TAX ISSUES IN FAMILY LAW
PROPERTY SETTLEMENTS - The difference between hacking and carving
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INTRODUCTION - FORCED ESTATE PLANNING

Family lawyers involved in financial matters are really undertaking forced estate planning. As such, they and the financial experts also involved need to come to grips with the full ramifications of their work in this regard.

This practical booklet covers the strategies that need to be understood by family lawyers when negotiating a family law property settlement or formulating orders to be made by the Family Court. Accountants and financial planners may also find this booklet of assistance when creating a financial plan for their clients. With care, the inevitable financial loss to both parties can be kept to a minimum, and unwanted revenue expenses can be avoided. Failure to take such issues into account can have disastrous consequences for the client, with a corresponding negligence action against the professional adviser.

This booklet was first published for the Australian Family Lawyer’s National Convention in October 1998, and has been constantly revised and updated. Television Education Network has produced several videos and audios based on this booklet. It is also available on the M+K Lawyers website - www.mk.com.au.

Peter Szabo
Principal | M+K Lawyers
Melbourne
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WARNING: This booklet is intended as a guide only as to when further expert tax, accounting or financial planning advice is needed. Every case is different, and different fact situations can impact substantially on what otherwise might be a straightforward case. It is trite to say that our tax laws are complicated. As indicated, what follows is designed to prompt you to take care in what you are doing when you restructure your client’s financial affairs during a relationship breakdown.
TAX ISSUES IN FAMILY LAW PROPERTY SETTLEMENTS

Distributing the spoils – the difference between hacking and carving

The Family Court gives consideration to the parties’ respective contributions and to their special needs. An enforced distribution of assets may take place, with the resultant taxation consequences. It is very much up to the parties’ legal and financial advisers to ensure that all of the possible consequences are taken into account. This is done either when negotiating a final resolution, or when making submissions to the Family Court regarding what orders it should make.

At this stage a good level of co-operation between the parties or at least their respective advisers is desirable.

It is not uncommon for a Family Court judge to indicate broadly the likely orders they will make after a contested hearing. The parties’ legal practitioners are then invited to submit draft minutes of orders designed to give effect to that intention, and for the judge to then settle those orders. There have been instances of the Court requiring one party to co-operate in tax minimisation arrangements recommended by the other party’s accountants. It is important to have such information available for consideration by the judge during a hearing. Unnecessary revenue consequences clearly should be avoided. The distribution should also provide for legal and other professional advisers’ costs.

Careful attention to the method of dismantling existing structures will be appreciated by clients. The approach by the Family Court is to group all of the parties’ respective assets (whether in corporate structures or otherwise) and categorise them as their assets or financial resources. When considering how to distribute and restructure the assets, the tax issues as they apply to the different entities must be carefully considered. The entities may have been established for estate and tax planning reasons, or to achieve limited liability. While the structures may have been effective in minimising tax during the accumulation phase, tax is likely to be payable when dismantling, restructuring or disposing of such assets.

It is impossible to cover all the issues given the enormous complexities involved with taxation. CGT alone is highly complex. Incessant amendments to taxation laws have forced financial advisers to constantly rethink strategies in tax planning, with family breakdown situations being no exception.

A number of situations are outlined below, with a view to prompting the family lawyer or financial adviser to seek appropriate help should the warning bells ring. There is a very real danger that should a party find out that their expected property settlement is substantially eroded by unforeseen revenue consequences, they will look to their professional advisers for compensation. On the other hand, the ability to now split superannuation may offer planning opportunities which can significantly increase the net asset pool for distribution between the parties. You need to be aware of these opportunities. Expert advice should be obtained when you first obtain instructions, not when the parties are about to sign off on consent orders.

De facto & same sex couples come under Family Law Act as of 1 March 2009

As of 1 March 2009, (1 July 2010 for South Australia) de facto and same sex couples who separated on or after those dates, came under the Family Law Act 1975 (“FLA”). Now, all references to ‘spouses’
in that Act include de facto and same sex couples. If a couple separate before, they can ‘opt in’ provided that both parties agree. This is an important option if a superannuation split is contemplated.

### REAL ESTATE AND OTHER ASSETS HELD BY INDIVIDUALS

#### Introduction

Transfers of otherwise dutiable assets are almost always exempt from duty where they occur between spouses as a result of a breakdown of their relationship. This is either because State/Territory stamp duty legislation allows such transfers between spouses regardless of the situation (as is the case in Victoria) or there is an exemption specifically for family breakdowns.

The main residence is exempt from CGT in most instances. After separation however, a jointly owned residence becomes the main residence of only one of the parties. That is, CGT can become applicable to one half of that property. Careful attention to this situation must now be paid having regard to amendments to tax laws effective 12 December 2006. An obvious solution would be to effect a transfer of the former matrimonial home to the party in occupation. The issue arises in circumstances where the exiting spouse purchases another property to live in and (naturally enough) would want to have that residence treated as their main residence.

#### Rollover relief

A property purchased prior to 19 September 1985 can be transferred to the other spouse free of any CGT. It retains its exempt status in the hands of the other spouse if the requirements for rollover relief are satisfied.

Inter-spouse transfers of assets subject to CGT (eg investment properties, shares and equities) attract rollover relief if they are consequential to a family breakdown. However to qualify, the transfer must be undertaken pursuant to a Family Court order.
or Federal Magistrates Court order or a Binding Financial Agreement.

The rollover provisions have the effect that the transferring spouse does not incur a CGT liability at the time of transfer. Rather, the spouse taking over the asset acquires the same CGT cost base as the other spouse had. CGT is incurred as and when the asset is realised. When calculating the net worth of a settlement to a client, this effect should be kept in mind. There may be some instances where rollover relief is deliberately avoided so that a CGT event is triggered. This would be to offset existing losses in appropriate instances. Another example might be where a main residence which is exempt from CGT will later be used for income-earning purposes. In that case, a high cost base may be desirable. The client’s advisors should carefully check the particular circumstances of each case to see whether any estate planning opportunities are present. Changes to tax laws effective 12 December 2006, referred to above, now also mean that a jointly owned main residence has potential CGT issues to deal with.

The impact of amendments to the Income Tax (Assessment) Act 1997 (“ITAA”) introduced in response to the Ralph Report (1999) is a perfect example of how quickly changes to tax legislation can impact on family law settlements. The tax burden arising from the sale of personally owned assets, including shares and real estate, was effectively halved from what it was.

Minimising CGT on a sale of real estate

Investment properties are often registered in the name of the higher income-earning spouse, to attract the most effective negative gearing. Remembering that the capital gain on the disposed asset is taxed at the same marginal rate as the owner is taxed, and that the transfer of such an asset to the other spouse is usually not an expensive exercise, there is scope for tax minimisation.

For example, one might transfer an investment property from the higher income-earning spouse to the lower income-earning spouse. That transfer would probably be free of stamp duty and, if properly timed, would attract rollover relief from CGT. (The spouse who acquires the property will, for the purposes of the 50% discount, be treated as having acquired it at the time the transferring spouse acquired the property.) The property could be sold and the proceeds apportioned between the parties, taking into account the tax saved. Alternatively, the transferee could retain it. In that case, an adjustment in favour of the other party would be warranted given the higher net worth of the property to the new owner. If one of the parties has capital losses, the property could be transferred to that party instead, to take advantage of those losses. Again, the tax savings can be apportioned between the parties.

Legal and other costs associated with obtaining title to the asset are relevant to the acquisition costs. Of course, any tax planning must be undertaken with anti-avoidance provisions of tax legislation in mind.

