Local Tax Club-Melbourne & Geelong

The hidden tax consequences of family law

Presented at Leonda by the Yarra on Thursday, 18 September and Novotel Geelong on Friday, 19 September 2025.

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1. Introduction

This paper discusses some of the common intersections between family law and tax law, including:

- The property settlement framework
- Status (who is a de facto spouse);
- Dealing with division 7A;
- Applying CGT rollovers;
- Issues relating to the small business CGT concessions;
- The use of discretionary trusts (and whether the family jewels can be protected); and
- Intergenerational transfers and the ‘bank of mum and dad’.

2. Property Settlement Framework

The property settlement framework that applies to separated spouses is contained in section 79 (married couples) and 90SM (de facto couples) of the *Family Law Act 1975* (Cth) (**the Act**) and it is summarised below.

2.1 Just and Equitable Finding

The court cannot make a property settlement order unless it is satisfied that, in all circumstances, it is just and equitable to make an order. The court must have a principled reason for interfering with the existing legal and equitable interests of the parties, arising out of how they conducted their relationship.

Circumstances where the court may not be satisfied that it is just and equitable to make an order include where:

a. The relationship was short;

b. The parties kept their property separated;

c. The parties did not keep a joint bank account, have joint property or otherwise intermingle their finances;

d. The parties dealt with their individual assets without consultation with the other;

e. A Binding Financial Agreement has been entered into, that although not valid, has been relied upon by the parties; and/or

f. The parties did not have children.

In practice it is rare for the court to make a finding that it is not just and equitable to make an order. In most cases, it will be sufficient to show that there has been a common use of property, which will no longer occur due to the end of the relationship.

2.2 Identify the Property Pool

a. The existing legal and equitable rights and interests in any property of the parties to the relationship or either of them; and

b. The existing liabilities of the parties of the relationship of either of them.

In essence, this step is to determine the assets and liabilities of each party and their values at the time of concluding the settlement. This includes all assets (including superannuation entitlements), financial resources and liabilities held by parties in their personal names, or within corporate entities or trusts in which they either control or have an interest. This also includes property and liabilities brought into the relationship by either party or received by way of gift or inheritance during your relationship.

Prior to the amendments to the Act which took effect in June 2025, if one party had spent or lost funds or property prior to settlement, the Court would sometimes treat the assets as if they still existed and would include them in the total pool of assets in the balance sheet as an ***Addback*** to then be divided between the parties.

In the recent Full Court case of *Shinohara & Shinohara* [2025] FedCFamC1A it was held that the legislative amendments to the Act made ***Addbacks*** no longer consistent with the Act. In its reasoning, the Court clarified that only existing property is to be identified and considered in the balance sheet for the purposes of division or adjustment between the parties. Although, premature disposals of property or wastage and still be considered in the assessment of contributions and current and future circumstances of the parties, as an adjustment to the overall percentage of the existing asset pool they each receive.

2.3 Considerations as to Contributions

To take into consideration contributions made by each party throughout the relationship to the acquisition, conservation and improvement of property, including direct and indirect, financial and non-financial contributions to property, together with contributions to the welfare of the family i.e. as a homemaker and/or parent.

At this step the Court must also consider the effect of any family violence, to which one party to the relationship has been subjected or exposed to by the other party, on the ability of a party to a relationship to make these contributions. The effect being that the Court may conclude that greater recognition may be afforded to the contributions of a party if those contributions were made more arduous by making them whilst experiencing family violence.

For the purposes of the Act, family violence is not limited to physical violence. Family violence is defined as violent, threatening, or other behaviour by a person that coerces or controls a member of the person's family or causes them to be fearful. Examples of family violence include but are not limited to assault, sexual assault, stalking, repeated derogatory taunts, intentionally damaging property, isolating a family member from their support networks, financial abuse and depriving a family member of their liberty.

Consideration is then given to any initial contributions brought into the relationship by either party, as well as to external contributions made by a party during a relationship, such as any gifts or inheritances received by a party.

The relevance of, and the weight to be attached to, any initial or external contribution received will depend on factors such as the amount of the contribution and for external contributions when it was received. Generally speaking, the longer the relationship, and the earlier in the relationship the external contribution was made, the less significance will likely be placed on the contribution.

At this stage, the Court will generally assign a percentage value attributable to each party’s contributions. For example, if contributions were equal then 50/50, or if one party made greater contributions 65/35 or some variation thereof in one party’s favour.

2.4 Consideration of Current and Future Circumstances

Consider what adjustment should be made to the contributions-based-assessment (the contributions percentage assessment), having regard to the parties’ respective current and future circumstances.

