Making superannuation an asset haven

By MICHAEL BENNETT

The simplified superannuation system provides opportunities for asset protection for clients.

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Certain benefits of superannuation are well known – the main benefit being it provides a low-tax environment,[1] or in some cases a no-tax environment,[2] in which to invest. Less well known are the asset protection advantages provided by superannuation. The extent of the asset protection which superannuation provides has recently increased for those with superannuation account balances large enough to be affected by the recent legislative changes.

This article assumes that the interest in the superannuation fund is a totally preserved benefit and that the client does not have a vested interest. Where the client, as a member of the superannuation fund, has an entitlement to the amount in the superannuation fund (say, they have satisfied a trigger event that entitles them to draw the benefits from the fund), then different consequences may arise.[3]

Previous position

If a client commits an "act of bankruptcy",[4] the property characterised as property divisible among their creditors (pursuant to s.116 of the *BankruptcyAct 1966* (the BA)) will be available to their trustee in bankruptcy to be used in paying the client's creditors.

Previously, s.116(2) of the BA excluded from property divisible amongst the creditors of a client the interest of the client in a regulated superannuation fund within the meaning of the *Superannuation Industry (Supervision) Act 2003* (Cth), to the extent that such interest did not exceed the client's pension reasonable benefit limit (RBL). The RBL would have been calculated under s.140ZD of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936).

Reasonable benefit limits were the amounts of retirement and termination-type payments that a person may receive over their lifetime for which concessional tax treatment applied. There were two RBLs: a pension RBL and a lump sum RBL. For the year ending 30 June 2007, the pension RBL, determined under s.140ZD of the ITAA 1936 is $1,356,291. At the time of the legislative changes to superannuation, the extent to which the client's interest in a superannuation fund was protected against their trustee in bankruptcy was $1,356,291 – their pension RBL.

This figure is substantial and may have provided a level of protection sufficient for most clients. However, superannuation account balances continue to grow. Between June 2004 and June 2006 there was a 48.7 per cent increase in the average superannuation balance for men and a 30.3 per cent increase for women.[5] This trend, when coupled with the increasing awareness and attractiveness of superannuation, must be increasing the number of clients whose superannuation account balance exceeds the 2007 pension RBL.

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Current position

From 1 July 2007 the superannuation system has been inverted in terms of how it seeks to restrict the accumulation of excessive benefits in a concessionally taxed environment.[6] The new 'simpler super' regime caps the level of contributions that can be made on the way *into* a superannuation fund instead of imposing a higher rate of tax on excessive end benefits above a client's RBL on the way *out* of a superannuation fund. Part of this change in approach included entirely abolishing the concept of the RBL from 1 July 2007

onwards.

Consequential amendments were made to s.116 of the BA 1966 to reflect the abolition of the concept of RBLs.[7] As a result, ceiling of protection provided to interests in a superannuation fund is removed. The client's entire interest in their superannuation fund is now protected from being divisible among their creditors.

For those clients lucky enough to have contributed substantial amounts to superannuation before the contribution restrictions were enacted, the abolition of RBLs is a boon, providing greater protection than they would have anticipated when making those contributions. For those clients who have not yet contributed significant amounts to superannuation, but intend to build up their superannuation account balances in the future, a considered and consistent approach is advised. Such an approach to superannuation contributions is advised for two reasons: first, the contribution restrictions already mentioned (and to which I will give greater consideration below); and second, other amendments to the BA 1966 set out in the following paragraphs.

BankruptcyAct 1966 amendments

Superannuation contributions, like other payments by a bankrupt to another, are subject to the clawback provisions of the BA 1966 such as undervalued transactions and transfers to defeat creditors.[8] In this context, however, the High Court[9] gave considerable protection to superannuation contributions, in endorsing the opinion of the majority of the full court of the Federal Court[10] that a superannuation fund had provided valuable consideration to a member when that member made contributions to the superannuation fund.[11]

To counter the additional protection this decision provided to superannuation contributions, specific anti-avoidance provisions were introduced in respect of contributions to superannuation funds made on or after 28 July 2006.[12] The amendments introduce new ss.128B and 128C to the BA 1966 and, importantly for the discussion that follows, make the exclusion of an interest in a superannuation fund in para 116(2)(d) from property divisible among creditors expressly subject to the new sections. It will be sufficient to consider s.128B only as s.128C operates to a similar effect in circumstances where a third party makes the contribution on behalf of the client rather than the client making the superannuation contributions in their own right.

Subsections 128B(1) and (3) are relevant here – see box. The legislation makes clear how important an established pattern of superannuation contributions will be in order to remove the ability of a trustee in bankruptcy to claw back under s.128B the contributions so made. Compliance with s.128B(3) will be effective in two ways. It will avoid a legislative direction to the decision-maker that tends against the client's interest, but also create a legislative direction in favour of their interests. The trustee in bankruptcy would have to convince the decision-maker that one or more of the contributions to a superannuation fund, taken from a larger number of many consistent contributions, were made for a main purpose of defeating the client's creditors.

I would suggest a contemporaneous statement of intention that recites the client's intention of maximising their superannuation account balances consistently over a number of years in order to provide for their retirement (the purpose and premise of superannuation) may also assist in establishing there was no intent to avoid creditors.[13]

It is also interesting to speculate whether the wave of superannuation contributions leading up to 30 June 2007 under the transitional rules to the new 'simpler super' system could be justified on the grounds of tax planning and not for the avoidance of creditors. That the catalyst for the widespread spike in superannuation contributions in this period was a legislative period of grace[14] must provide at least limited comfort to a client who availed themselves of the opportunity to contribute.

