Court was the proper construction of section 50 of TAA Qld, specifically whether the statutory garnishee notices were invalid and ineffective where the Commissioner of State Revenue knew that the taxpayer's right to receive payment was not beneficially held by the taxpayer.[76] In the first instance, Bond J declared that the garnishee notices were invalid and ineffective stating:

> I would construe that phrase as encompassing only circumstances in which the right to payment from the garnishee was legally and beneficially held by the taxpayer and the taxpayer was free to use the right in the taxpayer's own interest. To take any other view would be to attribute intention to the parliament in a way which I am not prepared to do.[77]

The Court of Appeal upheld the primary judge's decision, specifically noting that:

> The purpose of the statute is not to permit the recovery of tax by recourse to money which belongs to someone other than the taxpayer or which, for some other reason, could not be lawfully applied by the taxpayer in the payment of his or her own tax debt.[78]

Philip McMurdo JA then went on to hold that it was not open for Bird and Scott, as trustees, to pay the Commissioner from the Fund as this would amount to a contravention of section 62 of the SIS Act, as well as the terms of the Trust Deed.[79]

The second limitation on the effectiveness of a statutory garnishee notice is the Commissioner of Taxation's acknowledgement that the issue of such notice is an exercise of coercive power, so that care must be taken when exercising the power.[80] In the case of *Denlay v Federal Commissioner of Taxation*,[81] Logan J found in favour of the applicant taxpayer in relation to a garnishee notice pursuant to section 260-5 of schedule 1 to the *Taxation Administration Act 1953* (Cth). On the question of the validity of the statutory garnishee notices, Logan J reasoned that section 260-5 confers a discretionary power on the Commissioner which required that the Commissioner take into account a number of mitigating factors when exercising that discretion. Those factors include, among other things, the impact of section 116(2)(d)(iii) of the Bankruptcy Act if the taxpayer were to become bankrupt,[82] the merits of the taxpayer's appeals against certain tax assessments,[83] and the effect of issuing section 260-5 notices on the taxpayer's ability to prosecute the appeals against their assessment.[84] The Commissioner's omission in considering such factors led Logan J to state that the decision to issue the section

[74] *Commissioner of State Revenue v Can Barz Pty Ltd & Anor* [2016] QCA 323, [7].
[75] Ibid.
[76] Ibid [8].
[77] *Can Barz Pty Ltd & Anor v Commissioner of State Revenue & Ors* [2016] QSC 59, [39].
[78] *Commissioner of State Revenue v Can Barz Pty Ltd & Anor* [2016] QCA 323, [81] (Philip McMurdo JA).
[79] Ibid [35]–[38], [82].
[80] Australian Taxation Office, above n 67, [101].
[81] [2013] FCA 307.
[82] Ibid [58].
[83] Ibid [73].
[84] Ibid [75].

260-5 notices was 'subversive of a considered judicial value judgment',[85] and therefore one that no decision maker, acting reasonably, would have made.[86]

When considering whether to issue a section 260-5 notice, it is the Commissioner's policy to pay regard to the financial position of the debtor, other debts of the debtor, whether the collection of tax revenue is at risk and the likely implications of issuing a notice on a tax debtor's ability to provide for a family or to maintain the viability of a business.[87] On the collection of tax revenue being at risk, Logan J noted:

> The 'risk to the revenue' referred to by the decision-maker is undoubtedly a relevant consideration in the making of a s 260-5 notice decision, just as it is in deciding whether or not to grant a stay of a judgment. Reference to that consideration is not a panacea for a failure to consider others. Further, 'risk to the revenue' is not to be considered in the abstract.[88]

In circumstances where prime consideration is given to the collection of tax revenue being at risk, as might typically occur in the event of insolvency, the serving of the section 260-5 notice on the superannuation fund does not ensure a fair distribution of the debtor's assets amongst the tax debtor's creditors, but rather prioritises payment to the ATO. For this reason, it is argued that the Commissioner should include additional considerations when considering whether to issue a statutory garnishee notice. These considerations could include those identified in the *Denlay* and *Can Barz* decisions. For example, the ATO's Practice Statement[89] on enforcement measures could be amended to include specific reference to clarify that the Commissioner is not authorised to issue a section 260-5 notice on a third party in respect of monies where the Commissioner knows that the taxpayer's right to receive payment is not beneficially held by the taxpayer.[90] Specific inclusion of all the factors provided in Logan J's reasoning in *Denlay* could also be included as policy, so as to gauge whether the decision to issue a section 260-5 notice is an excessive use of coercive power.[91]

V CONCLUSION

The protected asset status given to a regulated superannuation fund under the Bankruptcy Act plays a significant role in providing a discharged bankrupt with a 'fresh start'. However, the interaction of taxation, superannuation and personal insolvency laws is such that the balance between the objectives of providing the bankrupt with a fresh start and achieving a fair distribution of the debtor's assets among creditors is under threat. This threat is particularly evident in regard to SMSFs and the impact of a SMSF member becoming an insolvent under administration. Tensions also exist around the validity of the ATO serving a garnishee notice on a superannuation fund in recovering the unpaid taxes of a superfund member who is an insolvent under administration. This paper has suggested how to defuse those tensions through changes to the current approach which may assist in maintaining the importance of superannuation as a means of providing a 'fresh start' in the broad sense of the term while still retaining the equilibrium between the competing bankruptcy goals.

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[85] Ibid [71].
[86] Ibid [72].
[87] Australian Taxation Office, above n 67, [102].
[88] *Denlay v Federal Commissioner of Taxation* [2013] FCA 307, [80].
[89] Australian Taxation Office, above n 67.
[90] *Can Barz Pty Ltd & Anor v Commissioner of State Revenue & Ors* [2016] QSC 59, [29].
[91] *Denlay v Federal Commissioner of Taxation* [2013] FCA 307.