Motor vehicles

Transfers of motor vehicles between spouses are usually exempt from stamp duty. Most motor vehicles would not incur a capital gain. If it does, rollover relief would then apply.
DIVORCING THE PARTNERSHIP

Consider a typical corner store partnership arrangement. There are two primary issues involved in the event of family breakdown. The first relates to the apportionment of the income stream pending a dissolution of the partnership. The second concerns the disposal of capital assets and trading stock.

Apportioning the income stream

On a separation, one party invariably takes full control of the partnership resources and income. The ousted (or “exiting”) partner may call for an accounting of this additional income up until the time the partnership resources are officially allocated by agreement or by Court order.

In reality, the controlling partner continues to control the cash flow. This is then either divided equally or, more commonly, a lesser sum is paid to the exiting party. This usually reflects the fact that the remaining partner bears the brunt of the work and wants to be compensated accordingly. The other party’s allocation often takes the form of spousal maintenance and child support. This will be based on that person’s actual needs rather than an equal share of the partnership profits. At the end of the financial year, or on dissolution of the partnership, the income is equally divided between the parties for tax purposes. The remaining partner would pay the tax assessed on the allocation to the exiting partner, which usually results in a better net return to both parties.

Thereafter the remaining partner loses the benefit of income splitting. The resulting PAYG and direct tax burden needs to be factored into the settlement equation. In some cases (depending on the terms of the partnership agreement), it may be possible to divide the profits unequally in the year the parties separate in order to take into account changes in the parties’ duties. This may allow an advantageous distribution to the spouse with a lower taxable income. Regardless of the outcome, differing tax liabilities between the parties must be taken into account.

Remember that distributions of partnership income will almost certainly impact on the eligibility of the exiting spouse to receive a pension. The ultimate consequences of this must be carefully considered.

Capital assets and trading stock

CGT may apply on dispositions of partnership assets to a spouse. It is important to remember that CGT may apply to a disposal of goodwill even if the goodwill is not recognised in the partnership’s balance sheet. However, rollover relief is available in the same manner as is explained above (in relation to real estate), ie there is an exemption for family breakdown. That rollover relief is automatic. In some instances, electing not to take advantage of rollover relief may be appropriate if there are capital losses in existence. This could be achieved by keeping particular asset transfers outside of court orders.

The disposal of trading stock on breakdown of marriage is not in the ordinary course of business and is therefore deemed to be a fully taxable disposal by the partnership for market value. This could be evidenced by the values set out in the parties’ respective financial statements filed in court proceedings. Any tax on the resulting profit should be paid by the partners. If rollover relief is available, tax on the profit on that stock should be paid by the transferee spouse. The two options need to be carefully considered in each particular partnership to achieve the best possible net result for the parties.

Depreciable assets are not subject to CGT but any excess of the value of those
assets over their written down value may be subject to income tax. If depreciable assets remain with the controlling partner, rollover relief is automatic for transfers on marriage breakdowns. No tax accrues to the exiting partner and the remaining partner retains the rollover benefits. If certain depreciable assets are transferred out of the partnership to one of the spouses, tax consequences may flow and the individual circumstances of any such possibility should be examined. For example, tax consequences could arise from the transfer of plant because of depreciation rules.

In structuring a spouse’s exit from the partnership, the remaining spouse may prefer to bypass the operation of the family breakdown CGT rollover provisions and buy the exiting spouse out. For example, if the partnership is profitable and has grown in value, the remaining spouse may wish to obtain a cost base for the partnership interest acquired from the exiting spouse. The remaining spouse will probably want to allocate as high a purchase price as is reasonable, in order to maximise the cost base of the partnership interest.

By contrast, if the rollover provisions are invoked, the remaining spouse will acquire the exiting spouse’s cost base which, if the major asset is goodwill, will usually be nil. On a subsequent disposal, the remaining spouse will pay CGT on the entire value of the business even though he/she may have only held the entire business for a short period of time.

If the spouse’s exit is structured as a buy-out, the exiting spouse will usually be subject to a CGT liability on the payout, although the capital gain will be subject to the general 50% reduction applicable to disposals after 21 September 1999.

Minimising CGT - the small business entity concession

If the family’s business is a “small business entity” (within the meaning of the ITAA then any potential capital gain may be able to be reduced by accessing the small business CGT concessions available under Division 152 of that Act. A small business entity is a business which has net assets of up to $6 million or annual turnover of not more than $2 million. Under these concessions, the potential capital gain may be reduced, deferred or totally exempt from CGT for the business owner. For example, under one part of small business concessions where the exiting spouse is under 55, the payout may be exempt from CGT if it is made directly into a superannuation fund for the benefit of the exiting spouse. The proceeds would remain “locked in” to the superannuation fund until the spouse reaches retirement. Another possible outcome is that any capital gain may be eligible for a reduction of up to 50% under the “active asset” exemption. The active asset exemption may be applied together with the general reduction of 50% available to an individual so that the combined effect is that an exiting spouse may pay tax on only 25% of the capital gain. There may be no tax payable in that situation if the remaining 25% is “rolled over” into superannuation.

Indemnities with partnerships

Commonly, the exiting partner obtains an indemnity from the remaining partner for all tax liabilities that may arise from their involvement in the partnership. This may also extend to limiting the exiting partner’s legal liability.

Capitalising instalment payments

Situations frequently arise where one party can only pay the required capital sum by instalments. The recipient demands interest on that sum. Capitalising that interest means a tax-effective payment in the hands of the payee. The payer may negotiate a lower capitalised payment given that benefit. If payments of these capitalised sums are late, penalty interest (under the Family Court Rules 2004 being 9% as at 1 January
2013) could be written into the terms of settlement. This interest would remain taxable in the hands of the recipient.

DIVORCING THE DISCRETIONARY TRUST

Income and assets of the trust

There are several aspects in relation to discretionary trusts which usually require attention. These can relate to:

- distributions of trust income and capital;
- the possible distribution of trust assets such as real estate, motor vehicles and equities to one or both of the spouses; and
- the removal of the exiting spouse from points of control of the trust, ie from any involvement as trustee or in the trustee company and from appointer or guardianship control.

The income stream

As with partnerships, in practice the remaining spouse often controls the cash flow, while the other party receives payments based on considerations such as a reasonable level of spousal maintenance and child support. Distributions of assessable income are usually resolved for tax purposes at the end of each financial year. At that point a decision is made on whether distributions are to continue and who is to pay the tax.

Unlike a partnership, which invariably becomes unworkable with estranged spouses, the trust structure may remain viable despite a family breakdown, and distributions to the exiting spouse may still be possible. However, there are some pitfalls to avoid, eg the exiting spouse may only be a beneficiary by reason of the relationship with the remaining spouse. On divorce, that relationship is severed and the exiting spouse will no longer be a beneficiary of the trust.

A complication to be alert to arises if the trustee has made an election under the ITAA for the trust to be a “family trust”. If the trust ever needed to take advantage...
of income losses or bad debt deductions of its own or of a related trust, or received franked dividends, it may have made such an election to use those deductions or franking credits. When this is done, a test individual is nominated. Thereafter the range of tax-effective beneficiaries is narrowed considerably, ie to the immediate family members, close relatives and current spouse of that individual. A divorced spouse was (until the rules were relaxed in 2006) specifically excluded. While that divorced spouse may remain a beneficiary as defined in the trust deed, and therefore eligible to receive distributions of income, penalty tax rates would apply to those distributions if the trust is a family trust, probably making the exercise hardly worthwhile. Accordingly, if distributions to the exiting spouse are desirable, you need to determine whether an election to become a “family trust” has been made and if so, that the exiting spouse remains within the family group for tax purposes.