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To make this assessment, the Court will take into consideration a number of factors relating to parties current and future circumstances. These considerations include, amongst others:

a. The effect of family violence, to which one party of the relationship has been subjected to or exposed the other party, on the current and future circumstances of the other party;

b. The age and state of health of each of the parties;

c. The income, property and financial resources of the parties and the physical and mental capacity of each of them for appropriate gainful employment;

d. The effect of any material wastage, caused intentionally or recklessly by a party to a relationship, of property of either party or both of them;

e. Any liabilities incurred by either of the parties or both of them, including the nature of the liabilities and circumstances relating to them;

f. The extent to which either party has the care of a child or children of the relationship under the age of 18, including the need of either of them to provide appropriate housing for such a child;

g. Commitments of each of the parties of the relationship that are necessary to enable the party to support themselves and any other child or person that party has a duty to maintain;

h. The duration of the relationship and the extent to which it has affected the earning capacity of a party to the relationship;

i. If a party to the relationship is cohabitating with another person, the circumstances relating to the cohabitation; and

j. Any other fact or circumstance which, in the opinion of the Court, the justice of the case requires to be taken into account.

This step is essentially prospective and broadly considers if one party will be worse off than the other, and if as a consequence they should receive a greater portion of the existing assets of the parties.

In high-net-worth cases, significant adjustments for a party's circumstances are less likely, given parties should be receiving enough assets to support themselves into the future.

Similarly, in modest asset pool larger future needs adjustments can be expected, given there are less items of value to divide between the parties.

2.5 Just and Equitable

The final step in the property settlement framework, is for the Court to be satisfied that the orders it is making are just and equitable overall.

The Court has a wide discretion which permeates each step of this process and different judges could very well come to different findings.

An illustrative example of how this process applies in practice is set out below:

a. Step 1: A Husband and Wife buy a property together and have two children. Their relationship lasts 10 years. The court finds it is just and equitable to make an order.

b. Step 2: The parties' home is worth $2,000,000 and has no mortgage. The parties have no other assets or liabilities.

c. Step 3: The Husband and Wife both work to the best of their ability, although the Wife earns more and the Husband takes greater care of the children. Neither receive inheritances, windfalls or had assets at the commencement of the relationship. The Court makes a finding of equal contributions and assigns a contributions assessment of 50/50.

d. Step 4: Given the Husband is the primary carer of the children and works part time, whilst the Wife is a high earning executive, the Court adjusts the Husband's entitlement upward by 5% to reflect his current and future circumstances. The overall result in this case would be that the net asset pool is divided 55/45 in favour of the Husband.

e. Step 5: The Husband does not have capacity to make a payment to affect a 55/45 division of the asset pool, in this case the property. Orders are made for the property to be sold and the proceeds divided 55/45 in the Husband's favour. The Court is satisfied this is just and equitable overall.

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3. Navigating Division 7A and CGT rollovers

3.1 Overview

Family law property settlements frequently involve companies and trusts controlled by one (or both) spouses. When these structures are used to satisfy settlement obligations, the following taxing regimes must be considered:

- Division 7A of the ITAA36, which can deem unfranked dividends where a private company provides a payment, loan or forgives a debt to a shareholder or their associate (including a 'spouse');
- CGT, which can apply unless an exemption applies. Typically, this will be the marriage/relationship breakdown CGT in Subdivision 126-A of the ITAA97, which defers CGT on certain spouse-to-spouse transfers made because of qualifying FLA instruments; and
- Where real property is involved, transfer duty. In the context of family law and Victorian property, reliance is typically placed on section 44 of the *Duties Act* 2000 (Vic). Transfer duty is beyond the scope of this paper, however it should be noted that the duty exemption allows for transfers to a broader group (e.g. dependant children and certain trusts) and does not require a qualifying FLA instrument.

3.2 Division 7A – purpose, mechanics, and reach

Division 7A is an anti-avoidance regime designed to prevent private companies from distributing profits to individuals outside the dividend system. Key operative provisions include:

- Section 109C (payments), 109D (loans), 109F (debt forgiveness) and 109Y (distributable surplus);
- The 'associate' of a shareholder concept, which via section 318 of the ITAA36, includes a 'spouse' of a shareholder.

Where a private company provides a payment, loan, or debt forgiveness to a shareholder or associate, the amount can be treated as an unfranked dividend up to the company's distributable surplus. The default position is unfranked. Franking is generally not available for Division 7A deemed dividends (see below in relation to section 109RC).

3.2.1 Company-funded settlements

It may be proposed for a settlement to be funded from a company controlled by one spouse. Division 7A should be at the forefront of any advisor's mind where this is proposed. The potential relevant Division 7A issues include:

1. Firstly, consideration should be given to the status of historical and existing loans from the private company to marital parties. Some of the issues to consider include:
    a. Have those loans been compliant with Division 7A?

b. Do written loan agreements exist that are compliant with section 109N?

c. Have minimum yearly repayments been made in accordance with those terms?

d. Is there any potential that deemed dividends have arisen in prior years?

e. Is the Commissioner within his Period of Review to assess those deemed dividends?

f. Should corrective action be undertaken and the Commissioner's discretion under section 109RB be sought?

