

SUPERANNUATION

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SUPERANNUATION

1. What is Superannuation?

The general meaning of the word is a method of investment or savings that provides financial support for an employee or the employee's dependants, the benefit of which may be realised on the employee's cessation of employment, retirement, or death (1). In the current world, there are four broad types of superannuation fund. These are:

1.1 Self-Managed Superannuation Fund

These are superannuation funds set up by individuals for their own benefit and are defined in section 17A of the Superannuation Industry (Supervision) Act 1993 (the Act). A self-managed superannuation fund (SMSF) may be a regulated fund, or not. The term "regulated superannuation fund" is defined in section 19 of the Act as one which complies with subsections (2) to (4) of that section, including that the fund has elected that this Act applied to the fund. The fact that a SMSF may or may not be a regulated fund is important for its treatment for taxation purposes, and in bankruptcy. The status of a regulated fund in bankruptcy is discussed later in this paper, otherwise SMSFs are outside the scope of this paper.

1.2 Defined Benefit Fund

Defined benefit funds are funds with a long history. Generally they are set up by governments or large companies for the benefit of their employees. They often employ a formula such as that an employee may retire at a specified age with a lump sum which is a particular multiple of the employee's final salary. The scheme may contemplate that the employee retires at age 55, 60 or 65. If the employee resigns before the set time, the retirement benefits may be quite modest, for example the employee's own contributions and interest. Some governments and large corporations have become concerned about the liability

outstanding to their employees under such schemes, and the present trend is for these funds to move away from a defined benefit model towards an accumulation model.

1.3 Accumulation Fund

An accumulation fund is a retirement scheme to which contributions are made by an employer, or the employee (a member), or both, and earning on investments are added. Costs of management of the fund, and taxes, are deducted, so the balance of the fund accumulates over a period of time.

1.4 RSA Retirement Savings Accounts

RSAs are similar to an accumulation fund, except that an RSA is an account, usually with a bank, to which a person can make contributions for their retirement. They differ from a bank account in that they are specifically intended to provide for retirement rather than ordinary savings. The account is owned by the account holder, but is subject to regulation similar to a superannuation fund in terms of access to the money and contribution eligibility. The disadvantage of these accounts is the regulation of them. The advantage is that they are capital guaranteed, and the operating costs are very low. An RSA is protected in bankruptcy in a way similar to a regulated superannuation fund. (2)

2. Preservation of Superannuation

2.1 Differing Uses of Superannuation

As noted above, Superannuation funds are primarily intended to make provision for payments to people when they retire. However, because superannuation funds attract a favourable tax treatment (and have a privileged status in bankruptcy) they have been used by some individuals over the years for various financial planning purposes.

.2.2 Government Policy

In the later 1980s a realization of a looming crisis in funding the retirement of the baby-boom generation – that is – those people born between 1946 and 1964 – began to develop, and the Commonwealth Government set about regulating superannuation in such a way as to ensure that all employed Australians will have superannuation. Due to the growing understanding of the dimension of the problems the law regarding superannuation has changed, and is continuing to change. For this reason, the time at which money was paid into a superannuation fund is important in determining whether a person has access to it prior to retirement, as well as the tax treatment of the money. As noted above, another important consideration is whether the fund is a **regulated** fund, that is, regulated by the Superannuation Industry (Supervision) Act 1993, and the Superannuation Industry (Supervision) Regulations 1994. These regulations are referred to in this note as “the Commonwealth Regulations”.

2.3 Important Terms in Superannuation

The law concerning superannuation is quite complex, and this paper is intended only to address areas of concern to financial counsellors. To assist clients in dealing with their superannuation entitlements, which usually relates to a client’s wish to access their superannuation early, it is useful to be familiar with some words used in discussing superannuation. These words are often used with a different meaning from the way they are used in ordinary speech.

2.3.1 Preserved Benefits

This includes employer contributions, the person’s own contributions, and earnings from investment of the fund which cannot be accessed until a condition of release has been met. A condition of release may be attaining **preservation age**.

