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Asset protection, super, bankruptcy rules and reading the deed

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The recent decision in *Kirk as trustee of the Property of Smith (a Bankrupt) v Smith* [2024] FCA 240 provides a timely reminder of the key rules in relation to the ways in which superannuation benefits that might otherwise be assumed to be protected are in fact at risk on the financial misadventure of the member.

The two key heuristics which underpin the regime in this area are as follows:

1. lump sum payments from a super fund to a bankrupt are protected from a trustee in bankruptcy, provided they are received on or after the date of bankruptcy of the member; and

2. payments from a super fund made prior to bankruptcy are divisible property of the bankrupt member.

Briefly the case confirms each of the above points and provides further clarity on related issues, in particular the court determined:

1. Had the member benefits not been transferred they would have been exempt from being divisible amounts available to the member's creditors (see section 116(2)(d) of the Bankruptcy Act).
2. Contributions by the husband to the wife's superannuation account were void under section 128B of the Bankruptcy Act as contributions that were made to defeat creditors, that is:

(a) there was a transfer of property by a person who later became a bankrupt (the transferor) to another person (the transferee);

(b) the transfer was made by way of a contribution to an eligible superannuation plan;

(c) the property transferred would probably have become part of the transferor’s estate or would probably have been available to creditors if the property had not been transferred; and

(d) the transferor's main purpose in making the transfer was to prevent the transferred property from becoming divisible among the transferor's creditors, or to hinder or delay the process of making property available for division among the transferor's creditors.

3. The claim that a "Quistclose trust" arose was not made out, as the member could not provide evidence of any mutual intention that the monies withdrawn from his superannuation accounts should be used exclusively for a specific purpose, such that if the purpose failed the money would be repaid to the member's account (see *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567 where it was held that the provision of funds to a company in financial difficulties for the specific purpose of paying a dividend gave rise to a relationship of a fiduciary character or trust in favour of the persons entitled to the dividend and, if the primary trust failed, of the party which advanced the money).

Given the above conclusions it is perhaps not surprising therefore to hear anecdotally of situations where a trustee in bankruptcy has deliberately delayed a bankruptcy petition until after a member satisfies a condition of compulsory cashing, as a strategy to increase the prospects of a bankrupt's superannuation savings being available.

Ultimately, the protection of superannuation benefits can be summarised succinctly as follows:

(a) superannuation entitlements are protected in their entirety if they remain in the superannuation fund;

(b) any payment made from a superannuation fund to a member prior to the date of bankruptcy is available as property to be divided amongst creditors upon that person's bankruptcy; and

(c) any payment made from a superannuation fund to a member on or after the date of bankruptcy will not be property available for division amongst creditors. This comment however relates only to lump sum payments. If the payment is by way of pension, this is income earned by the bankrupt and therefore divisible according to the rules that relate to income of a bankrupt over amounts set out in the legislation.

Particularly for self managed superannuation funds it is important to understand that the circumstances in which a benefit becomes payable will vary from trust deed to trust deed. Some common circumstances are set out below.

Furthermore however, the mere fact that a member becomes entitled to the payment of a benefit under a trust deed does not of itself give rise to a right of the member to obtain payment of the benefit - unless the deed requires the payment to take place automatically.

From an asset protection perspective therefore the trust deed for a superannuation fund should ideally (at least from an asset protection perspective) be drafted in a permissive, rather than prescriptive, manner.

For an example in this regard, see the clause below where the key word in the first sentence after the word 'Member' is 'may' – as opposed to (for example) 'must'.

Voluntary payments (example clause)

Subject to the Law, any Member may elect to receive a Benefit on or after the occurrence to them of any of the following events:

(a) Retires from Gainful Employment;

(b) suffers Permanent Incapacity;

(c) suffers Temporary Incapacity;

(d) if a temporary resident, departs Australia permanently in circumstances described in the Law, and requests the Trustee for the release of their Benefits;

(e) ends Gainful Employment with an Employer who had (at any time) made Contributions to the Fund;

(f) suffers Severe Financial Hardship;

(g) attains age 65;

(h) suffers events that lend to release on Compassionate Grounds as determined by the Trustee;

(i) attains Preservation Age; or

(j) satisfies any other condition of release permitted by the Law.