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Practical issues in property settlement matters:
Tax and accounting for the family lawyer

1. INTRODUCTION

In ever increasing numbers, property settlements between parties to a relationship breakdown will incorporate issues involving corporate and trust entities, which may have been established for any number of reasons, including for taxation purposes, asset protection or estate planning purposes. In this context, it is essential that practitioners be alive to and take into account the possible revenue consequences of any orders for property settlement proposed, whether by agreement between the parties or as a result of litigation before the Courts.

Without doing so, the grave risk for both practitioners and their clients is that unintended consequences will result from the parties' property settlement, maintenance arrangements or other dealings, beyond those considered by the parties or the Court in determining the appropriate orders to be agreed or made (as the case may be) and substantially altering the overall property settlement intended.

While it is beyond the scope of this paper and our presentation to cover in detail all of the potential issues that may arise in any given case, we will examine a number of main issues that commonly arise in property settlement matters including the following:

(a) The relevance of tax in ascertaining the pool of property for the purposes of a property settlement; and,

(b) Avoiding unintended consequences of transactions to give effect to property settlement orders.

Further, the fact that, in addition to property settlement proceedings potentially raising future tax implications for the parties, it is commonly the case that the proceedings will expose the parties' previous taxation history, including any tax irregularities, deliberate or accidental. Accordingly, this may be a further issue to be considered in the circumstances of particular cases.

2. TAX AND THE PROPERTY POOL

2.1 General Principles

It is a basic premise of property settlement proceedings that the Court must identify and value all property of the parties to the marriage. In the majority of circumstances, it is also equally clear that the Court should similarly identify and deduct from the relevant property the value of any liabilities owing by the parties.

As with the identification and valuation of the property of the parties, the Court's approach in relation to liabilities is not always one of precision. In *Biltoft and Biltoft*[1], the Full Court discussed the approach of the Court in the following terms (at 82,124):

A general practice has developed over the years that, in relation to applications pursuant to the provisions of sec 79, the Court ascertains the value of the property of the parties to a marriage by deducting from the value of their assets the value of their total liabilities. In the case of encumbered assets, the value thereof is ascertained by deducting the amount of the secured liability from the gross value of the asset … Where the assets are not encumbered and moneys are owned by the parties or one of them to unsecured creditors, the Court ascertains the value of their property by deducting from the value of their assets the value of their total liabilities, including the unsecured liabilities.

While there are some instances in which it is appropriate to depart from that general practice, those instances are the exception rather than the norm. However, a common area where this practice interacts with the interests of the Australian Taxation Office is in relation to future capital gains tax liabilities.

2.2 Capital Gains Tax and Other Realisation Costs

In recent years, the Court has been called upon to consider the relevance of a potential or future liability for capital gains tax (CGT) in relation to properties held by the parties, either personally or through corporate and trust entities in which one or both of the parties hold an interest.

Capital gains tax has now well and truly attained the age of majority. Introduced in 1985, it is becoming increasingly relevant in relation to property settlement proceedings, particularly as the likelihood decreases of an asset being pre-CGT. Accordingly, practitioners must be increasingly conscious of the potential for properties that may form part of a property settlement to be laden with a future CGT liability.

While it is not proposed to deal in detail with the circumstances in which a CGT liability may arise, there is the potential for any disposal of assets held by the parties to a property settlement to trigger a CGT liability which, without either relief (for example, rollover relief, which will be discussed below) or recognition in the property settlement itself, may have significant implications for one or both of the parties.

The Court's approach to whether or not a potential CGT liability, or any realisation costs that may be occasioned on the sale of a property at some time in the future, has been the subject of discussion in a number of cases, the most well known of which is the decision of *Rosati & Rosati*[2]. However, while traditional accounting methods ordinarily bring to account likely taxation and realisation costs to arrive at an opinion of the net value of an asset or assets held by an entity the subject of the valuation, the Court has taken a strict view in relation to whether these liabilities should be deducted from the property pool.

Cases leading to Rosati & Rosati – an uncertain situation

While there are some decisions as early as 1981 dealing with the impact of realisation costs (although, at that time, not CGT)[3], one of the earliest reported decisions in relation to the topic of that is *Rothwell & Rothwell*[4], a first instance decision of Holden J. In that case, his Honour considered a number of earlier decisions in determining whether, in that case, CGT should be deducted from the assets available for distribution. Ultimately, his Honour determined that CGT should be deducted from the assets.

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[1] (1995) FLC 92-614
[2] (1998) FLC 92-804
[3] See, for example, *Kelly & Kelly (No. 2)* (1981) FLC 91-108 and, later, *Bland & Bland* (1994) Fam LR 325.
[4] (1994) FLC 92-511

His Honour, in his discussion, noted that for some time it had been the practice of the Court not to deduct notional realisation costs, including real estate commission, from the property pool where the sale of real estate was not going to take place. However, he referred to a number of earlier reported and unreported authorities[5], which, he stated, did not provide any clear authority about the appropriate treatment of CGT and other realisation costs. In particular, he noted that in the decision of *Sorenson and Sorenson*, the Full Court had found it appropriate to deduct realisation costs incurred in the sale of various properties that the husband would have to sell in order to meet the property settlement awarded in favour of the wife.

In this case, his Honour was called upon to consider the relevance of potential CGT relating to shares held by the husband in an entity (Austal Ships Pty Ltd) and units in a unit trust (the Bali Hai Trust). The total value of those assets was approximately $2.1 million, and would see the husband incur a CGT liability of approximately $795,000.00 if disposed of. While the husband argued at trial that the liability should be deducted from the property pool, there was no evidence before his Honour that the assets would be disposed of.

With no clear authority to draw upon, his Honour referred to a number of decisions from Canada, New Zealand and the United Kingdom in relation to the treatment of realisation costs. However, his Honour found that there were inconsistent approaches taken in those jurisdictions to the treatment of tax and realisation costs. His Honour noted, in particular, the fact that, in some authorities, earlier courts had had regard to matters such as the method of valuation of a particular asset, whether an investment carried with it other risks, and the nature of assets that were to be retained by the spouse who would not continue to bear the responsibility for any future CGT liability.

His Honour therefore determined that, in the particular facts of this case, notional CGT should be deducted from the pool in relation to the value of the husband's shareholding in Austal Ships (valued at over $1.6 million). His Honour took into account a number of factors, including:

- The valuation of the shareholding was one based on the net realisable value of the shares.

- There were two distinct types of assets held by the parties to the marriage. The wife would be retaining most of those assets that did not attract CGT, however claimed a percentage of the balance of assets which did attract CGT. His Honour found that it would be unfair to value the shares disregarded the CGT liability and then to award the wife, as a cash sum, a percentage of that sum on a tax free basis.

- The business in which the husband held shares faced substantial risks and uncertainties in the future.

Accordingly, his Honour held that the potential CGT relating to the shares in Austal Ships should be deducted from the pool. Holden J adopted a differing view, however, in relation to the units held by the husband in the Bali Hai Trust, including on the basis that they were not valued on a net realisable basis, did not face the same risks in the future as in relation to the shares in Austal Ships, and there was doubt about whether CGT would arise in the future in Australia.

In the later decision of *Carruthers & Carruthers*[6], Nicholson CJ was called upon to consider a similar set of authorities from both Australia and overseas in determining whether, in the circumstances of that case, the costs of sale of several properties held by the husband, and the significant CGT liability which would be incurred upon their sale should be taken into account in a determination of the property pool.

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[5] *Gamer and Gamer* (1988) FLC 91-932, *Sorenson and Sorenson* (unreported decision of the Full Court, Appeal No 56/91), *Galway and Galway* (unreported decision of Lindenmayer J handed down on 9 June 1992).
[6] (1996) FLC 92-707

Ultimately, his Honour accepted the statement of the Ontario Supreme Court (Court of Appeal) in the case of *McPherson v. McPherson*[7], where Finlayson JA stated as follows:

The cases appear to turn on their own facts and, if I might hazard a broad distinction, an allowance should be made in the case where there is evidence that the disposition will involve a sale or transfer of property that attract tax consequences, and it should not be made in the case where it is clear when, if ever, a sale or transfer of property will be made and thus the tax consequences of such an occurrence are so speculative that they can be safely ignored.

Nicholson CJ referred to the task of the Court in exercising a discretionary judgment to effect a just and equitable settlement between the parties to a marriage. His Honour therefore noted that, having regard to that exercise and the evidence in each case as the potential for a transfer or disposition of an item of property to trigger a CGT liability:

There is a huge range of fact situations that emerge and I think this approach is better suited to the determination of disputes in this jurisdiction than a rigid arithmetical one based on theoretical sales that may not happen.

This approach was continued in the Full Court decision of *Harrison & Harrison*[8], where the Court expressed the view that any liability for CGT could, in reality, only be calculated if an immediate sale were contemplated. The Court took the view that, therefore, if no sale was contemplated, there was no basis upon which any CGT could reasonably be calculated.

However, despite this statement, parties seeking to have deducted from the property pool a notional liability for CGT attempted to glean some support from the statement by the Full Court in *Elsey & Elsey*[9] that, at least where an entity was valued on a net assets backing basis, some consideration should be made of any taxation implications as a result.

In that case (concerning the valuation of a crane business operated by the husband), Baker J (with whom Ellis and Coleman JJ agreed) found that, in the circumstances, the acceptance by the trial Judge of a valuation prepared on a net assets backing basis was fundamentally flawed. However, his Honour then stated that, if such a methodology was to be adopted, the trial Judge fell further into error in failing to make any provision for income tax payable upon the sale of any of the assets held by the relevant business operated by the husband in that case.

The position was further clouded by several unreported decisions at first instance including the decision of O'Ryan J in *Holzner & Holzner*[10], where his Honour stated that (notwithstanding that in that particular case he determined not to take into account a notional taxation liability), in his opinion, there may be circumstances in a particular case where it would be necessary to take into account the incidence of CGT even if there is no intention to effect an immediate sale. In that case, his Honour opined that:

The fact that it may be difficult to calculate the quantum of tax payable is not necessarily a reason for excluding consideration of the tax payable.

