Chapter 18

Financial and estate planning on family breakdown

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¶18-000 Financial and estate planning on family breakdown

The big picture

Think outside the box: There are significant financial planning, estate planning and taxation *issues* and *opportunities* that financial advisers (and family lawyers) should be aware of and address on marriage or relationship breakdown for their clients. With 40% of first marriages ending in divorce and a higher rate of breakdowns for de facto relationships, divorce or relationship breakdowns can be emotionally and financially draining ....¶18-005

The Family Court: The *Family Law Act 1975* confers wide powers upon the Family Court in relation to property and financial resources of separated spouses. These powers were broadened from 1 March 2009 to also include de facto matters. De facto couples include both heterosexual couples as well as same-sex couples ....¶18-010

Estate and financial planning: is it necessary?: One of the greatest areas where negligence claims could be levelled against professional advisers (including financial advisers and lawyers) relate to lack of advice on estate and financial planning prior to or on marriage breakdown. For instance, the risk of death is one of the financial planning issues that professional advisers should address with their clients on marriage breakdown ....¶18-020

The four-step approach: Up until the High Court decision in *Stanford* was handed down in late 2012, the Family Court's approach to property settlement was enshrined in a methodical four-step approach. Has the four-step approach been turned on its head? The four-step approach the court undertakes is as follows:

(1) identify the pool of property (including superannuation and tax liabilities, if applicable) ....¶18-105

(2) assess contributions that each of the parties have made to the accumulation of the pool ....¶18-110

(3) assess the s 75(2) factors — commonly known as ''future needs factors'' ....¶18-115

(4) examine whether or not the result will deliver justice and equity between the parties ....¶18-120

Superannuation splitting: Superannuation splitting has been available since 2002, and from 1 March 2009, was also extended to de facto separated couples. Superannuation has become both a sword and a shield in financial settlement negotiations. There are a number of super interests that are unsplittable such as small super interests of less than $5,000. The court still has discretion as to whether to split super or not. The nature of a superannuation interest would also have an effect on whether the super interest will be added to the pool or taken into account as a financial resource. There are also opportunities in enlarging the property pool by doing a super split ....¶18-200

Taxation issues: There are significant taxation issues and opportunities to take into account in any property settlement. These include:

- Realisation and taxation costs ....¶18-300
- Taxation losses ....¶18-305

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- CGT on supersplitting ....¶18-400
- CGT on transfer of property ....¶18-500
- Deemed dividends and company loans ....¶18-510
- Tax avoidance ....¶18-515

Stamp duty exemptions on marriage or relationship breakdown: There are exemptions from duty following breakdown of a marriage or de facto relationship ....¶18-600

Land tax: In NSW, land tax is a tax levied on the owners of land situated in NSW as at midnight on 31 December of each year. There is no land tax roll-over relief on marriage or relationship breakdown ....¶18-610

Income and taxation opportunities: During the duration of a marriage or relationship, parties generally split the income of partnerships, companies or trusts between husband and wife. Should such arrangements continue from separation until the family law matter is resolved? Who should pay the tax? What protection will the client need from a nasty tax bill that may arrive after the settlement has been concluded? ....¶18-615, ¶18-620

Spouse maintenance: Under the Family Law Act spouses have an obligation to continue to support each other after separation to the extent that one spouse has a need and the other spouse has capacity to pay. From 1 March 2009 that obligation also applies to separated de facto couples ....¶18-700

Child support: Children born after 1 October 1989 or their parents separated after that date fall under the child support scheme set up under the *Child Support (Assessment) Act 1989*. The child support legislation overhaul commenced on 1 July 2006 and was completed on 1 July 2008. The changes are far reaching. In some cases (and particularly for paying parents on the highest tax margin), the new changes have resulted in some parents' child support liability dropping by as much as 40% ....¶18-705

Child maintenance trusts: A child maintenance trust is a trust that arises as a result of the family breakdown and would be set up to receive child maintenance payments. One of the principal benefits of a child maintenance trust is that it enables tax-effective income splitting to beneficiaries of a trust (including beneficiaries who are under 18 years of age) without attracting the penalty tax provisions contained in Div 6AA of the *Income Tax Assessment Act 1936* (ITAA36) ....¶18-715

Full and frank disclosure: The cornerstone of all property settlements is built on parties making full and frank disclosure of their financial position. Failure to do so could spell a disaster for the client's credibility before the court and give their spouse a higher adjustment from the property pool. The adviser's role is therefore significant in assisting the client to discharge their obligations of full and frank disclosure ....¶18-800

Third parties standing in the Family Court: A party that may be affected by a decision of the court has standing to intervene in Family Court proceedings. Generally, family law proceedings are inter partes; however, there may be occasions where third parties need to intervene to protect their position ..¶18-815

Bankruptcy: Since 19 September 2005, the Family Court also has jurisdiction to determine financial matters (property and spouse matters) where one of the spouses becomes bankrupt. The court can alter the rights of the trustee in bankruptcy in relation to the bankrupt's property that has vested in the trustee in bankruptcy ....¶18-820

Financial agreements: Financial agreements provide a good measure of asset protection on marriage or relationship breakdown because they provide certainty of result on division of assets rather than rely on lawyers and judges to come up with a result that will cost tens of thousands of dollars. However, more recently lawyers have shied away from financial agreements. Why is this and how will this impact on clients? ....¶18-825

Mediation: The Family Law Rules 2004 mandate that parties undertake Pre-Action Procedures (PAP) before proceedings are commenced. This is an opportunity for advisers to seize upon and be involved in the settlement of their client's family law disputes. This would be done in conjunction with the family lawyers retained by the client(s) ....¶18-835

¶18-005 Introduction to financial planning on family breakdown

There are significant financial planning, estate planning and taxation *issues* and *opportunities* that financial advisers (and family lawyers) should be aware of and address on marriage or relationship breakdown for their clients. With 40% of first marriages ending in divorce and a higher rate of breakdowns for de facto relationships, divorce or relationship breakdowns can be emotionally and financially draining. Divorce is a reality for many financial planning clients.

It is, therefore, incumbent upon advisers and lawyers to consider, plan and implement strategies that take into account marriage or relationship breakdowns when providing financial and estate planning advice to their clients before the marriage or relationship breaks down and be proactive if and when the client's relationship or marriage fails.

Most clients choose to undertake estate planning because an adviser or lawyer identifies significant financial and other benefits to them and their family. A property settlement is the corollary in that it is a compulsory estate plan that clients are forced to undertake.

Lawyers and advisers must not shy away when their clients' relationships or marriages break down. Lack of action or awareness of the *issues* and *opportunities* by the adviser (or the lawyer, for that matter) of the financial impact and consequences of marriage or relationship breakdown could have a disastrous financial impact on the client and place a client's future estate planning and retirement in disarray.

With careful planning and cooperation between lawyer and adviser, clients' financial costs could be kept at a minimum and leave their estate planning intact. This holistic approach that lawyers and advisers give to clients is akin to an insurance policy and crucial, regardless of whether or not divorce or separation will become a reality.

From 1 March 2009, the laws on de facto relationships breakdown commenced in Australia with the exception of Western Australia. The new laws were a revolution as they represent a significant departure from the de facto laws that existed in some states. The laws apply to de facto couples and couples in same

gender relationships. Under the new regime, the rights of de facto partners (including same-sex partners) are equated with those of married couples in relation to matters such as property settlement, superannuation splitting and spouse maintenance. De facto rights are now determined in the Family Court/Federal Magistrates Court, under the Family Law Act. It was the revolution that had to happen.

Previously, some people may have entered into de facto relationships deliberately because of the difference in the laws that applied to de facto couples versus married couples upon a relationship breakdown. From 1 March 2009, that difference no longer applies. Accordingly, now more than ever before, there is a need to work through the mire with a view to try and preserve the client's financial and estate plan. How will this be achieved?

Some of the advice that an adviser should give a client include consideration of whose name the assets should be held in — the client, their spouse or an entity, and what involvement should the client/spouse have in the running of a business that is being set up by the adviser on behalf of the client.

Traditionally advisers, and lawyers for that matter, have advised clients to have their spouse as partners in the business. While this may provide tax benefits during the course of the relationship or marriage, consideration ought to be given by the adviser and the client as to whether or not this is a sound structure, given the risk of marriage or relationship breakdown. One of the considerations that need to be taken into account is the level of involvement of a non-financial activist spouse in companies or trusts set up by the financial activist spouse. This may have an ultimate bearing on the entitlement of that spouse in short relationships and short marriages.

Financial advisers need to also understand who their client is. While this issue may seem trivial, in fact it has significant legal consequences. Invariably an adviser may be acting for the financial activist spouse and, as part of the financial planning for that spouse, advice is given that certain assets be purchased in the name of the non-financial activist spouse to minimise tax or for other such reasons. By doing so, the professional adviser has inadvertently become the adviser for both clients. However, the adviser believes that they are the financial activist spouse's adviser. This is a misconception and has serious ramifications in relation to whether the adviser has discharged their obligation of assessing ''the client'' risk profile before investments are purchased in the name of the non-financial activist spouse; the level of contact between the adviser and the non-financial activist spouse; privacy issues and flow of information between the files of both clients; the role of the adviser on marriage breakdown; and whether the adviser can have or retain ''both clients''.

Purpose of Chapter 18

This chapter is a practical guide for advisers to use in their daily practice. Its purpose is to outline many of the estate and financial planning issues that advisers should be aware of and should incorporate in a checklist to examine

and re-examine on behalf of their clients, not just at the first point of contact but throughout the duration of their professional relationship with the client.

Given a client's reliance upon professional advisers for advice, it is incumbent upon advisers to keep in mind the various financial and estate planning issues that are raised in this chapter whenever they give advice to clients. This is not to suggest that the adviser should become a de facto lawyer in giving advice to clients. It is about the professional adviser being attuned to the various legal ramifications of financial decisions that clients may make and being able to identify those issues. The adviser and the lawyer work together to ensure that clients make informed decisions.

¶18-010 The Family Court

The *Family Law Act 1975* (the Act) commenced in January 1976. The Act confers wide powers upon the Family Court in relation to property and financial resources of separated spouses. (In de facto matters, such powers were until 2009/10 conferred under the *Property (Relationships) Act 1984* in New South Wales on the Supreme Court, District Court and Local Court (depending upon the pool of assets under consideration).)

The word ''property'' is widely defined in the Act and includes real estate or shares in public or private companies, interest in trusts (where the spouse is a controller or a spouse is a beneficiary and where there has been regular distributions from the trust), interest in any business and bank accounts.

The Family Court does not distinguish between assets held in the name of a spouse or in a company or trust controlled by a spouse or in circumstances where a company or trust, for instance, are controlled by third parties who are mere puppets for the spouse in Family Court proceedings. They are all ''matrimonial property''.

The decision of the High Court in *Kennon v Spry* highlighted the broad powers given to the court in relation to what ''property'' is. The decision may have some significant ramifications on trust law generally and also on areas that traditionally viewed trusts as separate entities. This includes bankruptcy cases where trusts are generally excluded from a property that vests in the trustee in bankruptcy.

In *Kennon v Spry*, the High Court confirmed what the Family Court has done over the years — including trusts in the general property pool of the parties. The courts have endorsed the concept that a typical family trust is in effect for the family, and an individual cannot exclude their spouse from the fruits of that trust even if the trust was originally established to benefit the parties' children.

Superannuation is ''*another species of assets*''. In some cases, superannuation will be treated as if it is property but in other cases it will be treated as a financial resource. The nature, characteristics and form of a superannuation interest will determine whether super will be added to the property pool in Step 1 (of the four-step approach adopted by the court which will be discussed in ¶18-100) or will be taken into account in Step 3. This distinction is not

cosmetic but has significant consequences for the parties and the overall property division. If the super value is included in Step 1, the property pool is enlarged. However, if the super value is characterised as a financial resource, then the value will not be added to the property pool in Step 1 but will be taken into account in a broad brush way in Step 3.

Financial resources are taken into account in dividing the property pool between spouses in Step 3 in that the court examines whether there should be an adjustment to the notional property pool divided in Step 2 by reason of a party having an interest in a financial resource. Financial resources include being a beneficiary in a trust where the trust distributions to the beneficiary spouse are not regular, taxation losses, frequent flyer points or rewards points, long service leave and in some circumstances, superannuation.

The powers of third parties in the court have been increased and strengthened in recent years. This is evident in the third parties powers in Pt VIIIAA, which allows third parties such as government instrumentalities and creditors to institute proceedings to set aside financial agreements or consent orders where it can be shown that the agreement or consent orders were entered into with an intention to defeat or defraud creditors.

The court's powers also extend to deal with bankruptcy matters where bankruptcy and family law collide. The court has the jurisdiction to deal with and make orders as to property or spouse maintenance from property that has vested in the trustee in bankruptcy.

Since 1 March 2009, de facto couples' (which include same-sex relationships) financial settlements and spouse maintenance are determined in the Family Law Courts. This applies to all couples in all states with the exception of Western Australia. For people living in some states, this will have some serious consequences on the property settlement or spouse maintenance outcome as determined by the Family Court versus what that outcome might have been if the case was determined in the state courts.

¶18-015 What about de facto relationships?

This chapter outlines the financial and estate planning and taxation issues and opportunities required for a married couple, and for couples who have separated after 1 March 2009. On a practical level, most of the chapter also applies to de facto couples who also separated before 1 March 2009.

The law that commenced on 1 March 2009 (or 1 July 2010 if parties have geographical connections to SA) confers jurisdiction on the Family Court to determine financial settlements for de facto couples who separated after 1 March 2009 (or 1 July 2010 for SA). For those couples who separated pre-1 March 2009 (or 1 July 2010 for SA), the state courts will continue to determine those cases under the relevant state-based legislation. In NSW the relevant legislation will continue to be the *Property (Relationships) Act 1984*.

For example, capital gains tax (CGT) roll-over relief is available for de facto couples (who separated pre-1 March 2009) where transfers of property are

made pursuant to a court order or a Domestic Relationship Agreement or Termination Agreement, just as it is available for married couples.

Super splitting between separated de facto couples who separated before 1 March 2009 does not apply. Rather, super is taken into account as a financial resource under the relevant state law. However, if de facto couples separated after 1 March 2009, the Family Court does have the jurisdiction to split superannuation interests.

¶18-020 Estate and financial planning: is it necessary?

One of the greatest areas where negligence claims could be levelled against professional advisers (including lawyers) relate to lack of advice on estate and financial planning prior to or on marriage breakdown. For instance, the risk of death is one of the financial planning issues that professional advisers should address with their clients on marriage breakdown.

Since 2000, parties have been able to enter into Binding Financial Agreements (BFA) to ensure financial certainty in the event of separation. In theory this is a very useful tool of financial and estate planning. Unfortunately, this area of law has proved problematic for both clients and lawyers. The courts have frequently set aside the agreements due to invalidity, ambiguity as well as a raft of other reasons. Notwithstanding the attack on BFAs, they still are a useful tool for protection and certainty of outcome.

Lawyers as well as financial advisers could be at risk of negligence claims, not only from their clients, but from disappointed would-be beneficiaries if the client dies while the family law matter remains unresolved. Often the professional adviser is the first to know of the divorce, sometimes even before the client's partner.

In one case, while proceedings were still pending in the Family Court, one of the spouses died. At the date of separation, the family home was in joint names. Neither party had changed their wills as at the death of the husband, and the husband's super death nomination was directed to his estate. By reason of the ownership of the house in joint tenancy, the wife took the title. In light of the nomination, and the absence of any claim from the children of the parties, the super trustee gave the husband's superannuation death benefits to the estate. The will that had been prepared a significant time prior to the parties' separation was still active so the wife was the sole beneficiary. Had the husband and the wife been divorced by the time that the husband died, the gift in favour of the wife under the husband's will would have been void; however, this had not happened in this case.

It should be borne in mind that divorce can only be applied for after the parties have been separated for more than 12 months. When people are in the midst of Family Court proceedings they generally delay filing the application for divorce until the property settlement and parenting issues are finalised. This means that parties could be separated and yet not divorced for periods of

up to two if not three years, or even longer. Even if the parties were divorced, the wife would still have received the house by survivorship.

In all likelihood the husband in the case did not intend for the above to occur. He was in the Family Court because he wanted a financial separation from his wife. The question that must be considered is whether the lawyer for the husband, or for that matter his professional adviser breached any duties to him. It is arguable that they should have advised that death meant the person he was trying to secure assets from would inherit everything, but that a few small steps could have avoided this outcome.