2. Second, while the general Division 7A position is that a deemed dividend is unfrankable, an exemption exists in a family law context. Section 109RC of the ITAA36 permits franking of a deemed dividend that arises due to a "family law obligation". In effect, section 109RC carves out an exception to the usual prohibition on franking Division 7A dividends. The term 'family law obligation' is defined in section 109ZD ITAA 1936 by reference to Subdivision 126-A (discussed below) and in essence, covers obligations under the FLA or corresponding state/territory or foreign laws relating to marriage or relationship breakdown.

3. Third, advisers have historically argued that section 109J of the ITAA36 provides that a payment made to discharge 'an obligation of the company' will not be treated as a dividend. The argument is that when a court orders a company to pay or transfer assets as part of a property settlement, the company is under a legal obligation to do so – potentially bringing the payment within the section 109J exception (i.e. not a dividend). Indeed, prior to 2014 the ATO had accepted this position in a number of private binding rulings. The ATO reversed that view in Taxation Ruling TR 2014/5 and the Commissioner's current position is that Family Court orders can never enliven section 109J, because the 'obligation' arises only out of the non-arm's-length connection with the shareholder. Whether the Commissioner's view in TR 2014/5 is in fact correct remains to be seen, however it would take a brave taxpayer to challenge the Commissioner's view.

3.2.2 Case study: *Lacey & Lacey* [2020] FamCAFC 73

Pursuant to subsection 79(2), the Court must not make an order in property settlement proceedings unless it is satisfied that, in all the circumstances, it is just and equitable to make the order.

Lacey is an important case study about the risks concerning company funded settlements, and how failing to appreciate the Division 7A tax issues associated with them can result in defective property settlement orders.

Background

The parties married in 1973 and finally separated in 2010.

The Husband controlled a long-standing private company that operated the family business.

At trial, the net pool (including super) was roughly $10 million. The primary judge assessed contributions at 60% to the Husband, then ordered the Husband to pay - *or cause the company to pay* – to the Wife roughly $3 million within four months and otherwise left each to retain what was in their hands. The judge expressly noted there was no evidence about the taxation consequences of funding that payment.

The Husband appealed. The Wife opposed the appeal and cross-appealed, arguing relevantly that the primary judge could not be satisfied that the final orders were 'just and equitable' in circumstances where the method of payment (here, "pay or cause to be paid by the company") may trigger significant tax liabilities, without evidence of those tax consequences.

Decision

The Full Court held that the absence of evidence about the likely tax consequences of the very mechanism chosen to affect the property division was an error of law: without that evidence, the primary judge could not be satisfied the orders were just and equitable. The Court emphasised that, from the Wife's perspective, a direct cash payment from the company would probably be deemed a dividend under Division 7A because she was an "associate" of a shareholder (in the context of the previous discussion regarding section 109J and Taxation Ruling TR 2014/5, in Lacey it appears that the private company had no legal obligation to pay a sum of money to the Wife – however the decision does not contain any discussion regarding section 109J).

The Court quoted the primary judge's acknowledgment that there was "absolutely no evidence" about taxation consequences, and noted that both parties bore responsibility for leading the Court into error by not adducing evidence of tax impacts, even though the impugned order mirrored what each had sought. Nonetheless, because it was a legal error, the Wife could rely on it.

Impact

From *Lacey*, the takeaway for advisors is that if a company funded settlement is contemplated, cogent tax evidence is required (and required to be understood by all parties, including the Court). Situations could arise where company funded settlements occur, but the company has no distributable surplus under section 109Y. A further interesting but unresolved question the interaction between this issue and the uncertainty regarding section 109J / the ATO's change of interpretation in TR 2014/5.

3.3 CGT marriage/relationship breakdown rollover - Subdivision 126-A

3.3.1 Overview

Where assets move because of a qualifying FLA instruments (generally a court order, arbitral award, or financial agreement), Subdivision 126-A provides for a CGT rollover:

- **Section 126-5:** provides for a roll-over if a CGT event happens involving an individual (the transferor) and his/her spouse (or a former spouse);
- **Section 126-15:** provides for a roll-over if a CGT event involves a company or trustee (the transferor) and a spouse (or a former spouse). In relation to section 126-15, it appears there is no qualifier as to which spouse receives the asset. Subsection 126-15(2) contains various 'value shifting' type cost base adjustment rules to deal with companies / unit trusts having reduced values.

The rollover is mandatory when its conditions are met (i.e. you cannot "opt out" to crystallise a gain/loss, unless a transfer is structured in a way that does not qualify for Subdivision 126-A rollover relief).