In the unreported decision of *Wilson & Wilson*[11], Warnick J also commented upon position of realisation costs and whether they should be considered in determining the property available for division between the parties. His Honour stated that, while he agreed with the approach taken by Nicholson CJ in *Carruthers & Carruthers*[12]:

[7] (1988), 13 RFL (3d)
[8] (1996) FLC 92-682
[9] (1997) FLC 92-727
[10] (unreported, October 1996)
[11] (delivered 11 March 1998)
[12] *supra*

There may … be cases when it is not clear when, if ever, a sale or transfer of property will be made and the tax consequences are therefore speculative, or hypothetical but a preponderance of other pertinent factors nonetheless makes the deduction of the tax an appropriate exercise of discretion.

His Honour also summarised a number of factors which, in his opinion, might bear upon the exercise of discretion by the Court in dealing with the area of deductibility of realisation expenses, including:

- The methodology of valuation;
- A comparison of the incidence of taxation or otherwise in respect to the property to be retained by each of the parties;
- Uncertainty and risk surrounding the retention of property, which might render a sale likely or a possibility;
- The length of time anticipated before a sale;
- The degree of control by a party to the question of retention or disposition of an asset, to which the costs or taxation pertains;
- Whether, where a party seeks a share of an asset which cannot be sold, with the consequence that the other party must raise money to pay that share, any taxation or other costs upon realisation should, as a means of recognising that consequence, be deducted before the share is calculated.

On appeal, the Full Court (comprising Ellis, Finn and O'Ryan JJ) in their judgment delivered 30 November, 1998 found that, in the circumstances of the case, it was open to his Honour to take into account in the manner on which he did the notional tax on retained earnings, an allowance for realisation costs and the notional CGT.

In a demonstration, however, as to the unpredictability of the Court's approach, a slightly different view was taken in the Full Court decision of *Phillips and Phillips*, an unreported decision delivered only two months earlier on 30 September, 1998. In that case, the Full Court (comprising Ellis, Kay and O'Ryan JJ), was called upon to determine an appeal from a decision at first instance of May J where her Honour dealt with a pool of property amounting to $25,939,054.00. Evidence in that case was led that notional CGT and realization costs were $7,984,409.00. Her Honour held:

In my view it would not be realistic to ignore such costs and wrong to place them wholly upon one party. An additional complicating factor is the realisation cost is not the same in relation to all of the shares, it is dependent upon the date of purchase …

The only proper result is that the parties share the burden of realisation costs and capital gains taxation of any assets that attract such costs in consequence of the settlement. I conclude that it is not the correct approach to deduct the whole cost. In this case it is not necessary to sell any assets to effect the settlement…

Consequently the whole pool should be divided as to 40% to the wife and 60% to the husband. Should the husband decide to sell shares held by Aviground as trustee for the GD and NB Phillips Family Trust, to satisfy the balance of the wife's entitlement then the wife would receive the balance less 40% of the realization costs of those shares.

The Full Court held, on appeal, it was open to her Honour not to deduct the whole of the taxation and realisation costs as it was not necessary to sell any assets to effect a settlement and further that each of the parties bear the taxation and realisation costs attributable to the assets to be received by them.

Rosati & Rosati – The enunciation of guidelines

The confusion surrounding this area did not, however, go unnoticed by the Court, with the Full Court in *Rosati & Rosati*[13] eventually seeking to provide some clarity in relation to the relevance of CGT and realisation costs in the determination of the property pool. In that decision, the Full Court (comprising Ellis, Lindenmayer and Kay JJ), after noting the "degree of confusion, and possibly conflict, in the reported cases", stated, at 85,043, that in determining the proper approach to be adopted by the Court in relation to the effect of potential capital gains tax the following general principles emerged:

(1) Whether the incidence of capital gains tax should be taken into account in valuing a particular asset varies according to the circumstances of the case, including the method of valuation applied to the particular asset, the likelihood or otherwise of that asset being realised in the foreseeable future, the circumstances of its acquisitions and the evidence of the parties as to their intentions in relation to that asset.

(2) If the Court orders the sale of an asset, or is satisfied that a sale of it is inevitable, or would probably occur in the near future, or if the asset is one which was acquired solely as an investment and with a view to its ultimate sale for profit, then, generally, allowance should be made for any capital gains tax payable upon such a sale in determining the value of that asset for the purpose of the proceedings.

(3) If none of the circumstances referred to in (2) applies to a particular asset, but the Court is satisfied that there is a significant risk that the asset will have to be sold in the short to mid term, then the Court, whilst not making allowance for the capital gains tax payable upon such a sale in determining the value of the asset, may take that risk into account as a relevant s 75(2) factor, the weight to be attributed to that factor varying according to the degree of the risk and the length of the period within which the sale may occur.

(4) There may be special circumstances in a particular case which, despite the absence of any certainty or even likelihood of a sale of an asset in the foreseeable future, make it appropriate to take the incidence of capital gains tax into account in valuing that asset. In such a case, it may be appropriate to take the capital gains tax into account at its full rate, or at some discounted rate, having regard to the degree of risk of a sale occurring and/or the length of time which is likely to elapse before that occurs.

While the expression of these "general principles" has given some guidance to practitioners dealing with potential income or CGT liabilities, it still left the court with a number of avenues, each dependent upon an exercise of discretion of the Court, including:

- Having no regard to the incidence of taxation;
- Taking into account the total calculation of taxation on an assumed or ordered immediate sale;
- Making an adjustment for the potential risk of taxation under section 75(2); or
- Making a reduction to the value of an asset by a discounted proportion of any likely taxation.

Further, the Court's acceptance of using section 75(2) to make adjustments for potential liabilities that may or may not arise in the future was in stark contrast to the statement by the Full Court in *Campbell & Kuskey*[14] when dealing with a potential liability under section 108 of the *Income Tax Assessment Act*, the precursor to Division 7A, which will be discussed below. In that case, the Court held that it is inappropriate in most cases to use section 75(2) as a means of bringing to

[13] *supra*
[14] (1998) FLC 92-802

account, in a general way, a liability, or potential liability, not otherwise brought to account in determining the net pool of assets in view of the risk of injustice to one or other of the parties.

The application of the Rosati principles

Notwithstanding these issues, the Court's statements in *Rosati & Rosati*[15] are generally regarded as the guidelines to be followed as to whether or not a potential CGT or other liability that may arise in the future should be deducted from the pool.

One such decision is that of *JEL & DDF*[16], a decision of the Full Court, best known for its consideration of "special contributions". At first instance, May J was called upon to consider whether, in the context of a significant pool of property (exceeding $35 million), future CGT liabilities and other realisation costs should be deducted from the pool. There was no precise evidence, it appears, in relation to the amount of CGT generally, although there was evidence as to the CGT that would be payable in the event of sale of several particular items of property.

Her Honour approached the question to be determined as whether the realisation costs should be deducted from the "whole pool or from only those assets to be sold or distributed". Her Honour determined that the realisation costs:

should only be taken into account in respect of any assets which are actually to be sold or transferred pursuant to the orders of this Court or which must inevitably be sold to enable the husband to comply with such orders.

And, further, that:

While, of course, it is correct the assets have been acquired with a view to making a profit, the husband cannot fairly be allowed to assert that the wife should contribute to capital gains liability and other potential tax liabilities when it is far from clear when and if these liabilities will ever arise.

May J accepted that she could not be satisfied that there existed a significant risk that other assets would have to be sold in the short to mid-term future as a result of the orders, and that no CGT or realisation costs should therefore be deducted from the pool. On appeal, this position was not altered by the Full Court, notwithstanding submissions on behalf of the husband that:

- The net assets were contained in a trust structure and the only way for the husband or wife to access the assets was to transfer them out of the trust or convert them to cash, which would attract realisation costs.

- The net realisable method of valuation had been adopted by the accountants for each of the parties.

- Each and every asset of the parties and the trust in question had been acquired for investment with a view to ultimate sale at a profit.

In the course of their judgment, the Full Court referred to the principles outlined in *Rosati*. However, while the Court accepted that the assets had been valued on an asset realisation approach, that was only one of the matters to be taken into account. The Court noted that the trial Judge had not been satisfied that a sale of other assets was inevitable, or would probably occur, nor was there any evidence that would allow the Full Court to conclude that the husband had evinced an intention to collapse the corporate and trust structure to achieve personal ownership of the assets.

[15] *supra*
[16] (2001) FLC 93-075.

Accordingly, the Full Court concluded that

Having regard to the principles enunciated by the Full Court in Rosati (supra), and the findings made by her Honour, we are not satisfied that her Honour erred in treating the realisation costs in the manner that she did.

A similar approach was taken in the 2005 decision of *Noetel and Quealey*[17]. The husband submitted, both at trial and on appeal, that notional CGT should be deducted from the value of the pool, including a number of properties that he had inherited during the marriage.

The Full Court noted the following factors in determining the issue:

- There was no evidence before the trial Judge that the husband intended to sell the properties in the foreseeable future.
- There was evidence that the husband had rejected a proposal by the wife to sell the properties.
- There was evidence that the husband would be able to re-accommodate himself by the purchase of a new home without the sale of the properties.
- The Court found that there was no discernible risk that the husband would sell the properties in the foreseeable future.

Accordingly, the Full Court accepted the proposition enunciated in *Rosati*, and concluded that, for CGT to be included as a liability of the husband, there must be an intention by the husband to sell the properties in the foreseeable future, or a significant risk that the properties will have to be sold in the short to mid term. In the absence of evidence supporting findings in relation to those matters, the Full Court held that the trial Judge had correctly determined not to include a value of CGT in relation to the properties.

One of the most recent authorities from the Full Court in relation to this issue is the decision delivered in May 2006 of *IABH & HRBH*[18]. That case involved a sizeable property pool, found at trial to be approximately $6.4 million. However, the trial Judge had, in making that determination, deducted a number of liabilities from the property pool including the following:

- A guarantee given by the husband to two of his business partners in the amount of $210,000.00.
- "Contingent liabilities" in the amount of $1,890,000.00, comprising realisation costs of approximately $280,000.00 and CGT liabilities exceeding $1.6 million.