In the example above, the husband could have severed the joint tenancy on separation, changed his will and changed his binding death nomination. These steps were simple yet necessary and it was crucial to have been taken or for the husband to have been advised upon and his mind be applied to those issues. This is where the adviser's role becomes critical immediately upon separation.

The adviser's role, however, is not confined to providing advice of the type referred to above on marriage breakdown. The role of the adviser is dynamic and ever changing, and given changes in community standards and developments in society, the adviser needs to turn their mind to issues that impact upon their clients.

One timely example relates to baby boomers assisting their Generation X and Y children by providing them with a deposit on a house or giving them money to set up a business. It is not unheard of, in Sydney at least, that parents give $500,000 and in some cases more to an adult child to assist them in buying a home. What is unclear in such cases is the basis of the advancement of funds. That is, did the parents intend the money advanced to be a gift or a loan? If a gift and the adult child was in a relationship already, was the money advanced to the adult child or to them and their partner? Is the partner aware of the nature of the advance? How is that proven in the future if the parties separate and the partner denies the advance as a loan because they were unaware of the terms of the advance or they were not involved in discussions?

The adviser should give advice to the client to deal with the above issues. Advisers are constantly approached by clients asking them to liquidate assets for purposes such as the above. The adviser's obligations extend to enquiring about the purpose of the advancement; how the advancement of the monies to the Generation X and Y children should be done; that documentary evidence should be put in place **before** the funds are advanced; whether interest rates will be charged or should be charged if certain conditions come into play. Even if the adviser does not know the legal implications of the above, the client should be advised (and such advice should be documented in a file note at least) to seek legal advice before the money is advanced.

The above steps are necessary because the baby boomer client, while wishing to benefit their Generation X or Y child, would not want to see the funds lent or advanced being shared by a future spouse of their son or daughter in the

event of marriage breakdown. A deed of loan evidencing the advancement of funds could be entered, which outlines the amount given in situations when the funds are repayable, such as marriage breakdown, sale of business, or death of the adult child.

If the adult child later separates from their spouse, the money advanced would, prima facie, be a liability that will reduce the property pool to be divided between the spouses. If, on the other hand, the funds advanced were not the subject of documentation such as a deed of loan, the adult child and the parents will be put to the task of proving the existence of the debt and, if this is not established, the court may only accept that the money advanced was a gift. A monetary gift made on behalf of a spouse is taken into account by the court at Step 3; however, it does not receive the same weight as a loan that has the effect of reducing the pool of property available for distribution. The difference between gift and loan is not cosmetic. It is significant and substantive.

Even if there is a deed of loan, that may not be sufficient to get the client over the line and have the debt deducted from the pool of property. This generally occurs because a spouse would argue that the debt is not a real debt or is not repayable. It is therefore crucial to consider whether the baby boomer should insist on there being a Binding Financial Agreement between their adult child and their spouse before the money is lent, which deals with the financial consequences relevant to the money to be advanced in the event of a breakdown of the relationship or marriage.

There are a number of advisers who set up trusts on behalf of their clients by simply buying a standard trust deed without giving any consideration to the client's particular circumstances. There is a potential negligence claim here as the adviser needs to consider whether or not the trust should benefit a child of the client (or that child's spouse or former spouse), who should be the appointor or appointors of the trust, who should be the trustee of the trust and whether there should be any statements of intentions as to the reasons for the setting up of the trust to be incorporated in the trust deed. The High Court decision in *Kennon v Spry* is a reminder of how crucial it is to turn your mind to the structure as to who should be the appointor, the trustee and the beneficiaries from the outset rather than seek to amend the trust deed after the event. More recent cases in the Family Court have provided guidance on what happens when a trust is set up in a way that control is not conferred on a party but the control remains with, for example, the parents of the spouses. In a recent case the court found that such a trust was not property for family law purposes given that the husband did not have the control of the trust. In that case the trust owned the family home. The husband's father set up the trust and bought the home which the parties used as their matrimonial home during the marriage. The wife was unable to convince the court that the Trust is the alter ego of the husband as the husband's father was in **real** control of the trust.

Advisers should also be aware that their clients can enter into binding financial agreements (before the client gets married or into a relationship,

during marriage or the relationship, following separation or divorce). Until 1 March 2009 for most states except SA and WA, couples used to enter into domestic relationship agreements. These types of agreements have the effect of ousting the court's jurisdiction. They outline the financial consequences to each of the parties on relationship or marriage breakdown. Such certainty of outcome may be necessary because of the significant wealth that a client has as compared with that of their spouse, or because the client is in business with third parties where certainty that the business will not have to be sold as a result of a claim by a spouse in the future is necessary for the running of the business and the financial planning not only of the client but also of the business partners.

In cases where one of the spouses refuses or simply does not want to enter into a binding financial agreement, there are practical steps an adviser can take to protect their client to some extent. One of the greatest debates in family law cases centre around the initial financial contributions of spouses. In cases where a client has some wealth and they cannot convince their spouse to enter into an agreement, then it is important for the adviser to ensure that there are objective records available to establish the client's initial financial contributions. This can take the form of bank statements, share trading records showing the number of shares owned and the price at the end of the relationship or marriage, valuation of real estate, copies of the financial statements of any company or trust under the spouse's control. These records must be kept in a secure place and not destroyed. They may come in handy one day if the client and their spouse separate.

All of the above are examples of the value-added service that an adviser can and should provide to their client. Failure to identify the issues may result in a negligence claim against the adviser not only by the client but (as we saw above) by intended but disappointed beneficiaries.

PROPERTY SETTLEMENT

¶18-100 The four-step approach to property settlement

Until 2012, the process for the making of orders pursuant to s 79 of the Act was commonly dealt with by reference to a four-stage process (see eg *Hickey & Hickey*). That process involved:

(1) identification and valuation of the property of the parties

(2) identification and evaluation of contributions to the property (including property no longer owned by the parties)

(3) identification and assessment of the various matters in s 79(4)(d) to (g) including, to the extent they are relevant, the matters in s 75(2), and

(4) consideration of matters of justice and equity.

In the High Court of Australia decision of *Stanford v Stanford* [2012] HCA 52; [2012] FamCAFC 1 in 2012, the joint judgment of French CJ, Hayne, Kiefel and

Bell JJ noted three fundamental propositions relevant to the operation of s 79. Those propositions were conveniently summarised by Bryant CJ and Thackray J in the decision of the Full Court of the Family Court in *Bevan and Bevan* [2013] FamCAFC 116.

The High Court in *Stanford* has laid down three ''fundamental propositions'' which will provide useful guidance to trial judges in approaching the task under s 79. These were recited above, and could be summarised thus:

- determination of a just and equitable outcome of an application for property settlement begins with the identification of existing property interests (as determined by common law and equity).
- the discretion conferred by the statute must be exercised in accordance with legal principles and must not proceed on an assumption that the parties' interests in the property are or should be different from those determined by common law and equity.
- a determination that a party has a right to a division of property fixed by reference only to the matters in s 79(4), and without separate consideration of s 79(2), would erroneously conflate what are distinct statutory requirements.

It has been suggested that the four-step approach ''merely illuminates the path to the ultimate result'' and is not an approach that is mandated by the Act. Rather, it is the ''mandatory legislative imperative (to reach a conclusion that is just and equitable) that drives the ultimate result''. Ultimately, it appears that *Stanford* requires judges to consider whether the jurisdiction be invoked. The preliminary step for a judge is to consider whether the s 79 enquiry will be engaged. In doing so, the judge will need to consider any equitable principles that would need to be attended to in relation to property registered in the name of a spouse and once this is done, consider the assets that each party has an interest in and look over the fence to see what contributions were made by the parties and assess whether an adjustment may be required to be made under s 79. In most cases, this will be an easy exercise in particular where parties have lived together for a long time and/or have children.

The difficult cases will be where the marriage is short and/or where it is short and no child or children were born of the relationship or marriage. If there has been no merger of finances in such a marriage and the assets of the parties were purchased in names that one of the spouses considers that there should be no adjustment in favour of the other spouse, then it is open to that spouse to raise as a threshold argument that the court should not exercise jurisdiction. That spouse would argue that there ought be no adjustment to the property because the other spouse is not or will not be able to establish that they have an interest in the property of the other spouse because of the short relationship. This gateway question is gaining momentum and as time passes, there may be more cases on this point.

Once the gateway issue is addressed and if the judge comes to the view that justice and equity dictates there being an adjustment of property, then the s 79 enquiry commences and the four-step approach is engaged.

The four-step approach, being:

(1) identification of the pool of property (including superannuation and tax liabilities, if applicable)

(2) assessment of contributions that each of the parties have made to the accumulation of the pool

(3) assessment of the s 75(2) factors for married couples. For de facto couples, there are identical provisions in s 90SF(3) — commonly known as ''future needs factors'', and

(4) examination of whether or not the result will deliver justice and equity between the parties.

¶18-105 Property settlement step 1: Identification of the property pool

In identifying the property pool to be divided, the court generally looks at the property pool each of the parties had at the commencement of the relationship and their values (known as initial financial contributions), what happened to the initial property and the accumulation of property during the course of the marriage and since separation.

It may be easy to identify the initial financial contributions of each of the parties; however, it is difficult to ascribe a value to the initial property that the court would accept unless valuation had been obtained at the time the parties entered into the relationship or shortly thereafter. Some advisers advise their clients to obtain a valuation of their assets as they are about to enter into a relationship or get married so that that could be evidence of that party's initial financial contribution in the event the relationship or marriage breaks down in the future.

Initial financial contributions by one spouse could have a significant impact on the outcome of the property settlement. The value of the initial financial contribution, the length of the marriage and the value of the property pool at hearing or settlement are important considerations as to the weight the court will give to initial financial contributions.

The court has generally adopted the value of the property pool as at the date of hearing (or as close as possible to that date). However, this may not be adopted in each case. In circumstances where the period between separation and hearing could be up to two years or longer, it may be prudent to obtain a valuation of property as at the date of separation, as well as at the date as close as possible to the hearing. This need not be the case for each parcel of property. It may be appropriate where a spouse runs a business and the business value has significantly increased from the date of separation as compared with the date of hearing.

Superannuation is another example where valuation at the two dates should be obtained. This is relevant in particular to accumulation interests where a spouse has continued to make contributions into the fund or even in defined benefit super funds, post separation.

As for the family home or other real estate, the Family Court has traditionally looked at the value of such property as at the date of hearing or as close as possible to that date rather than as at date of separation. This is because the court takes the view that any increase in the value of real estate occurs not by reason of any direct contribution by either of the parties but by reason of fluctuation in the property market. One wonders why the Family Court has taken this approach given that generally the court does not give any, or any significant weight to the spouse who continues to make mortgage repayments on the family home, notwithstanding that that spouse no longer resides in the family home following separation (as the court assesses that such contributions would have been offset by the homemaker and parenting role carried out by the other spouse during separation).

Taxation liabilities

Taxation liabilities have the effect of reducing the property pool by the amount of tax liability that either or both of the parties have to pay. This includes unpaid income tax and capital gains tax payable in relation to property sold. As for CGT that may become payable in the future by a spouse who will retain a particular property or shares in a company, the test that the court applies is whether or not the property is likely to be sold in the short to medium term by that spouse. If the answer is in the affirmative, then the court will generally reduce the pool of property by the amount of the CGT that would become payable on disposal. If the answer is in the negative, but the court is satisfied that the spouse will ultimately dispose of the property in the future, the court takes the CGT into account under s 75(2) (Step 3). Further, if the property was purchased for investment purposes, then the tax consequences have generally been taken into account in the first step, thus reducing the value of the property pool by the tax that would be payable.

''Add-backs''

''Add-backs'' are notional property that the court adds back to the property pool which has the effect of enlarging the pool. Up until recently, add-backs occupied significant court time arguing over property that no longer exists and the reasons why this ''property'' ought to be added to the property pool. The Full Court has recently made it clear that add-backs are a thing of the past. If the property no longer exists then how could it be added back. This appears to be true in relation to all except legal fees, waste (such as gambling) and ''interim property settlement Orders''.

Family law proceedings can take a significant time to resolve. From date of filing an application to date of trial is about three-year delay. Such delay is unfortunate but that is the reality. The consequences for parties though can be far reaching in particular in relation to partial or interim property orders (discussed in detail below).

The Full Court of the Family Court in the decision of *Bevan and Bevan* made it clear that add-backs need to be dealt with ''carefully, recognising the assets no longer exist, but that the disposal of them forms part of the history of the

marriage — and potentially an important part''. The court went on to say that the court can take into account assets that no longer exist when the court looks at s 75(2) being the third stage in the assessment where the court looks at whether there should be an adjustment of the percentage notional division made by the court in respect of the contributions assessment in respect of the existing assets and superannuation. The court does this relying on s 75(2)(o) being ''any fact or circumstance which, in the opinion of the court, the justice of the case requires to be taken into account''.

To satisfy the court that an item of property that is no longer in existence should be added back, a party must be able to show that the item of property was in some way wasted by the spouse in control of the item. Examples of add-backs include legal fees paid from capital and assets that were wasted by a spouse, such as by gambling.

In relation to legal fees paid, these will generally be added back if they were paid from capital. That is, if a spouse withdraws money from a savings account that the parties had as at the date of separation or sells an asset to pay legal fees, the legal fees are added back as notional property and will be taken as if there has been a partial distribution in favour of the spouse who paid the legal fees from that savings account or disposal of the asset.

On the other hand, legal fees paid by a spouse from their earnings are not generally added back as they have been paid from that spouse's earnings. However, a judge still has the discretion to add-back the legal fees paid from earnings or to exclude legal fees paid from capital. The circumstances of the case can, in some instances, sway judges to act in this manner. For example, in cases where a judge makes a finding of non-disclosure, and where one spouse pays legal fees from capital and the other spouse pays legal fees from borrowings, there have been cases where judges have ignored the legal fees paid and excluded the loan obtained to fund one party's legal fees.

Most advisers and lawyers also do not appreciate that when adding back certain property and then dividing the pool say equally, then the pool is enlarged by the amount added back and then divided between spouses. So the spouse pushing for an add-back could be sharing in something that no longer exists. If that spouse receives 60% of the total property, then an add-back would see that spouse receive 60% of something that no longer exists. Thus, proportionality needs to be considered as the add-back may hold up settlement of a family law matter because one party is convinced that a certain sum be added back. The reality is, in an add-back, both parties end up sharing the amount added back. This was never the intention. So perhaps consideration ought be given to depart from add-back and argue that a spouse has received a financial benefit and seek a higher contribution of what is left in the pool or seek an adjustment back against the other spouse from their share of the property pool. The latter would be better argued in cases such as waste.

''Assets waste''

''Assets waste'' has become more popular in recent times in family law disputes. The court has to make a finding that the spouse who dealt with an

asset did so with reckless indifference to the parties' accumulation of the pool. It is difficult to establish that a spouse has been recklessly indifferent to the asset if the asset has been lost, given the test that the full court has formulated.

An extreme example of waste is where a spouse gambles $100,000 at the casino and loses the money, then the court will add as notional property the amount of property that has been wasted by that spouse, namely $100,000. In the overall property division the court will take into account that that spouse has received the property that has been wasted as partial distribution.

Gifts and inheritances

Gifts and inheritances are treated differently to assets accumulated by spouses. If the inheritance or monetary gifts have been intermingled in the parties' property pool, the court would still take them into account in assessing each of the parties' contributions. However, if the inheritance or gifts, for instance, were not intermingled or were received close to or following separation, it is likely that the court will quarantine them from the property pool in Step 1 on the basis that the other spouse did not make any contributions to the inheritance or gift. Notwithstanding this, however, the court would still take such inheritance or gifts into account in Step 3 (s 75(2) factors).

¶18-110 Property settlement step 2: Assessment of contributions

In assessing the parties' respective contributions to the acquisition, conservation and improvement of the pool of property, the court assesses the following:

- the parties' respective initial financial contributions
- gifts and inheritances received and their application
- the direct and indirect financial contributions of each of the parties
- the direct and indirect non-financial contributions of each of the parties, and
- the parenting and homemaker contributions made by each of the parties.

Initial financial contributions

It is incumbent upon advisers to advise clients who, at the commencement of their cohabitation or marriage (whichever is earlier), own property that they should obtain valuation of the assets so as to be able to prove the value of the assets and therefore the value of their initial financial contribution in the event of separation. For businesses owned by a client, an adviser should advise the client to retain the financial statements and income tax returns for the business for the three financial years prior to the commencement of cohabitation or marriage as these documents can be used to value the business if the client and their spouse were to separate in the future.