3.3.2 Rollover Issues in Practice

- The transfer must be because of a qualifying FLA instrument. Private side deals without an order/qualifying agreement will **not** obtain rollover, and a capital gain may arise may on the market value of the CGT asset.

- *Ellison v Sandini* (see below) makes clear that the recipient must be the spouse/ex-spouse personally. Rollover generally does not extend to transfers to entities (trusts/companies).

- The transferee spouse inherits the cost base and history (and latent gains). For a main residence that is rolled over from individual to individual, this includes whether the transferring spouse occupied the property as their main residence (section 118-178 of the ITAA97).

- The rollover does not determine state tax (transfer duty) nor Division 7A outcomes. The 'main residence trap' case study below illustrates that while a CGT rollover may apply, a deemed dividend under Division 7A might also apply.

3.3.3 Case Study: Entities and the *Ellison v Sandini* problem

Ellison v Sandini confirms that Subdivision 126-A cannot apply in the context of transfers to companies or trusts. It is an important case study about the risks concerning transferring assets by direction to third-party entities.

Background

This case arose from a property settlement following the divorce of Mr. and Mrs. Ellison. Mr. Ellison controlled a trust (Sandini Pty Ltd as trustee for the Karratha Rigging Unit Trust) which held 2,115,000 shares in Mineral Resources Limited.

In September 2009, the Family Court (by consent orders under the FLA) directed that Sandini Pty Ltd[1] *"do all acts and things and sign all documents necessary to transfer"* those shares to Mrs. Ellison.

Rather than taking the shares in her personal name, Mrs. Ellison gave a written direction a week later asking that the shares be transferred to Wavefront Asset Pty Ltd (Wavefront) as trustee of the Felstead Family Trust.

Mr. Ellison (via Sandini) complied and executed a transfer of the shares to Mrs. Ellison's trust as requested. Mr. Ellison (Sandini Pty Ltd as trustee for the Karratha Rigging Unit Trust) adopted the position that Subdivision 126-A would apply to disregard any capital gain on this transfer

Decision

On appeal, the Full Federal Court (Ellison v Sandini Pty Ltd [2018] FCAFC 44) overturned the trial decision by a 2-1 majority. The majority (Jagot J and Siopis J) found that the marriage breakdown rollover did not apply to the transaction. Two of the key points from the majority judgment include:

1. **That Family Court orders do not themselves result in a CGT event.** The majority view was that a Family Court order directing a transfer is not a dispositive instrument, it simply mandates that steps be taken. Thus, CGT event A1 did not occur at the time of the court orders, and

[1] In its capacity as trustee of the Ellison Family Trust (noting that Sandini was not the trustee of the Ellison Family Trust. Sandini was the trustee of the Karratha Rigging Unit Trust (KRUT) and, in that capacity, owned over 35 million shares in Mineral Resources Limited.

happened only later (in this case, when Sandini executed the share transfer form and the transfer was registered in favour of the trust); and

2. **Party to party requirement.** The CGT event was the transfer from Sandini Pty Ltd as trustee for the Karratha Rigging Unit Trust to the trustee of Mrs. Ellison's trust. Mrs. Ellison herself was neither the legal transferee nor the direct recipient in that transaction – she only benefitted via her trust's ownership. The majority emphasised the literal wording of section 126-15(1): it requires the transferee be "a spouse or former spouse".

Impact

No matter how fully she consented or "was involved" in that arrangement, the transferee of the shares was not Mrs. Ellison herself. The Family Court order required a transfer to Mrs. Ellison, but that was not what occurred.

The direct implications of the CGT rollover in Subdivision 126-A not applying was that Mr. Ellison's trust made a capital gain and bore a tax liability (which presumably was not taken into account in division of assets), and Mrs. Ellison's trust received the shares with a stepped-up cost base equal to that market value.

Finally, there a variety of implications a Family Court order not constituting a CGT event. Timing of a CGT event may be important for a number of reasons (e.g. relevant income year, whether capital losses exist, whether the general 50% CGT discount applies, whether the $6m maximum net asset value test is met, etc.).

3.4 Case Study: The Main Residence Trap

3.4.1 Facts

1. Bob sets up B&B Pty Ltd (BBCo) in 1990 as its only shareholder and is married to Betty.
2. BBCo owns a residential property (ostensibly purchased via a company for asset protection reasons).
3. The property has been used as Bob and Betty's main residence at all relevant times.
4. The property has a cost base of $200,000, and a current market value of $2 million.
5. BBCo has no other assets or liabities.
6. BBCo has no franking credits.
7. BBCo has issued share capital of $200,000.
8. Bob and Betty are now going through a divorce, and are considering the following:
    a. **Scenario A:** selling the property and extracting the funds;
    b. **Scenario B:** Transferring the Property to Betty (whereby BBCo is itself legally obliged pursuant to a FLA instrument to transfer the main residence to Betty).