Although the trial Judge determined that "selling expenses and capital gains tax should be regarded as liabilities and deducted from the total value of the parties' assets", the evidence of the husband was that he did not intend to sell the investment properties. His Honour, at trial, referred to the principles set out by the Full Court in *Rosati*, before considering the unreported Full Court decision of *G & G*[19] and the Court's statement in that case that:

… in our view, where property which is held by a party or the parties to proceedings under s79 of the Act was acquired as part of a business of acquiring, developing and reselling real property for profit (i.e. essentially, as trading stock of that business) then in valuing that property for the purpose of the proceeding, the Court should ordinarily take into account both the estimated realization costs and the tax

[17] (2005) FLC 93-230
[18] [2006] FamCA 379
[19] [2001] FamCA 1453

which will ultimately be paid on its sale, even if the Court's orders leave the property in the hands of one party and the sale of it is not seen as an inevitable or even likely consequence of those orders. We think that statement falls within the purview of the principle stated in paragraph (2) … from Rosati.

Accepting this statement, the trial Judge in this case stated that he was:

… the entities in question were acquired as investments with a view to their ultimate sale for profit … the sale of the entities are an inevitable consequence of the Husband continuing to conduct his business in the manner in which he has done so for many years.

On appeal, the wife challenged the inclusion of the CGT liabilities and other realisation costs, submitting that the trial Judge had misapplied the principles in *Rosati*. The wife further submitted that the properties had not been acquired solely for the purpose of investment with a view to sale, and relied on the evidence of the husband that he did not intend on selling various of the properties in question.

The Full Court accepted that the trial Judge had erred in his decision to find that the sale of the property was inevitable. The Full Court referred to the decision of *G & G*[20] to which the trial Judge had referred, noting that the Court in that case had taken a "wide interpretation of *Rosati*", however stating that:

In our view, the Full Court in G & G did not "widen" the ambit of what had been said in Rosati, but rather made clear that expenses referrable to notional realisation of assets in the nature of "trading stock" could appropriately be taken into consideration in cases of that kind.

However, in this case, Full Court found that the trial Judge's findings that the sale of the entities was an inevitable consequence of the manner in which the husband had conducted his business previously, was not open to him in view of the evidence of the husband that he was determined not to sell items of property with the exception of one villa. Accordingly, the CGT liabilities and realisation costs should not have been deducted from the pool.

From this point, however, the Full Court noted the following:

… it remains, as Rosati clearly envisaged, for the possibility of Capital Gains Tax and selling expenses being incurred to be considered within s 75(2) or s 79(2). It was submitted on behalf of the wife that, in the circumstances of this case, the appropriate course would have been for the trial Judge to have had regard to the possibility of those liabilities within the context of either s 75(2) or s 79(2). Had he done so, the trial Judge could, by formulaic orders, have prevented the wife's entitlement being reduced by reference to substantial expenses which may never materialise, thus providing a "windfall" for the husband, and protected the husband against paying to the wife more than her property entitlement if, having written back the selling expenses and Capital Gains Tax, a property or properties had to be sold which attracted a Capital Gains Tax liability and selling expenses, thereby preventing a "windfall for the wife".

The extent, however, to which these matters should be taken into account is not clear, as the parties were directed to file written submissions about the future course of the proceedings, as the Full Court was unable to re-exercise the discretion in this matter.

2.3 Summary – Position in relation to Capital Gains Tax and Realisation Costs

While the principles outlined by the Court in *Rosati* do provide some guidance as to the manner in which CGT and other realisation costs should be treated in the context of the property pool, the position is far from clear. Each case will be determined on its own facts and, indeed, notwithstanding the guidance from the Court in *Rosati* about the matters that the Court should take into account in determining this issue, various decisions still refer to a lack of precise evidence to enable it to properly consider this matter, either by virtue of no evidence from the

[20] *supra*

parties about the quantum of the potential liability, or inconsistent or unclear evidence about the parties' intention.

What is clear is that practitioners must, when representing a party who may, at some time in either the immediate or distant future, dispose of or deal with an asset in such a manner which may attract CGT take into consideration not only the intention of the parties as to the time of disposition of an asset but also the intention of the parties at the time of its acquisition. This evidence will be required in order to place before the Court, if necessary, material to allow the Court to determine the appropriateness of making a deduction of these costs and, in the event of a failure to do so, it appears likely that the Court will make no consideration of this issue.

Accordingly, any material drafted should necessarily reflect these matters and, in particular:

- As a preliminary matter, it is clear that there must be evidence that, in the event that the relevant asset is sold, a liability for CGT and other realisation costs will arise. As a corollary to that point, there must therefore also be reasonably certain evidence quantifying the amount of that liability. Future tax liabilities will, of course, be difficult to predict. However, as with the valuation of any asset, the valuation of this liability will be required to be the subject of expert evidence based upon such information as is available at the relevant point in time.

- The likelihood of the particular asset being realised in the future. If necessary, practitioners should seek instructions regarding whether it will be necessary for a particular asset to be sold as a result of property settlement proceedings, even if a formal order for its sale may not be made.

- The intention of the parties at the time of acquisition of the particular asset. Was it purchased for the purpose of investment and eventual resale? Is it possible to establish that the asset will be sold, even if the precise timing of such sale is unknown? This may include providing a history of the parties' previous dealings with assets, particularly if there is an established history of the acquisition of assets for the purposes of investment and eventual sale.

- Are there any other factors which will impact upon the incidence of CGT or which, in the event that a sale is not contemplated, would make it appropriate for the Court to take into account by way of a possible section 75(2) adjustment the potential for taxation liability. For example, even if a sale is not contemplated in the immediate future, evidence tending to show the time in which a sale may occur may be relevant in assisting the Court to determine what, if any, consideration should be given to this issue, including whether any adjustment is necessary or whether the liability should be included with some discount to its value.

The role of an accountant in this process if also important, particularly as to:

- Whether, in the event the asset is sold, a liability for CGT will arise; and

- The anticipated amount of that liability based upon current evidence.

2.4 Other examples of application of the *Rosati* principles

It is not only in relation to potential CGT liabilities and realisation costs that the *Rosati* principles may have application. In *G & G*[21], the Full Court acknowledged that the principles referred to in *Rosati*, while referring specifically to CGT, would extend to ordinary mainstream tax.

A further example where the principles have application is in relation to taxation likely to be incurred by a party in dealings with their superannuation entitlements. In *H, DM and H, SA*[22], the

[21] *supra*

Court referred to the principles in *Rosati* in the context of the valuation of the husband's superannuation. In that case, it was held that the Court does not need to take into account potential tax liability in relation to superannuation due to the fact that the superannuation splitting legislation mandated a specific valuation methodology pursuant to which tax did not affect the value of the asset, other than undeducted contribution tax and any applicable surcharge levy.

The Court further stated, however, that the tax may be a relevant liability as distinct from the valuation exercise in relation to the superannuation interest. In the circumstances of that case, however, the notional tax liability was not taken into account as it was "too many years away" from when the husband could take his superannuation. The Court noted, however, that it may be a relevant section 75(2) factor in certain circumstances.

2.5 The *Campbell & Kuskey* scenario

Set out below in this paper is a discussion of some of the issues surrounding Division 7A of the *Income Tax Assessment Act 1997* and deemed dividends. In the decision of *Campbell & Kuskey*[23], the Full Court was called upon to consider the relevance of a potential taxation liability arising under the precursor to Division 7A, being section 108 of the *Income Tax Assessment Act 1936.*

In that case, the expert's report issued by the parties' accountants pursuant to Order 30A noted that the parties' loan accounts with a company through which the parties operated an electrical contracting company incurred a potential liability pursuant to section 108 of over $190,000.00. Accordingly, both accountants recommended that the parties reduce their loan accounts by the payment of fully franked dividends, with the result that the potential liability would be limited to approximately $86,000.00.

At first instance, the trial Judge did not take into account the parties' contingent liability pursuant to section 108 as a liability yet considered it appropriate, rather than adjusting the net assets of the parties, to consider the potential liability pursuant to section 75(2) and considered this a relevant matter in favour of the husband, who was ordered to indemnify the wife for this potential liability. In particular, the trial Judge considered it appropriate to make an allowance in favour of the husband, notwithstanding his expression that he had "no way of knowing what the ultimate chances are that the Commissioner will assess the parties' loan account under Section 108".

The treatment by his Honour of this liability was, *inter alia*, the subject of appeal to the Full Court. In dealing with this issue, the Full Court referred to the obligation of the trial Judge to identify and make findings regarding the parties' assets and liabilities prior to a consideration of the parties' respective contributions and any relevant section 75(2) factors. Their Honours therefore stated that, in addition to the difficulties in apprehending from the reasons of the trial Judge what adjustment was precisely made:

it is inappropriate in most cases to use s75(2) as a means of bringing to account in a general way a liability, or potential liability, which has not otherwise been brought to account as a liability when determining the overall net pool of assets. The reason for this is that by so doing, a trial Judge may produce a result that works an injustice as against one party or the other. For example, in the circumstances of this case, his Honour gave the husband the benefit of an adjustment pursuant to s75(2) of somewhat less than $86,328 [i.e. the reduced possible taxation liability]. If the husband had then entered into the scheme suggested by the accountants he would have accrued a taxation liability of $86,238 and would therefore be at a disadvantage. If however, the Commissioner of Taxation failed to deem the loan accounts to be dividends under s108 the husband will receive the s75(2) adjustment in his favour as a windfall benefit. This would work an injustice to the wife.

[22] (2003) FLC 93-168; [2003] FMCAfam 41
[23] (1998) FLC 92-802

As a result of various factors arising out of the judgment of the trial Judge, the Full Court, when called upon to re-exercise their discretion to determine the matter, considered that, in the circumstances of the case, including the manner in which the case was presented at trial, the various concessions made by the wife throughout the proceedings as to the likelihood of this liability being incurred and the joint evidence of the parties' experts, it was appropriate, in order to bring about a just and equitable result, to bring to account the sum of $86,238.00 as a liability of the parties.

In the subsequent decision of *DJM & JLM*[24], the Court considered the application of *Campbell & Kuskey*[25] in determining whether it was appropriate to visit a proportion of a potential $12,000.00 penalty tax debt of the husband upon the wife in the context of their property settlement proceedings. The Court considered that that determination would have depended upon evidence as to how the liability was incurred however, absent any significant evidence as to that matter, it was appropriate for a trial judge to treat such a liability overall as party of the "vicissitudes of the economic life of the parties and a debt to be shared between them". It should be noted, however, that whilst the Full Court considered it appropriate to take into account the liability in determining the net assets of the parties, there was strong evidence that such a liability was to be incurred by the husband.