The initial financial contributions by one spouse, however, could be eroded by the contributions of the other spouse to a greater or lesser extent by the later contributions of the other party even though those later contributions do not necessarily at any particular point outstrip those of the other party.

Example 1

A spouse's initial financial contribution of $70,000, 20 years ago as compared to the parties' current pool of property of $2m may have been eroded by the passage of time and the contributions made by the other spouse.

Example 2

One spouse made an initial financial contribution of $500,000 at the commencement of cohabitation five years ago. The current combined value of the property pool is now $1m. It could not be said that the passage of time and the contributions made by the other spouse have eroded the initial financial contribution.

In such a case and assuming no children, the contributions could be assessed at approximately 75% to 80% in favour of the spouse who made the initial contribution.

Gifts and inheritances

Gifts and inheritances received by a spouse during the marriage or after separation are treated differently by the Family Court. A gift or inheritance received either during the parties' cohabitation and marriage or following separation is taken by the court to have been received by the person to whom the gift or inheritance is given rather than to the parties jointly.

Gifts and inheritances therefore are assessed as a contribution by or on behalf of the spouse receiving the gift or inheritance as an indirect financial contribution. Depending on when the gift or inheritance is received and what the parties did with the gift or inheritance, the court has discretion to quarantine the gift or inheritance received from the pool of property in assessing the parties' respective contributions.

Example 1

If a spouse receives a property as part of an inheritance during the course of their relationship or following separation and that property remained quarantined throughout the parties' cohabitation, marriage or following separation, then the court has a discretion to quarantine that property and not include it in the pool of property in assessing the parties' contribution. This is because the other spouse did not make any contribution to the property in question.

If the property inherited remains in the same state and the court excludes the property value from the property pool assessment, the court will take the inheritance received into account as a s 75(2) factor (Step 3).

Example 2

If the property, however, is sold during the course of the parties' marriage and the proceeds intermingled with the parties' other wealth, then the court will take the inheritance into account in assessing contributions rather than try and quarantine the value of the inheritance.

There may be circumstances where the adviser may advise a client who is about to receive an inheritance or a large monetary gift that such assets should remain quarantined and should always be identifiable so as not to lose their character during the course of the parties' marriage in the event that the marriage breaks down in the future. This may work if the asset in question is property, but may be difficult if the asset received is a sum of money which the parties may apply towards reduction of a mortgage or the like. However, at the very least, the client should be advised to keep all documentary evidence to show the amount of the inheritance or gift received and how the inheritance or gift was applied.

Financial contributions

The financial contributions the court examines are the income that each of the parties receive during the course of the marriage and how that income was applied. The court also examines indirect financial contributions that are made for the benefit of spouses — for example, the parties occupying a home owned by one of the spouse's parents without paying rent or paying below market rent. Generally, the court takes a broad brush approach to such contributions. That is, the court does not mathematically adds up the income of each of the parties to reach a conclusion about each party's contributions. This is important having regard to the High Court decision in *Mallett* where the High Court made it clear that contributions made by a spouse as a homemaker and parents are not inferior to financial contributions made by the other spouse. This applies even if the financial activist spouse earned $50,000 per annum or $1m per annum.

Non-financial contributions

The non-financial contributions that the court looks at relate to matters such as home renovations carried out by the parties themselves or by a parent, relative or friend, thereby saving the parties' money in paying contractors to do the work and where such work has added value to the property in question.

Homemaker and parenting contributions

In regard to the homemaker and parenting contributions, the court examines the parties' respective contributions to caring for the children (ie each party's role in raising the children) and attending to the homemaking activities such as cooking, cleaning, ironing and the like.

The High Court said that homemaking and parenting contributions should be recognised not in a token way but in a substantial way. Accordingly, in most cases in the Family Court (let us call them the ''house and garden cases''),

generally the court assesses contributions made by spouses equally. This is notwithstanding one spouse was the financial activist and the other spouse attended to the homemaking and parenting role during the marriage.

What the Family Court has developed in house and garden cases is a partnership analysis where each partner contributes to the partnership. If one spouse is the financial activist, then the other spouse freed that party to pursue wealth-making activities and thus to be a contribution not just to the welfare of the family but also to the generation of wealth.

There have been cases determined by the Family Court going back to 1994 where the court gave loading to a financial activist spouse contributions entitlement because of what the court termed as ''special contributions'', ''business acumen skills'' and ''entrepreneurial skills''. These cases started with the case of *Ferraro* [1992] FamCA 64. However, in the year 2000 in the case of *Figgins* [2002] FamCA 688, the court started to distance itself from such concepts. The recent decisions of the Full Court in *Kane and Kane* [2013] FamCAFC 205 and *Hoffman and Hoffman* [2014] FamCAFC 92 appear to lay to rest such concepts and confirm that such a path was a ''terrible mistake'' that the court embarked upon and it should not go down that path. In 2015, in the case of *Fields and Smith* [2015] FamCAFC 57 (17 April 2015), the Full Court all but laid to rest the concept of special contributions.

No doubt assessing homemaker and parenting contributions versus financial contributions is like comparing apples and oranges. What makes an apple better than an orange in a basket is difficult to say. In a way the court does not want to consider the quality of contributions that each spouse makes as that would be a very difficult and time consuming task and is highly subjective.

It is a very difficult task to evaluate contributions where one party was homemaker and parent and the other party was the financial activist as the evaluation and comparisons are not conducted on a level playing field. In essence, you are comparing two different matters, one can be quantified and the other cannot.

In *Kane and Kane*, the parties had a net asset pool of $4.2m of which $3.4m was in a self managed superannuation fund (SMSF). The parties were married for 28 years and had four children; the youngest being almost 18 years at the time of trial. Shortly prior to separation, the parties sold a jointly owned company for $1,650,000. Of this sum, the amount of $1,060,400 was paid into the parties' SMSF. The value of the SMSF at the date of trial was $3,420,294.

The trial judge awarded the husband, a retired businessman, two-thirds of the SMSF, and the wife one-third having acknowledged ''the assertion of the husband that the application of his acumen to investment decisions, which caused the superannuation fund to prosper, was a contribution of significance which differentiates his contributions from those of the wife and entitles him to a much greater share of the superannuation interests''.

The Full Court of the Family Court overturned the decision, ruling the trial judge had given unacceptable weight to the husband's ''special skill''. Deputy Chief Justice Faulks made the following comment ''. . . the trial judge's

discretion miscarried because he took into account the 'special skills' of the husband in accordance with what he might reasonably have thought was authority binding on him, but which in my opinion should not have been''.

Faulks DCJ further stated that ''The reason for attributing (or not) special weight to the contributions of the husband in this case may be tested by asking whether, if the parties (before the husband invested what the learned trial judge found were joint funds) had been asked if they agreed that while losses would be shared equally between them, any gain would be disproportionally acquired by the husband there would have been agreement by the wife or the husband to proceed.''

In *Hoffman and Hoffman*, the parties had net assets of almost $10m. The parties resided together for 36 years. The trial judge ordered that the assets be divided equally. The husband appealed submitting that his '''[s]pecial [s]kills and [e]ntrepreneurial flair' applicable to both substantial investments in real property and the share market'' should have resulted in him receiving a greater proportion of the pool.

The Full Court dismissed the appeal and rejected the notion that there was a binding principle of law relating to ''special contributions'' or that there was any legitimate guideline in respect of such contributions. The Full Court quoted O'Ryan J in *D & D* [2005] FamCA 1462 at [271] who stated ''. . . the notion of special contribution has all been a terrible mistake . . .''.

The above spells the death of the argument that has been advanced in big money cases about special contributions and therefore a greater entitlement to the financial activist spouse. However, that does not mean that, in an appropriate case, the court would not assess a party's contributions as higher than 50%. While this will involve the court in an analysis of the contributions made and cause judges to go down a very rocky terrain of balancing contributions that can be measured versus those that cannot be measured by a known yardstick, namely in dollar terms, such cases may crop up.

In the decision of *Smith and Fields* [2012] FamCA 510, Murphy J embraced not the big money cases concept that appeared in prior cases where there was an emphasis or finding of special contributions in one spouse, generally the financial activist spouse but the circumstances surrounding the accumulation of the parties' wealth. In *Smith and Fields*, the pool was valued between $32m–$40m, which had been accumulated by the parties after nearly 30 years of marriage. The judge rejected the concept of special contributions, favouring instead **an assessment of the form, nature and characteristics of the contributions made by each of the parties** in ultimately awarding the husband 60% of the pool. His Honour said:

> ''. . . it is then important to identify the nature, form, characteristics and extent of the contributions made by each of the parties by reference to the sub-paragraphs of s 79(4) of the Act — in effect to identify each and all of those contributions of varying types and extent and compare them.
>
> 30. Having done so, what remains is the exercise of discretion — to do what is just and equitable — as between these particular parties, not

> because one or the other has 'special skills' or because there is a 'matrimonial partnership', but because the identification and comparison of contributions and the 'general counsel of experience' pulls toward a particular result. Or, as Coleman J recently put it:
>
> > 'Given that the evaluation of contribution based entitlements inevitably moves from qualitative evaluation of contributions to a quantitative reflection of such evaluation, there will inevitably be a ''leap'' from words to figures. That is the nature of the exercise of discretion, whether it be in the assessment of contributions in the matrimonial cause, assessment of damages in a personal injuries case, or determination of compensation in a land resumption case . . ..'''

Ultimately the judge took into account the husband's stewardship of the company in reaching the conclusion that the parties' contributions were not equal. His Honour said:

> ''However, an analysis of those contributions points to a greater contribution having been made by the husband directly to the business, predominantly by reference to the design of the buildings which the business constructs and sells so successfully and to what I will call the stewardship of the company including the plainly clever strategies and planning that have given it such success and to the financial and other planning that have led to it doing, relatively speaking, remarkably well in very adverse macro-economic conditions. These are important contributions in which it is, in my view, both appropriate and just to distinguish between the parties to this lengthy union. I consider that disparity to be particularly evident and pronounced in the period post-separation.''

After reaching the view that the parties' contributions were not equal, his Honour struggled as to how to jump from a qualitative assessment of contributions to a quantitative assessment. His Honour then said:

> ''91. I consider that it is the 'real worth in money terms' that should inform the assessed difference in contributions between the husband and the wife in this case when the 'leap' described by Coleman J in Steinbrenner is performed.''

His Honour then took the view that a 20% disparity between the husband and the wife was appropriate. In a pool of $30m, that disparity is worth in money terms $6m. That is, the first $6m would be received by the husband and the balance be divided equally. *Smith and Field* is on appeal and yet to be determined. What is noteworthy is that Murphy J was one of the judges on the full court in the case of *Hoffman and Hoffman*.

After assessing the contributions made by each of the parties to the acquisition, conservation and improvement of the property pool, the court notionally divides the property pool, for example, 50/50, 60/40, etc, and then moves to the next step.

On appeal, the Full Court of the Family Court in *Fields and Smith* upheld the appeal and set aside the orders of Murphy J. The Full Court disagreed with Murphy J's assessment of contributions of each of the parties as shown by the evidence. They rejected the concept that the wife's contributions as a homemaker and parent and to the welfare of the family reduced once the children have grown up. Of those contributions, the court said that they were evolving and changing in nature. The Full Court was of the view that his Honour gave undue weight to the husband's work in the company when the evidence did not support the conclusions he reached. Of contributions to the welfare of the family post separation, in the joint judgement of the Chief Justice Bryant CH and Ainslie-Wallace J, their Honours said:

> ''93. *If there was a diminution of the contributions of the wife to the welfare of the family post-separation, that was not the subject of any direct evidence. We do not suggest that her role had not altered, that much is evident from the fact the children had left home and she and the husband no longer belonged to a household in which mutual support was provided. But as senior counsel for the wife submits, the husband's role changed as well during that period, and there was a lack of evidence on a number of other relevant matters.*
>
> *94. Senior counsel for the wife submitted that, absent evidence, the approach of the trial judge to the wife's diminishing contribution in her principal sphere is an argument which leads into murky waters or, as he submitted at [46] of the wife's summary of argument, is 'controversial' and would mean that in a marriage of a long duration the negative: . . . trend line perhaps starts when the children leave home, the parties are only having take away meals and there is a housekeeper and/or regular use of a laundromat. In other words, the value to be given to a contribution as homemaker either ceases or becomes less relevant, even in a case where, as here, there is no evidence that the further accumulation or conservation of wealth is the consequence of the post separation efforts of the 'male'/'breadwinner'/'business empire' builder after the notional retirement of the primary homemaker and parent. . ..''*

Chapter 18

¶18-115 Property settlement step 3: s 75(2) ''Future needs''

After assessing the notional division of the property pool, the court examines s 75(2) (or s 90SF(3) in the case of de facto couples) which is commonly known as the ''*future needs factors*''. Generally the factors the court takes into account include health and age of the parties, income-earning capacity of the parties, the care of a child or children, the standard of living that the parties were accustomed to during the course of the marriage, the child support being paid by the parent who has the children less of the time and any other factor.

Not all the factors may be applicable in any one case. For instance s 75(2)(ha), which deals with bankruptcy, will not be relevant unless one of the spouses is bankrupt. Some of the factors are only applicable in spouse maintenance cases.

Example

In a $1m pool of property case, where the parties' contributions have been assessed at 50/50 and where the parties have two children under age 10 and the husband earns $200,000 and the wife does not work, it is likely that the s 75(2) (or s 90SF(3) in the case of de facto couples) factors will be approximately 10%–15%.

Under s 75(2), the court takes into account any financial resources that a party has, such as a spouse being a beneficiary in a trust, or inherited property that the court quarantined in Step 2.

The adjustment made under s 75(2) (or s 90SF(3) in the case of de facto couples) varies depending on the circumstances of each case. Certainly it is true that if the property pool is not large, then the adjustment in percentage terms would be higher than if the property pool was large where the adjustment would, in percentage terms, appear low. This is because an adjustment of 10% on a $3m property pool equates to $300,000, which is quite a significant sum of money. In a property pool of, for example, $500,000, an adjustment of 20% is $100,000.

It is important in the s 75(2) (or s 90SF(3) in the case of de facto couples) step that the court not fall in the error of making an adjustment for one spouse having significant superannuation in circumstances where, by reason of the adjustment itself, that spouse will no longer have a ''significant superannuation pool''. Accordingly, the court has to be mindful when making the adjustment not to double dip in the assessment of contributions under s 75(2) (or s 90SF(3) in the case of de facto couples) factors.

¶18-120 Property settlement step 4: Justice and equity

The final step in the approach is for the court to stand back from the exercise that it undertook in Steps 1 to 3 and examine whether the outcome will deliver justice and equity between the parties. The court has to consider not just the percentage division of the assets but also the monetary division so as to determine whether or not justice and equity will be achieved. However, it should be emphasised that justice and equity must be applied at every ''step'' in the exercise of the court's determination of the matter.

New approach to property settlements?

The High Court in *Stanford* did not appear to endorse the four-step process that was endorsed by the Full Court of the Family Court in *Hickey* (2003) FLC ¶93-143. In determining applications under s 79, the High Court appear to have set out three fundamental propositions that it says must not be obscured:

> **Is it just and equitable to take jurisdiction?**
>
> ''First, it is necessary to begin consideration of whether it is just and equitable to make a property settlement order by identifying, according

to ordinary common law and equitable principles, the existing legal and equitable interests of the parties in the property. So much follows from the text of s 79(1)(a) itself, which refers to 'altering the interests of the parties to the marriage in the property'. The question posed by s 79(2) is thus whether, having regard to those existing interests, the court is satisfied that it is just and equitable to make a property settlement order.''

Section 79 must be applied in accordance with legal principles

''Second, although s 79 confers a broad power on a court exercising jurisdiction under the Act to make a property settlement order, it is not a power that is to be exercised according to an unguided judicial discretion. In *Wirth v Wirth* (1956) 98 CLR 228 at 231–232, Dixon CJ observed that a power to make such order with respect to property and costs 'as [the judge] thinks fit', in any question between husband and wife as to the title to or possession of property, is a power which 'rests upon the law and not upon judicial discretion'. And as four members of this Court observed about proceedings for maintenance and property settlement orders in *R v Watson; Ex parte Armstrong* (1976) 136 CLR 288 at 257:

> 'The judge called upon to decide proceedings of that kind is not entitled to do what has been described as ''palm tree justice''. No doubt he is given a wide discretion, but he must exercise it in accordance with legal principles, including the principles which the Act itself lays down' . . ..''