The tax outcomes under Scenario A and Scenario B are set out below.

3.4.2 Scenario A – Sale and Extraction

Under Scenario A:

- CGT event A1 will happen when a contract of sale is entered into for the property and a capital gain of $1.8 million will arise.[2]
- BBCo will pay tax at the corporate tax rate on the entire capital gain ($1.8 million). This rate is likely to be 30%, resulting in tax of $540,000.
- $200,000 is paid to Bob (as a return of share capital).
- The remaining $1,260,000 can be paid as franking dividend (to Bob as shareholder, or via section 109RC if a payment were ordered to be made to Betty). Assuming a marginal tax rate of 47%, tax payable at the individual level is $306,000.
- **Total tax payable: $846,000**.

3.4.3 Scenario B – Transfer pursuant to FLA

Under Scenario B:

- CGT event A1 will happen when the transfer occurs and a capital gain of $1.8 million will arise. However, Subdivision 126-A should apply to disregard this capital gain.
- BBCo will pay zero tax at the corporate tax rate.
- Assuming that Commissioner of Taxation's views in Taxation Ruling TR 2014/5 are correct, the transfer of the property will result in a deemed dividend to Betty of $2 million (reduced to $1.8 million on account of BBCo's distributable surplus). While section 109RC may permit franking, BBCo has no franking credits and therefore cannot frank the dividend. Tax payable by Betty (assuming a marginal tax rate of 47%) is $846,000.
- Due to section 118-180, Betty cannot apply the main residence exemption (on a future disposal of the property) for the period from 1990 to 2015.
- Due to Subdivision 126-A, Betty's cost base going forward remains the same as BBCo's cost base (i.e. $200,000). Practically this means that Betty will at some point make a capital gain of at least $1.8 million on which tax must be paid (approx. $423,000 based on a 47% rate after general 50% CGT discount).
- Bob's shares in BBCo are now worthless, however Bob cannot claim a capital loss as Subdivision 126-A reduces Bob's cost base in the BBCo shares to $nil.
- **Upfront tax payable: $846,000**
- **Total tax payable (including on future sale of the property): $1,269,000**.

[2] Ignoring cost base indexation and noting that the general 50% CGT discount does not apply to companies.

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A variation of this issue was raised in response to the draft version of TR 2014/5 (Draft Taxation Ruling TR 2013/D6), and is included in the compendium to TR 2014/5 (TR 2014/5EC). As part of its response, the ATO states that:

> *"these consequences do not arise if the transfer of property is not 'because of' the section 79 order (that is, if the transfer of property is not in compliance with that order). For example, if the order requires that money be paid, and the parties separately agree to satisfy that obligation by the transfer of property, the transfer of property is not 'because of' the order in the strict sense, and the roll-over provisions and cost base adjustment of the shareholder's interests in the private company will not occur. Instead, the company will be assessed on any capital gain that arises upon that transfer."*

The above statement does not discuss how section 109RC would operate. If this scenario, a further consideration is whether BBCo would even have franking credits (given that tax is not crystallised on a capital gain until the income year ends). A related consideration is that BBCo's tax liability would also crystallise at a point in time where it has no assets (i.e. at the end of the income year).

Unless it desired to challenge TR 2014/5, it suggested that Scenario B should be either completely avoided, or structured in such a way that ensures the Subdivision 126-A **does not** apply.

Finally, it is noted that the situation in *Lacey* may arise if these tax issues are not appropriately ventilated.

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4. The Small Business CGT Concessions

4.1 Why Division 152 matters in Family Law settlements

Family-law property settlements often involve business assets – for example shares in a private company or business real property. In these cases, the Small Business CGT Concessions in Division 152 of the ITAA97 can dramatically impact tax outcomes. When available, they can eliminate or materially reduce CGT, either:

1. On a sale to third parties as part of the family-law settlement;
2. On a later disposal by the spouse who retains the asset;
3. On a later disposal by the spouse who receives the asset; and
4. On a transfer of assets relating to a family-law settlement where Subdivision 126-A does not apply.

At a high level, Division 152 CGT relief is available where the basic conditions are met: the taxpayer satisfies either the $2 million aggregated turnover test or the $6 million net asset value test; the asset is an active asset. Additional requirements apply is the asset in question is shares or units. The concessions are:

1. **15-year exemption** (Subdivision 152-B);
2. **50% active asset reduction** (Subdivision 152-C);
3. **Retirement exemption** – lifetime cap **$500,000** (Subdivision 152-D); and
4. **Small business rollover** (replacement-asset deferral) (Subdivision 152-E).

Each can apply alone or in combination (other than the 15-year exemption).

Practitioners should closely examine whether or not the small business CGT concessions could apply to the scenarios mentioned above. Practitioners should also closely scrutinise claims / non-claims regarding the small business CGT concessions.