In summary, it can be seen that a similar process in relation to the relevance of CGT should be undertaken in relation to this issue. In particular, the Court's reliance and emphasis in *Campbell & Kuskey* accentuates the need for expert evidence regarding, firstly, whether a tax liability will be incurred and, secondly, the likely quantum of such liability. In that case, the Full Court also considered the likelihood that the scheme proposed by both parties' accountants to reduce the taxation liability would be followed, in determining the relevant manner in which to deal with the liability and criticised the trial Judge for failing to make consequential orders requiring both parties to undertake the course recommended by their accountants in order to provide a greater amount of certainty.

Practitioners should consider, therefore, the necessity for appropriate consequential orders (extending beyond the usual indemnities), particularly if representing the party to take the burden of the liability.

2.6 **The Treatment of Loan Accounts**

While the Court has a discretion as to the manner in which it treats liabilities, as a general rule, the Court will take into account the liabilities of the parties in such manner as it finds them and will not ignore the interests of third parties in the property[26]. In dealing with most situations, the value of a liability will usually be its face value, particularly in circumstances involving commercial, arm's length transactions and it is therefore unnecessary in those cases to consider issues regarding whether the liability should be included or whether it should be discounted in some manner[27]

However, in certain circumstances, it may not be appropriate to include certain liabilities in determining the property settlement to be effected. There is a history of cases involving the scrutiny given to alleged debts due to third parties and, in many cases, this will involve the calling of accounting evidence to establish the debt, to indicate the present value of the debt and any elements which would justify a discount being applied to its value[28].

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[24] (1998) FLC 92-816
[25] *supra*
[26] See, for example, *Ascot Investments Pty Ltd v. Harper & Harper* (1981) FLC 91-000
[27] For an example of the discounting of a liability, see *O'Connell & O'Connell*, unreported decision of O'Ryan J delivered 6 August 1996.
[28] In this regard, reference should be made to cases including *Antmann & Antmann* (1981) FLC 91-101; *Anderson & Anderson* (1981) FLC 91-104; *Kowaliw & Kowaliw* (1981) FLC 91-092; *Petersens & Petersens* (1981) FLC 91-

In *Foda & Foda*[29], the Full Court also had cause to consider the relevance of a debit loan account owing by the husband to a company which was, it was found, his alter ego. This case is one which highlights the difficulties that practitioners (and the Court) are faced with in determining the relevant pool of assets, particularly where that consideration involves an examination of entities the creature of the parties themselves.

In *Foda*, the husband alleged that a debit loan account in his name with a company which was, for all purposes at family law, his alter ego, had been debited with moneys advanced by the company for the purchase of two properties which were held by the parties or either of them. It was further submitted on behalf of the husband that, as both parties had had the benefit of those moneys, the liability should be brought to account in determining the total net assets of the parties, as would commonly be the traditional accounting approach.

The position was clouded in that case by virtue of the fact that the trial Judge was unable to make a confident finding as to the amount of the loan account. However, in considering the trial Judge's approach to the husband's loan account, the Full Court criticised the manner in which the trial Judge dealt with this issue and found that the trial Judge should have disregarded transactions between the parties and the company. In coming to this conclusion, the Full Court, in referring to the attempted accounting exercise undertaken by the trial Judge, stated that:

we do not think that his Honour needed to have done this accounting, nor to have made a definite finding as to the amount of the loan account. This is a case in which the company was the husband's alter ego.

The Full Court continued on to say that:

Transactions between the parties and the company should have been disregarded by his Honour. This is the effect of the company being the alter ego of the parties or one of them. There is no need for accounting between them.

In ultimately determining the matter, the Court took into account in determining the value of the company only the gross property of the company less any moneys owing to third party creditors of the company and the costs of administration and liquidation. That is, the Court found it appropriate to ignore the liability of the husband to the company. Accordingly, therefore, while the value of the liability was ignored, it was similarly not included in the valuation of the company as an asset of that entity.

Whilst the effect of this decision could be argued to be quite harsh and result in an artificial position with respect to ongoing treatment of the company in the future, it gains some support from traditional accounting concepts which dictate that a liability should be recognised only where:

- It is probable that the future sacrifice of economic benefit will be required; and
- The amount of the liability can be measured reliably.

In circumstances where the company is the alter ego of one or other of the parties, these tests are unlikely to be satisfied without evidence of a strict accounting between them in the past and quantifiable evidence of the amount involved (which was absent in the case of *Foda*).

More recently, Warnick J in the decision of *SL & EHL*[30] considered whether, in the circumstances of that case, a liability owing by a trust created and controlled by the husband, the KM Trust,

095; *Prince & Prince* (1984) FLC 91-501; *Ferraro & Ferraro* (1993) FLC 92-335 and *Biltoft & Biltoft* (1995) FLC 92-614.

[29] (1997) FLC 92-753

[30] [2005] FamCA132

owing to one of the beneficiaries of the trust, a charitable institution (BU), should be deducted from the value of the trust.

The loan account (at trial amounting to over $1.1 million) had been caused by distributions being made to BU from the trust. Those distributions were tax free in the hands of the beneficiary. The husband's evidence was that the money was loaned back to the trust, interest free. Although the loan had existed for a lengthy period of time, there had been no drawings of any significance whatsoever on the loan account, although the husband gave evidence that, by his will, in the event that the loan owing to BU had not been repaid before his death, it was to be paid from his estate.

The evidence of the husband was, further, that if there was a demand made in relation to the loan, he would pay it, however no payments had been made, nor was BU provided with copies of the accounts. The husband also gave evidence that he had informed previous secretaries of BU of the loan and that he was making allocations on an annual basis.

It was submitted on behalf of the wife that the property of the trust should be brought to account, disregarding the value of the liability to BU or, alternatively, that it should be brought to account at its "present value", assuming it was not payable until the husband's death. The evidence from the wife's accountant was that the present value of the loan was just over $300,000.00.

His Honour found that it was probably that the loan would not be repaid during the husband's lifetime. However, in determining the appropriate course of action, his Honour took into account a number of factors including:

- The loan arrangement had presented the husband and, indirectly, the wife with considerable financial advantages by allowing for tax deductibility of distributions to BU, but the retention of the moneys interest free for use by the trust.

- It would be unfair to add in the loan account without giving credit for that advantage, which had not been calculated.

Accordingly, Warnick J found that the preferred approach was to bring the loan into account at the present value, being the amount of $300,000.00, as opposed to $1.1 million.

2.7 Summary

In the vast majority of cases where loan accounts are in existence in corporate and trust entities controlled by one or both of the parties, ordinary accounting methodologies will dictate that, provided there is reliable evidence as to the amount of the loan account, the loan account should be brought to account. In most cases, the position will be one of neutrality, where it is an asset of an entity that will otherwise increase the pool, and then a corresponding liability of either or both of the parties.

However, as can be seen from some of the authorities, each case must be determined and considered on its own facts. In circumstances where the inclusion of the loan account would result in a substantial injustice to one of the parties, or where the likelihood that it will be repaid (or in what amount) must be considered by the Court and, where necessary, evidence should be given by the parties or the relevant experts to assist the Court in relation to these matters.

3. OTHER TAX CONSIDERATIONS IN PROPERTY SETTLEMENT PROCEEDINGS

3.1 Tax Evasion

As practitioners of the Court, we have an obligation to ensure that full and frank disclosure of our client's financial affairs is made to the Court. We may represent people who conduct cash businesses and from time to time do not disclose "black money" to the Australian Taxation Office or in some other respects have evaded tax, for example by deliberate understatement of income or overstatement of deductions. In two early decisions of this Court *T v T*[31] and *P v P*[32], the trial Judges found there had been tax evasion and directed publication of their judgment to the Attorney-General, with the obvious purpose of investigation and prosecution.

In the later decision, Lindenmayer J held:

In the result, I am of the opinion that this Court, as a Federal Court exercising the judicial power of the Commonwealth, has a duty to protect the revenue of the crown in right of the Commonwealth. That duty extends to requiring this Court to take such steps as it is able to take to ensure that the revenue laws of the Commonwealth are not defrauded or evaded by litigants or others that come before it.

Since those decisions, the Court has not adopted a consistently robust approach to deliberate tax avoidance. For instance in *Weir & Weir*[33] the Full Court found that the husband who conducted a quarry business had made a deliberate non-disclosure to the Court. The Court found that it was the husband's practice to pocket cash payments without recording them in the normal course of events. The evidence of the parties' son who worked in the business from time to time, was that the husband only recorded sufficient cash payments to allay any suspicion on the part of the ATO. Whilst the Court made an order in favour of the wife going beyond the identified property it did not take the step of referring the matter to the Attorney-General. In assessing the additional award to be made to the wife the Full Court stated:

Mr Calabro said that $153,605.00 remained unaccounted for. His Honour found that the husband had made a partial explanation of this discrepancy but did not make a finding as to the extent of it. On the evidence given by the husband we think that it would be generous to make an allowance of $50,000.00 in his favour in this regard. This would leave a little over $100,000.00 unaccounted for and we would be prepared to infer, in all the circumstances, that this is what the husband received and did not account for.

In practice, it is often the case that these issues will arise. We may act on behalf of a client who has not operated the business or been party to active tax evasion, but who was aware of it and who has enjoyed the remuneration from the business during the marriage (whether disclosed to the ATO or not). In a somewhat fatalistic approach they invite an audit into the business whether by their expert accountant or by anonymous complaint to the ATO. What these clients do not realise is that they are potentially shooting themselves in the foot because if it is ultimately found that there has been an underpayment of taxation then it may be not only visited upon their partner with whom they are at war but it also may be visited on them and ultimately paid out of the property pool reducing their entitlement.

It is not always the case of one of the parties taking this step, however, that may lead to an audit in any particular case. For instance, in the decision of *Atkinson v. Federal Commissioner of Taxation*[34], during an audit of the taxpayer, an officer of the ATO inspected affidavits and other materials prepared in the course of property settlement proceedings including the material filed in the Family Court of Australia. The ATO then issued default assessments assessing the husband in relation to taxable incomes based upon the parties' yearly domestic expenditure, as set out in their filed material. Objections raised by the taxpayer to those assessments were ultimately rejected by the Federal Court.