Judges must not conflate the statutory requirements

''Third, whether making a property settlement order is 'just and equitable' is not to be answered by beginning from the assumption that one or other party has the right to have the property of the parties divided between them or has the right to an interest in marital property which is fixed by reference to the various matters (including financial and other contributions) set out in s 79(4). The power to make a property settlement order must be exercised 'in accordance with legal principles, including the principles which the Act itself lays down' (*R v Watson, Ex Parte Armstrong* (1976) 136 CLR 248 at 257). To conclude that making an order is 'just and equitable' only because of and by reference to various matters in s 79(4), without a separate consideration of s 79(2), would be to conflate the statutory requirements and ignore the principles laid down by the Act.''

The High Court concluded that adhering to the above three fundamental propositions ''gives due recognition to 'the need to preserve and protect the institution of marriage' identified in s 43(1)(a) as a principle to be applied by courts in exercising jurisdiction under the Act. . . . These principles do so by recognising the force of the stated and unstated assumptions between the parties to a marriage that the arrangement of property interests, whatever they are, is sufficient for the purposes of that husband and wife during the

continuance of their marriage. The fundamental propositions that have been identified require that a court have a principled reason for interfering with the existing legal and equitable interests of the parties to the marriage and whatever may have been their stated or unstated assumptions and agreements about property interests during the continuance of the marriage''.

It is still too early to work out whether the Family Court will embrace the concepts elicited by the High Court given that *Stanford* was a unique case which involved an involuntary separation between spouses and where the spouse applicant was represented by a litigation guardian.

How does the Family Court deal with De Facto matters

Under the old law as contained in the *Property (Relationships) Act 1984* (NSW) (which law was similar in some of the other states laws on de facto relationships), the only matters that the state courts took into account in determining the financial consequences on relationship breakdown was the contributions that were made by each of the partners during the course of their relationship to the property pool. The property pool did not include superannuation; albeit in a recent Supreme Court decision it was suggested that while superannuation was a financial resource, it would or should have been taken into account in the property pool assessment (the difficulty with this is that for over 20 years superannuation was somewhat ignored in the assessment of contributions by lawyers acting for parties and the courts!).

The state courts also developed a concept of compensation to counteract contributions made by a de facto partner. That is, in determining someone's entitlement to the property pool based on their contributions the courts looked at the benefits that a spouse received from the other spouse such as gifts, holidays, a nice home to live in, restaurants attended, etc, to reduce that party's overall entitlement. This made it difficult to see how relationships could be viewed as partnerships, a concept that was developed very early on in the family law sphere when the Family Court dealt with property matters. Even if we ignored the concept of compensation, the assessment of contributions by the state courts (be in Local, District or Supreme Court) have been so inconsistent that it was difficult to advise a client as to the likely outcome. State courts generally, however, were less robust in their assessment of contributions. Accordingly, a case that was determined in the state courts versus a case determined in the Family Court with the same set of facts, might have yielded significantly different results.

The Family Law Courts have had a wave of de facto cases filed. There have been a number of cases that have been filed where the other spouse have taken issue with jurisdiction, namely whether the de facto spouse applicant can show that the de facto relationship was in existence for more than two years. In the case of *Jonah & White* [2011] FamCA 221, Murphy J found that parties who were in a relationship for 17 years were not de facto as that term is understood under the Act. His Honour found that they lacked the ''coupledom'' requirement that is so essential to establish jurisdiction. The

matters that his Honour took into account as indicia of there being no de facto relationship (as against a relationship) were:

- each of the parties kept and maintained a household distinct from the other
- no relationship between the applicant and the respondent's children who were relatively young when the relationship commenced
- the relationship between the applicant and the respondent was clandestine and the time spent between the parties was spent (on either party's case) very much together, as distinct from time spent socialising as a couple
- the respondent emphasised during the relationship the limits of the relationship with the applicant and, in particular, if circumstances ever required him to ''make a choice'', he would ''choose'' his wife and family over the applicant
- despite the regular monthly payments (about $3,000 per month) and the payment of $24,000 the parties maintained no joint bank account; engaged in no joint investments together; and acquired, or maintained, property in their own individual names
- the parties rarely mixed with each other's friends
- the respondent ran what seems to have been a successful business, in which for some (early) years, the applicant was employed, but the parties did not mix with the respondent's business associates. After the applicant's employment with that business had ceased, she had no involvement with it at all
- there was virtually no involvement by the respondent in the applicant's life in Brisbane (where she lived between about 1996 and 2006), and virtually no involvement by the respondent in the applicant's life in Sydney where she has resided since 2006
- the respondent accepted that he hoped that the relationship with the applicant was permanent, he considered the relationship as an ''affair''
- there was very little time spent by the applicant and the respondent with the applicant's family
- the parties did not have a ''reputation'' as a couple; indeed, there was, on the evidence, very few public aspects to their relationship.

The court made it clear that how one party regards a relationship (in this case, ''an affair'') is not determinative as to whether or not a de facto relationship actually exists or not. Having regard to the facts in *Jonah & White*, the court found that the parties were not in a de facto relationship. The effect of this is the applicant could not make a claim for property settlement against the respondent.

No doubt the aim of the new de facto laws is to unify the legal consequences that will flow on from a relationship or marriage breakdown. Of course, there will still be a range of possible outcomes, however, it is likely that the range of

outcomes may be smaller. In addition to contributions, the Family Court will take into account the future needs of the parties. The future needs of spouses were not something that was taken into account under most of the state-based legislation as there was no such provision. In addition, superannuation was not capable of splitting under the state-based legislation. However, under the new amendments to the Family Law Act, the Family Court will deal with super for de facto couples in the same way as they do for married couples, and super is also capable of being split.

Example

Assume that Jack and Jill lived together in a de facto relationship for 15 years during which they accumulated $1m in property plus $200,000 in super, all of which is in Jack's name. They have three children aged 12, 10 and 8. At the beginning of their relationship, neither Jack nor Jill had any assets. Assume further that Jill has not been employed since the birth of the eldest child 12 years ago. Jack is a manager and earns $100,000 per annum.

If the matter had proceeded in a state court in NSW, the best result that Jill would have achieved would have been approximately 40%–50% of the property pool (excluding super) as the court would only have assessed contributions. Under the new laws, the Family Court might assess the contributions at 50/50 as to the property and super. The sting for Jack will come in the form of the s 90SF(3) assessment. The court will take into account the following matters:

(1) Jack's income

(2) Jill's inability to find gainful employment

(3) the level of care that each of the parties are providing for the children.

The above factors are likely to result in an adjustment of about 10%–15% of the property pool. That is, Jill could well end up with $600,000 to $650,000 of the property pool and a super split of $100,000. The court also has the discretion to trade-off cash for super and vice versa. If Jill shows the court that she needs, say, at least $650,000 to buy a home, the court may ultimately order a smaller super split in her favour and adjust the balance from the available cash.

What about spouse maintenance? Under state law in New South Wales, for example, there was no legal obligation on de facto partners (including same-sex partners) to support each other financially. There were limited circumstances where a spouse could have applied for spouse maintenance and it was granted for very short periods of time, and generally in cases where the relationship was of significantly long duration and the partner required retraining for future employment or where there was a disabled child of the relationship. The state courts also took into account a partner's entitlement to any Centrelink benefit in determining whether to grant spouse maintenance. That is, if a partner was entitled to or receives Centrelink benefits, then that would reduce that person's needs.

Under the new federal laws, there is a *right* to spouse maintenance. This is premised on the basis that parties have an obligation to support each other to the extent that one spouse has a need and the other spouse has capacity to pay. This is a significant departure and increase in the rights (and obligations) of spouses who live in a de facto relationship (including same-sex relationships). In determining whether or not a partner is entitled to spouse maintenance, the Family Court will consider a threshold question of whether or not a spouse has a need. Once that need has been established the court will look at the capacity of the other spouse to maintain the first spouse. Centrelink benefits are disregarded under the new law. Certainly under the new law it will be much easier to obtain a spouse maintenance order on behalf of a de facto partner than it was under the old law prior to 1 March 2009. Further, it is likely that the duration of the spouse maintenance order will be for a significantly longer period of time.

A way out?

A significant number of people have entered into de facto relationships deliberately and now they are thrown into the family law den. Financial advisers and accountants will need to reassess their clients' needs including their asset protection, estate planning and financial planning, as the financial consequences of a relationship breakdown could spell disaster for their clients.

One way to protect the client is to have them and their spouse (married, de facto or in same-sex relationships) enter into Binding Financial Agreements (BFAs). The effect of a BFA is to oust the court's jurisdiction to deal with part or all of the property which is the subject of the BFA, as well as spouse maintenance and superannuation. Such agreements can give peace of mind to your client as they provide certainty of outcome in the event of a relationship breakdown.

Interim Property Settlement

In cases where one spouse has control of the matrimonial property including liquid assets or assets that both parties agree will be sold whereas the other party has no assets to enable it to support itself or to run the litigation, an applicant can make an application for interim property settlement or interim costs. More recently, this has become the weapon of the financial controlling spouse seeking to carve out part of the property pool before a final trial or settlement where there is liquid funds and the funds are locked up.

In *Strahan* [2010] FamCA 423, the Full Court revisited the principles that will be applied in relation to interim property settlement applications. The Full Court said that an interim property settlement involves two steps:

(1) identify the section in the FLA that gives the court the power to make the order: that is, is it an order that will be made under s 79 (property) or s 117 (costs) and ensure that s 80(1)(h) of the FLA was enlivened to allow an interim property settlement order under s 79. When considering

whether to make an interim order, the overarching consideration is the interests of justice. That is, the court has to be satisfied that in all the circumstances it is appropriate to exercise the power.

(2) have regard to the matters in s 79 (FLA s 79(2) and 79(4)). A detailed enquiry, however, is not necessary but there must be some assessment of the factors in s 79. The interim order, however, has to be conservative so that the final outcome cannot be compromised by the interim order.

Recently, judges have been quick to allow interim or partial property settlement orders to be made. These are orders applied for by one spouse to receive part of the available property on an interim basis. Generally, this is able to be done where there is cash at bank available and the funds are locked up because they are in joint names. A spouse would apply for funds to be released to them for partial property. The applicant does not have to show a reason for wanting the money. The test adopted by the court in deciding whether to make an order is this: ''*the overarching consideration is the interests of justice*''.

This is a very loose concept and it appears to have been interpreted in this manner: *if the order sought is less than what a party's entitlement would be at a final hearing then they should be entitled to receive their entitlement ''early'' and deal with it as they please.*

The above appears to offend the concept of there being one property settlement not multiple or interim property settlement/s. Judges routinely say that when one receives their partial settlement then whatever they do with the property is their prerogative. That in itself can cause injustice if that is what judges do at a final trial.

Take for example the spouse who did not work during the marriage, the other spouse's income is not sufficient to support the other spouse for there to be an interim spouse maintenance order made, and the spouse receives say $150,000 in partial property settlement which they apply over three years of waiting for the final trial to come on in meeting their needs. The suggestion that the $150,000 is part of that spouse's entitlement suggests that add-backs are back in a different guise. The more worrying though about the approach above is that if the court considers that the spouse already received part of their entitlement, that suggests that the discretion conferred on judges in achieving justice and equity is being curtailed and that goes against the principles in the Act. How could justice and equity be achieved if the pool available for distribution is $150,000 less than what it was or should be? The spouse who received the $150,000 spent the money on meeting their needs (thus obviating the need for the court to determine say a spouse maintenance application), the other spouse has more money available to them because the court did not make an order against them to support the other party. If that other spouse spends the surplus because of the court not making the order against them, that may then cause injustice against the spouse who received the $150,000.

SUPERANNUATION AND FAMILY BREAKDOWN

¶18-200 Superannuation splitting

The Family Court has the power to split superannuation interests between separated spouses. There are a number of super interests that are unsplittable, such as small super interests of less than $5,000.

The court still has discretion as to whether to split super or not. In the first supersplitting case decided by the Family Court after the amendments came in, the trial judge notionally split the super between the spouses 49/51 in the husband's favour, but when applying Step 4 said that the wife needed to rehouse herself and the children and that she needed the cash now rather than keep it all in super. The judge, however, was still keen that the wife have some super in retirement and ultimately gave her 20% of the husband's super interest and made up the balance of her super entitlement from the other property the parties owned.

In the first supersplitting case decided by the Full Court of the Family Court, it was held that superannuation was property regardless whether or not a party seeks a superannuation splitting order. However, a differently constituted full court in the case of *Coghlan and Coghlan* (2005) FLC ¶93-220 held that superannuation was not property.

The Full Court held that ''*Superannuation interests are another species of asset which is different from property as defined in s 4(1), and in relation to which orders* ***also*** *can be made in proceedings under s 79*''. *C v C* highlighted the importance of understanding the nature, form and characteristics of a superannuation interest. That is, one has to consider whether:

- an interest is in the growth or payment phase
- an interest is capable of being commuted to a lump sum
- the interest was accumulated before, during the relationship or marriage or a combination of both periods
- the interest is capable of being paid as a lump sum or pension or combination of both (where the interest is in the accumulation phase).

Although the changes to superannuation in 2007 somewhat diluted the benefits of superannuation splitting, there are still situations in which super can still be used as weapon or shield by a spouse.

The nature of a superannuation interest is that investments inside a superannuation fund is taxed concessionally. Investment earnings in a super fund, in the growth phase, is taxed at 15% flat rate. Earnings in the payment phase attract zero tax. Further, drawing down on a super interest after age 60 is generally tax-free.

As announced in the 2016 Federal Budget, the government is considering some significant changes to superannuation. At the time of writing, it was unclear if all of the changes proposed would be passed into law or the impact

of such changes on how lawyers and advisers would approach superannuation.

In any property settlement, the super spouse can use super as a way to extract a better deal. If for example, the super spouse knows that the non-super spouse needs the cash to rehouse themselves, they could offer part of their super interest as a way to reduce the cash payment ultimately to be made. By the same token, the super spouse would not want to split the super if they can offload an investment property to the other spouse, thereby retaining the super interest intact.

Superannuation splitting may take prominence again from 1 July 2012. The government has announced that from that date, if a person has a superannuation balance of $500,000 or more, then the maximum they can contribute in any one year will be $25,000. However, it is unclear what scope, if any, will exist for spouse superannuation splitting to be used to keep a person's account balance under $500,000.

For spouses who are concerned with meeting their future retirement plans, and those who are attuned to the significant tax benefits that super confers on them as they approach retirement, they may not be so willing to give up their super for the cash as they may never be able to accumulate the super they give to their spouse in a property settlement. It may be far more financially advantageous to them to retain the super and part with the cash, as super is taxed concessionally, and they will ultimately benefit in retaining their super. It is a balancing act whether to give up the super or retain it. Financial advice is crucial in this area.

Opportunities for financial advisers

The Family Law Regulations 1984 prescribe a method for valuing superannuation interests. Generally, there are no issues of valuation for accumulated funds. The valuation issues relate to defined, hybrid funds and self managed superannuation funds (SMSF). The Regulations do not provide a method for valuing SMSFs. These are valued generally by forensic accountants and if the fund owns real estate a property valuer is also required to value the real estate.

The super splitting law recognises that some people will marry or have many relationships and divorce or separate more than once in their lives, and provides for splitting when this occurs. The Act allows for more than payment split to operate on the same superannuation interest. The provision works by setting an order of priority with earlier spouses taking before later spouses.

The Act provides that super trustees must be provided with procedural fairness before a super split order is made. For a SMSF, this is not an issue. However, for accumulated or defined interests, it is important that a copy of the court's application or terms of settlement is served on the trustees. The trustee has 28 days to respond as to whether or not the orders are such that the trustee can comply with them.

There may also be circumstances where it would be appropriate not to split the super fund but to freeze the fund until a condition of release is satisfied. This may be because the member will retire within a short period of time or there may be issues as to valuation of the particular fund. In those cases, the member's interest is flagged (ie frozen).

Just as parties can now enter into financial agreements, they can also enter into superannuation agreements which can determine how in the event of separation their respective superannuation interests will be split. Generally, a financial agreement includes a superannuation agreement.

¶18-205 Binding death nominations and superannuation splitting

Super splitting has effect despite any other law to the contrary and therefore will normally override binding death nominations. The major exception is where a payment is made by a trustee to or on behalf of a child. This exception has significant consequences for advisers and clients as a payment to a child will make a super interest unsplittable and therefore make a super splitting order worthless.