If the “prime movers” of a trust are involved in a family breakdown when a family trust election must be made, care must be taken to nominate the test individual to ensure future tax planning options are not lost. Nominating a prime mover may remove the option of making maintenance payments from the trust to the exiting spouse upon divorce. One solution is to nominate one of the children of the parties as the test individual. This would leave both parents as tax-effective beneficiaries. In summary, the careless nomination of the test individual can have disastrous results as an election is irrevocable once made.

If an election to become a family trust is not made or is not seen to be desirable, the trust must pass more stringent tests to be able to make use of income loss or bad debt deductions. In that case the legislation and possible exemptions for family breakdown need to be carefully examined in each case to ensure that the trust can comply with those more stringent requirements.

Should the “emotional factor” come into play, and client co-operation with tax planning issues not be forthcoming, serious financial consequences may result. For example, if the failure to agree on distributions through the trust means the trustee must retain income in a tax year, the trustee will be taxed at the highest marginal rate. The failure to distribute to a spouse during property settlement negotiations may result in a failure to later comply with the pattern of distributions test for the purposes of the trust loss legislation, and the ability to use losses and deductions may be lost.

It is probable that most discretionary trusts will, at some stage, be forced to become a family trust for tax purposes. That being the case, financial advisers need to know who the test individual is and confirm that the election has in fact been made. These elections can be made simply by the trust’s tax agent making a note on the trust tax return. Liaising with the trust accountant is therefore essential.

In the previous section dealing with partnerships, reference was made to the CGT concessions available if an interest in a partnership is being dealt with. These concessions may be available if the business is held through a trust provided you can establish that there is a “significant individual” within the trust structure. A significant individual is someone who has a “small business participation percentage” of at least 20% which may be a combination of direct or indirect participation. However, if the structure is such that you cannot establish the existence of a significant individual it may still be possible to access these concessions if you can establish that the “90% control test” has been met. This is achieved if the distributions from a trust to an individual amount to at least 90% in the year in which the concessions are to be accessed and prior to the CGT event occurring. However, if a particular individual cannot pass the 90% control test on their own they may be able to do so in combination with “their spouse”.

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Therefore, it may be important to ensure that the divorce and any settlement do not take place before the distributions are made so that a party does not lose his or her status as “a spouse” and these CGT concessions can still be accessed.

**Dealing with the assets of the trust**

**Real estate**
Real estate held by the trustee can, in some instances, be transferred to a spouse, with rollover relief available for CGT purposes. Similarly, stamp duty may be avoided. However, in most States this only applies where the recipient spouse was a beneficiary at the time of the purchase of the property in question, and stamp duty was paid at that time.

**Motor vehicles**
Transfers of motor vehicles owned by a trustee will attract stamp duty in most instances.

**Other assets**
Other assets for CGT purposes, such as shares or units in unit trust investments, can similarly attract rollover relief. Such assets are often also dutiable for stamp duty purposes and the relevant legislation should be checked for possible exemptions.

**Disengaging control**
It is typical for the exiting spouse to do most, if not all, of the following:
- resign as appointer of the trust;
- transfer any shareholding in the trustee company to the other party or their nominee;
- resign as director of the trustee company or as an individual trustee; and
- (if the remaining spouse insists) be excluded as a discretionary beneficiary.

The resignation or change of appointer is not considered to be a resettlement of the trust for stamp duty or CGT purposes.

The transfer of a shareholding in the trustee company also does not cause any complication as the company is very often a $2 paid-up company and the trustee is invariably controlled by the appointer. Stamp duty would be on the $1 paid-up share only. The share transfer may, in any event, be exempt as being a transfer between spouses. Care must be taken where the trustee company also owns assets in its own right. In such instances, the most effective strategy may be to remove the company from its trustee role.

The removal of a beneficiary may constitute a resettlement for either stamp duty or CGT purposes. If the trustee can discriminate between the discretionary beneficiaries under the terms of the trust, which is usual, it is often unnecessary to amend the trust deed to exclude the exiting spouse. The trustee, which the remaining spouse controls, can simply cease distributions to the exiting spouse. The trustee, which the remaining spouse controls, can simply cease distributions to the exiting spouse, but care should be taken if the exiting spouse is a taker in default to ensure that they do not receive income or capital in default of a decision to distribute income or capital elsewhere. As a result of taxation determination TD 2012/12, the better view is that removal of a beneficiary is made easier, and is not considered a resettlement.

The resignation of a director of the trustee company also has no stamp duty or CGT implications. However, there is one caveat. This relates to the situation where the trust in question has not elected or does not want to elect to become a family trust for the purposes of the ITAA. In this instance, one of the tests the trust must satisfy in order to use income loss or bad debt deductions is a continuity in the control of the trust during the relevant period. While a narrow exemption applies if a change in control is due to a family breakdown and there is no change in who benefits from the trust, this situation is not straightforward. Change of control can
be occasioned by a change of trustee, a change of appointer and the resignation of a director of a trustee company. Each situation must be examined carefully to avoid unwanted consequences.

**Loan accounts**

Throughout a marriage, a common approach is for distributions to be allocated annually in the accounts of the trust but not actually paid to various beneficiaries, resulting in large loan accounts, or unallocated beneficiary accounts, in favour of those beneficiaries. In the meantime, actual income is loaned to one of the other beneficiaries who then uses the funds to pay for the family’s needs. That individual ends up owing the trust a very significant sum. The prudent accountant should annually allocate the expenditure against the relevant beneficiaries’ loan accounts. This would also have the effect of reducing the debt owed by the spouse to the trust or vice versa.

If the exiting spouse has a debit loan account with the trust, the best option is to have the loan actually repaid. This could be either by way of a cash payment or by adjusting against the transfer of other assets. If the debt is discharged through an income distribution, tax will be payable by the exiting spouse. Another option would be to forgive the debt, but this may have unwanted tax consequences as well. It could amount to a deemed distribution for the purposes of the trust loss legislation. If the trust has not elected to become a family trust, the trust, as a result of the forgiveness of debt, may not be able to take advantage of tax deductions or capital losses. Alternatively, that forgiveness of debt may force the trust to make an unwanted election to become a family trust for trust loss legislation purposes.

Sometimes the exiting spouse has what appears to be a credit loan account, i.e. the trust owes money to that individual. Paying the sum out will be tax-free whether it is paid by way of lump sum or by instalments, repayment in cash, adjustments in transfers of property or by forgiving the loan. The repayment of the loan is usually CGT-free. Interest paid on borrowings by the trust to repay credit loan accounts may be tax deductible, provided the credit loan account was not created through a distribution out of an asset distribution reserve. If commercial debt forgiveness provisions apply, there may be an unwanted impact on the trust with the possible reduction of deductions and the CGT cost base of assets. In the typical family trust situation this is not likely to be the case, but it is best to carefully check the circumstances of all loans before deciding which course of action to take.

The ultimate result with most discretionary trusts is for the exiting spouse to resign as director and officeholder, to transfer the shareholding in a trustee company or resign individual or joint trusteeships, and to surrender appointment and guardianship powers. The issue of indemnities must be carefully considered, with the exiting spouse usually receiving a blanket indemnity to cover all possible permutations. Care must be taken to ensure that tax liabilities resulting from trust distributions are covered in case of any tax reassessments arising at a later stage.