3.2 **Income Splitting**

[31] (1994) FLC 91-588
[32] (1985) FLC 91-605
[33] (1993) FLC 92-338
[34] (2000) ATC 4332

It is not uncommon where the parties have conducted a business, for example, via a family trust, company or partnership, for the income to have been divided between the parties in such a fashion to maximise the tax advantage for the parties. We may then be instructed by the party who had the conduct of the business that, notwithstanding the income splitting arrangements, it was that party that derived the income solely and therefore they should be accorded the financial contribution.

However, ordinarily, the Court's approach in cases of this kind is that where a party represents to the ATO that his or her spouse is a partner in a business operated by a party, or is a *bona fide* employee of such a business and is paid a salary and other benefits as such, that party cannot then state, in subsequent proceedings for property settlement, that his or her spouse was not, in fact, a partner or employee[35].

This should not, however, be seen as a strict rule to be applied regardless of the circumstances in all cases. In case should be considered, however ordinarily both parties will benefit from income splitting and, to that extent, the argument may also be run that, by permitting income splitting, the spouse not active in the business is indirectly contributing to the income generated, at least to the extent of any tax advantage gained.

4. MARRIAGE BREAKDOWN CGT ROLLOVER

4.1 Basic Elements of Rollover

There is a CGT roll-over for CGT events that involve an individual (the ***transferor***) and his or her spouse (the ***transferee***), or a former spouse (also the ***transferee***), where the relevant CGT event occurs because of:

(a) a court order under the *Family Law Act 1975* (**the FLA**) or a corresponding foreign law; or

(b) a maintenance agreement approved by a court under section 87 of the FLA or a corresponding agreement approved by a court under a corresponding foreign law; or

(c) a court order under a State law, Territory law or foreign law relating to de facto marriage breakdowns.[36]

TD 1999/47 confirms that an order made by consent of the parties is a "court order" for the purposes of paragraph (a) above. TD 1999/50 and 1999/51 also confirm that paragraph (a) applies in respect of both original and subsequent orders made by the court.

The rollover extends to cases where an asset is transferred from either a company or trust to a spouse (or former spouse) because of a court order or maintenance agreement referred to in paragraphs (a) to (c) above. Certain cost base adjustments apply in this case in respect of interests held in the relevant company or trust to reflect the fall in market value of those interests because of the transfer of the assets out of the company/trust.[37]

However, the relief is not available where:

- an asset is sold or transferred from a spouse to a company or a trust in which the other spouse has an interest; nor

[35] See, for example, *Gascoigne v Gascoigne* [1918] 1 KB 223; *Tinker v Tinker* [1970] 2 WLR 331; *Elias and Elias* (1977) FLC 90-269; *Lee Steere and Lee Steere* (1985) FLC 91-626 and *Dawes & Dawes* (1990) FLC 92-108.
[36] *Income Tax Assessment Act 1997* s126-5
[37] *Income Tax Assessment Act 1997* s126-15

- an asset is sold or transferred to an unrelated third party pursuant to a court order.[38]

Proposed Extension of Rollover

The *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* (**the Amending Bill**) was introduced into parliament on 22 June 2006. At the date of publication, the Amending Bill has yet to be enacted and amendments in it are expressed only to apply in respect of events which occur after the date of Royal Assent.[39] The Amending Bill contains provisions[40] which, once enacted, will see the operation of the rollover extended to :

(d) something done under:

  (i) a financial agreement made under Part VIIIA of the FLA that is binding because of section 90G of that Act; or

  (ii) a corresponding written agreement that is binding because of a corresponding foreign law; or

(e) something done under:

  (i) an award made in an arbitration referred to in section 13H of the FLA; or

  (ii) a corresponding award made in an arbitration under a corresponding State law, Territory law or foreign law; or

(f) something done under a written agreement:

  (i) that is binding because of a State law, Territory law or foreign law relating to de facto marriage breakdowns; and

  (ii) that, because of such a law, cannot be overridden by an order of a court (except to avoid injustice).

In respect of paragraphs (d) and (f), additional conditions must be satisfied, namely:

- the spouses must be separated;
- there must be no reasonable likelihood of cohabitation being resumed; and
- the CGT event must have happened because of reasons directly connected with the breakdown of the marriage or de facto marriage.[41]

The question whether spouses have separated is to be determined in the same way as it is for the purposes of section 48 of the FLA.[42]

4.2 Rollover only applies to certain CGT events

The rollover only applies in respect of certain CGT events[43], essentially those relating to disposal of CGT assets[44] and the creation of rights.[45] The rollover would not apply, for example, if a trust

[38] *AAT Case* [2004] AATA 1210, *Re Kok Yong Tey v FCT* 57 ATR 1359.
[39] *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* Schedule 1 s10
[40] *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* Schedule 1 s3 and s7
[41] *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* Schedule 1 s9
[42] *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* Schedule 1 s9
[43] *Income Tax Assessment Act 1997* s126-5(2)

was declared over a particular CGT asset.[46] Further, the rollover does not apply if the asset involved is trading stock.[47]

It should be noted, however, that the Amending Bill contemplates a new CGT exemption in respect of CGT Event C2.[48] Technically, at present, where a cash payment is made by one spouse to another in settlement of the recipient's entitlement to make a claim, CGT Event C2 occurs because the recipient's right to make that claim is extinguished. Once enacted, new section 118-75 will ensure that a capital gain does not arise in respect of cash payments made which extinguish a right in circumstances where :

(a) that right directly relates to the breakdown of a marriage or de facto relationship; and

(b) at the time of the CGT event, the relevant spouses are separated and there is no reasonable likelihood of cohabitation being resumed.

Again, the question as to whether spouses have separated is to be determined in the same way as it is for the purposes of section 48 of the FLA.[49]

4.3 Effect of Rollover

The rollover is automatic[50] – any capital gain or loss that the transferor makes as a result of the CGT event is disregarded[51] and the transferee "inherits" the cost base of the transferor.[52] The acquisition date is also inherited in respect of the operation of particular CGT provisions[53] and this is particularly important, from the transferee's perspective, in respect of assets acquired before 20 September 1985 and also in respect of the availability of the general 50% CGT discount.

4.4 Main Residence Provisions

The general rollover provisions in section 126-5 can apply in respect of the transfer of a main residence between spouses if the general requirements of the section are satisfied.

Where section 126-15 applies (i.e. where a dwelling was transferred from a company or trust to a spouse), the transferee spouse is only entitled to the main residence exemption for the period after the transfer occurs (even if the transferee actually lived in the dwelling during the period of the company or trust's ownership).[54]

In respect of section 126-5, as the law presently stands, the rollover fails to give effect to the respective uses of the dwelling during the period of ownership of the respective spouses. The Amending Bill proposes to address this issue.[55] New section 118-178 will operate such that the transferee spouse will be taken to have owned the dwelling for the entire period (i.e. the period during which it was owned by both the transferor spouse and the transferee spouse) and will further be taken, in respect of the period of the transferor spouse's ownership, to have used the

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[44] CGT Events A1 and B1
[45] CGT Events D1, D2, D3 and F1
[46] Creation of a trust is CGT event E1, which is not referred to in section 125-5(2) of the *Income Tax Assessment Act 1997*.
[47] *Income Tax Assessment Act 1997* s126-5(3)(a)
[48] *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* Schedule 1 s1
[49] *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* Schedule 1 s1
[50] TD 1999/60
[51] *Income Tax Assessment Act 1997* s126-5(4)
[52] *Income Tax Assessment Act 1997* s126-5(5)
[53] *Income Tax Assessment Act 1997* s126-5(6); s115-30(1)
[54] *Income Tax Assessment Act 1997* s118-180
[55] *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* Schedule 1 s2

dwelling in the same way as the transferor spouse. The following examples in the Amending Bill illustrate the operation of the proposed amendment:

Example 1: Peter (the transferor spouse) is the 100% owner of a dwelling that he uses only as a main residence before transferring it to Susan (the transferee spouse). Susan uses the dwelling only as a rental property. Susan will be eligible for a partial main residence exemption having regard to how both Peter and Susan used the dwelling.

Example 2: Caroline (the transferor spouse) is the 100% owner of a dwelling that she uses only as a rental property before transferring it to David (the transferee spouse). David uses the dwelling only as a main residence. David will be eligible for only a partial main residence exemption having regard to how both Caroline and David used the dwelling.

5. STAMP DUTY

5.1 Exemption – section 90(1) FLA

Section 90(1) of the FLA provides that the following agreements, deeds and other instruments are not subject to any duty or charge under a State law:

(a) a deed or other instrument executed by a person for the purposes of, or in accordance with, an order made under Part VIII of the FLA;

(b) a relevant maintenance agreement[56] that confers a benefit upon a party to, or a child of, the marriage to which the maintenance agreement relates, to the extent that the maintenance agreement confers that benefit;

(c) a deed or other instrument executed by a person for the purpose of, or in accordance with, a relevant maintenance agreement, being a deed or other instrument that confers a benefit upon a party to, or a child of, the marriage to which the maintenance agreement relates, to the extent that the deed or other instrument confers that benefit.

In respect of paragraph (a) above, the relevant deed or other instrument must be executed **after** the relevant order is made.[57] However, instruments which are executed prior to, and conditional upon, an order being made, and which are held in escrow until the order is made, will fall within the exemption in section 90(1)(a) of the FLA, provided that the terms of the order are consistent with the instrument. A copy of the escrow agreement (and, obviously, the order) must be lodged when lodging the relevant instrument for assessment of duty[58] together with a statutory declaration confirming certain matters. [59]

The Commissioner of State Revenue has also confirmed, in respect of deeds or instruments executed in accordance with an order, that the *transferee* need not be a party to the marriage. In the case of transfers in accordance with an order, the exemption will therefore apply even if the property is transferred, for example, to a discretionary trust or even an unrelated third party.[60]

However, the Commissioner's view is that, for the exemption in section 90(1)(a) to apply, the *transferor* **must** be a party to the marriage.[61] Note the following example contained in Practice Direction DA 45.1 :

[56] See *Family Law Act 1975* s90(2)
[57] Revenue Ruling DA29.1 paragraph 2
[58] Revenue Ruling DA29.1 paragraph 3
[59] Practice Direction DA29.1 paragraph 9
[60] Revenue Ruling DA29.1 paragraph 5
[61] Practice Direction DA45.1

A transfer is executed between the trustee of the family trust as transferor and the wife as transferee. The transfer is executed in accordance with the terms of a consent order made by the court under Part VIII of the Family Law Act. Under the terms of the consent order, the court orders that the husband and wife will "use their best endeavours to procure the trustee of the family trust" to transfer an asset of the family trust to the wife.