Appropriate measures can be put in place to protect super splitting orders from binding death nominations. Section 90ME(2) of the Act and reg 13 of the Family Law Superannuation Regulations 2001 provide that after the death of a member spouse, a super interest reverts to a child or to a person to hold on trust and apply for the benefit of a child either because a trustee decides at their discretion in favour of the child or because the trustee directly provides for that to happen.

The federal government made a decision when setting up the new super splitting laws that payments to a non-member after the death of the member spouse are unsplittable if the benefit goes to children under the age of 18 and in some circumstances children over the age of 18. This is the case notwithstanding that there may be super splitting orders in place. This may alarm the adviser and the client but with careful planning the problem can be avoided.

The Superannuation Industry (Supervision) Regulations 1994 (SISR) require trustees to report significant events to a former spouse. One such event that trustees must report on is where a member lodges a binding death nomination in favour of a child. The amendments also relieve a trustee of the duty to pay benefits in accordance with a binding death nomination if the trustee is aware that such a payment or the lodgment or failure to revoke the nomination would breach a super splitting order.

The amendments referred to above may provide some protection; however, it is respectfully submitted that the protection is not complete. There are a number of ways the non-member spouse could be protected, namely:

- following the making of the super splitting orders, the non-member insists on the rolling out of their new interest into a new superannuation interest. This will be achievable in accumulation interests. Where the

member spouse's interest is a defined benefit interest, most of those interests are now capable of being split and rolled out. In cases where the interest is not capable of being rolled out, it is important that the non-member spouse insist on a new interest being created in the member spouse's interest which is merely an accounting exercise but such an exercise defines that non-member's interest in the member's superannuation interest

- that injunctions and indemnities be included in all super splitting orders or agreements to the effect that:
  - the member spouse is restrained from making or giving a binding death nomination in favour of a child or children, which in any way affects a non-member spouse's interest under a super splitting order (if a nomination had already been given, the nomination can be revoked immediately insofar as it affects the super splitting orders). This does not mean that the member spouse cannot lodge a binding death nomination. The member spouse can do so but only in respect of their interest in the super fund without impacting on the non-member spouse's interest under the super splitting order
  - that there be an indemnity that the member's estate indemnify the non-member spouse in respect of any loss suffered by reason of the member lodging a binding death nomination.

In multi-member superannuation funds where the interest is an accumulation interest, it is relatively easy to roll out a non-member's interest into another fund. Most defined benefit funds now are also capable of being split. However, some do not allow a splitting of the interest such as state super. In that case, state super will create an interest for the non-member spouse within the member's account. The non-member will not be entitled to receive their interest until the member spouse retires or satisfies a condition of release. This is not ideal and no doubt in due course this situation will be rectified.

In relation to SMSFs, there may be taxation issues that would not make it effective to undertake a super split, or that because of the taxation issues, the level of the super split should not be as the parties thought it would be. For example, if a property has to be sold to effect the split, there are realisation costs and capital gains tax payable on the disposal which must be taken into account in any settlement.

It is important to that note that in a multi-member superannuation fund, binding death nominations commonly have a life of three years and must be renewed every three years. Some funds do, however, provide for non-lapsing nominations which are binding upon trustee consent pursuant to s 59(1) of the *Superannuation Industry (Supervision) Act 1993*. In an SMSF, a binding death nomination does not typically have a time limitation.

TAXATION AND FAMILY BREAKDOWN

¶18-300 Realisation and taxation costs to be taken into account in property valuations

The Full Court in 1998 in the case of *Rosati* (1998) FLC ¶92-804 set down principles in relation to the circumstances when the court ought to take into account potential capital gains tax which would be payable upon the sale of an asset. The Full Court in *Rosati* held:

> ''It appears to us that although there is a degree of confusion, and possibly conflict, in the reported cases as to the proper approach to be adopted by a court in proceedings under s 79 of the Act in relation to the effect of potential capital gains tax, which would be payable upon the sale of an asset, the following general principles may be said to emerge from those cases:
>
> (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 acquisition 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 on 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.''

Based on the principles or guidelines enunciated by the Full Court in *Rosati* above, the likelihood of a possible future sale is important in determining if and how, the potential CGT liability should be taken into account. Accordingly if there is no intention or the evidence does not establish that a party has to sell a CGT asset then the court generally would ignore any CGT liability.

On the other hand if the court makes a finding that it would be inevitable to sell a property in the near future, then CGT will be taken into account in Step 1 which has the result of reducing the property pool. Having said this, it should also be noted that the court may still take the CGT liability as a s 75(2) (or s 90SF(3) in the case of de facto couples) factor if the court is satisfied that there is a significant risk that the asset will have to be sold in the short to mid term.

It should be noted that because a property has been valued using a particular method, it does not necessarily follow that the realisation costs or CGT liability will automatically be taken into account and therefore reduce the property pool. Certainly, the court can still take the realisation costs and/or CGT in Step 3 under the s 75(2) (or s 90SF(3) in the case of de facto couples) factor.

In *JEL v DDF*, certain assets of the parties were valued on a tangible asset or asset realisation approach; however, the Full Court noted that this is only one of the matters to be taken into account under the *Rosati* principles. The Full Court also noted the trial judge's finding that while the assets had been ''acquired with a view to making a profit'' this did not equate to a finding that ''all of the assets were acquired solely as an investment and with a view to ultimate sale for profit. To the contrary, it is clear that all of the assets were not acquired solely as an investment''. The Full Court referred to the parties' former matrimonial home and their holiday home.

Income tax

In *SPG and BAG (*unreported, Full Court of the Family Court, 20 December 2001*)*, the Full Court held that the principles in *Rosati* apply to income tax. The Full Court held that ''where property which is held by a party or the parties to proceedings under s 79 of the Act was acquired as part of a business of acquiring, developing and the re-selling of real property for profit (ie essentially as trading stock of that business) then, in valuing that property for the purpose of the proceedings, the court should ordinarily take into account both the estimated realisation costs and the tax (in that case) 'mainstream' income tax 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 a likely consequence of those Orders''.

¶18-305 Are tax losses property?

There are cases where a company controlled by either of the parties or both of them may have significant tax losses and the question that will arise in the

proceedings is whether or not such tax losses are property or financial resources.

This issue is significant because tax losses have the effect of reducing the tax that ultimately may be paid in respect of future profits earned by the company that would be retained by one of the spouses.

In *JEL v DDF* (2001) FLC ¶93-075, the trial judge found that the husband would retain the benefit of losses in a company with a tax benefit of $1.866m while the wife would retain a benefit in another company of approximately $239,000. The trial judge found, on the evidence, that the tax losses did not constitute property as they had no immediate realisable value. However, the judge found that they constituted a financial resource of potentially significant benefit to the husband in the future. It appears that the trial judge thereafter omitted to return to this issue in the course of her judgment; however, on appeal to the Full Court, the Full Court made an adjustment in the wife's favour under s 75(2) in the sum of $200,000 by reason of the husband's significant tax losses that he would retain the benefit of.

¶18-400 Superannuation splitting

The simpler super changes that came into effect on 1 July 2007 may have caused advisers to discourage their clients from agreeing to or offering a super split as part of an overall property settlement.

However, that ignores the basic principles to a super split, namely that super can be used as a weapon and a shield. It is submitted that super splitting still has significant benefits. For a non-member spouse, the effect of a super split in their favour is to allow that person to have a super fund where in the usual course of events such an interest would not have been accumulated. Further, investing in a superannuation environment has significant tax benefits, including tax rates of 15% on earnings and nil on withdrawal of the investment after the member turns 60 years old. It is crucial that superannuation is brought to the forefront of discussions between the spouse and the adviser. For example, it is proposed that from 1 July 2012, the maximum voluntary contribution that can be made by a spouse to their super fund will be reduced from the current level of $50,000 to $25,000, if the member spouse account has a balance of more than $500,000. Accordingly, if a spouse has to split say $100,000 of their super with their spouse they may need up to four years to recover that money in the super environment. This is an important consideration when viewing the spouse's retirement plans and whether they will be in a position to still maintain their estate plan overall.

As a result of the significant concessions that superannuation provides, it can be used to a party's advantage in any property settlement negotiations.

Let's consider an example where a party owns an investment property and has a superannuation interest and both are of similar value. If the member is able to survive financially without the benefit of say rent from the investment property, the member can offer their former spouse the investment property and retain their superannuation interest. The member will therefore retain the

super interest and the non-member will receive the investment property. The member will pay 15% tax on the earnings in the super fund. On retirement the member will receive the investment (made up of the capital invested as well as earnings) and pay zero in tax.

The non-member will pay tax on the rent received (and this could be as high as 46.5% if the non member is on the highest tax bracket) and in the future when the investment property is sold, CGT will be paid on the investment property. (The non-member will inherit the investment property history and therefore the cost base will be the cost base of the member.) The tax for the non-member could be significant.

Capital gains tax (CGT)

CGT roll-over relief is available where the super split is made under a court order or a Binding Financial Agreement (BFA). An in specie transfer of property, for instance, by one SMSF to another SMSF under a court order or a BFA will give rise to CGT roll-over relief. However, in NSW at least, stamp duty is payable on the transfer of the property.

However, if the asset owned by the SMSF is sold to effect the super split, CGT roll-over relief will not apply. CGT will be payable and it will be levied on the SMSF which sold the asset. Therefore, caution is required to ensure that the CGT liability is taken into account at the time of settlement. If the asset has been held for more than 12 months, there is a 30% discount (not 50% as is the case with individual ownership) and then 15% is levied on the capital gain.

The same would apply in relation to a member client's interest in a multi-member fund whereby the super split will require the sale of shares or managed funds and the rolling out of the interest to the non-member spouse; however, the trustee may pay the split from inflows and therefore no CGT may be payable.

Since 1 July 2007, spouses in a marriage breakdown have been able to transfer their entire in specie interest in a small superannuation fund (a complying superannuation fund with four or fewer members) to their former spouse without instant CGT consequences. The amendments to the CGT roll-over in s 126-140 of ITAA97 exempt existing personal contributions made in a fund by the departing spouse from giving rise to an immediate CGT event when transferred to another small superannuation fund. The amendments allow greater choice of fund options for the departing spouse. The roll-over provisions as they stood until 30 June 2007 did recognise that the spouse who benefits from the payment split may have made their own personal contributions to the fund. The amendments now allow all the in specie interests of the departing spouse to be transferred to a new complying superannuation fund without there being an immediate CGT taxing point.

The 2007 amendments recognised that it is often in the interests of spouses in a marriage breakdown not to continue to provide for their future superannuation arrangements through a single small superannuation fund.

¶18-450 Trusts and family breakdown

Where trusts are involved in a family breakdown, certain provisions are included in agreements or orders for the spouse exiting from the trust to relinquish their rights as to income and/or capital from the trust. If that spouse is a co-appointor of the trust, provision is also made for them to relinquish their rights as appointor. Such relinquishment does not generally cause resettlement of the trust and therefore does not trigger any tax issues. However, it is crucial that the trust deeds are reviewed to ensure that no resettlement of the trust will occur.

A trust structure is a viable way for divorced or separated spouses to still run a trust for the benefit of their children. More and more cases are being settled on the basis that certain assets owned by a trust are retained for the benefit of the parties' children. In those circumstances, there may be possibility for income distributions, for instance, to be made by the trust to the exiting spouse. If this is agreed to by the exiting spouse, care must be taken to ensure that that spouse remains entitled to receive the income as some trust deeds provide that the beneficiaries are, for instance, the appointor and their spouse.

For considerations relating to family trust elections, see ¶18-615.

¶18-500 Investment properties and family breakdown

Generally, investment properties are registered in the name of the spouse with the higher income so as to attract the most tax deductions. On marriage breakdown, there are tax savings to be made in relation to the disposal or transfer of the investment property. This assumes that the anti-avoidance provisions in Pt IVA of the *Income Tax Assessment Act 1936* (ITAA36) are not contravened.

Example

An investment property has a cost base of $500,000. Assume that a sale price of $1,000,000 is achieved when the property is sold more than 12 months later. The property is jointly owned. Assume that the husband is on the highest tax bracket and the wife does not receive any income. The tax calculations are:

Total capital gain = $1,000,000 (sale proceeds) – $500,000 (cost base) = $500,000

Therefore, the husband and wife each make a capital gain of $250,000.

As the property has been held for more than 12 months, the assessable portion of the capital gain is: $250,000/2 = $125,000 each. Assuming the:

Tax payable by husband = $58,125

Tax payable by wife = $38,975.

Another way to deal with the property is for one spouse to transfer their interest in the investment property to the other spouse pursuant to a court order. Stamp duty will not be payable on the transfer as there is a stamp duty exemption under the marriage breakdown.

¶18-505 CGT roll-over relief on family breakdown

Marriage or relationship breakdown CGT roll-over between spouses

Under s 126-5 of the *Income Tax Assessment Act 1997* (ITAA97), there is a compulsory or automatic same assets roll-over if a CGT event involves an individual taxpayer disposing of an asset to, or creating an asset in, their spouse (or former spouse) because of:

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

(b) a maintenance agreement under section 87 of that Act 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; or

(d) something done under:

(i) a financial agreement made under Part VIIIA of the *Family Law Act 1975* 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

. . .

(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, prevents a court making an order about matters to which the agreement applies, or that is inconsistent with the terms of the agreement in relation to those matters, unless the agreement is varied or set aside.''

Accordingly, any capital gain or capital loss from a CGT event is ignored if the marriage or relationship breakdown roll-over happens. This applies to married couples and de facto couples (including same-sex couples). However, the changes to the definition of spouse (which commenced on 9 December 2008) have an operative date of 1 July 2009. This means that any transactions entered into prior to 1 July 2009, despite having arisen as a consequence of the

breakdown of a same-sex relationship and entered into pursuant to a Family Court order, state or territory order, BFA are **not** eligible for capital gains tax roll-over relief.

If the asset is a post-CGT asset and the transferor disposes of the asset to a transferee spouse and the marriage or relationship breakdown roll-over happens, the first element of the cost base (or reduced cost base) for the transferee will be the same as the cost base of the transferor at the time the transferee acquires the asset. Therefore, any costs incurred by the transferor in effecting the transfer (such as conveyancing costs) pursuant to the court order will form part of the first element of the cost base (or reduced cost base).

Since 12 December 2006 CGT roll-over relief has been extended to:

(1) assets transferred to a spouse or former spouse under a financial agreement for married couples and domestic relationship agreements and termination agreements for de facto couples or a similar agreement under a corresponding foreign law or an arbitral award under the Family Law Act or a corresponding award made under a corresponding state law, territory law or foreign law, and

(2) changes to the CGT main residence exemption so that a spouse who receives a property pursuant to a court order will inherit the history of the property.

In relation to the second measure above, under the previous law as it stood prior to 12 December 2006, if a spouse received an investment property owned by their former spouse pursuant to a court order, and immediately upon receiving that property the spouse commenced to use the property as their main residence, then the CGT main residence exemption applied and that spouse would not pay CGT when they sold the property in the future.

Under the amendments which came into effect on 12 December 2006, the transferee spouse inherits the property's history so that CGT will be apportioned between the periods when the property was held for investment purposes and when it was used as the main residence with CGT being payable on ultimate disposal for the period the property was used for investment purposes.

It should be noted that since 27 December 2000, s 87 maintenance agreements are no longer possible to be entered into and receive court approval. Maintenance agreements have been replaced by financial agreements.

For CGT roll-over relief to apply pursuant to a court order or a BFA, the transfer of a property must be to a spouse and **not** to a company or trust controlled by or associated with the spouse.

While s 126-5 and 126-15 of the ITAA97 do not expressly require that there be marriage breakdown, this is implicitly required (see *Taxation Determination* TD 1999/49).

CGT roll-over on transfer from company/trust to spouse

Section 126-15 of the ITAA97 extends the CGT roll-over relief if the trigger event involves a company (the transferor) or a trustee (also the transferor) and a spouse or former spouse (the transferee) of another individual because of:

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

(b) a maintenance agreement approved in accordance with section 87 of that Act 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 breakdown; or

(d) something done under:

(i) a financial agreement made under Part VIIIA of the *Family Law Act 1975* 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

. . .

(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, prevents a court making an order about matters to which the agreement applies, or that is inconsistent with the terms of the agreement in relation to those matters, unless the agreement is varied or set aside.''