Proposals to significantly amend the tax rules applicable to trusts have been deferred and at the time of writing it is uncertain whether they will proceed and if so, in what form.
DIVORCING A SPOUSE FROM THE COMPANY

In the situation where a family has interests in a company (most commonly a private company), the following will need to be considered:

• what happens to the income stream from separation until settlement;
• the possible transfer of various assets of the company, in particular real estate and motor vehicles; and
• the removal of one of the spouses from the company itself, involving the transfer of any shareholding, resignation as director, and retirement as employee.

The income stream

As with partnerships and trusts, the remaining spouse often controls the cash flow. Appropriate adjustments may need to be made when the matter is resolved, and tax-effective allocations may be made in each relevant financial year. Careful consideration must be given to who will bear the tax burden. As with the partnership scenario, the likelihood is that, upon the parties reaching a settlement, distributions of income or profit to the exiting spouse are unlikely to continue, as that spouse will no longer be involved with the entity.

The remaining spouse will need to consider carefully any arrangements entered into to ensure that unexpected tax liabilities are avoided. If the exiting spouse is an employee of the company, the likelihood is that the employment will be terminated and the income stream will cease. The remaining spouse will retain the company and its underlying assets, but may have lost the ability to minimise income tax consequences.

Transfer of assets from the company

Real estate

A conveyance of real property by a company to a spouse may be exempt from stamp duty. However, the relevant legislation should be checked.

The main residence exemption for CGT does not apply to company-owned premises. Rollover relief is available if the transfer is by court order or a section 90 Agreement. In that case, there is no election and rollover relief applies automatically. Note however, that as companies are taxed on distributions of profit, the otherwise exempt capital growth of assets will be effectively taxed at the company tax rate, currently 30%. This issue is far more difficult to avoid. See discussion below.

There may be times when it would be better to avoid rollover relief, eg where the company has a capital loss made which would offset a capital gain. In that case, some transactions should be undertaken before the finally documented property settlement between the parties takes place, thus side-stepping the compulsory rollover effect. These transactions should take place before the final court documentation is executed, otherwise there can be severe problems with enforcement should either party go back on the deal after the orders or agreement have been put in place.

Motor vehicles

The transfer of a motor vehicle from a company to a spouse will attract stamp duty and might also subject the company to an FBT liability. A further risk of transferring a motor vehicle to a spouse is that the transfer might be deemed to be a dividend equal to the value of the motor vehicle, which would be fully taxable to the spouse receiving it. In the latter case FBT would not apply. There is also the possibility of GST applying.
Court ordered cash payments minimises deemed dividend

As of 2005, the Family Court has had powers over third parties, including companies. As a result, certain tax planning options may be possible. Where funds are held in a company, a payment out to one or both of the parties could be treated as a deemed dividend. However, if the company was made a party to those orders, and it was ordered to make the payments, this might minimise the problem. The payment becomes an obligation of the company. The exemption appears to be limited to cash payment.

(Note: as of November 2013 the ATO was reviewing their attitude. See TTR 2013/D6).

Some solutions
A common transaction in family breakdown situations is for an exiting spouse to retain a company owned motor vehicle. Care must be taken to avoid having this transaction being deemed a dividend. One solution is for the exiting spouse to purchase the vehicle at market value, and for the other spouse to make an appropriate additional payment to cover that transaction, provided there are sufficient resources outside of the company. Otherwise, the company should be made a party to the orders and ordered to make the appropriate payment to the exiting spouse. Stamp duty would be payable. So would CGT, although with motor vehicles this is unlikely.

The same concept would apply for real estate. Stamp duty and CGT are more likely to be a problem, as could GST for commercial properties. It is a matter of ascertaining what the most cost effective solution is.

Share transfers

Stamp duty
Stamp duty exemptions due to family breakdown are likely to apply in most States. Tasmania and Victoria have abolished duty on share transfers. However, in the other States and Territories duty is assessed on the higher of the market value of the shares or the consideration paid for the transfer of the shares.

CGT on share transfers
Inter-spouse transfers will constitute a disposal for CGT purposes. Where there is a rollover, a pre-CGT asset retains that status. With a post-CGT asset, the transferor retains the transferor’s cost base and the transferor does not make a capital gain. If there is no rollover relief, a pre-CGT asset becomes subject to CGT and the deemed cost base is current market value at the time of acquisition. Valuations obtained for Family Court proceedings would be evidence of that market value.

There is a further possible CGT issue if the company owns pre-CGT assets. In this case, a change of 50% or more in the underlying ownership of the company effectively “freshens up” pre-CGT assets to make them subject to CGT for remaining shareholders. An exemption applies for family breakdown situations, although such situations can cause potential problems for companies in which shareholders are not restricted to solely the spouses.

Companies with losses

If a company has tax losses, particular care must be taken so as not to inadvertently lose the ability to make use of those losses or deductions. For tax purposes, to make use of carried forward losses, the company has to satisfy one of two tests. One is the “continuity of ownership” test; if that is failed, the other is the “continuity of business” test. The latter test is difficult to satisfy, hence qualification under the first head is desirable. To achieve this, there must be a continuity of ownership of shares carrying more than 50% of all voting, dividend and capital entitlement. Practically speaking, this means that if spouses are each 50%
shareholders, the exiting spouse must not transfer all of their shares until the use of losses is no longer required. A restructuring of the shareholding may be necessary to give effect to this result. Where the company is owned by a discretionary trust, the situation may force the trust to elect to become a “family trust” election (as discussed above) in order for the company to use that loss. This of course significantly limits the class of tax-effective beneficiaries of the shareholder trust.

Loan account entitlements
The tax issues with respect to loan account entitlements are potentially complex. Issues which require attention include the commercial debt forgiveness provisions, the potential deeming of dividends and FBT implications.

Debit loan accounts
Loans to “associated persons” of the company may become subject to the deemed dividend rules. “Associated persons” includes shareholders, their spouses, and related entities. Whether the loans were made or their terms varied before or after 4 December 1997 will also need to be determined. On that date, legislation came into effect that automatically deems loans from a company to a shareholder and related associates to be a dividend, subject to limited exceptions. If proper account-keeping records are not available, the deeming provisions may come into play, depending on how you attempt to disengage the parties.

One obvious (and the safest) solution to the problem is for the exiting spouse to repay the loan to the company. Sometimes this is just not possible.

A temptation is for the loan simply to be forgiven. However, forgiving the debt may result in the deeming of an unfranked dividend in the hands of the exiting spouse. Correspondingly, if that loan was post 4 December 1997, the company would lose any franking credits it may have had. One way around this problem is to repay the loan from the proceeds of a franked dividend paid to the exiting spouse. While this may use some of the company’s available franking credits, in the overall scheme of things it may have a better net result, provided both parties consider the tax ramifications.

Fringe benefits tax issues may also arise if the spouse is an employee. If interest has not been charged, this potential ramification is more likely. The commercial debt forgiveness rules may also apply if the exiting spouse used the loan moneys for income-producing purposes to deny the benefit of available tax deductions or to reduce the cost base of assets purchased from those funds in the hands of the exiting spouse. Clearly, the exiting spouse will want indemnities to cover any possible tax liability that may arise.

Another way of dealing with the loan would be as part of the exiting spouse’s termination of employment from the company. The issue would have to be addressed in any event to ensure that the company and the remaining spouse were released from any obligations to the exiting spouse under employment laws. Each particular case needs to be checked carefully for potential benefits or problems.