The instrument transferring the asset is not exempt from duty under section 90(1)(a) of the Family Law Act.

The Commissioner's view seems to be predicated on the fact that the relevant order merely contemplates that the husband and wife will use their best endeavours to procure the trustee to effect the transfer. Practice Direction DA45.1 was issued on 1 March 2002 (indeed, its predecessor was issued on 21 May 1998 in almost exactly the same terms under the *Stamp Act 1894*) and does not appear to take into account the operation of Part VIIAA of the FLA and the fact that the trustee, itself, could actually be a party to the order and be compelled by the order to transfer the property. As is often the case, revenue law in respect of this particular issue has not kept abreast of developments in other areas of the law, and, accordingly, as things presently stand, a transfer from a party that is not a party to the marriage will be treated by the OSR as being dutiable.

The exemption from duty which arises in relation to maintenance agreements will only apply where the maintenance agreement confers a benefit on a party to, or a child of, the marriage[62].

5.2 Exemption – Chapter 10 Part 3 *Duties Act 2001*

Section 424 of the *Duties Act 2001* (**the DA**) provides that Duty is not imposed on a transaction to the extent that it gives effect to a matrimonial instrument or de facto relationship instrument.

In respect of marriage, section 90(1)(a) of the FLA will generally apply without need to refer to section 424 of the DA. The fact that section 424 may not exempt a particular transaction does not alter the exempt status of that transaction if it is caught by section 90(1)(a) of the FLA. Section 424 has some residual operation in relation to transfers resulting from marriage breakdown by virtue of the operation of the reassessment provisions in section 425. For example, if a transfer is made prior to an order being made (and in circumstances where the escrow arrangements above are not put into effect), the transfer would not be exempt under section 90(1)(a) of the FLA. However, if an order is subsequently made which provides for that transfer, and the requirements of section 424 are satisfied, section 425 may entitle the parties to a refund of any duty which has been paid.

Section 424 is of greatest importance, however, in relation to the breakdown of de facto relationships.

As noted above, section 424 exempts from duty "matrimonial instruments" and "de facto relationship instruments". These terms are specifically defined in sections 420 and 422 of the DA respectively.

Matrimonial Instruments

"Matrimonial instrument" is defined as any of the following instruments :

(a) an agreement registered or approved under the FLA;

(b) an order of a court under the FLA;

(c) an instrument made under an instrument mentioned in paragraph (a) or (b);

[62] Revenue Ruling DA 29.1 paragraph 11

(d) an instrument made after the start of a proceeding for the dissolution or annulment of the marriage,

but **only** where the relevant instrument provides for the transfer of matrimonial property (see below) from one party to a marriage *to only the other party* to the marriage. That is to say, section 424 only applies to transfers between spouses and does not operate to exempt transfers involving trusts or companies. It should also be noted that an instrument only becomes a matrimonial instrument on the dissolution or annulment of the marriage. However, as noted above, the reassessment provisions in section 425 of the DA may entitle parties who have paid duty to a refund in circumstances where the instrument was executed prior to the dissolution of the marriage but such dissolution ultimately occurs.

A matrimonial instrument must provide for the transfer of "matrimonial property", which is defined in section 421 of the DA as property of the parties to a marriage (or of either of them) that is:

(a) residential land, the residence on which is for use as the principal residence of the transferee; or

(b) a vehicle for use for private purposes by the transferee.

The exemption is therefore fairly narrow – a commercial property which is owned by a party to the marriage would not attract the benefit of the exemption.

De Facto Relationship Instrument

"De facto relationship instrument" is defined in section 422 of the DA to be any of the following instruments to the extent they deal with de facto relationship property—

(a) a recognised agreement under the *Property Law Act 1974* (**the PLA**), section 266;

(b) an order of a court under the PLA, part 19;

(c) an instrument made under an instrument mentioned in paragraph (a) or (b).

The requirement, in the context of matrimonial instruments, that the instrument only provide for a transfer between spouses is not present in section 422 of the DA. Therefore, property held by a de facto partner could be transferred to a company or trust, provided that is what is contemplated by the order.[63] The escrow arrangements described above in the context of section 90(1)(a) can also apply in respect of de facto relationship instruments. [64]

The definition of "de facto relationship property" is also much broader than that of "marriage relationship property". Section 423 merely provides that de facto relationship property is property of the de facto partners of a de facto relationship or of either of them.

Care must be taken when regard is had to the definition of "de facto relationship" in the DA. The definition, in Schedule 6, adopts the definition contained in section 32DA of the *Acts Interpretation Act 1954* (**the AIA**) but imposes an additional requirement, namely, that the de facto partners must have been living together or on a genuine domestic basis for at least 2 years.

Revenue Ruling DA 30.1 indicates (albeit in the Preamble, rather than in the Ruling itself) that the definition of "de facto relationship" in Schedule 6 of the DA **does not** apply to section 422. It should be noted, however, that the Commissioner's rationale for this statement, as expressed in the Revenue Ruling, is that section 422 requires a court order to have been made under Part 19

[63] Revenue Ruling DA30.1 paragraph 5
[64] Revenue Ruling DA30.1 paragraph 3

of the PLA and that such an order is contingent upon the existence of a de facto relationship. The reason that the Revenue Ruling is framed in this way is that section 422, as originally enacted, only contemplated an exemption for instruments made in accordance with a court order. The operation of section 422 was extended in 2002[65] so that recognised agreements, and instruments made in accordance with them, are exempt from duty. The Revenue Ruling has not changed since it was issued in March 2002 to take account of this amendment and, in those circumstances, it is unclear whether the 2 year requirement in the DA definition is intended to apply to section 422 so far as it exempts transfers in accordance with recognised agreements. Logic would dictate that it should not, given that the PLA contemplates that cohabitation agreements can be made *in contemplation of* parties entering into a de facto relationship.[66] The policy objective in the definition, however, appears to seek to impose a temporal requirement on the treatment of de facto relationships, in the absence of a court order, presumably to import an objective criteria that obviates the need for the Commissioner to make a determination as to the matters in section 32DA(2) of the AIA. If the definition of de facto relationship in Schedule 6 of the DA does not apply to section 422, then its operation would appear to be limited to section 151[67] of the DA as the term is not otherwise used in the DA.

Revenue Ruling DA 30.1 also indicates that transfers of property from, for example, a corporate trustee of a discretionary trust to a de facto spouse will be exempt under section 424 on the basis that such property would be a "financial resource" of de facto partners.[68] The basis of this view is not entirely clear, given that section 424 refers to "de facto relationship instruments" and the definition of that term, as noted above, applies to instruments to the extent that they deal with de facto relationship ***property***. The definition does not appear to contemplate exempting instruments which deal with financial resources of de facto partners but the Commissioner's view, as expressed in Revenue Ruling DA 30.1 would seem to operate to the advantage of taxpayers and, indeed, would seem to extend the operation of the exemption for de facto partners beyond that which, on the Commissioner's interpretation, is available in the case of marriage breakdown (see above in paragraph 5.1 regarding Practice Direction DA45.1).

6. DIVISION 7A

6.1 Operation Generally

When most people think of Division 7A of the *Income Tax Assessment Act 1936* (**the 1936 Act**), they think of loans made by private companies to shareholders or their associates. Division 7A is, in fact, much broader in its operation and also applies to certain payments made and debts forgiven by private companies. This paper will focus on the provisions of Division 7A that deal with payments and loan forgiveness as these provisions are more likely to be of relevance, from a family law practitioner's perspective, than the provisions which operate to deem certain loans to be dividends.

6.2 Payments

A deemed dividend arises when a private company pays an amount to a shareholder or an associate of a shareholder. A deemed dividend can also arise in respect of such a payment to a past shareholder or associate, when a reasonable person would conclude (having regard to all of the circumstances) that the payment is made because the payee has previously been a shareholder or an associate of a shareholder.[69]

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[65] See *Revenue and Other Legislation Amendment Act 2002* s7
[66] *Property Law Act 1974* s264(1)(a)(i)
[67] Section 151 exempts from duty certain transfers of the main residence of parties to a subsisting marriage or de facto relationship.
[68] Revenue Ruling DA30.1 paragraph 7
[69] *Income Tax Assessment Act 1936* s109C(1)

The term "associate" is broadly defined in section 318 of the 1936 Act. If the shareholder is a natural person, it includes the spouse of that person.[70] Spouse, as defined in the 1936 Act[71], does not include a former spouse so if the payment occurs after the shareholder and the payee are no longer married, the first limb of the above test will not be satisfied. However, if a reasonable person would conclude that the payment was made because the payee had previously been the shareholder's spouse then a deemed dividend will still arise.[72]

Importantly, section 109C(3) of the 1936 act broadly defines "payment" to include a transfer of property to the shareholder or their associates. The amount of the "payment" that arises by virtue of such a transfer of property is the amount that would have been paid for the transfer by parties dealing at arms length less any consideration given by the transferee.[73] In other words, if the property is transferred at market value, no deemed dividend arises. If it is transferred for less than market value, however, a deemed dividend arises in an amount equal to the difference between the market value and the amount paid by the transferee.

ATO ID 2004/461 confirms the ATO's view that section 109C of the 1936 operates to deem a private company to have paid a dividend to a shareholder's spouse in relation to a transfer of property from the company to that shareholder's spouse because of an order under section 79 of the FLA.

The ATO also holds the view that a transfer of property does not fall within the exception to section 109C contained in section 109J of the 1936 Act.[74] Section 109J provides that a deemed dividend does not arise because of the payment of an amount which :

(a) discharges an obligation of the private company to pay money to the entity; and

(b) is not more than would have been required to discharge the obligation had the private company and the entity been dealing with each other at arms length.

The ATO's view is that a transfer of property does not satisfy the following requirements of section 109J[75] :

- Firstly, a court order section 79 of the FLA does not create an obligation on the part of the company. This view, expressed in an ATO Interpretive Decision which was issued on 4 June 2004, does not appear to take into account the operation of Part VIIAA of the FLA and the fact that the company, itself, could actually be a party to the order and be compelled by the order to transfer the property.