Accordingly, there is also an automatic or compulsory marriage breakdown roll-over if the marriage breakdown conditions between spouses are met, except that the transfer is from a company or trust associated with the parties to a spouse or former spouse.

Caution

Notwithstanding the above roll-over relief, there are other significant consequences in respect of transfers of property owned by a company or trust to a spouse pursuant to court orders which are dealt with under the heading ''Division 7A consequences'' (¶18-510).

Marriage or relationship breakdown CGT roll-over on transfer of shares

CGT roll-over relief is also available on transfer of shares (in public and private companies) if made pursuant to court orders.

Depreciation rules and marriage or relationship breakdown

Assets that are depreciated, such as plant and equipment or motor vehicles, are not generally subject to CGT; however, income tax may be payable on any excess value over and above the written down value. If these assets remain with the controlling partner, CGT roll-over relief is available.

However, the CGT roll-over relief does not apply for trading stock of the transferor's spouse's interest in that trading stock.

CGT roll-over not appropriate in all instances

There may be instances where it would be beneficial for the controlling spouse to buy out the exiting spouse rather than rely on the CGT roll-over relief. For example, if the business was started by the parties and has increased in value over the years, it may be in the controlling spouse's interest to crystalise the value of the business at marriage breakdown rather than take advantage of the CGT roll-over provisions. This is especially in relation to business goodwill. As the business was started by the parties, the goodwill cost base is nil.

If the controlling spouse buys the exiting spouse's interest in the partnership, CGT concession rules may apply (where family business assets do not exceed $6m) and this may be for the benefit of not just the controlling spouse but also the exiting spouse.

Exemptions from CGT

In general terms the following assets are exempt from CGT:

- assets acquired before 20 September 1985
- certain categories of motor vehicles and motor cycles
- personal use assets with acquisition costs of less than $10,000, and
- principal place of residence (subject to various restrictions).

CGT and de facto matters

Property transfers pursuant to court orders or Domestic Relationship Agreements or Termination Agreements (these being equivalent to BFAs) under the *Property (Relationships) Act 1984* (NSW) and other similar legislation in the various states, will also trigger CGT roll-over relief under s 126-5 and 126-15 of ITAA97.

¶18-510 Deemed dividends and company loans

Division 7A consequences

While capital gains tax roll-over relief may apply to transfers of property from a company or a trust to a spouse associated with the company or trust (and for this matter, stamp duty exemptions may apply as will be discussed below), there are significant tax consequences that will flow from a transfer of property owned by a company or trust to a spouse pursuant to court orders.

Division 7A of ITAA36 deals with three situations where a company will be deemed to have paid a dividend to an associate namely:

(1) payments made by the company to a shareholder or shareholder's associate (s 109C)

(2) amounts lent by the company to a shareholder or shareholder's associate (s 109D and 109E), and

(3) amounts of debts owed by a shareholder or shareholder's associate to the company that the company forgives (s 109F).

The effect of Div 7A is that, if for instance, a property owned by a private company is transferred to a spouse even pursuant to a court order, then Div 7A deems that transfer as a dividend payment upon which the company would have to pay tax at the current rate of 30%. The transferee spouse will also have to pay tax at their own marginal rate, although they will receive a franking dividend in relation to the tax already paid by the company in respect of the transfer.

Certain payments may qualify as excluded payments. That is, Div 7A does not apply to the payment by the company. Some of the most common exclusions are:

- loans made from one private company to another private company (s 109K)
- payment of a genuine debt (s 109J)
- loans made on commercial terms (s 109M), and
- loans which meet specified minimum interest rate and term criteria (s 109N).

A payment of a genuine debt (s 109K) takes place where the payment:

(a) discharges an obligation of the private company to pay the money to a person, and

(b) is an arm's length amount required to be paid to discharge the obligation.

A court order that provides for a private company to pay a spouse a sum of money is taken to be a s 109J type of payment (see ATO Binding Private Ruling no 46679). The liability of the private company cannot, however, be satisfied by an in specie transfer of a property (such as shares or real estate). It must be a cash payment. Notwithstanding the interpretation given to s 109J, it is strongly recommended that private ruling be applied for in each case where there will be an order involving the payment of an amount of money by a private company to a spouse.

In addition, the following also applies:

(1) a payment can be made from a company to one of the shareholders or their associate (eg ex-spouse) and the payment can be a franked dividend. Generally when a company pays a dividend, it must pay it to every shareholder. Under the amendment, a dividend payment can be

made to only one shareholder if the payment arises out of marriage breakdown (s 109RC of ITAA36)

(2) loans or debt forgiveness as part of a property settlement will not trigger Div 7A of ITAA36

(3) the Commissioner has a discretion to either disregard deemed dividends or allow them to be franked where they have been triggered by honest mistakes or omissions by the taxpayer. This amendment applies from 1 July 2001 (s 109RB of ITAA36).

Company loans

Loans to associated persons of a company may become the subject of the deemed dividend provisions. Associated persons include shareholders, their spouses and related entities.

Section 108 of ITAA36 applies where a private company pays an amount to an associate as an advance or a loan or credits an amount to an associated person and the Commissioner forms the view that the amount represents a disguised distribution of profits. In those circumstances, the payment received will be deemed as an unfranked dividend paid by the company to the person and therefore assessable to income tax by the recipient.

Division 7A provides that where there is a loan from a company to an associated person, a deemed dividend will arise from the company unless either the loan is repaid before the end of the financial year, or if there is a genuine commercial loan evidenced in writing with all of the relevant terms and interest conditions. In addition, the loan must be repaid within seven years from the date that the loan was issued, otherwise the loan will be deemed as dividends in the hands of the associated person.

When dealing with loan accounts the following should be taken into account and considered:

- forgiveness of the loan is not an effective way of dealing with the loan account as this will trigger the deeming dividend provisions
- consideration should be given as to whether loan accounts should be brought to nil by declaring a dividend payment in favour of the spouse in whose name the loan account is in; however, it should be noted that this would trigger income tax liability but such income tax will be less than if s 108 operates
- the loan could be assigned to the other spouse who will retain the company; however, it is important to obtain the relevant indemnities to ensure that the spouse exiting the company is protected from any tax liabilities that may flow on from such an assignment.

The above should be read subject to the changes that came in on 21 June 2007 where the Commissioner has the discretion to disregard Div 7A or allow the dividend to be franked. This applies in relation to property settlements that have occurred as early as 2001 on the condition that the mistake or omission occurred due to an honest mistake (s 109RB).

¶18-515 Part IVA considerations when advising on family breakdown

An important matter that must also be addressed in any family law matter which involves tax restructuring or tax advice is the potential impact of the general anti-avoidance provisions of Pt IVA of ITAA36.

The most important ingredient which will attract the operation of Pt IVA is where it could be concluded that a participant in the scheme had the sole or dominant purpose of obtaining a tax benefit for the taxpayer.

The anti-avoidance legislation is concerned with the following aspects of the scheme:

- manner — this refers to the manner in which the scheme was entered into or carried out
- form and substance of the scheme — this requires the Commissioner to look at the commercial reality as well as the legal or literal form of the scheme
- timing — this refers to the time at which the scheme was entered into and the length of the period during which it was carried out
- result achieved — this refers to the result that would have been achieved by the scheme if Pt IVA did not apply
- change in the financial position of the taxpayer that has resulted or may reasonably be expected to result from the scheme
- change in the financial position of the person connected with the taxpayer
- any other consequence for the taxpayer connected — ie non-financial consequences, and
- nature — if there is a connection between the taxpayer and the other person, the connection may be of a business, family or other nature.

STAMP DUTY AND FAMILY BREAKDOWN

¶18-600 Stamp duty exemptions on marriage or relationship breakdown

Stamp duty exemptions vary between each of the Australian states and therefore it is important to ascertain the stamp duty consequences as well as the stamp duty exemptions in the state where the property the subject of any property settlement is located. All references in the following paragraphs are based on the duties law for NSW.

Stamp duty exemptions on marriage breakdown

Section 68 of the *Duties Act 1997* (NSW) provides exemption from duty on transfer of matrimonial property following the breakdown of the marriage or relationship. Similar provisions apply in respect of breakdown of domestic relationships pre-1 March 2009.

Notwithstanding the changes that came into effect on 1 March 2009 in relation to de facto couples, at least in NSW the *Duties Act 1997* has not been amended to reflect changes to the definition ''matrimonial property''. This term remains defined as outlined below. However, it is submitted that this should not in any way affect the exemptions to payment of stamp duty. For the exemption to apply, the property transferred must be ''matrimonial property'', that is to say property of the parties to the marriage or of either of them. This has been interpreted widely by the court in *Commissioner of Stamp Duties (NSW) v Bryan* (1989) 89 ATC 4529. In that case, the property was transferred by the trustee of a family trust to one of the parties to the marriage. The trust was discretionary and provided for a gift over to parties to the marriage subject to the trustee's discretion. At the time, the only beneficiaries named were the husband and the wife; however, the trustee had the power to add new beneficiaries. At both first instance and on appeal to the Court of Appeal, it was held that the property transferred was matrimonial property and the exemption applied.

Where property is transferred by a company to a spouse, the property of the company is considered to be matrimonial property, if the only members of the company are the parties to the marriage. If only one party is a member of the company, the voting power of the spouse who owns the shares would be examined.

Pursuant to s 68(1) of the Duties Act, no duty is chargeable in respect of a transfer of matrimonial property if:

(a) the property is matrimonial property. Property includes real estate as well as shares in private companies

(b) the transferee is a party to the marriage (and this includes a child or children)

(c) the marriage has either been dissolved or annulled or in the opinion of the Chief Commissioner, has broken down irretrievably

(d) the transfer is affected by or in accordance with:

  (i) a financial agreement under the Family Law Act

  (ii) a court order

  (iii) an agreement that the Chief Commissioner is satisfied has been made for the purpose of dividing matrimonial property as a consequence of the dissolution, annulment or breakdown of the marriage, or

  (iv) a purchase at public auction of the property that immediately before the auction was matrimonial property where the public auction is held to comply with any such agreement or order.

Section 68(4) provides for refunds to be made by the Chief Commissioner in respect of duty charged following breakdown of marriage (or pursuant to s 68(4A) in respect of the break up of domestic relationships). The circumstances where the Commissioner can reassess the transfer or the agreement and refund the duty paid after:

(a) if duty was paid on the transfer of matrimonial property to the parties to a marriage or either of them, or to a child or children of either of them, and

(b) the transfer was effected as referred to in s 68(1)(b), and

(c) the marriage has been dissolved or annulled or has broken down irretrievably.

Refunds are also available in respect of financial agreements entered into and stamp duty paid in respect of transfers of property between spouses prior to the amendments made by the *State Revenue Legislation Further Amendments (No 2) Act 2001*.

¶18-605 Principal place of residence

There is an exemption from stamp duty under s 104B of the Duties Act in respect of a transfer by one spouse of one-half of their interest in a property to their spouse or de facto partner. The transfer must be such that the property will be held as joint tenants or as tenants in common in equal shares. In respect of de facto partners, the Duties Act provides that the parties must have been living together in a de facto relationship for not less than two years, otherwise the exemption is not allowed.

The further pre-condition in relation to the exemption is that the property must be held as the principal place of residence of the parties after the transfer is effected.

The exemption also extends to vacant land in circumstances where the married couple or de facto partners intend to use it as the site of a private dwelling house to be solely or principally used as their principal place of residence, as well as to the transfer of shares that confer an entitlement to exclusive possession of a company title dwelling that was solely or principally used as at the date of the transfer as the principal place of residence of the married couple or de facto partners.

Care must be exercised when obtaining instructions from clients to effect the above transfer. While the stamp duty exemption will apply regardless of whether the property was used by the spouse as an investment or principal place of residence, as long as the property will be used by the parties as their principal place of residence then the exemption will apply.

However, if the property had been used for investment purposes or not as the spouse's principal place of residence, then CGT issues may arise. CGT is payable on the transfer of a half interest in a property from a partner to their spouse. The CGT roll-over will not apply as s 126-5 of the ITAA97 applies on marriage breakdown.

LAND TAX AND FAMILY BREAKDOWN

¶18-610 Land tax and family breakdown

The following applies to land tax in NSW.

Land tax is a tax levied on the owners of land situated in NSW as at midnight on 31 December of each year. In general, a principal place of residence or land used for primary production (a farm) is exempt from land tax. However, land tax may be levied on:

- vacant land, including vacant rural land
- a holiday home
- investment properties
- company title units, or
- residential, commercial or industrial units.

The taxable value of each parcel of land is generally determined by adding the land value for the current tax year to the land values that applied for the two preceding tax years and then calculating the average. For 2017, the averaged threshold is $549,000.

Chapter 18

Example

If a party has land holdings with a total value of, say, $1,000,000 (excluding their principal place of residence), then the land tax payable in the 2015 tax year will be as follows:

$1,000,000 – $549,000 = $451,000 × 1.6% = $7,216 plus $100 = $7,316

The rate of land tax in NSW is $100 plus 1.6% of the land value between the land tax threshold ($549,000 for 2017) and the premium rate threshold ($3,357,000 for 2017). Amounts above the premium threshold are taxed at 2%. If a land tax liability is less than $100, no land tax will be payable.

A company is assessed in the same way as a sole owner unless it is related to another company. A trustee of a trust is assessed in the same way as a sole owner unless it is a special trust.

There is no threshold for non-concessional companies and special trusts. These entities will be taxed at the flat rate of 1.6% on the total value of all the taxable land owned. This includes hybrid trusts.

Where land is owned by a trustee of a special trust, or is owned by a company classified under s 29 of the land tax legislation as a non-concessional company, the land tax threshold does not apply and land tax will be charged at a flat rate of 1.6% of the taxable value. From the 2009 tax year, a premium land tax marginal rate of 2% will apply if total taxable land value is above $3,357,000 (for 2017).

It is important to consider the land tax implications of a property settlement as there is no land tax roll-over on transfer of land pursuant to court orders. Thus, if a company is to transfer land to a spouse pursuant to a court order, then land tax may well be payable by the company and this needs to be considered at the time of settlement. Similarly, this also applies to the transfer of an investment property between spouses under a court order.

FAMILY TRUST ELECTIONS

¶18-615 Income and taxation opportunities in making a family trust election

Generally, the trustee of a discretionary trust would consider making a family trust election in the following circumstances:

- the discretionary trust has tax losses and would like to carry forward its losses. If the discretionary trust had made a family trust election, it only needs to satisfy the income injection test to enable the losses to be carried forward
- the discretionary trust is the shareholder of a company that has tax losses and the company would like to carry forward the losses. If a family trust election is made, the discretionary trust is deemed to hold the shares in the company in the capacity of an individual. This will assist the company to satisfy the various tests which must be passed before it can carry forward its tax losses
- the discretionary trust will be receiving franked dividends for shares that it acquired after 31 December 1997 and would like to pass on the franking credits that are attached to the dividends to its beneficiaries.

Although the making of a family trust election will ensure that the relevant tax benefits can be passed on to the beneficiaries and related entities, the election has the effect of narrowing the class of beneficiaries to whom distributions from a discretionary trust can be made tax-effectively. This narrower class of beneficiaries (called the ''family group'') is defined in the ITAA36 by reference to a ''test individual''. Any income distributions made by the trustee to a beneficiary that is not within the ''family group'' will result in the trustee being liable to family trust distribution tax (FTDT). FTDT is charged at a rate equal to the top marginal rate plus the Medicare levy on the amount of income distributed to that beneficiary.

Section 272-95 of Sch 2F of the ITAA36 sets out the members of a ''family group'' as:

''(a) any parent, grandparent, brother or sister of the test individual or the test individual's spouse;

(b) any nephew, niece or child of the test individual or the test individual's spouse;

(c) any lineal descendant of a nephew, niece or child referred to in paragraph (b);

(d) the spouse of the test individual or of anyone who is a member of the test individual's family because of paragraphs (a), (b) and (c).''

Section 272-90(2A) extends the family group further to include:

''(a) a person who was a spouse of either the primary individual or of a member of the primary individual's family before a breakdown in the marriage; and

(b) a person who was a widow or widower (whichever is applicable) of either the primary individual or of a member of the primary individual's family and who is now the spouse of a person who is not a member of the primary individual's family; and

(c) a person who was a step-child of either the primary individual or of a member of the primary individual's family before a breakdown in the marriage of the primary individual or the member of the primary individual's family.''