The exiting spouse needs to ensure that appropriate indemnities are obtained from the remaining spouse and also from the company in relation to any liabilities which may arise from dealing with the loan. Where the exiting spouse is a shareholder, or an associate of a shareholder in a private company as defined for tax purposes, the very existence of the loan, the forgiveness by the company of a debit loan or the conversion of the loan to a payment other than a franked dividend could bring about the above results.

Credit loan accounts
Credit loan accounts involve loans to companies from a spouse. The best option would be for the loan to be repaid to the
Exiting spouse. Generally this would be CGT-free in the hands of the recipient. Interest on borrowings by the company may be tax deductible depending on the circumstances of the loan. The company records should ensure that the transaction is properly documented as a repayment of the existing loan. Failure to do so could result in the repayment being deemed an unfranked dividend, which results in higher tax for the recipient and the loss of franking credits to the company. It should be noted that after 1 July 2004 interest free and “at call” loans to a company may be non-deductible.

### OTHER ASPECTS TO CONSIDER

#### Impact on third parties

On 18 December 2004 the Family Court’s powers over third parties were dramatically extended. Whilst the constitutional validity of these powers is questionable, they are at this point valid. Broadly, these powers now mean that some of the following situations are now possible. A bank might be ordered by the Court to release a spouse from a Mortgage, leaving the other solely responsible for the debt. Parents could be ordered to sell a farm property to satisfy a claim being made against one of their children by an estranged spouse. A company likewise could be ordered to transfer a motor vehicle to a spouse, or to make a payment to that spouse. In the case of banks, no adjustment is to be made unless there is a high probability that the loan will be repaid.

The Court’s preferred approach is not to interfere with third party rights where there are enough assets in the control of one or both of the parties to achieve a fair result. However, situations arise where all assets are out of the direct control of the parties. A relatively common example is the farm property owned by the parents referred to above. The married couple have contributed to the farming venture, often for many years in the expectation of inheriting the land. On separation, the son or daughter in law finds themselves in a very difficult position. The remaining spouse of course is likely to one day gain their inheritance, its value increased by the efforts of their former spouse. Now the excluded spouse may have a more powerful remedy to bring the other party to the bargaining table.

Adverse taxation consequences may sometimes flow on to others involved in the business structure, even if those
adjustments are only as between the spouses. An obvious example is where a settlement involves a change in the shareholding of a company which holds assets. This could cause pre-CGT assets held by the company to be freshened up and become subject to CGT, or the benefit of losses or deductions being forfeited. Similarly, the way in which loan accounts are dealt with may attract deemed dividend issues, FBT liabilities, loss of cost base problems and the inability to use deductions and other losses.

The financial consequences of Family Court adjustments to other shareholders may be significant indeed. It may be worthwhile for business partners to keep a careful eye on those possible consequences and take remedial action where appropriate.

**Future tax assessments to the individual**

As previously indicated, dealing with the income streams of partnerships, trusts and companies from separation until final disengagement requires adjustments for tax liabilities. This may result in taxation assessments being made in later years and both parties must be clear on who is to pay them. Financial advisers must ensure that indemnities are put in place where appropriate and that they are backed by appropriate security. An unsecured indemnity for the payment of tax is of course useless where the other spouse has gone bankrupt or absconded with all the assets. For that reason also, debit loan accounts must be properly dealt with and releases obtained from the corporate entity.

An often overlooked situation is the issue of tax refunds. If the exiting spouse has a reducing income stream, PAYG tax payments will result in significant tax refunds arising the following year. Logically, the spouse who pays the tax in the first place should have the benefit of that refund in later years.

**Accounting issues**

Depending on what restructuring strategies are adopted, additional accounting expenses can be incurred. The preparation of additional books of account other than at the end of the financial year might be required. For example, the resignation of a director in a non-fixed trust situation where a family trust election is not possible or wanted could trigger this requirement, while the change of directorship may trigger a different treatment of the trust for tax purposes.

In many instances, the actual date of resignation of a director makes no difference to the exiting spouse and the simple step of co-ordinating that resignation with the end of the financial year can avoid unnecessary paperwork and expense, or the necessity to rely on the Commissioner’s discretion. Of course there may be good reason for the exiting spouse to immediately resign as a director of a company, given the potential for personal liability for debts where companies are trading when insolvent. For companies that are employers, directors are made personally liable for the non-payment of PAYG deductions to the ATO, even if they had no knowledge or control over the non-payment. The resignation should therefore take place as soon as possible to avoid these situations.
GST – GOODS AND SERVICES TAX

There is no “rollover” relief on a breakdown of marriage with GST as there is with CGT. The ATO issued rulings in early 2003 confirming that position.

Transfers of real estate and other assets between husband and wife personally will generally not attract GST. This is primarily due to the fact that they are not considered to be “supplies” made “in the course or furtherance” of an “enterprise” for the purposes of the legislation. That said, investment property transfers may in some instances incur GST, such as where the holding of that real estate is seen to be “an enterprise”.

Where there are entities other than individuals involved (and for tax purposes this includes partnerships), and where there are business assets, the situation requires very careful analysis. Each transaction within the settlement reached must be carefully considered. In a simple case where one party retains the entity and the other keeps outside assets, GST is probably not payable. This will depend on how the entity is structured and how the disengagement of the exiting spouse is structured. Where, for example, the wife receives the partnership/entity motor vehicle, GST will be payable on that transaction by the partnership/entity. With the common husband/wife partnership, by definition there is a dissolution of partnership when one party disengages. In that case the partnership may incur a GST liability by transferring assets to the remaining spouse. The parties are jointly liable for this payment.

It may be possible to minimise the impact of GST on a transfer of business assets from one entity to another or to an individual by having the transaction undertaken as a sale of a “going concern”. Otherwise, the exiting spouse (“vendor”) may incur a GST liability. In normal circumstances, a spouse leaving the business would expect the remaining spouse to accept full responsibility for any tax or other revenue costs associated with that transaction. Husband/wife partnerships can pose particular problems. Whilst the remaining spouse will be considered an “entity” carrying on the business, care must be taken to ensure that further unwanted revenue triggers (such as CGT or stamp duty) are not activated. Where third parties are involved in an entity, the situation is potentially more complex, remembering that the entity is often liable for the GST imposed.

Accordingly, the general approach in family law matters would be for the exiting spouse to receive an indemnity from the remaining spouse should any GST be payable as a result of any transactions as between them and the entities they are involved in. The spouse giving that indemnity should know the value of it by being made fully aware of the GST consequences of the family law settlement. Care should also be taken to ensure that any credits for GST revert to the intended party. The giving of the indemnity to the exiting spouse itself is not likely to be subject to GST.

The concept underlying the Tax Office’s approach to GST is that if parties have obtained the tax benefits of an entity holding their assets (for example by being able to claim GST imput tax credits), taking them out of that entity will incur GST despite this being solely the result of a marital breakdown. This may cause hardship in many cases, but that is the reality of the situation at present. Clearly, specialist accounting advice is needed before formalising arrangements in such cases.
TAX ISSUES WITH SPOUSAL MAINTENANCE

In Australia, the payment of spousal maintenance is not deductible to the payer, nor is it taxable in the hands of the recipient. In dealing with the disengagement of the exiting spouse with partnerships, trusts and companies, it can be seen that there is some opportunity for tax-effective distributions to take place, certainly from the time of separation until the disengagement. After that, the ability to distribute tax effectively is limited.