2.3.2 Preservation Age

Due to the Governmental concern described in 2.2 above to ensure that there is enough money to support people retiring in the future, the age at which a person can access their superannuation benefits is being steadily increased. A person's preservation age depends on their date of birth, as set out in the following table:

<u>Date of Birth</u>	<u>Preservation Age</u>
Before 1 July 1960	55
1 July 1960 - 30 June 1961	56
1 July 1961 - 30 June 1962	57
1 July 1962 - 30 June 1963	58
1 July 1963 - 30 June 1964	59
After 30 June 1964	60

2.3.3 Retirement

The general meaning of retirement is a departure from employment or working life permanently and voluntarily, usually on the grounds of age or ill health. A useful definition of retirement is found in Regulation 6.01 (7) of the Superannuation Industry (Supervision) Regulations 1994. The retirement of a person is taken to occur:

- * in the case of a person who has reached a preservation age that is less than 60 - if:
 - an arrangement under which the employee was gainfully employed has come to an end: and
 - the trustee is reasonably satisfied that the employee intends never to again become gainfully employed, either full-time or part-time; or

- * in the case of a person who has attained the age of 60 - an arrangement under which the person was gainfully employed has come to an end, and either of the following circumstances apply:
 - the employee attained that age on or before the ending of the employment;
 - the trustee is reasonably satisfied that the employee intends never to again become gainfully employed, either full-time or part-time (3).

2.3.4 Restricted Non-Preserved Benefits

There are a number of qualifications in the definition of this term in the context of different times when calculations were made, however the essence is that it refers to the total entitlement of a member in a fund, less the sum of the member's preserved benefits, and the member's unrestricted non-preserved benefits in the fund (4).

2.3.5 Unrestricted Non-Preserved Benefits

If a member of a fund satisfies a condition of release and the relevant cashing restriction in respect of preserved benefits is nil, the member's benefits become unrestricted non-preserved benefits (5). These can be cashed by the member at any time (6).

2.3.6 Concessional or Deductible Contributions

In the context of superannuation, concessional or deductible contributions are contributions for which somebody has claimed a tax deduction. This may be an employer, or an employee's own contributions. Non-concessional and non-deductible contributions have the opposite meaning: they are contributions for which nobody has claimed a tax deduction.

2.3.7 Conditions of Release of Benefits

Regulation 6.01 of the Regulations sets out cashing restrictions and conditions of release for superannuation benefits, and the Schedule to the regulations gives specific detail of these.

Notable items are that cashing restrictions are nil for:

Item 101 - retirement

Item 102 - death

Item 102A - terminal medical condition

Item 103 - permanent incapacity

Item 106 - attaining age 65

3. Ordinary Withdrawal of Superannuation

As noted in paragraph 2.2 above, the intention of the federal government is to ensure superannuation is preserved in superannuation funds until a person retires, or reaches retirement age. Accordingly, a person can withdraw superannuation without any restrictions on:

3.1 Attaining Age 65

A person who has attained the age of 65 can withdraw their superannuation entitlements without restriction (7).

3.2 Retirement

A person can withdraw their superannuation on retirement. However, as noted earlier some words used in superannuation have a specific meaning, and retirement is defined in sub-regulation 6.01 (7) in a way that takes into account

both the persons age, and the change in their work status. This is discussed in paragraph 2.3.3 above.

3.3 Death

Sub-regulation 6.01 of the Regulations defines the words **condition of release** by referring to Schedule 1 of the Regulations, and item 102 in the Schedule is death. Regulation 6.21 gives detail of this.

4. Withdrawal of Superannuation on Other Grounds

Regulation 6.01 of the Regulations sets out cashing restrictions and conditions of release for superannuation benefits, and the Schedule to the Regulations gives specific detail of these. Notable other grounds for release of superannuation benefits are:

4.1 Coronavirus

Regulation 6.19B provides that a person could make application for release of benefits if they met certain conditions related to being adversely affected financially by coronavirus. This regulation provides that no application can be made after 31 December 2020 (Regulation 6.19B (2)).

4.2 Severe Financial Hardship

Regulation 6.01 (5) lays down the criteria for a person to access a payment from their superannuation entitlements on the basis of severe financial hardship. The first thing to check is the rules of the particular super fund.