For example, without appropriate scrutiny, the situation could arise where a separating party has ‘not claimed’ on an asset sold to third parties as part of the family-law settlement (deliberately or otherwise), the tax liability has been factored in to the division of property, and the separated party goes back some time later (as an amendment request or objection within the period of review) to then claim the small business CGT concessions (potentially receiving a windfall).

4.2 Interplay with Subdivision 126-A

Subdivision 126-A is automatic where its conditions are satisfied. The transferor disregards the gain/loss and the transferee inherits the cost base.

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4.2.1 Preserving Small Business Concessions after a rollover

Where an asset does move under Subdivision 126-A, subsections 152-45(2) and 152-115(2) provide that the transferee may elect to rely on the transferor's:

- Ownership period (for the purposes of the 15-year exemption), and
- Active asset history (for the purposes of the active asset test).

This ensures that matrimonial transfers pursuant to Subdivision 126-A do not 'reset the clock' for the purposes of a future small business claim. For example - a farm held for 12 years by Spouse A is rolled to Spouse B, who owns it for 3 more years. B can elect to count A's 12 + B's 3 = 15 years, potentially unlocking the 15-year exemption.

The election is optional**.** In some cases, a transferee may prefer to start fresh – conceivably this would only be a consideration in situations where the CGT asset may not have been an active asset while owned by the transferor (e.g. a property that was previously not used in a related business, or share in a company which may not have satisfied the 80% test).

4.2.2 Preferring a No-Rollover Path?

A transfer may be structured in a way that does not qualify for Subdivision 126-A rollover relief. In certain situations, this may be a deliberate structuring choice.

Outside of the small business CGT concessions, one example of this may be that the transferor has significant carry forward capital losses. In that situation, the transferor may not make a capital gain due to those capital losses, while the transferee acquires an uplifted cost base reducing future CGT exposure.

Within the context of the small business CGT concessions, there are a variety of situations where it may be overall advantageous to instead apply the small business CGT concessions – for example:

- If transferor would satisfy the maximum net asset value test, but the transferee is unlikely to satisfy the maximum net asset value at a future time of disposal;
- If the transferor is a small business CGT entity (carrying on a business and less than $2 million turnover), but the transferee is unlikely to qualify as a small business CGT entity at a future time of disposal;
- If the asset in question is currently an active asset, however, will not be an active asset in the hands of the transferee; and
- The parties want a clean separation without having to factor in future unrealised capital gains.

4.3 Should future CGT liabilities be deducted?

When an asset with an unrealised gain is retained (or rolled over under Subdivision 126-A), the question is whether to discount for unrealised CGT in the asset pool. Under *Rosati v Rosati* (1998) FLC 92-804 (discussed below), Courts generally deduct only certain or imminent tax (e.g. when a sale is inevitable or would probably occur in the near future).

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If no sale is planned and the asset may be held long-term (or sold later under Division 152 concessions), a notional CGT deduction is usually inappropriate.

In relation to the small business CGT concessions on an impending sale, the question arises regarding how that the notional CGT deduction would be calculated (particularly given that the small business CGT concessions themselves contain various choices – such as the retirement exemption, and where there are real questions about whether or not the small business CGT concessions would apply.

4.3.1 Rosati v Rosati (1998) FLC 92-804

The Full Court in the case of *Rosati v Rosati* (1998) FLC 92-804 is the leading case on the following principles in relation to the circumstances when the court ought to take into account unrealised capital gains in calculating the value of the available property pool to be divided between the parties:

> *'(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 articulated by the Full Court above, appropriate evidence such as expert evidence and/or affidavits regarding the probability of a future sale is critical to determine to if, and the extent to which, unrealised capital gains (and potential capital gains tax liabilities) should be taken into account in the valuation of the property pool.

4.3.2 Marlin & Henson [2025] FedCFamC1A 71

The principles outlined in *Rosati v Rosati* have been recently demonstrated in *Marlin & Henson* [2025] FedCFamC1A 71.

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In *Marlin & Henson*, the Husband owned several investment properties (directly or through his business trusts) and asserted he intended to sell them in the coming 3-5 years and would incur an estimated tax liability of $3.3 million.

The Husband argued that the principles under *Rosati v Rosati* required the potential CGT liabilities from the disposal of the investment properties must be taken into account when assessing the property pool. The issue was therefore whether the Court should deduct potential future capital gains tax liabilities associated with the Husband's investment properties when calculating the net asset pool.

On this issue, the Full Court upheld the primary judge's decision that the potential CGT liabilities should not be taken into account. While the Husband asserted an intent to sell the investment properties "within 3–5 years" to fund his retirement, he simultaneously sought orders allowing him to retain those properties and opposed any immediate sale. Accordingly, the primary judge concluded that the Husband had failed to persuade her that sale was inevitable, or likely to occur in the near future, or intended to occur at all.

