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Recent court decisions clarify protection of death benefit payments to bankrupts

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Broadly, a member's interest in a superannuation fund is fully protected upon bankruptcy. This protection even extends to lump sums being paid to the bankrupt.

A question that may arise is whether this would be true if the benefit being received by the bankrupt is in respect of someone who has died (eg, a death benefit being paid to the deceased's member's bankrupt spouse). Would those benefits be protected from creditors? This would have implications for estate planning where there is potential for a dependant to go bankrupt.

Two recent cases help answer this question.

Statutory Background

Section 116(1)(a) of the *Bankruptcy Act 1966* (Cth) ('Act') provides that subject to the Act:

all property that belonged to … a bankrupt at the commencement of the bankruptcy, or has been acquired … after the commencement of the bankruptcy and before his or her discharge

is property divisible amongst creditors of a bankrupt.

Property that is exempt from being divisible amongst creditors of a bankrupt is contained in s 116(2) of the Act. Subject to several anti-avoidance provisions, certain superannuation interests and payments are included in this exemption, particularly in ss 116(2)(d)(iii) and 116(2)(d)(iv) of the Act.

Section 116(2)(d)(iii) exempts:

the interest of the bankrupt in: (A) a regulated superannuation fund (within the meaning of the *Superannuation Industry (Supervision) Act 1993*) …

and s 116(2)(d)(iv) exempts:

a payment to the bankrupt from such a fund received on or after the date of the bankruptcy, if the payment is not a pension within the meaning of the *Superannuation Industry (Supervision) Act 1993.*

That means the bankrupt's interest in their own superannuation fund and lump sum payments from their own fund are exempt from being divisible amongst creditors. However, the question is whether this extends to payments received from another person's superannuation fund where that other person died and it is determined that the bankrupt is to receive a death benefit. Two recent cases have helped clarify this.

Are lump sum death benefit payments to a bankrupt divisible amongst creditors?

On 22 July 2016 the Federal Court of Australia handed down a decision for the matter of *Morris v Morris* [2016] FCA 846. A widow was made bankrupt on 28 August 2013, about three months after her husband passed away (19 May 2013) and seven months after she gave birth to her second child (26 January 2013).

After being made bankrupt, the widow received various death benefit payments from superannuation funds in respect of her late

husband. The widow's trustees in bankruptcy claimed that two of those payments were divisible amongst creditors of the bankrupt widow as they did not fall under the exemptions in s 116(2) of the Act. They argued that the interest in a regulated superannuation fund is the interest of the late husband and not the widow. Therefore the property should not fall under either ss 116(2)(d)(iii) or 116(2)(d)(iv) of the Act.

The court decided that although the widow initially did not have an interest in the superannuation fund, when the trustees of the respective superannuation funds exercised their discretion to pay death benefits in the widow's favour, an interest in the superannuation funds was created thereby satisfying s 116(2)(d)(iii)(A) and exempting the property from being divisible amongst creditors. Further, the court also decided that s 116(2)(d)(iv) was satisfied, as the bankrupt widow directly received payments from the funds after the date of bankruptcy, and it was not a pension.

This case has clarified that, broadly, lump sum death benefit payments will be protected from creditors provided the payments were determined using the exercise of appropriate powers of superannuation fund trustees and that they are directly received by the bankrupt.

But what about death benefit payments that were paid to the deceased estate and then paid from the deceased estate to a bankrupted beneficiary? Would such payments fall under the s 116(2) exemption?

Are lump sum death benefit payments divisible amongst creditors if the bankrupt receives it from a distribution of a deceased estate?

On 13 July 2017, the Federal Court of Australia handed down a summary judgment that further clarifies death benefit payments and bankruptcy. In *Cunningham v Gapes* [2017] FCA 787, the wife of a bankrupt received a distribution from the bankrupt's deceased mother's estate. The payment was made to the bankrupt but the wife received the money because the bankrupt did not have a bank account in his name. The distribution from the estate came from death benefit lump sum payments from the deceased mother's superannuation fund.

The trustee of the bankrupt's estate argued that the payment did not fall under s 116(2) exemption contained in the Act because the bankrupt did not have an interest in the superannuation fund, rather it was the deceased mother's estate that had the interest. Further, in respect to s 116(2)(d)(iv) of the Act, payment was not received from the fund, but rather it was received from the deceased mother's estate. They argued that if it is accepted that it could pass through the deceased mother's estate and still be considered a payment from the fund, then it would allow bankrupts to avoid property being made divisible amongst creditors simply by showing the source of their property was from a third party's superannuation fund, regardless of how many hands the funds passed through.

The court agreed with the trustee of the bankrupt's estate. The matter was distinguished from *Morris v Morris* [2016] FCA 846 by the fact that the benefits from the superannuation fund of the deceased were paid to the estate of the deceased prior to being distributed to the bankrupt. The court concluded that as a result it could not be said that the money represented an interest of the bankrupt in a superannuation fund. The bankrupt only received the funds because he was a residuary beneficiary under his mother's will and not because the trustee of the superannuation fund ever exercised any discretion giving him a proprietary interest in the fund.

This case clarified that for the relevant s 116(2) exemptions to apply, the superannuation fund death benefit payments must come directly from the exercise of the appropriate powers of the superannuation fund trustees in favour of the bankrupt and the bankrupt must receive the payments directly from the superannuation fund. If the benefit passes to the deceased estate first, in most cases the benefit will become divisible amongst creditors when it devolves to the bankrupt in accordance with s 116(1)(a) of the Act.

Estate planning lessons that can be learned from these two cases

It can be seen that, when it comes to bankruptcy, there are asset protection advantages in ensuring that death benefits go directly to the intended dependant. Keep in mind that pension payments are not fully exempt under s 116(2)(d)(iv) of the Act.

If one is aware of the bankruptcy or potential bankruptcy of a dependant, it would be wise to structure the succession plans so that the dependant receives lump sum death benefits directly from the superannuation fund, rather than having their portion go to the estate first and be dealt with via a will. (Naturally the situation could be different if the will caters for a testamentary trust under which the bankrupt is a mere discretionary object.)

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