4.2.1 The Rules of the Fund

If a member of the fund wishes to withdraw money, the necessary starting point is to contact the fund and ask if the rules allow this. If the rules do not, the person can consider transferring their superannuation to another regulated fund with more liberal rules.

4.2.2 Types Financial Hardship

Item 105 of the Schedule defines the amount of benefits that may be paid to a person in severe financial hardship under paragraph 6.01 (5) (a).

There are two separate categories to be considered. These are defined in the Regulations. Both are examples of severe financial hardship.

4.2.3 Continuous Receipt of a Benefit

26 Week Test

The first is that if a person has been in receipt of a specified Commonwealth support payment for a continuous period of 26 weeks, and was in receipt of that type of payment on the date upon which they obtained the written evidence of their being on that benefit. The specified income support payments include:

- * a social security benefit; or
- * a job search allowance; or
- * a social security pension; or
- * a youth training allowance; or
- * a service pension; or
- * income support supplement; or
- * a veteran payment

(Commonwealth Income Support Payment is defined in Regulation 6.01 and subsection 23 (1) of the Social Security Act 1991.

In addition, the person must be unable to meet reasonable and immediate **family living** expenses. Business expenses will not suffice. (Regulation 6.01 (5) (a)).

4.2.4 Earliest Retirement Age & Benefit & Unemployment

39 Week Test

An alternative ground upon which a person can access super when in severe financial hardship is if a person has reached their preservation or retiring age, which varies with the date of birth of the person concerned, and has been in receipt of one of the specified Commonwealth income support payments listed above for a **cumulative** period of 39 weeks after reaching their preservation (retiring) age and was not gainfully employed on the date of application for cashing his or her super benefit. (Regulation 6.01 (5) (b)).

4.2.5 Cashing Restrictions

A person withdrawing money from a super fund on the ground of severe financial hardship must withdraw a minimum of \$1,000, or the balance of the fund, if that is a lesser figure. For a person withdrawing on the ground of 26 continuous weeks receipt of a benefit, the maximum that can be withdrawn in a twelve-month period is \$10,000. No upward limit applies to withdrawals by persons who are applying on the ground of 39 cumulative weeks after they have reached their preservation age.

4.2.6 Preservation Age

A table setting out a person's preservation age is at paragraph 2.3.3 above.

4.3 Withdrawal On Compassionate Grounds

Super funds may be withdrawn on compassionate grounds. The compassionate grounds are available even if the person is not in severe financial hardship. Compassionate grounds are:

4.3.1. Health Related

A person may obtain super for the purpose of payment of medical expenses for the person or a dependant of the person to treat a life threatening illness or injury, to alleviate chronic or acute pain, to alleviate chronic or acute mental disturbance, or to meet the cost of medical treatment not readily available through the public health system. This must be certified by two appropriately qualified medical practitioners one of whom is a specialist. (Regulation 6.19A (a).

4.3.2 Mortgage Payment

To allow a person to make a payment on a loan over their principal residence to prevent the mortgagee exercising a power of sale under a mortgage, or to prevent foreclosure. In these circumstances the maximum amount that may be obtained is a sum equal to 12 months interest on the outstanding balance of a loan plus 3 monthly repayments of the mortgage. (Regulation 6.19A (1) (b), 6.19A (5) and 6.19A (6).

4.3.3 Disability Modification

Modification to a members principal residence or vehicle to accommodate special needs resulting from severe disability of the person concerned or one of their dependants. (Regulation 6.19A (1) (c).

4.3.4. Palliative Care

To pay for palliative care for the person or costs associated with palliative care, funeral or burial expense for a dependant of the person concerned. (Regulation 6.19A (d) and 6.19A (e)).

4.3.5. Other – related – expenses

Some other expense of a type consistent with these preceding categories. (Regulation 6.19A (f)).

5. Leaving Australia

A person who is not an Australian or New Zealand citizen, or was not a permanent resident of Australia, can apply for a Departing Australia Superannuation Payment (DASP). This is normally applicable to persons who are over 18 years of age, were working in Australia, and were paid \$450 per month, or more. A person in this category can apply through ATO's DASP on line system. (Regulation 6.20A and 6.20B).