Partnerships

The distribution of income in lieu of maintenance can only be up to and including the time of dissolution of that partnership. Income, of course, is taxable in the hands of the recipient whereas maintenance is not taxable. Following dissolution of the partnership, there is no right remaining for the exiting spouse to receive partnership income. This does not include capitalised payments or instalment payments. However, these do not give the payer tax deductions nor are they taxable in the hands of the recipient.

Trust distributions

The ability to distribute to the exiting spouse remains, but the tax effectiveness can be severely challenged as a result of the election to become a family trust. If the election has taken place, the test individual must not have been the remaining spouse, otherwise this avenue is lost. If no election has been made or if the exiting spouse remains within the family group, distributions can continue as before.

Companies

If the parties so wish, it may be possible, subject to the value shifting rules, to restructure the company to allow the exiting spouse to have dividend access shares with no rights to vote or attend meetings, and so on. Otherwise, payments will cease when the exiting spouse stops working for the company and removes him/herself as shareholder and director.

Spousal maintenance and termination packages for spouses

Where the parties are employed in a family business and one party retires, it may be possible to structure a “retirement package” tax-effectively. The spouse, however, must have been performing real and substantial duties as an employee or company director. Payment likewise must be made in good faith and in consideration of past services, and must be a reasonable sum having regard to those considerations. Such a payment would be tax deductible to the employer but will nonetheless be treated as an eligible termination payment to the exiting spouse, who will be taxed on that payment on a concessional basis. In considering the above, careful attention needs to be given to the impact such planning will have on possible pension entitlements.

Lump sum payments and use of assets

Spousal maintenance can be satisfied by way of a lump sum payment or the provision of a right to use assets. Lump sum payments are capital. The amount in question may affect the assets test for pension purposes. There is no tax benefit for the recipient in this case. In some cases it may be possible for one spouse to provide the other with the use of property or a motor vehicle. However, that invariably means that any tax deductions for maintaining the premises or vehicle will not be claimable by the spouse providing the benefit.

In considering options for the tax-effective payment of spousal maintenance, the
full financial circumstances of both parties must be carefully considered. In structuring any settlement between the parties, the terms of settlement must clearly spell out who is to bear the tax burden.

TAX CONSIDERATIONS FOR CHILD SUPPORT

Given that child support is paid out of after-tax income, payments in the hands of the recipient are tax-exempt and are not tax deductible to the payer.

It is clear that manipulation of the administrative assessment is possible. For example, upon separation a payer may persuade their employer to restructure their salary package. Obviously, FBT would apply which would be payable by the employer. However, the net amount of the package payable to the employee could be less than before, so that the employer would benefit from this arrangement. The employee likewise would benefit because of the reduced child support obligation which results from the narrow interpretation of taxable income for child support purposes.

However, as from 1 April 1999, the Government introduced changes in relation to reportable fringe benefits. The purpose of the changes was to enhance the fairness of the taxation and social security systems. The effect of this is that the Child Support Agency will be able to “add back” those benefits when making an initial assessment. Nevertheless, it is likely that salary sacrificing would still result in a lower assessment than would otherwise be the case.

Even though the payee can seek an administrative review or, if appropriate, a departure order from the Court to rectify the situation, the enforcement of child support reverts to the Child Support Agency. The Agency’s ability to enforce the payments is limited to a percentage only of the taxable income, not counting the protected amount, and again fringe benefits are not “added back”. Invariably this means that although a higher child support amount is payable, the Child Support Agency cannot enforce the full
payment unless a tax refund is due or there are cash or other assets available for sale. In these situations, parties commonly negotiate child support agreements for fixed amounts per annum to be increased by an inflation factor, as well as the provision of other expenses such as medical cover and private school fees.

**Child support trusts**

Normally, unearned income of minors attracts a penal tax rate. It is therefore not usually tax effective to distribute assessable income to minors from trusts or other structures. The major exemption is where such income will be treated as “excepted trust income” if it is derived from property transferred to a trustee as a result of family breakdown.

Child support trusts were relatively popular during the 1980s. A variety of amendments to the ITAA were implemented in 1994 whereby on the one hand the number of people who may potentially benefit from the use of a child maintenance trust was increased and, on the other hand, the requirements for a transfer of property to that trust and the ability to invest such property were tightened up considerably.

Nowadays any child of a broken relationship, and even those who are the result of a “one night stand”, come under the definition of a “family breakdown”.

The qualification for the establishment of a child support trust is a legal liability to pay child support. This is evidenced by the existence of an assessment under the *Child Support (Assessment) Act* 1989.

A simple example of a maintenance trust would be the transferring of, for example, $1 million cash to a trust. The income generated could be distributed to infant beneficiaries and marginal tax rates would apply, provided the income is derived at arm’s length rates. The capital must pass to the children when the trust ends. Many people do not have such cash available to give to their children. Hence, other alternatives may need to be investigated carefully. Some examples could be the transfer of units in a unit trust which conducts a business, the transfer of units in a service provider trust or the transfer of an investment property. Such transfers do not attract stamp duty exemptions or CGT rollover relief and this must be taken into account in determining whether a child support trust is viable.

For family law purposes, the possibility of a child support trust is well worth considering, as the gaining of a tax advantage invariably means the payer has more disposable income to pay maintenance for the benefit of the children. Importantly, whilst the ability to transfer property to the Child Support Trust has tightened, the timing for doing so has been extended. For example, a parent with primary school aged children wanting to send them to private secondary school now has some years to build up trust assets. Those assets do not have to be provided by the children’s parents. Funds can come from anyone, commonly grandparents. The trust itself should be established at the time child support payments are resolved and documented, although this is not essential.
ADVANCE PLANNING

Cohabitation, prenuptial and financial agreements

Because of the emotional issues involved, few couples are willing to consider problems that may arise on a separation when they enter into a relationship, even though it is clearly sensible to do so given the incidence of divorce in this country. Cohabitation or pre-nuptial agreements are becoming more common.

As of 28 December 2000, legislation introduced into the FLA the concept of legally binding Financial Agreements. Couples contemplating marriage or a de facto relationship can now make enforceable contracts, provided they satisfy the stringent requirements set out in the legislation. Independent legal advice is mandatory. Lawyers acting for the parties must certify that certain advice was given. Prior to this development, the Family Court would only enforce the terms of a cohabitation agreement if the terms were fair, independent legal advice had been given, and the parties had abided by the terms of the agreement. Even then, the Court in its discretion could make other orders, thereby effectively circumventing the effects of the agreement. A financial agreement that satisfies the provisions of the FLA is binding on the parties, thus reversing the previous approach.

Financial agreements can also finalise the right of a spouse to future spousal maintenance support, unless that party is entitled to a pension at the time the agreement comes into effect. This issue was previously only capable of being addressed in what were known as Section 87 Agreements. Those agreements were subject to court scrutiny and approval (not easily obtained), without which they were void. They were replaced by financial agreements in 2000. The ability to lock out this possible future right is a valuable prize.

An agreement enables both parties to address problems that arise if the relationship breaks down, without the emotional factors coming into play. Assets owned prior to the relationship can be quarantined, as can inheritances or advances received from family during the relationship. Unfettered, both of these issues cause enormous heartache for the parties and their families. Whilst the Court will inevitably provide a fair result in most cases, it is far better for the parties to determine this in advance, if at all possible. This provides the opportunity to undertake succession planning with more certainty. With “greying Australia” this issue is becoming far more important for clients. A financial agreement could include deadlock-breaking devices for a partnership, such as the appointment of an independent manager on a separation or for the automatic changing of company shareholders’ rights on a divorce. Another use could be to specifically categorise an advance from a parent as a loan that must be repaid in the event of a separation.