¶18-620 Income splitting during marriage or relationships and after separation

During the course of marriage or relationships, parties generally split the income of partnerships, companies or trusts between spouses. There is nothing unusual in this. However, on separation, one of the spouses may retain control of the entity while the other spouse is shut out. As family law cases can take up to two years to be determined, it is important as an adviser who may be acting for both spouses to consider whether the splitting of income should continue during the separation period. For the spouse who has been shut out of the entity, this may not be an arrangement that would be in their interest as income tax would be payable on such splitting and they may not receive any of the income.

On occasions where the controlling spouse is ordered by the court to pay spouse maintenance, they may pay that maintenance through income splitting, which again will trigger an income tax liability. The recipient spouse should ensure that if such an arrangement will or may likely be put in place by the controlling spouse, they are not liable to pay the tax or any penalties that may be levied by the ATO, if the ATO forms the view that such an arrangement falls foul of tax law, by obtaining indemnities from the controlling spouse.

It is also important that at the time of making final orders indemnities be provided by the controlling spouse in relation to all taxes that may be payable as well as other indemnities, which will be outlined below. Such indemnities could prove valuable if the client later finds out that their spouse had made declarations of income which they never received. For example, in one case a spouse declared a trust distribution in favour of their former spouse on the eve of the making of court orders without informing the spouse. The indemnities that were included in the orders proved valuable as they assisted the spouse in forcing the other spouse to be liable for the tax payable on the distributions which were never received.

¶18-625 Indemnities and guarantees from the controlling spouse

Generally, the exiting spouse must ensure that they obtain indemnities from the controlling spouse in relation to:

- all claims made against the entity by a third party
- any claims that the entity or the controlling spouse has against the exiting spouse of the entity
- all tax liabilities including CGT, goods and services tax (GST), income tax and all other tax liabilities,

that may arise in respect of any act or thing done or omitted to be done by the exiting spouse, whether by reason of the exiting spouse having been an employee and/or director and/or officer of the entity and/or by reason of the exiting spouse's shareholding within the entity and/or any loan account in the exiting spouse's name and/or the receipt by the exiting spouse of any monies at any time from the entity or otherwise.

It is also important to ensure that the exiting spouse is released from all guarantees they may have given during the period of the marriage. Omission to obtain such a release means that the client may be called upon to make good any default by the entity even years after the spouse exited the entity. While an indemnity may be obtained from the controlling spouse that they be responsible for and indemnify the exiting spouse in relation to all guarantees, this is not ideal and in some cases not sufficient. The exiting spouse should be released from the guarantees as part of the orders to ensure that they will never be called upon to make good any default.

MAINTENANCE

¶18-700 Spouse maintenance

In cases where one spouse earns the income and the other attends to the homemaker and parenting role, after separation the party who did not work during the course of the marriage or relationship may apply for spouse maintenance. This is maintenance for the support of the spouse (not the children). Generally, a spouse would make an application for spouse maintenance shortly after separation. The court has to be satisfied that the spouse making the application has a need and that the financial activist spouse has the capacity to pay spouse maintenance.

Need does not mean subsistent level but a reasonable standard based on the particular circumstances of the case. There may be cases where someone's needs may be found to be $300 per week whereas in another case the party's needs may be $10,000 per month. There is no hard and fast rule that the court applies as to the level of maintenance awarded.

The interim spouse maintenance, if awarded, will continue until the final hearing where the court has to assess whether the spouse does still need the maintenance, taking into account the property settlement that the court will

award that spouse. For instance, in a case where a spouse becomes entitled to $2m in property settlement, the court may take the view that the spouse would not have a need after receipt of the settlement and therefore until the settlement is effected, the spouse will continue to receive the maintenance. In doing so, the court has taken into account the spouse entitlement to spouse maintenance in the property award.

There may be cases where the parties may not have significant assets but the financial activist spouse earns significant income. Take, for example, parties who have a modest pool of about $500,000 but the husband earns in excess of $500,000 pa. It would be open to the court in such a case to award spouse maintenance for a lengthy period of time, especially if the parties have young children and the wife has limited or no capacity to return to the workforce.

Once the need threshold has been established, the court looks at the financial activist and examines whether they have the capacity to pay spouse maintenance. In doing so, the court looks at the wealth and income of the spouse from all sources, the history of support provided by the spouse and other factors.

Once the court's jurisdiction has been enlivened for spouse maintenance, the court is not confined to awarding periodic spouse maintenance but can award lump sum spouse maintenance. Lump sum may be awarded not only as a capitalisation of periodic spouse maintenance but because of the facts, justice and equity of the case.

It may be possible for a spouse running their own business to structure the payment of interim spouse maintenance by causing the company to pay spouse maintenance and the company to meet the tax payable. While this is possible, it may be that such an arrangement (in circumstances where the spouse ceases to be involved in the business) runs foul of Pt IVA of the ITAA36.

¶18-705 Child maintenance and support

For children born before 1 October 1989 and where the parties separated before that date, the financial support for the children is determined under the Family Law Act. The Act provides that parents have an obligation to support their children financially.

Children born after 1 October 1989 or if their parents separated after that date fall under the child support scheme set up under the *Child Support (Assessment) Act 1989*. Since 1 July 2009, same-sex couples who have separated and meet the new parentage definitions are able to apply for child support for eligible children from their relationship.

The Child Support Agency (or CSA, being an extension of the ATO) administers the child support scheme. The scheme is an administrative process rather than a judicial body. The child support tables published yearly outline the level of child support to be paid by a payer. The level of child support payable varies depending on the number of nights a payer has the

children in their care (ie stay overnight) and the income earned by the payer as well as the income earned by the payee.

The child support scheme was overhauled in 2006. Under the child support scheme:

- the upper limit on income taken into account is 2.5 times all employees average weekly earning (EAWE)
- child support payments are calculated based on the actual costs of children
- the combined income of both parents is used to calculate child support payments, treating the incomes of both parents equally
- both parties' contributions to the cost of their children through care and contact is recognised
- the proportion of child support that may be provided as non-agency payments is 30%, and
- children of first and second families are treated more equally.

The changes that commenced on 1 July 2006 included a reduction of the maximum amount of child support payable by high income earners to ensure these payments are better aligned with actual costs of children. The maximum combined adjusted child support income for the 2016 child support year is $181,155.

The changes also take all of the payee's income rather than the previous system which used a disregarded income figure of $45,505. The changes also treat more fairly income earned from second jobs and overtime that assists with re-establishment after separation.

Since 1 July 2008, six new formulas apply to the calculation of child support. Ninety per cent of cases will fall under the basic formula (formula 1). The new child support formulas are premised on the costs of children and take into account both parents' incomes after certain exclusion of a self-support amount (calculated as 1/3 of the Male Total Average Weekly Earnings indexed annually). The assessment will be affected after a child spends more than 14% of the time with the non-resident parent. The costs of children are ascertained by reference to the Costs of Children Table set out in s 55G of the *Child Support (Assessment) Act 1989*.

Since 1 July 2008, parties have been able to enter into child support agreements. There are two types of agreements that can be entered into, namely, limited child support agreements (LCSA), and binding child support agreements (BCSA).

For an agreement to be a LCSA, the following must apply:

- be in writing and signed
- can be made without legal advice
- can only be made in relation to a child in respect of whom an administrative assessment can or has been made

- can only be made between an eligible carer and a person who is a parent of the child and resident in Australia on the day the LCSA is entered into
- has no effect unless it is accepted by the Child Support Registrar
- must comply with s 80E of the *Child Support (Assessment) Act 1989* requirements — namely the amount of support to be paid must be at least equal to what the assessment provides for or would otherwise be payable under the formula
- has a statutory sunset clause of three years after which either party can terminate the LCSA.

For an agreement to be a BCSA, the following must apply:

- must comply with the same formal requirements under a LCSA
- must have legal advice and certificates as to legal advice annexed to the BCSA
- does not have to comply with s 80E requirements — namely the payment payable could be less than an administrative assessment or would otherwise be payable under the formula.

Under new changes, parents can make an agreement to pay some or all of their child support using a lump sum without agreeing about the amount of child support — they can continue to have formula assessments each year.

Example

John and Joanne separate and decide that Joanne can retain the house on the basis that Joanne has to pay John $100,000. Instead of making that payment, John and Joanne agree to enter into a lump sum agreement for the $100,000. This sum will constitute a credit for John which will gradually be drawn down as John draws against it to meet his child support obligations. The remaining credit will be indexed at the end of each financial year.

In the 2017/18 year, assume John's liability is $20,000 per year in child support. At the end of 2017/18, John's child support liability is met from the lump sum credit. Assume the agreement is entered into on 1 October 2017. The credit used up for the remaining 270 days is $14,785. The remaining credit is $85,215. This is indexed by the CPI. If the relevant factor for 2017/18 is 1%, then the indexed amount is $86,067.

When one parent lives overseas

Australia's international maintenance arrangements apply when one parent lives in Australia and the other parent lives in a country that is a reciprocating jurisdiction. A number of countries have signed treaties in relation to support of children and a list of the reciprocating jurisdiction countries are found on the CSA website. The principle of these arrangements is that, wherever possible, a liability should be issued and administered in the jurisdiction where the payee resides. The jurisdiction in which the payer is resident is responsible for collection and providing the payer with reasonable assistance in dealing with the overseas authority.

A payee in Australia can apply for a child support assessment if the payer is a resident of a reciprocating jurisdiction on the day they make the application, except if it is one of the excluded jurisdictions. A payee must obtain a court order for child maintenance if the payer resides in an excluded jurisdiction. An overseas authority can apply for a child support assessment on behalf of a liable parent resident in their jurisdiction. A liable parent who is resident overseas cannot make their own application for an administrative assessment.

A payee in a reciprocating jurisdiction can apply for a child support assessment for a child who does not meet the usual residence requirements (the child is in Australia when the person makes the application; and the child is an Australian citizen, or ordinarily resident in Australia on that day). An overseas authority can also apply on behalf of a payee resident in their jurisdiction. A payer in Australia cannot apply for a child support assessment payable for a child who does not meet the residence requirements.

Centrelink benefits

If the payee is in receipt of a Centrelink benefit, they must make an application through Centrelink and they cannot opt out of the child support scheme nor can they negotiate a payment of child support that is less than what they would be entitled to receive under an assessment.

If the payee is not in receipt of a Centrelink benefit, they are at liberty to negotiate a child support agreement with the liable parent. Such an agreement can only be enforced by the payee after they have registered the agreement with the CSA, and the CSA accepted the agreement in writing. An agreement that has not been accepted by the CSA Registrar means that the agreement cannot be enforced in the court. The agreement may be enforced as a contract; however, this is far from ideal.

Prescribed payments are certain payments that can be credited as child support even if the parent receiving child support does not agree the payment was in lieu of child support. As long as the paying parent pays 70% of their normal monthly child support payment on time, a maximum of 30% of the monthly payment can be credited in this way. Prescribed payments can be for childcare costs, school fees, school uniform and book fees, essential medical and dental items, the other parent’s share of rent, mortgage, utilities and rates, or some motor vehicle costs. The CSA, however, will only credit prescribed payments if the paying parent has less than 14% (regular) care for all the children of the assessment. This is because if the paying parent has more than 14% care of any of the children, the direct costs that parent incurs when caring for the children are recognised in the child support formula.

The child support scheme works and will work well with payers who are employees who are the subject of Pay As You Go (PAYG) income tax. Where payers are contractors or owners of private companies or those people who have the potential to distort their true income position, the child support scheme may not deliver justice to the payee, although parties are entitled to apply to review the child support assessment.

If either party is not happy with the assessment issued by the CSA, they can apply to review the assessment. The change to the assessment application is also done administratively by qualified officers within the Child Support Registrar's office. Lawyers are not allowed to represent clients; however, they can assist them in completing the form. The parties need not attend the hearing personally. They can do so by telephone and not at the same time as the other parent.

Reviewing the child support assessment

There are a number of reasons why a parent currently may seek a change to the assessment; however, the officer has to be satisfied that in the special circumstances of the case, one of the following main reasons are made out:

- it costs more than 5% of child support liability to exercise contact
- it costs the payee extra to cover the children's special needs
- it costs extra to care for, educate or train the children in the way that the parents intended. This may result in the payer being asked to pay in addition to the periodic child support amount, the children's school fees and for extra curricular activities or part thereof
- the child support assessment does not take into account the income, earning capacity, property or financial resources of the children, and
- the child support assessment does not take into account the income, earning capacity, property or financial resources of one or both parents.

If a parent is unhappy with an assessment issued by the agency, they can lodge an objection which will be determined by the registrar. If either parent is unhappy with the Registrar's decision, the parent can make an application to review the assessment on any of the grounds referred to above. If either party is still dissatisfied with the result, they will have to apply to the Administrative Appeals Tribunal (AAT). Parties can have legal representation at the AAT. A decision from the AAT can be appealed to the court but only on questions of law. The road to the court is a long one and the new process is aimed at trying to ensure that child support matters are dealt with efficiently.

It is still possible to bypass the various steps above and proceed to court if there is a financial matter that the court is dealing with at the same time.

A current child support year runs for 15 months; however, a new assessment is issued when a tax return is lodged by either party. The current child support payable by a payer will be reduced if the payer has the children for more than 109 nights. The new scheme will be different in that there will be no threshold number of nights before there will be a reduction in child support payable. The new formula will take into account the number of nights the child or children stay with each parent.

While negative gearing has the effect of reducing one's taxable income, for child support assessment purposes, the CSA will ignore negative gearing in calculating the payer's child support liability.

The income a partner of either the payee or the payer receives does not affect the assessment. The payer's liability for child support will not be calculated on the basis of overtime work done by the payer to support their new family.

¶18-710 Adult child maintenance

There are limited circumstances where parents may be obliged to continue to support their adult children. Generally, this occurs where a child has a disability or where a child is undertaking tertiary studies and therefore is unable to support themselves. The level of adult child maintenance payable will depend on the standard of living of the parties and children, the income of the parents and the children's needs. The court apportions the amount payable by the parents to reflect the parents' capacity to support the adult child.

¶18-715 Child maintenance trusts

A child maintenance trust is a trust that arises as a result of the family breakdown. As the name suggests, it is a trust which is set up to receive child maintenance payments.

One of the principal benefits of a child maintenance trust is that it enables tax-effective income splitting to beneficiaries of a trust (including beneficiaries who are under 18 years of age) without attracting the penalty tax provisions contained in Div 6AA of the ITAA36. Minor beneficiaries can only receive tax-free distributions of trust income up to $416. Any amount received by minor beneficiaries above this sum will be taxed.

Specifically excluded from these penalty provisions is income received by minor beneficiaries of a child maintenance trust.

Under the tax rules applying to child maintenance trusts, minor beneficiaries are given the benefits of ordinary tax treatment. That is, each minor beneficiary of a child maintenance trust will enjoy a tax-free threshold of $18,200 **and** the usual marginal tax rates applying to income distributions from the child maintenance trust in excess of $18,200. By recognising the circumstances where a child maintenance trust can be used, considerable amounts of after-tax dollars can be saved.

But there are also benefits to the person making the child maintenance payments. Ordinarily, child maintenance or child support payments are made from after-tax dollars, that is, from the pool of money on which tax has already been paid. A properly structured child maintenance trust can enable child maintenance payments to be effectively paid out of pre-tax dollars.

Example

Robert has recently been separated from his wife Janet. The children, Daniel aged six years and Alyssa aged four years, live with Janet but spend five nights per fortnight with Robert.

In accordance with the child support tables, Robert must pay $30,000 pa to Janet for the benefit of Daniel and Alyssa.

Robert currently earns $215,000 as an accountant, and $35,000 as income from an investment vehicle. His tax (including Medicare levy of 2%) will be $90,731 with an after-tax income of $159,262. As a result of his $30,000 child support obligations, Robert is left with $129,262.

Robert's after-tax and ''after-child support'' income position could be improved by the effective utilisation of a child maintenance trust.

Robert could transfer property (for example, an interest in an investment vehicle, cash, income-generating shares or income-generating property) to a child maintenance trust for the benefit of the children. The property transferred to the child maintenance trust is invested to generate income and, as trustee of the child maintenance trust, Robert can direct that $30,000 per year be distributed to Daniel and Alyssa (ie $15,000 to each). If the income generated in the child maintenance trust was $35,000 per year, the balance of the income ($5,000) could be distributed to Robert.