6. Superannuation and Bankruptcy

If a person becomes bankrupt, any interest they have in a regulated super fund is protected. This includes an approved deposit fund and an exempt public sector super fund as defined in the Superannuation Industry (Supervision) Act 1993. Lump sums received from such funds on and after the date of the bankruptcy are also protected (8). However, lump sums received from such funds before the date of bankruptcy are not protected. Income received from a super fund is not protected.

It is common for clients in difficulty to decide that the best way to deal with their financial problems is to get money from their superannuation fund, to make an offer to creditors. From time to time clients get a sum of money from their fund, but the plan to divide it amongst their creditors does not work. This may be due to the fact that the sum they receive from the funds is insufficient, or perhaps one or more creditors has refused to accept the amount offered. The client may then decide to give up on the effort to do a deal with their creditors, and to become bankrupt. They may wish to put the money they got from their superannuation fund back into the fund. However, this may create a problem due to the new section 128B of the Bankruptcy Act.

Sections 128A to 128N set out a scheme which echoes section 121, which relates to transfers of property (including money) by persons who later become bankrupt. The legislation is retrospective in operation. It applies to payments made to superannuation funds on or after July 2006. The new provisions apply to payments made to prevent the money from becoming divisible amongst the person's creditors, or to hinder or delay that process. Subsection 128B(2) provides that **the person shall be deemed to make the payment for that purpose if the person was, or was about to become insolvent at that time.**

Many people experiencing financial difficulty may prove to be insolvent.

The wording of the section has been drawn widely, to catch sophisticated debtors who put available cash into superannuation to defeat their creditors. This wide wording may pose a problem for an honest debtor who has drawn out superannuation to attempt to reach a deal with creditors, but the plan does not proceed for the reason outlined above.

It is common for clients to follow their own strategies, and to consult a financial counsellor when things go wrong. If a client has created a problem of the sort mentioned above, what are the client's options?

The fact that a client has made an offer to creditors, which they have not accepted, does not mean that a debt agreement proposal should not be made. A formal offer made in a debt agreement proposal may well be considered by different decision makers in the creditor's organizational structure, who may see merit in accepting something which their debt collecting staff may not. The client may also be in a position to offer some modest payments from income over a period of time in addition to the lump sum, which may make it more attractive to creditors.

There is no time limit on section 128B (or 128C) claims by a trustee in bankruptcy. Section 128D provides a trustee may commence an action at any time.

However, a debtor who has got money from a superannuation fund but finds the creditors uncooperative may use the money to live and meet essential expenses for some time, before becoming bankrupt. The main thing here is that the debtor must keep good and clear records of what the money is spent on. If the debtor is pressed for payment by one particular creditor, and becomes bankrupt within six months the trustee in bankruptcy has the power to take the money back from that impatient creditor. (s. 122).

Some debtors, particularly those nearing retirement, may be concerned about provision for their retirement. If they choose to pay the money back into the fund, they should do so with the knowledge that the process will be analysed carefully if they become bankrupt. A bankruptcy trustee will certainly wish to see all the documents relating to the transactions, and may decide the payment into the superannuation is void, under the provisions of section 128B. The trustee in

bankruptcy can then require the superannuation fund to pay the relevant amount into the bankrupt's estate.

The clear message that emerges from this is that it is now hazardous for a person to withdraw money from superannuation to pay debts unless they have a clear plan worked out with their creditors. Such a plan should be in writing, with creditors agreeing to accept a particular sum in full and final settlement of their claim. If a creditor wishes to impose an unreasonable condition, such as an unrealistically short time frame, then it is not safe to proceed with them. If some creditors have a constructive and cooperative approach, and others do not, then it may be appropriate to propose a debt agreement. If a debtor is considering a debt agreement, it is useful to note that a debt agreement is now accepted if a majority in value of the creditors who reply before the deadline accept the proposal (Bankruptcy Act s. 185 EC (1)).

Whatever course of action a debtor chooses to follow, it is vital to document each step fully, and to keep all records. If the debtor does become bankrupt, then of course full disclosure is required. It is also likely that a debtor who can give a clear account of their dealing with their superannuation entitlements, the reasons for the withdrawal and the reason for putting the money back into the superannuation fund, and their dealing with their creditors, has a much better prospect of their situation being viewed sympathetically by a trustee in bankruptcy.