Couples who entered into a prenuptial agreement prior to 28 December 2000 must enter into a fresh agreement which complies with the new requirements to make them binding. The legislation also allows couples in existing relationships to enter into financial agreements, to define their financial rights and responsibilities in the event of a breakdown of the relationship. Likewise, financial agreements can also be used by separating and divorcing parties to document the terms of settlement reached between them.

Tax planning structures require flexibility

Hopefully, careful consideration of the above will alert the financial adviser or estate planner to some preventative measures. Attention might be given to problems associated with changing the
“underlying majority interest” referred to above. Hence the prime mover should own the majority of the shares so that, if a breakdown does occur, the transfer of a minority interest does not attract CGT liabilities or prevent the use of carried forward losses or deductions. The nomination of a trust as a family trust can also have unfortunate ramifications. The consequences of a poor choice of test individual could mean that spousal maintenance payments are limited, passing control of that trust to the spouse is not possible as part of a divorce settlement, and the value of the trust as a tax planning vehicle is diminished. Luckily announcements in the July 2006 budget meant that the possible negative impact has been watered down significantly.

One-director companies may be an option. However, more than two shares should be issued to allow for a restructuring later on if required (preferably at least 100 shares should be issued). Partnership agreements can be written to allow an uneven distribution of income in certain circumstances. Self managed superannuation funds have more flexibility for restructuring, should the parties separate, as compared with apportioning other types of funds.

Wills also need to be drafted to take into account blended family situations and the possibility of bequests being made at an inappropriate time, such as when the recipient is bankrupt or is in the middle of divorce proceedings. Some flexibility may be useful, with testamentary trusts providing that benefit.

Throughout the life of an entity, accountants need to ensure that all loan account entitlements are properly documented and recorded, whether to or from entities, or from parents to their married children. Proper housekeeping is essential.

While a divorce forces estate planning on parties at an inappropriate time, lateral thinking by professional advisers can minimise the negative consequences. Your clients will appreciate the effort you put into such strategic planning.
SUPERANNUATION SPLITTING UNDER FAMILY LAW

Overview

As of 28 December 2002, superannuation has been treated as property, to be dealt with in the same way as any other asset of the parties to a relationship. Laws came into operation detailing how superannuation is treated when a marriage breaks down. This was extended to de facto and same sex couples who separated on or after 1 March 2009. Same sex and de facto couples who separated before this date can choose to “opt in” with the consent of both parties. The main legislative changes occurred in the FLA. Additional legislation also involved changes to the Family Law Regulations and to the SIS Regulations.

Specifically:
- superannuation interests are valued according to various pre-determined methods;
- the Family Court can make flagging orders and splitting orders;
- the parties can make superannuation agreements; and
- trustees of superannuation funds are bound by both Court Orders and superannuation agreements.

The Family Court retains its wide discretion when it comes to applying the above rules. This means that if the strict application of the laws produces an unfair result, the Court can decide upon a different outcome. This could involve one party retaining the marital home for the benefit of the children, with the other party receiving little or no cash payment. Instead, they will retain their superannuation entitlements.

The laws do not apply to cases where final property orders were made prior to 28 December 2002, unless those orders can be set aside, which can only be done in limited circumstances.

Objective of the laws – a fairer apportionment of all property

The laws were designed to provide clear guidelines to the Family Court so that decisions are fairer, more practicable and more predictable. A summary of the provisions is as follows.

Statutory formula

A statutory formula, subject to limited exceptions in the regulations, apply for the valuation of interests in each particular fund. The formulae themselves are complex, but in most cases, particularly accumulation funds, the result will be relatively straightforward. It may simply be the value/amount from the requested statement from the trustee. Complexities exist because of the many different funds in place, and the peculiar difficulties of valuing, for example, defined benefits funds. With those funds the formula can produce what appears to be an unfair result to the non fund member spouse. Actuarial calculations may be necessary to demonstrate this anomaly. It may be fairer to wait until the entitlement is paid, and then to divide it between the parties. The benefit of this is that the exact amount net of tax is known. Valuations are not mandatory if parties enter into a superannuation agreement or if a member benefit statement is available for an accumulation interest.

Splitting and flagging orders

The Family Court is able to make flagging orders, or splitting orders dividing the funds between the member spouse and non member spouse. A flagging order effectively directs a trustee not to make a splittable payment without the leave of the Court. A splitting order will, in most cases, cure the problem of attempting to freeze funds for what may be many years, and allow immediate financial separation. The new superannuation entitlement (known as an “interest”) will belong to the other party who can...
then access it in accordance with their own retirement qualifications ("conditions of release"). This is in accordance with Government policy to ensure that parties have and retain long term superannuation benefits.

A flagging order is only obtainable where the court is satisfied that a splittable payment will soon become payable. As to how long this means remains to be seen. By way of contrast, if the parties agree to flag the fund in a superannuation agreement, no time limit is applicable.

Components of the split
The various components of the particular interest will be split in the same proportion, ie the preservation components, as well as the different tax (ETP) components. Note that taxable and non-taxable components are treated as one component for splitting purposes. This can give rise to significant taxation consequences, some beneficial, some not.

Parties have flexibility
The parties can agree on how to split funds any way they wish. They can agree to flag a fund or to split it, depending on the circumstances. These agreements are binding in the same way financial agreements are binding on the parties and also on trustees of funds.

Some super splits cannot be put in place immediately
Some superannuation splits cannot be transferred into the non member spouse’s own name immediately. Whilst most funds can immediately separate the member spouse’s entitlement and rollover into an account in the non member’s own name, some defined benefit funds can only “piggy back” the non member spouse’s entitlement to the member spouse’s account. In these cases, the non member spouse has to wait until the member qualifies for, and acts upon, that entitlement to be released before being eligible to receive their entitlement under the superannuation split in their own name. Careful attention needs to be given to these possible anomalies and results. That said, most funds have moved to the concept of splitting funds rather than deferring entitlements.

Trustees bound by orders
Trustees are bound by Family Court orders, flagging agreements and superannuation agreements. Severe penalties for breaching orders apply. Complex regulations governing the scheme are being revised as anomalies arise and are rectified, in an attempt to simplify procedures.

Application of superannuation splitting laws

Valuing superannuation
Parties are now better guided by the statutory formula. Valuing an interest in a fund is not mandatory if parties enter into a superannuation agreement. It is, however, mandatory for Court purposes, unless it is an accumulation interest. Because of the potential complexities that might arise, a valuation is strongly recommended. Various organisations are available to provide superannuation valuations. It is recommended that their services be engaged for such purposes as they will be able to take into account the complexities of the particular superannuation fund as well as the associated tax aspects of the particular individual. Parties and their advisors can then contemplate what options are available to them.

Splitting order
A splitting order divides a superannuation entitlement between a member and a non-member. In order to be split the superannuation will need to be valued (see above). The valuation of the superannuation determines an amount called the base amount. The base amount can be transferred as an interest split or a payment split.

An interest split is where the non-member receives a transfer of superannuation from their spouse. Generally, a new account
is established for the non-member’s superannuation benefits. An interest split can only occur when the superannuation is in a SIS regulated accumulation style fund. This can be in either growth stage or payment stage, eg an allocated pension. Each account can then be managed in accordance with the member’s financial wishes. The benefit is that the new account will retain the preservation characteristics of the old account, except that restricted non-preserved amounts generally become preserved amounts. Interest splitting is generally not applicable to defined benefit interests, and other non-regulated superannuation funds.