4.4 When is a FL obligation a liability for the purposes of the MNAV?

One of the threshold conditions to access the small business CGT concessions is the maximum net asset value test (152-15 ITAA97). This test requires that the net value of a taxpayer's CGT assets[3] must not exceed $6 million.

In calculating the net value of CGT assets, 'liabilities' that are related to the assets must be subtracted.

The term 'liability' is not defined by ITAA97. The ordinary meaning of the term liability is usually considered to be legally enforceable debts that are due for payment, and to presently existing legal or equitable obligations to pay either a sum certain or ascertainable sum. Thus, the ordinary meaning of the term liability does not include future obligations, expectancies or liabilities that are that are completely uncertain. In *FC of T v Byrne Hotels Hotel Qld Pty Ltd* [2011] FCAFC 127 (Byrne Hotels), the Full Federal Court confirmed that the term 'liability' extended to certain contingent liabilities.

In particular, noting paragraph 53:

> *…If contingent assets can be included in the net CGT asset value calculation in s 152-20(1) on the basis that they meet the definition of CGT assets in s 108-5, then contingent liabilities should also be included in that calculation, provided that they are related to the CGT assets and can be classified as "any kind of property" or "legal or equitable obligations that are not property". …*

It seems clear that a family law obligation pursuant to an FLA instrument would be a sufficient liability for the purposes of the maximum net asset value. However, what if a CGT event occurs some time prior to the finalisation of a family law matter? It is unknown whether such a contingent liability could be taken into account, however the ATO's view in *Taxation Determination* TD 2007/14 at paragraph 19 ATO's view is that the term liabilities in the context of the maximum net asset value test does not include 'provisions for a possible obligation to pay damages in a pending lawsuit.

[3] Plus connected entities and affiliates.

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5. Who is a De Facto?

5.1 Overview (Family Law)

From a family law perspective, whether parties are in a de facto relationship is a threshold question with substantial downstream consequences.

Part VIIIAB of the Family Law Act 1975 (Cth) (**FLA**) applies to de facto financial matters. If the FLA's jurisdiction is not engaged, parties will need to look to other areas of law (such as contract or equity) for relief.

Section 4AA provides that a person is in a de facto relationship with another if

> *(a) the persons are not legally married to each other; and*
>
> *(b) the persons are not related by family (see subsection (6)); and*
>
> *(c) having regard to all the circumstances of their relationship, they have a relationship as a couple living together on a genuine domestic basis.*

The provision explicitly accommodates non-exclusivity (a party may be legally married to someone else or in another de facto relationship) and recognises same-sex relationships.

Subsection 4AA(2) lists factors that "may" be taken into account, including (and not limited to):

- Duration of the relationship;
- Nature and extent of common residence;
- Existence of a sexual relationship;
- Degree of financial dependence or interdependence, and arrangements for financial support;
- Ownership, use and acquisition of property;
- Degree of mutual commitment to a shared life;
- Care and support of children; and
- The reputation and public aspects of the relationship.

The authorities often summarise the inquiry as asking whether there has been a "merger of two lives" or a "substantial mutual commitment to a shared life". Importantly, full-time cohabitation is not essential; episodic or flexible living arrangements can still result in a finding of de facto status.

The inquiry is holistic: no single factor is determinative; the court weighs the indicia collectively. Exclusivity is also **not** a requirement. Parallel relationships (including marriage to one person and a de facto relationship with another) can co-exist, potentially raising exposure to claims from both a spouse and a de facto partner.

While section 4AA establishes status, jurisdiction to make property/maintenance orders additionally requires a gateway under section 90SB of the FLA which requires the Court to be satisfied that:

- That the period, or the total of the periods, of the de facto relationship is at least 2 years; or
- That there is a child of the de facto relationship; or
- That:
    - the party to the de facto relationship who applies for the order or declaration made substantial contributions of a kind mentioned in paragraph 90SM(4)(a), (b) or (c); and
    - a failure to make the order or declaration would result in serious injustice to the applicant; or
- That the relationship is or was registered under a prescribed law of a State or Territory.

5.2 Overview (Tax)

From a tax perspective, section 995-1 of the ITAA97 defines as a spouse as *including*:

> *(a) another individual (whether of the same sex or a different sex) with whom the individual is in a relationship that is registered under a *State law or *Territory law prescribed for the purposes of section 2E of the Acts Interpretation Act 1901 as a kind of relationship prescribed for the purposes of that section; and*
>
> *(b) another individual who, although not legally married to the individual, lives with the individual on a genuine domestic basis in a relationship as a couple.*

It is noted that the wording regarding de facto spouses is similar, though not identical to the definition of a de facto relationship under the FLA.