- Secondly, section 109J refers to the discharge of an obligation *to pay money* to the entity. A court order obliging a company to transfer property is not, according to the ATO, an obligation to pay money.

Accordingly, Division 7A will operate such that the transfer of property from a company to, for example, a spouse who is a shareholder in the company in accordance with an order under the FLA for less than market value will likely still have tax consequences that need to be taken into account when negotiating the terms of a settlement, notwithstanding the fact that CGT rollover relief may be available in respect of such a transfer.[76]

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[70] *Income Tax Assessment Act 1936* s6(1)
[71] *Income Tax Assessment Act 1936* s6(1)
[72] ATO ID 2004/461
[73] *Income Tax Assessment Act 1936* s109C(4)
[74] ATO ID 2004/462
[75] ATO ID 2004/462
[76] *Income Tax Assessment Act 1997* s126-15 – see paragraph 1 above

6.3 Debt Forgiveness

A deemed dividend arises if all or part of a debt owed by a shareholder, or an associate of a shareholder, is forgiven. A deemed dividend can also arise in respect of a forgiven debt owed by a past shareholder or associate, when a reasonable person would conclude (having regard to all of the circumstances) that the debt is forgiven because the debtor has previously been a shareholder or an associate of a shareholder.[77]

A debt is forgiven when it would be taken to be forgiven (if it was a commercial debt) for the purposes of the commercial debt forgiveness provisions in Schedule 2C of the 1936 Act (see paragraph 8.3 below)[78], except in the case of debt parking in respect of which specific provisions are contained in Division 7A.[79] In addition, for Division 7A purposes, an amount is taken to be forgiven if a reasonable person would conclude (having regard to the circumstances) that the company will not insist on payment.[80] However, a debt is not forgiven for Division 7A purposes if the obligation to pay is discharged by a payment to the creditor consisting of a transfer of property.[81]

6.4 Effect of Division 7A

Division 7A deems the shareholder, or their associate, to have received an unfranked dividend as a result of the payment/loan/debt forgiveness (as the case may be). A franking debit also arises in the company's franking account.[82]

The amount of the deemed dividend is restricted to the company's distributable surplus in the relevant income year.[83] The amount of the company's distributable surplus is calculated in accordance with section 109Y(2) of the 1936 Act. If the company has a nil distributable surplus then the amount of the deemed dividend that otherwise would arise is also reduced to nil. The fact that the company may have a distributable surplus in later years does not mean that a deemed dividend will arise in those later years.[84]

7. SECTIONS 109XA, 109XB, 109XC

Formerly, section 109UB of the 1936 Act operated to deem a loan as having been made by a private company to a shareholder or associate in circumstances where:

(a) the company was a beneficiary of a trust;

(b) the company was presently entitled to an amount of the net income of that trust which had not been paid;

(c) the trustee subsequently made a loan to a shareholder of the company, or an associate of a shareholder.

Such a loan, by virtue of the operation of Division 7A, was deemed to be an unfranked dividend paid by the company to the shareholder or the associate.

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77 *Income Tax Assessment Act 1936* s109F(1)
78 *Income Tax Assessment Act 1936* s109F(3)
79 *Income Tax Assessment Act 1936* s109F(5)
80 *Income Tax Assessment Act 1936* s109F(6)
81 *Income Tax Assessment Act 1936* s109F(4)
82 *Income Tax Assessment Act 1997* s205-30
83 *Income Tax Assessment Act 1936* s109Y(1)
84 ATO ID 2003/460

Section 109UB has been repealed and replaced with new sections 109XA, 109XB and 109XC of the 1936 Act.

Section 109XA provides that section 109XB will apply in certain circumstances. These circumstances include where :

(a) a trustee makes a payment to a shareholder of a company, or an associate of a shareholder, and the payment is a discharge of or a reduction in a present entitlement of the shareholder/associate that is wholly or partly attributable to an amount that is an unrealised gain that is not included in the assessable income of the trust in the year of income in which the payment is made nor in the preceding nor the following year;

(b) a trustee makes a loan to a shareholder of a company or a shareholder's associate (which is not repaid by the lodgement day);

(c) all or part of a debt owed to a trustee by a shareholder of a company, or an associate of a shareholder, is forgiven,

and, in respect of any of these circumstances :

(d) the company is, at the time the transaction takes place, presently entitled to an amount from the net income of the trust estate which has not been paid in full before the lodgement day (being the earlier of the due date for lodgement of the trustee's return or the actual date of lodgement for the income year in which the transaction takes place); or

(e) in respect of payments / loans / debt forgiveness which occur after 19 February 2004, the company becomes presently entitled to an amount from the net income of the trust estate after the transaction takes place, but before the lodgement day, and the whole of the company's present entitlement has not been paid before the lodgement day.

Section 109XB deems an amount to be included in the assessable income of a shareholder, or their associate, if :

(a) had the transaction been done by a private company ("the notional company"); and

(b) had the shareholder been a shareholder of the notional company (or had the associate been an associate of a shareholder in the notional company),

at the relevant time, a Division 7A amount would have been included in the assessable income of the shareholder/associate because of the operation of Division 7A.

Broadly, the changes to the operation of section 109UB effected by the enactment of these new provisions can be summarised as follows :

- the provisions now catch not only loans, but also payments and debt forgiveness;

- payments / loans / debt forgiveness which occur after 19 February 2004 will be caught by the provisions even if the company has no present entitlement when the payment / loan / debt forgiveness is made in circumstances where such a present entitlement arises prior to the lodgement day and is not paid in full by that date;

- if the present entitlement is paid before the lodgement day then there is no deemed dividend;

- a loan will not fall foul of the provisions if a loan agreement which satisfies the requirements of s109N is entered into by the lodgement day.

8. COMMERCIAL DEBT FORGIVENESS

8.1 Basic Overview

Creditors will often be entitled to claim a capital loss or tax deduction when forgiving (i.e. writing off) a commercial debt. The commercial debt forgiveness (**CDF**) provisions in Schedule 2C of the 1936 Act are intended to balance the revenue implications of such forgiveness by reducing amounts that could otherwise reduce the debtor's taxable income.

8.2 What is a Commercial Debt?

A commercial debt is one where the whole or part of any interest on the debt (whether actually payable by the debtor or not) is, or would have been, allowable as a deduction to the debtor.[85] Whether or not interest is, or would have been, so allowable is determined in accordance with section 8-1 of the *Income Tax Assessment Act 1997* (**the 1997 Act**).

However, a debt will not be subject to the operation of the CDF if the forgiveness results in an amount being included in the debtor's assessable income. Therefore, if a private company forgives a debt which, by virtue of Division 7A of the 1936 Act[86], results in an amount being treated as an assessable dividend in the hands of the debtor, then the CDF provisions do not operate in addition to the deemed dividend which arises.[87]

8.3 When is a Commercial Debt Forgiven?

A debt is forgiven if the debtor's obligation to repay the debt is released, waived or otherwise extinguished.[88] This includes circumstances where the relevant limitation period has expired.[89] A debt will also be taken to be forgiven if it is assigned in circumstances where the new creditor is an associate of the debtor or the assignment occurred under an arrangement or agreement to which the new creditor and debtor were parties (referred to as "debt parking" in the CDF provisions).[90]

However, the CDF provisions do no apply to forgiveness of a debt if :

(a) the forgiveness is effected under an Act relating to bankruptcy; or

(b) the forgiveness is effected by will; or

(c) the debt is forgiven for reasons of natural love and affection.[91]

The Commissioner's view is that the natural love and affection exception can apply in circumstances where the creditor is a company[92] or the trustee of a trust[93]. The Commissioner's rationale, in this regard, is that the CDF provisions do not require the trustee or company to feel natural love and affection, only that the reason for the forgiveness is natural love and affection. Therefore, if there is a degree of relationship between, for example, the debtor and a director of the creditor company, and the debt is forgiven because of the natural love and affection between those two persons, then the exception can apply.

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85 *Income Tax Assessment Act 1936* Schedule 2C s245-25
86 Specifically s109F
87 ATO ID 2003/68
88 *Income Tax Assessment Act 1936* Schedule 2C s245-35(1)
89 *Income Tax Assessment Act 1936* Schedule 2C s245-35(2)
90 *Income Tax Assessment Act 1936* Schedule 2C s245-35(4)
91 *Income Tax Assessment Act 1936* Schedule 2C s245-40
92 ATO ID 2003/589
93 ATO ID 2003/582

8.4 What is the Effect on the Debtor?

The "net forgiven amount" (see below) of a commercial debt that is forgiven is applied to :

(a) Firstly, reduce the debtor's deductible prior year[94] revenue losses[95];

(b) Secondly, reduce the debtor's deductible prior year[96] net capital losses[97];

(c) Thirdly, reduce undeducted balances of certain other expenditure that is being carried forward for deduction (for example, the written down values of assets subject to the uniform capital allowance regime)[98];

(d) Finally, to reduce the cost bases of the debtor's CGT assets[99] (excluding certain assets such as, for example, the debtor's main residence and goodwill[100]).

If any part of the net forgiven amount remains after making the reductions above, then the remaining part is disregarded[101], subject to special provisions relating to partnerships[102]. The balance does not result in an assessable receipt in the hands of the debtor.

The "net forgiven amount" is calculated in accordance with subdivisions 245-C and 245-D of Schedule 2C of the 1936 Act. Generally, a discussion of the calculation of these amounts is beyond the scope of this paper but it should be noted that there are provisions which allow companies under common ownership to enter into an arrangement whereby the operation of the CDF provisions can be avoided by virtue of the creditor agreeing to forgo any capital loss or deduction that would otherwise arise as a result of the forgiveness of the debt. [103]

9. OTHER STRUCTURING AND RESTRUCTURING TECHNIQUES

The following issues, although not unique to situations involving family breakdown, may prove useful in circumstances where assets are being transferred as part of a matrimonial settlement.

9.1 Victorian Registered Companies

In the course of property settlements, it is sometimes necessary to establish a new company to which property might be transferred. At present, it is advantageous, from a duty perspective, to incorporate such new vehicles in Victoria as any subsequent transfer of shares in that entity would not be dutiable. Duty on transfers of unlisted marketable securities has been abolished in Victoria.