NOTES:

1. Mahoney v Federal Commissioner of Taxation (1996) 10 AITR 463
2. Bankruptcy Act (Commonwealth) s 116 (2) (d) (v) and (vi)
3. Superannuation Industry (Supervision) Regulations 1994 Regulation 6.01 (7)

4. Superannuation Industry (Supervision) Regulations 1994 Regulations 6.07 & 6.08
5. Superannuation Industry (Supervision) Regulation 6.12
6. Superannuation Industry (Supervision) Regulation 6.20
7. Superannuation Industry (Supervision) Regulations Schedule 1 item 106
8. Bankruptcy Act s.116(2) (d).

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CASE STUDY

Dawn has come to see you. She wants you to help her do a letter to her superannuation fund. You ask what has brought this about.

Dawn explains that her work does not bring in enough money to pay the mortgage, and keep the family. She is 49, and works in a cafeteria. She brings home \$500 per week, which is just not enough to pay the mortgage and keep the family. You ask about the family.

Dawn's husband Jack is not able to work. He was seriously injured some time back, when their car fell on him. He had decided to save some money by servicing the car himself, but it slipped on the jack while he was under it. He was self-employed, and had no superannuation or workers' compensation. He is 51 years of age. However, he did have a sickness and accident insurance policy, which paid him \$100,000. He used most of that to buy a large new people-mover, which is specially adapted so he can drive it. The rest of the money went on Dwight's fines. You ask who is Dwight.

Dawn explains that Dwight is their son. He is 26, and lives at home. His income is Newstart. He is a musician. He is presently interested in a fusion of Afro-Cuban music with Australian folk music. He is writing a song which he has provisionally titled Tie My Tortilla Down, Amigo. When he finishes that he would like to study Spanish, as he feels he would have a better grasp of Afro-Cuban music if he could speak Spanish.

You ask if there are any other family members who may be able to help. Dawn says her daughter Desiree was very good when she lived at home. She had a good job and paid board. However, she is now married, and she and her husband Denis have bought a six bedroom three bathroom home. It has a home theatre room which is bigger than the triple garage. They are both working full

time, but are battling to pay their mortgage, and cannot help Dawn. Denis and Desiree's house has declined in value since they bought it, and if they sold it there would not be enough money to pay out the mortgage. Desiree feels trapped. She and Denis spend all their time working to pay the mortgage on a great white elephant.

You ask about Dawn's house. She says it is in her and Jack's name. It is worth about \$300,000. There is \$200,000 owing on the mortgage. The mortgage payment is \$1600 per month. There is another 22 years to go before it is paid out. Dawn says that things were going well when Jack was working, and Desiree was paying board, but now that she is not getting any help from them she cannot seem to make ends meet. She tries to get money together for the mortgage payment each month, but there is always something else to be paid. She is behind on the rates and water rates, and is now two payments behind on the mortgage. She keeps in touch with the bank, and has told them of the difficulty she is in. They have been quite good so far, though the last time she spoke to them they said they could not let it go too much longer. The lady in the bank suggested that Dawn could get some money from her super fund to catch up on the payments. Dawn would like your help in doing this. She has been in the same job for many years, and has \$50,000 in her super fund. She asks you:

- * Can she get some money from her super fund to catch up on the mortgage payments? If so, how could she go about it? If so, how much money could she get out of her super fund?
- * She is presently 49 years of age. Will her situation change in regard to access to her super fund shortly? If so, when?
- * A person Dawn works with says that Dawn should stop work, because she would be better off on Centrelink. The friend says her brother had a similar accident to that which befell Jack. The friend's brother is now on

disability support pension, his wife gets a carer pension, and they get a private rent subsidy. Dawn asks:

- * Would she be better off to stop work and for the whole family to go on Centrelink benefits? If they do this, could Dawn access her superannuation more easily?

- * When Dawn discussed the matter with Desiree, Desiree suggested that Dawn should ask the Australian Financial Complaints Authority for help. Do you think this is a good idea? If so, what would she ask them to do?

- * Is there anything else you would wish to ask Dawn?

- * Can you suggest any alternative strategies to Dawn, other than those she has mentioned to you?

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