What is Robert's income position now? His income is $220,000 (salary of $215,000 and child maintenance trust income of $5,000). His tax liability (including Medicare levy) is $76,631, leaving an after-tax and after-child maintenance income of $143,369. What is Robert's child support obligation? It is still the same, ie $30,000. Only now it has been paid from the child maintenance trust.

Robert has been able to improve his after-tax position and his after-child support position by $14,100 per year by utilising a child maintenance trust. Robert will make child support savings of at least $14,100 each year for the next 11 years (assuming the tax rates remain the same) (until the eldest child reaches 18 years of age) with further savings being made in years 12 and 13 (ie until the youngest child reaches 18 years of age).

There are a number of important factors to consider in the establishment of a child maintenance trust arrangement including the following:

- the terms of the child maintenance trust must comply with the prevailing tax laws (see s 102AG(2)(c)(viii) and s 102AGA of ITAA36) — principally, the trust must have arisen as a result of a family breakdown and the children must acquire trust property on vesting day)
- the child maintenance trust arrangements must be consistent with existing child support obligations
- the transfer of property to the child maintenance trust to generate income may give rise to capital gains tax and stamp duty implications depending on the nature, cost and value of the property transferred.

OTHER ISSUES

¶18-800 Full and frank disclosure of financial position

The Family Law Act and the Family Law Rules 2004 provide that each party must make full and frank disclosure of their financial position. The Rules provide that Pre-Action Procedures (PAP) must be attended to before parties file for property settlement and parenting issues (however, there are exceptions such as property at risk of dissipation).

The PAPs are aimed at ensuring litigation is a last resort. If the matter does not settle, a party may then wish to apply to the court for property settlement. There are two court phases, namely the resolution phase and the determination phase. In the resolution phase, there are two court events, namely a case assessment conference and a conciliation conference. If the matter does not settle at the conciliation conference, the matter then moves to the determination phase where the court makes directions for the preparation of the matter for trial and the appointment of single experts to prepare valuation of the property in dispute.

As part of the PAP and full and frank disclosure, parties must exchange financial documents and keep each other informed of changes in their financial position throughout the negotiations and until orders are made.

The parties' duty of disclosure is broad and very extensive so as to ensure that each of the parties and the court are fully informed of the parties' financial position before a decision is made about dividing the pool.

It is very crucial for clients to comply with their duty. Once a finding has been made by the court that a party did not make a full and frank disclosure of their financial position, then the court would not be unduly cautious about making findings in favour of the innocent party. To do otherwise might be thought to provide a charter for fraud in proceedings of this nature.

Advisers are in a good position to assist in this area, as they have a good understanding of the client's financial affairs.

¶18-805 Issuing or receiving a subpoena

Parties are entitled to cause to be issued by the court a subpoena to produce documents. A subpoena is directed generally to a third party to produce documents in that third party's possession, custody or control. Advisers may be served with a subpoena. It is important to note the following about a subpoena:

- a subpoena is a court order and must not be ignored
- if a subpoena is not complied with, the party at whose request the subpoena was issued can apply to the court for the arrest of the person named in the subpoena for failure to comply with the subpoena
- a subpoena must give the recipient at least five clear working days after it is served to produce the documents
- a subpoena must be accompanied with conduct money. Generally, $10 or $20 is paid at time of service. This is not the complete conduct money in compliance with the subpoena. A subpoena recipient can ask for money that they will incur in complying with the subpoena, such as time in compiling the documents, photocopying and the like
- a subpoena recipient cannot withhold production of documents on the basis that proper costs of the recipients have not been paid. If the conduct money is not sufficient to comply with the subpoena, negotiations should be entered into with the party on whose behalf the subpoena is issued

and if there is no agreement, an application for costs be made by the recipient to the court

- once served with a subpoena, the adviser should immediately provide a copy of it to their client as their client may wish to object to the subpoena or certain parts of it. (While the Rules provide that the party at whose request a subpoena is issued must provide a copy of the subpoena to the other party at least seven days prior to the return date of the subpoena, this may not occur and this may be the crucial time that the client requires to consider their legal position in relation to the subpoena issued.)

¶18-810 Family Court's powers over business entities

Where a company is owned by the parties, in all likelihood the court will find that the company is the alter ego of a spouse or both of them. The Family Court has wide powers against the company (or trust for that matter). The court can bind the company through the spouse as the company is the spouse's alter ego.

Where third parties are involved, the court's powers are not unfettered. The High Court in *Ascot Investments Pty Ltd v Harper and Harper* (1981) 148 CLR 337 found with respect to Family Court jurisdiction of third parties as follows:

- an order cannot be made where its effect will be to deprive third parties of an existing right
- an order cannot be made to impose on such a party a duty which the party would not otherwise be liable to perform
- parliament did not intend for third party interests to be subordinated to interests of parties through a marriage
- parliament did not intend that the court should be able to make an order that would operate to the detriment of third parties.

The court's ability to deal with family companies involving third party interests have been developed by the High Court and the Family Court, enabling the Family Court:

- to set aside transactions pursuant to s 106B of the Family Law Act
- to make orders directly in relation to property in ante-nuptial or post-nuptial settlements made in relation to the matter pursuant to s 85A of the Act
- if there are other ample assets for distribution between the parties, to establish that the party has a financial resource represented by the third party's property
- to find that the third party is the alter ego of a party to the proceedings
- to find that the third party is a sham brought into being in appearance rather than reality as a device to assist one party to evade their obligations under the Act

- to find that the third party is the puppet of a party to the marriage (eg the company is completely controlled by one party to a marriage) so in reality an order against the company is an order against the party
- to grant injunctive relief
- to make orders against the third party if the third party is in effect an accomplice of a party to a marriage whose actions are designed to assist one spouse to the disadvantage of the other
- to make a declaration pursuant to s 78 of the Act that the spouse be declared the equitable owner of certain property held by the company.

As can be gleaned from the above, the Family Court still has wide powers in relation to companies, including companies where third parties are involved.

One of the difficulties that the Family Court grapples with is the valuation of family companies. Such companies may be valued in a number of ways with significant differences in value. Some of the valuation methodologies that the court has accepted depending on the facts of each case include future maintainable earnings, net assets, and value to the owner of super profits. This last valuation method causes the greatest grief as a company is valued on the basis of what it is worth to the owner after taking into account a reasonable salary for the owner. This valuation method has no correlation to the reality of what the company would be sold for to a third party purchaser who is a willing but not an anxious purchaser, by a seller who is not an anxious seller.

Faced with such a valuation method, many clients now seek orders from the court for the sale of the company if the valuation by a single expert is found to be above a certain amount as that spouse can no longer keep the business and pay out their former spouse their entitlement. This will no doubt have a follow-on effect in relation to that spouse's future earning capacity and the adjustments that will ultimately be made by the court under the s 75(2) factors.

¶18-815 Third parties standing in the Family Court

A party that may be affected by a decision of the court has standing to intervene in Family Court proceedings. Generally, family law proceedings are inter partes; however, there may be occasions where third parties need to intervene to protect their position.

One example of third parties wishing to be involved in proceedings and even to commence proceedings is in the area of financial agreements. Third party proceedings can apply to set aside binding financial agreements (BFAs). The federal government had been concerned that the Act could be used to defeat or defraud creditors and those concerns have been addressed with amendments passed. ''Third party proceedings'' is defined to mean proceedings between:

- either or both of the parties to a financial agreement, and
- a creditor or a government body acting in the interest of a creditor,

being proceedings for the setting aside of the financial agreement on the grounds specified in s 90K(1)(AA).

Section 90K(1)(AA) provides that a financial agreement could be set aside by a court ''if the agreement was entered for the purpose or purposes that included the purpose, of defrauding or defeating a creditor or creditors of the party or with reckless disregard of the interests of a creditor or creditors of the party''.

A creditor in relation to a party to a financial agreement includes a person who could reasonably have been foreseen by the party as being reasonably likely to become a creditor of the party. A ''government body'' means the Commonwealth, a state or a territory or an official or authority of the Commonwealth, a state or a territory. The amendments to the Act are retrospective, that is they catch all financial agreements whether or not they were entered into before or after 5 December 2003.

The amendments allow government instrumentalities such as the Australian Securities and Investments Commission (ASIC) to commence proceedings to set aside financial agreements.

It is becoming increasingly common for third parties to be joined to family law proceedings. The third parties joined have generally been the parents of one of the spouses or a trust or company of the spouses parents. In addition, there has been a consistent attack by way of subpoena and discovery sought against trusts and companies of the parents of spouses in family law proceedings. It appears that the case of *Kennon & Spry* [2008] HCA 56 may have spurred some lawyers to seek financial documents from trusts. In recent cases such as *McDowell and Williams* [2012] FamCA 479 and the case of *Keech and Keach* [2011] FamCA 192, in determining whether financial statements should be the subject of a subpoena, judges have looked at effective control of and benefits received from trusts. This is achieved by examining whether the spouse has received trust distributions; whether the spouse is or has been a director of the trustee company (or is a trustee or co-trustee in their personal capacity) in determining the level of documentation to be provided. It is submitted that where a spouse has not received trust distributions and they are not and have never been directors of the trustee company and are not controllers of the trust then there is no apparent relevance to the financial statements being provided and disclosed. If a spouse never received a benefit from a trust, it would be hard to argue that there is a value to the interest in a trust where the interest is that of a beneficiary.

While it is true that a beneficiary of a trust has the right to be considered for trust distributions and can insist on the proper administration of the trust and that this right is one that is a chose in action, it is submitted that the value of the same is very little if anything where the trust has never made distributions to the particular beneficiary.

¶18-820 When one of the spouses is bankrupt

The Family Court also has jurisdiction to determine financial matters (property and spouse matters) where one of the spouses becomes bankrupt. The court can alter the rights of the trustee in bankruptcy in relation to the

bankrupt's property that has vested in the trustee in bankruptcy. In doing so, and after the court determines the pool of property that has vested by applying the equitable and bankruptcy principles, the court will apply the Family Law Act to determine the non-bankrupt spouse's interest in the vested property based on the contributions and s 75(2) (or s 90SF(3) in de facto matters) factors referred to earlier in the chapter. The way the new amendments have been drafted leads to the conclusion that the court will notionally divide the gross value of the vested property between the non-bankrupt spouse and the trustee in bankruptcy and then apply s 75(2) (or s 90SF(3) in de facto matters).

The new subsection, s 75(2)(ha) (s 90SF(3)(i) in de facto matters), provides that before making any orders in respect of vested property, the court has to consider:

> ''the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt, so far as that effect is relevant.''

The new subsection is important as the new s 79(1) (s 90SM in de facto matters) does not provide that the Family Court must, in altering the parties' interest, give all of the bankrupt's assets which have vested in the trustee to the trustee to distribute amongst the creditors. On the contrary, in relation to vested bankruptcy property, the court under s 79(1)(b) (s 90SM(1)(b) in de facto matters) has the discretion to alter the interests of the ''bankruptcy trustee in the vested bankruptcy property''. In doing so, no doubt the court will be concerned with the non-bankrupt's contributions and the s 75(2) (s 90SF(3) in de facto matters) factors and it is when the court examines s 75(2)(ha) (s 90SF(3)(i) in de facto matters) that the court will look at the interests of creditors and balance them against the family. The subsection does not give the trustee or the non-bankrupt spouse any priority. The playing field is level and in assessing the many s 75(2) (s 90SF(3) in de facto matters) factors, one of the factors the court will look at will be s 75(2)(ha) (s 90SF(3)(i) in de facto matters).

¶18-825 Binding financial agreements

Binding Financial Agreements provide a good measure of asset protection on marriage or relationship breakdown because they provide certainty of result on division of assets rather than rely on lawyers and judges to come up with a result that will cost tens of thousands of dollars. They are similar to ''pre-nuptial'' agreements as they are known in the USA but they are better than pre-nuptial agreements as BFAs can be entered into prior to the marriage, after the marriage, or after separation or divorce.

Are BFAs for everyone? The short answer is, it depends. If the client has significant wealth whereas their future spouse has no or modest wealth, then it would be in their interest to enter into a financial agreement. As an adviser, you have an obligation to ask the client to consider entering into an agreement with their future spouse. This is not to say that they will rip off their future partner if they enter into a BFA as the BFA would outline each of the parties' rights as to property division in the event of marriage breakdown.

A client may own a farm that has been in the family for generations; the client may be in business with third parties or there is a prospect that they may receive a large inheritance in the future. This would be a good reason why a BFA would be beneficial.

A BFA provides certainty of outcome in the event of separation. That is, by entering into the BFA the result of the property division is agreed upon and there is no question or argument. The Family Court's jurisdiction is ousted and therefore the lawyers are ousted as well!

Lawyers are required to provide a certificate confirming that they have provided advice on the agreement before the agreement can be valid. Each party must have their own independent lawyer.

Can BFAs be abused? It was never envisaged that parties could enter into BFAs in order to reduce assets and remove them from claims by third parties such as creditors. Some people have tried that in the past but ultimately the government closed that loophole and now creditors or trustees in bankruptcy can apply to the Family Court to set aside a BFA if it can be shown that the BFA was entered into with a view to defeat or defraud creditors.

A BFA can be used for a good measure of asset protection; however, planning when a BFA should be entered into and what it should provide for becomes crucial to ensure it will withstand attack from a future spouse, a creditor or future creditor or trustee in bankruptcy.

More and more lawyers are no longer prepared to draft financial agreements because of the risk of being found negligent in the way the agreement is drafted. There have been a number of cases following the introduction of BFAs into the Family Law Act where BFAs were set aside because the lawyers did not comply with s 90G requirements. That appears to have been rectified by the government introducing rectification provisions which enables a judge to rectify any technical defects, however, the judge still has the discretion to set aside the agreement notwithstanding the power to rectify.

More recently cases to set aside BFAs have centred on the substance of the agreement, namely whether the drafting was plain and covers the situation the parties find themselves upon separation. It appears that parties sometimes forget about their agreements once they are signed. In one case where the BFA was set aside, the parties set up a trust to run a business. Setting up a trust was never contemplated in the agreement and therefore no one could work out what each of them was entitled to. As a result the BFA was set aside.

In other cases, while parties may take into account contingencies such as the birth of children, if they do not specifically provide that regardless of whether they do or do not have children they want the same financial outcome to flow to the other spouse, the BFA is susceptible to being set aside.

Care must be exercised when drafting BFAs. They are not standard documents. They need to be tailor made to suit the client's needs and as such caution must be exercised when drafting. The adviser's role in assisting with the drafting of a BFA cannot be underestimated. Their job complements that of

the lawyer drafting as they understand the client's financial needs and depths and what structures will be put in place in the future.

¶18-830 Estate planning for blended families

If the adviser's client has children from a previous relationship or marriage, the adviser should advise the client to consider the impact of their superannuation death benefits as well as the structure of purchasing assets. For instance, if the client and their new spouse have just purchased a property in joint names or are intending to purchase a property in joint names then notwithstanding what the client provides for in their will, on their death their interest in the property will be given to their spouse by survivorship.

If the client nominates that their superannuation death benefits be given to their current spouse, the adviser should ask the client to consider the impact of such a nomination on their children from their first marriage.

Let us assume that the client separated from their spouse some time ago and has just met someone new. The client informs you, or you are aware that they have not yet done a property settlement with their former spouse; however, they are anxious to settle financially with their former spouse because they want peace and harmony in the new relationship. The client may inform the adviser that they have reached a settlement with their former spouse and wishes to give effect to that informal settlement.

Advisers should direct the client to consult with a lawyer in order to document the agreement reached, as the former spouse could spend the money received in the informal settlement and then consequently apply to the court for property settlement seeking a further division of whatever assets they have together with whatever assets the client has at the date of hearing, which may be months or even years after the informal agreement was effected.

The court has in the past made fresh property settlement orders in favour of former spouses who received their full entitlement when the first unenforceable agreement was entered into and required one spouse to pay the other further monies. This would be in addition to the significant legal costs that the client would incur. The adviser should advise the client not to hand the money until the agreement is signed, sealed and delivered.

¶18-835 Family law mediations

As discussed at ¶18-800, the Family Law Rules require parties to attend Pre-Action Procedures (PAP) before proceedings are commenced. This is an opportunity for advisers to seize upon and be involved in the settlement of their client's family law disputes. This would be done in conjunction with the family lawyers retained by the client(s). The adviser's role in the negotiations and structuring of settlements at mediation sessions could save the parties a significant amount in legal fees and in tax costs. Now, more than ever, lawyers and advisers need to communicate and collaborate to deliver wholesome and complete advice to their clients.