Restrictions on contributing to superannuation

Subject to the rules regulating who may contribute to a superannuation fund,[15] there is no legal prohibition that limits the amount a person may contribute to superannuation at any given time. It is only economic measures, through the application of different tax rates, that provides the incentive to limit superannuation contributions to certain specified levels.

Disregarding the transitional arrangements regarding people aged 50 and over, who can make a concessional contribution of up to $100,000 per annum until 30 June 2011,[16] the following tax treatment applies to superannuation contributions:

- *concessional contributions:* the contribution is tax-deductible to the person making the contributions and subject to tax at 15 per cent in the hands of the trustee of the superannuation fund up to $50,000 per annum.[17] Above this amount excess concessional contributions tax of 31.5 per cent is levied personally against the member,[18] bringing the effective tax rate to 46.5 per cent; and
- *non-concessional contributions:* the contribution is not tax-deductible to the person making the contribution and is tax-free in the hands of the trustee of the superannuation fund up to $150,000 per annum[19] with the ability to 'bring forward' two subsequent years for a one-off contribution of up to $450,000 in a given three-year period.[20] Above this amount, an excess non-concessional contributions tax of 46.5 per cent is levied personally against the member.[21]

The cap may cause problems where clients are selling a major asset, the value of which exceeds $450,000, and subsequently seeking to contribute the net sale proceeds, or seeking to contribute the asset in specie, to the superannuation fund.

The commercially inefficient result of exceeding the respective cap levels, with the top marginal rate of tax being paid on the quantum of the excess, makes it prudent to consider the superannuation contribution strategy well before it is time to contribute. This is especially relevant for most clients who will not have sufficient disposable income to make significant

Bankruptcy Act 1966 – Section 128B

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

Transfers that are void

(1) A transfer of property by a person who later becomes a bankrupt (the transferor) to another person (the transferee) is void against the trustee in the transferor's bankruptcy if:

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

(b) the property 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

(c) the transferor's main purpose in making the transfer was:

(i) to prevent the transferred property from becoming divisible among the transferor's creditors; or

(ii) to hinder or delay the process of making property available for division among the transferor's creditors; and

(d) the transfer occurs on or after 28 July 2006.

...

(3) In determining whether the transferor's main purpose in making the transfer was the purpose described in paragraph (1)(c), regard must be had to:

(a) whether, during any period ending before the transfer, the transferor had established a pattern of making contributions to one or more eligible superannuation plans; and

(b) if so, whether the transfer, when considered in the light of that pattern, is out of character.

superannuation contributions until the home loan has been repaid and the children have moved on, at which time their earning capacity is likely to be at its peak. The contribution caps may become considerably restrictive just when the idea of making contributions to a superannuation fund is most attractive.

Conclusion

The benefits of superannuation continue to expand. The low-tax environment or no-tax environment in which capital can be invested, the tax-free receipt of the money when drawn down (if the client is 60 years of age or older) and the inability of a trustee in bankruptcy to access the client's interest in a regulated superannuation fund (without the clawback provisions) suggest that clients should be seeking to maximise their superannuation account balances.

For the two reasons discussed, namely the establishment of a consistent pattern of contributions to avoid the possibility of the contributions being clawed back, and the restrictions imposed by the 'simple super' regime that favour consistent, smaller contributions in lieu of sporadic larger contributions, consideration should be given well in advance to how clients go about doing so. As legal advisors, it is important for us to comprehend these benefits and ensure our clients are set on a path of implementation early enough to properly avail themselves of the benefits. ❑

ENDNOTES

1. Broadly, a complying superannuation fund's tax rate is 15 per cent: s.26(1) of the *Income Tax Rates Act 1986* (Cth).
2. An exemption is available to complying superannuation funds in respect of the assessable income attributable to the funding of current pension liabilities pursuant to either of s.295-385 or 295-390 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997), as applicable.
3. See, for instance, *Bond v Ramsay* (1992) 25 ATR 61.
4. Which are set out in s.40 of the *Bankruptcy Act 1966* (Cth) (BA 1966).
5. ASFA Media Release, 11 February 2008 reported in *Thomson Weekly Tax Bulletin* [2008] 7 at [183].
6. As a result of the *Tax Laws Amendment (Simplified Superannuation) Act 2007* (Cth) and the Superannuation Legislation Amendment (Simplification) Act 2007 (Cth).
7. See Items 1 and 2 of Schedule 3 to the *Superannuation Legislation Amendment (Simplification) Act 2007* (Cth).
8. Sections 120 and 121 of BA 1966 respectively.
9. *Cook v Benson* (2003) 214 CLR 370 at 384 per Gleeson CJ, Gummow, Hayne and Heydon JJ.
10. Justices Beaumont and Kiefel, Hely J dissenting.
11. *Benson v Cook* (2001) 114 FCR 542 at 558-559 per Beaumont J; at 568 per Kiefel J.
12. See Items 3 and 6 of Schedule 1 to the *Bankruptcy Legislation Amendment (Superannuation Contributions) Act 2007* (Cth).
13. Clearly, the statement should not address the issue of avoiding creditors.
14. Between 10 May 2006 (Budget night) and 30 June 2007, people were able to contribute up to $1 million of post-tax undeducted contributions, subject to satisfying the relevant contribution rules.
15. For instance, other than mandated employer contributions, a superannuation fund cannot accept contributions in relation to a person who is not under 75: reg.7.04 of the Superannuation Industry (Supervision) Regulations 1994 (Cth).
16. Section 292-20 of the *Income Tax (Transitional Provisions) Act 1997* (Cth).
17. Section 292-20 of the ITAA 1997.
18. Section 292-15 of the ITAA 1997.
19. Section 292-85 of the ITAA 1997.
20. Subsections 292-85(3) and (4) of the ITAA 1997.
21. Section 292-80 of the ITAA 1997. ❑