The continued use of this structuring technique will be limited, given the impending abolition of duty on unlisted shares in Queensland companies which will come into effect on 1 January 2007.

9.2 Trust Cloning

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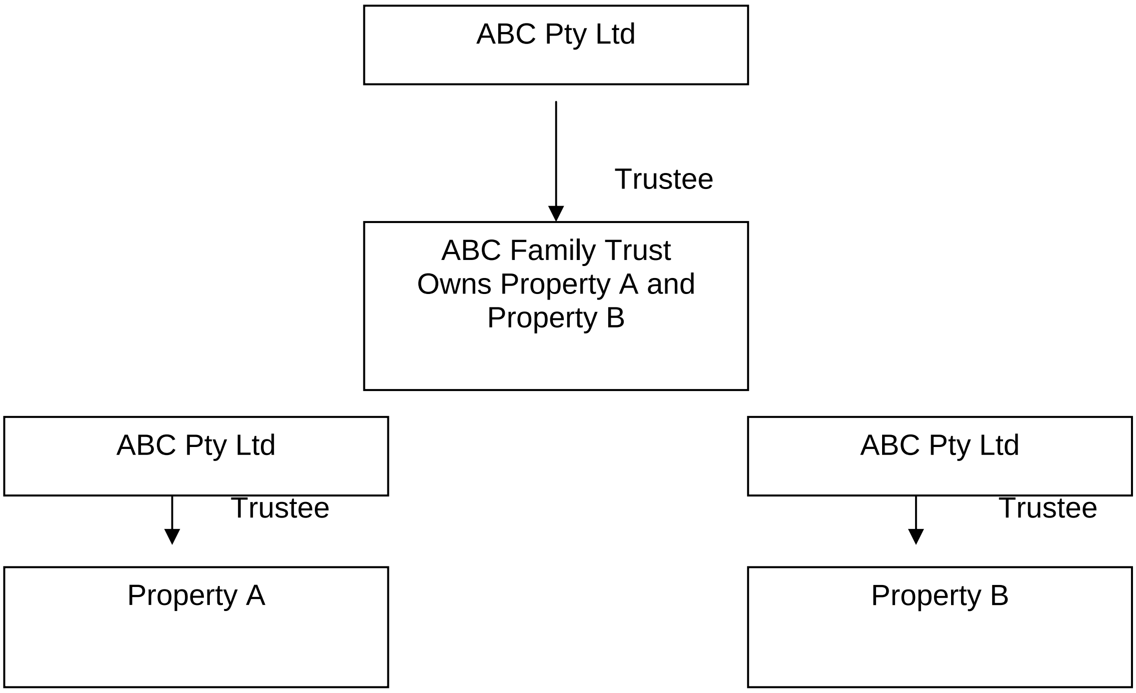
[94] That is, revenue losses in respect of income years *before* the forgiveness year of income
[95] *Income Tax Assessment Act 1936* Schedule 2C s245-105(5)
[96] That is, net capital losses in respect of income years *before* the forgiveness year of income
[97] *Income Tax Assessment Act 1936* Schedule 2C s245-105(6)
[98] *Income Tax Assessment Act 1936* Schedule 2C s245-105(7)
[99] *Income Tax Assessment Act 1936* Schedule 2C s245-105(8)
[100] *Income Tax Assessment Act 1936* Schedule 2C s245-170
[101] *Income Tax Assessment Act 1936* Schedule 2C s245-195
[102] *Income Tax Assessment Act 1936* Schedule 2C s245-215
[103] *Income Tax Assessment Act 1936* Schedule 2C s245-90

Trust cloning is becoming a popular restructuring technique where significant assets are held in a discretionary trust. In a matrimonial context, parties may consider trust cloning as an alternative to transferring property out of an existing discretionary trust (which, for example, may remain under the control of the wife) to a new discretionary trust (which, going forward, will be under the control of the husband).

The effect of cloning a trust is illustrated diagrammatically as follows :

Existing Structure



The Commissioner originally released TD2004/14 and ID 2003/554 to explain his view in relation to trust cloning. ID 2003/554 was withdrawn in May 2005.

The Commissioner has now released TR 2006/4 in which he explains that CGT Event E2 will not occur where property is transferred from one trust to another if the ***beneficiaries*** and the ***terms*** of both trusts are the same.

In relation to the requirement that the terms of both trusts be the same, the Ruling is somewhat inconsistent. On the one hand, the Commissioner indicates that *"even differences that might be considered minor will prevent the application of the exception"*[104] but at the same time indicates that the trust deeds do no need to be worded identically. [105]

Out of an abundance of caution, it is suggested that the terms of the new trust should, with only those exceptions noted below, be a "carbon copy" of this existing trust. This will avoid any need to conduct a "substance vs form" analysis in respect of the terms of the trusts.

The respects in which the new trust deed may differ from the old trust deed are[106] :

(a) the name of the trust;

(b) the date of the trust;

[104] TR 2006/4 paragraph 6
[105] TR 2006/4 paragraph 109
[106] TR 2006/4 paragraph 25

(c) the settlor of the trust.

The Commissioner suggests that the trustee may also be different but in Queensland the trustee of both trusts should initially be the same in order to satisfy the requirements of s53(2) of the DA (see below).

The perpetuity date of both trusts must be the same and, in this regard, care must be taken in respect of the definition of the perpetuity date in the new trust deed. If the perpetuity period in the old trust deed is defined by reference to the date which is 80 years from the date of establishment of the old trust, this definition cannot be adopted word for word in the new trust deed because it will result in the trusts having different perpetuity dates (given that the new trust will be established on a different date to the old trust). The actual date on which the perpetuity period of the old trust expires will need to be worked out and this date inserted as the perpetuity date in the new trust deed in substitution for the reference to 80 years.

The appointor of both trusts must be the same. [107] If the overall objective is to confer control upon two different persons (which will likely be the case if the trust is being cloned in the context of family breakdown), consideration needs to be given to whether the appointor can be changed and, if so, at what point in time that change should occur. The Ruling indicates that it is necessary to examine the terms of the trust at the transfer time[108], as well as immediately prior to, and immediately following, the transaction.[109] If the terms are the same at these points in time then no CGT event will occur. A variation in the trust (e.g. by changing the appointor) at some later stage is not relevant in determining whether the CGT exception applies. However, such a change at a later stage may have resettlement implications and the operation of the general anti-avoidance provisions will need to be considered.[110] The identity of the appointor needs to be taken into account when implementing trust cloning as a restructuring technique in the context of family breakdown.

The Commissioner also indicates that, if one trust has made a family trust election or an interposed entity election then the new trust must also have made the same type of election in respect of the same family group. The Commissioner's rationale for this is that any family trust election *"becomes part of the terms and conditions under which the trust operates"*.[111] The mischief that the Commissioner is trying to address here is obvious – if the old trust has made a family trust election and the new trust does not have to, then the limitations that arise by virtue of the irrevocable nature of the election can be avoided by cloning the old trust and transferring the assets to a new trust which has not made an election. This requirement could also be a barrier to the implementation of trust cloning in the context of family breakdown, given the limited definition of "family" for the purposes of family trust election provisions. "Family" for the purposes of the family trust election provisions, means :

(a) the specified individual's spouse;

(b) the children, grandchildren, parents, grandparents, brothers, sisters, nephews and nieces of the specified individual and the specified individual's spouse;

(c) the spouses of any of the persons listed in paragraph (b).[112]

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[107] TR 2006/4 paragraph 153
[108] TR 2006/4 paragraph 111
[109] TR 2006/4 paragraph 112
[110] TR 2006/4 paragraph 116
[111] TR 2006/4 paragraph 23
[112] *Income Tax Assessment Act 1936* Schedule 2F s272-95

The narrow definition of “spouse” for the purposes of the tax legislation[113] would mean that, if a family trust election has been made with the husband as the specified individual, his ex-wife would not be a member of the relevant “family” for the purposes of any discretionary trust which has made that family trust election, meaning that any distribution from that trust would be subject to family trust distribution tax. In the 2006-2007 Federal Budget, the Treasurer announced that trust distributions to former spouses, and to widows or widowers of family group members who have new spouses, will be exempted from family trust distribution tax. These measures will apply from the income year in which the enabling legislation receives Royal Assent. The enabling legislation has not yet been introduced into parliament. Until it is passed, the fact that the existing trust has made a family trust election (and, therefore that the cloned trust must make a similar election) could well be another barrier to implementing this restructuring technique in the context of family breakdown.

The stamp duty consequences of cloning a trust will depend on the location of the assets and the governing law of the trust. From a Queensland perspective, section 53(2) of the DA provides :

(1) A trust of dutiable property is created if a person, who has acquired property other than as trustee, starts to hold the property as trustee.

(2) Also, a trust of dutiable property is created if all the following apply--

(a) a person holds dutiable property on trust (trust 1);

(b) the person is also trustee of another trust (trust 2);

(c) the person ceases to hold the dutiable property as trustee of trust 1 and starts to hold the dutiable property as trustee for trust 2;

(d) when the person starts to hold the dutiable property as trustee for trust 2--

(i) a person who has a trust interest for the dutiable property under trust 2 did not have a trust interest for that property when it was held for trust 1; or

(ii) a person who has a trust interest for the dutiable property under trust 2 had a trust interest for that property when it was held for trust 1 and that person's trust interest increases.

Accordingly, a trust of dutiable property is not created where property is transferred from old trust to new trust if the trustee and the terms of both trusts are the same. The subsequent replacement of the trustee of the new trust will not attract duty if the general requirements in section 117 of the *Duties Act 2001* are satisfied.

10. CONCLUSION

It is true to say that, as family lawyers, we cannot be a “Jack of all trades”. However, to some extent, it is not possible for family lawyers to avoid at least a basic understanding of tax and accounting issues. The case involving only a “house and garden” for division is now, perhaps, more of an exception rather than a rule, as parties commonly employ corporate or trust entities to operate businesses, for example.

While there are certainly many traps for the unwary practitioners, with careful planning, appropriate advice and, where necessary, expert assistance, unintended issues will be minimised in the context of the determination and practical effect of a property between the parties to a marriage.

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[113] *Income Tax Assessment Act 1936* s6(1)

This approach will also, potentially, allow parties to a marriage to take advantage of some opportunities in the context of their property settlement, re-order affairs tax effectively and without unintended consequences.