An interest split allows an immediate financial separation. It overcomes the problem of benefits being left in limbo, possibly over many years, waiting to be apportioned.

Example 1
Chris and Susie are separated. Susie has $224,000 in an accumulation fund while Chris has no superannuation. The benefit is made up of $4,000 unrestricted non-preserved and $220,000 preserved. The Family Court makes a splitting order that provides an interest split to Chris of half of the superannuation benefit. Chris’s $112,000 superannuation benefit is now made up of $2,000 unrestricted non-preserved and $110,000 preserved. The unrestricted non-preserved benefit will remain unrestricted unless the new fund has cashing restrictions, eg if he rolled the funds into his employer fund which only allows funds to be accessed if the member ceases employment with the employer.

Where the preserved part of the account balance includes a non-concessional component (for example contributions made without any tax deductions being available) consideration should be given as to whether your client will benefit from such a component. A client at age 55 accessing superannuation by way of lump sum would not pay tax on the non-concessional component but would pay tax on the concessional component.

Defined benefit funds or non-regulated (SIS) accumulation interests
A payment split will be made where the superannuation entitlement is not eligible to be dealt with by an interest split. An interest split will generally not take place if the superannuation entitlement involves a defined benefit fund or non-regulated accumulation interest. A payment split makes the transfer when the superannuation is able to be paid out. Most defined benefit funds have changed their trust deeds to allow an immediate payment split, ie a “clean break” for the non member spouse.

Flagging orders
A flagging order effectively directs a trustee not to make any type of payment without the leave of the Court. As a result the fund is frozen and cannot be accessed by the member or trustee. This order may be used where a splitting order (see above) is not appropriate. The analogy is similar to a caveat in conveyancing parlance.

Superannuation agreements
The parties can agree on how to split benefits any way they wish. They can agree to flag a benefit or to split it, depending on the circumstances. Agreements are as binding as a Court Order. As such they are binding upon trustees of superannuation funds.

To create a superannuation agreement the parties must have received separate and independent legal advice. The parties are also required to provide the trustee of the superannuation fund/s with evidence of their separation. The ETP components and the ESP of a new superannuation interest that is created as a result of a splitting agreement will be treated in the same manner as a splitting order from the Court.
The difference between hacking and carving when apportioning superannuation

Tax planning opportunities
With the new regime, significant tax planning strategies can be considered. These strategies, however, can only be successfully implemented where the net tax consequences are carefully considered, having regard to the particular circumstances of each case. This applies with superannuation in particular, in that both the fund member and non-member spouse’s financial circumstances and tax positions are highly relevant. The parties may decide to leave all superannuation with one party and make an adjustment to the other in terms of the other assets, most likely the former matrimonial home. Alternatively, they may divide superannuation on an appropriate basis taking into account each of their (and any dependants) different needs for readily realisable assets.

Splitting may not be cost effective
It may not be cost effective to undertake a splitting order or agreement with small benefits, particularly if the non-member spouse seeks to retain other assets such as the family home. Consider whether all superannuation is divided on an appropriate basis taking into account each of their (and any dependants) different needs for readily realisable assets.

Example 2 - Planning opportunities
As your client moves closer to retirement, consideration needs to be given to limits on lump sum contributions to superannuation. The Federal Government has constantly tinkered with superannuation contributions. At one stage $100,000 deductible could be made. This was for people over 50 until 2012. Prior to 2012, this was reduced to $50,000 and then to $25,000. Now deductible contributions are limited to 25,000 for everyone. Will the Government make any further changes? Inevitably!

Consider the following fact situation:

Tony and Meredith are divorcing. Tony is 51 and Meredith is 47. Tony has superannuation valued at $800,000. Meredith has nominal superannuation, having stayed at home looking after the children during their marriage.

Splitting Tony’s fund equally means that Meredith’s receiving $400,000 overcomes the annual limit. If the above example applied but Tony was 55 and Meredith was 60, the split from Tony to Meredith of $400,000 would mean Meredith could access those funds immediately. It may be that $600,000 could be transferred to Meredith who could then pay $200,000 to Tony.

Separation declaration
Given the potential for tax minimisation, before making an agreement of above the tax free threshold ($175,000 in 2012/13) the legislation requires the parties to provide a declaration to the trustee of the fund that they have lived separately for 12 months immediately before the declaration and there is no reasonable likelihood of cohabitation being resumed. Alternatively, a Divorce Order evidencing their divorce is to be provided. The other option is for a court order to be made. Such orders can only be made if the parties are separated, and are subject to the scrutiny of the court. It is not possible for couples who are not separated to split superannuation under these laws.

Cooperation of parties needed
This requires cooperation between the parties to determine whether the result is acceptable having regard to
the delayed payment. Sometimes the non-member spouse can take advantage of ESP qualifications aggregating other funds, if they exist. There will be other tax components and planning issues to consider in actual cases as against the distilled example provided above, dependent on the amounts involved, the ages of the parties, when they joined their respective funds and their requirement for immediate funds. Clearly, the various permutations need to be considered to ascertain the best option. For the non-member, it may in fact be better to leave the interest with the member spouse, and to put in place a flagging agreement, to take advantage of a better net result on the member’s retirement package when received. The member may prefer to split the interest, to take advantage of the investment opportunities within the superannuation environment without involving the other party.

Other planning strategies to be implemented might, in the right circumstances, involve making a delayed payment to take advantage of the superannuation environment. For example, a spouse who is 52 years of age and exiting a family business could agree to a delayed payment of their CGT-exempt component until they reach 55, thus making it possible to roll it over into a superannuation fund with more flexibility. As a lump sum payment election has to be made within seven days of receipt of sale proceeds, this strategy may be used to enhance planning options. Term payments are possible, given that a CGT liability will usually not be triggered when splitting benefits between the parties, provided assets are transferred to a self-managed fund or a small APRA fund.

Changes announced with effect from 1 July 2006 and 1 July 2007 have considerably widened the scope for tax planning opportunities.

CGT issues
With CGT, care must be taken to make certain this is avoided. Expert advice in this regard is highly recommended, particularly with funds holding investment properties. Steps will have to be taken to separate the parties financial ties within the fund and this will possibly involve the establishment of another self-managed fund. CGT roll-over relief where applicable, is available whether or not the apportionment takes place by Court Order or by way of a superannuation agreement.

Special care needs to be taken with self managed superannuation funds and how particular assets such as rental properties are apportioned. There may be issues of who gets control. Ideally one party ends up agreeing to roll over assets into their own self managed fund. Once again, careful attention to detail with the assistance of expert advice is strongly recommended.

Particular circumstances important
The particular personal circumstances of the case may determine a different course of action to just splitting superannuation benefits. For example, a man may have re-partnered. His new spouse is much younger, and they have a young child. He may prefer to keep his benefits intact to maximise pension entitlements, which can be left to his new partner or other eligible beneficiaries. This option is of course only possible if there is other property his first spouse can take to adequately compensate for this arrangement. Very clear instructions will need to be given to the preparation of Court Orders and agreements splitting superannuation. Otherwise, trustees of funds will not be able to give proper effect to what the parties really want.

Aspects to consider when advising on superannuation splitting necessitates a full understanding of superannuation issues. The constant reminder is that superannuation, whilst treated as property under the new Family Law regime,
nonetheless has “strings attached”, more so as time passes given Government policy to enforce the retention of superannuation benefits until retirement. Appropriate financial planning advice is necessary to ensure parties do not fall into any traps. It is an ever-changing, complex area. Specialist advice is essential to achieve the desired and most advantageous outcome for the parties and their dependants.

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