Given that the definition of ‘spouse’ is widely used in a tax law context, whether a person in a de facto relationship is a ‘spouse’ has a variety of tax law consequences. Those include:

- Trust Distributions (whether a person is a member of the ‘family group’ for the purposes of family trust distribution tax, whether a person is a beneficiary of a trust pursuant to the terms of the Trust Deed)
- Offsets and family benefits (historic dependent spouse offset legacy, spouse super contribution offset, Family Tax Benefit A/B, childcare subsidy, reporting of spouse income);
- Superannuation (eligibility for contribution splitting, tax-free death benefits to spouses);
- CGT (only one main residence across a couple, access to the relationship breakdown rollover); and
- Division 7A (whether a person is an associate of a shareholder).

5.3 Case example: *Cizek & Mihov* [2024] FedCFamC1A 151

Background

The Appellant sought a declaration that the parties were in a de facto relationship in circumstances where she alleged that they were in a 12-year relationship over two periods from 2011 until 2013 and from 2014 until 2023.

During those periods, the parties lived separately. However, the Appellant argued that during those periods, she was receiving financial support from the Respondent and, on occasion, travelled with the Respondent and enjoyed social events with him. The Respondent also had an intention to eventually live with the Appellant in the same residence. However, there was no evidence to suggest that the Appellant had an intention to have a relationship with the Respondent which went beyond financial support.

Decision

While there was a long duration of a 'relationship', evidence of financial support and attendance to social events, there were numerous agreed facts which were compelling in there being no de facto relationship:

- There was no common residence and overnight time together was irregular;
- During COVID lockdowns when there were exceptions to see intimate partners, the parties did not spend time together;
- While the parties travelled together on occasion, they usually travelled alone;
- While existence of financial support to the Appellant was agreed, it was also agreed that they did not intermingle their incomes, assets or financial resources.

The Court also commented that while the Respondent wanted the relationship to progress, it was uncontroversial that this was not the intention of the Appellant. The parties therefore did not have the mutual commitment to a shared life.

Takeaway

There is no closed list of indicia and no presumption based on any single factor (e.g., joint title or joint accounts). The correct and prudent approach is to assess the circumstances of the relationship as a whole:

- Living arrangements (including duration – generally at least two years);
- Financial interdependence (shared liabilities, pooling patterns, mutual support), acknowledging that some couples keep separate accounts while still evidencing interdependence;
- Intention of the parties (query whether they seem committed to a shared life in the future);
- Representation to the public (family occasions, travel, social media, beneficiary designations, HR/insurance designations); and
- Existence of children (children from the relationship or the level of involvement to step-children).

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6. Protecting the Family Jewels – Discretionary Trusts

6.1 Overview

The Court has broad powers to adjust the property interests of spouses and de facto partners. For marriages, section 79 of the FLA authorises alteration of interests where it is just and equitable. For de facto partners, the parallel is section 90SM. "Property" is defined broadly to cover property "to which the parties are… entitled, whether in possession or reversion", and the Court must also have regard to financial resources.

The powers of the Court include:

- Section 106B FLA – power to set aside transactions entered into to defeat, or likely to defeat, a party's claim; and
- Part VIIIAA FLA (e.g. section 90AE) – power to make orders binding **third parties**, including companies and trustees, to do or refrain from acts where necessary to produce a just property settlement.

A discretionary family trust gives the trustee discretion to allocate income/capital among a class of beneficiaries (often a spouse, children, and related entities). At general law, a mere discretionary beneficiary has:

- no fixed entitlement to trust property, and
- only the so-called "core rights" to due administration and due consideration.

In general from a Family Law perspective, the Court looks through the structure to the substance: who calls the shots, how the trust has been used, and who has benefitted in practice.

6.2 *Kennon v Spry*

The High Court's decision in ***Kennon v Spry* [2008] HCA 56** is the modern anchor. Dr Spry had established and controlled a discretionary trust that included his Wife as a beneficiary. When the marriage faltered, he varied the trust to remove himself and his Wife as beneficiaries and shifted assets to new trusts for their children. The Family Court set those steps aside under **s 106B** and treated the trust assets as part of the matrimonial property; the High Court (majority) upheld that approach.

Key themes from the judgments:

- The 2008 High Court decision of Kennon v Spry established that for the assets of a discretionary trust to be considered property in the property pool available for division between separated parties, one of the parties to the relationship needed to have both:
  1. effective control of the Trust (whether that be de facto or actual control); and
  2. a right as a beneficiary of the Trust.

- Without these two factors being apparent, at most depending on the circumstances, the Trust may be considered a financial resource.
- It also resulted in the "**reversal**" of several complex amendments to the Discretionary Trust (pursuant to **Section 106B** which had removed the Husband and Wife as beneficiaries of the Trust and split the assets of the Trust into 4 Trusts for the benefit of the parties' children as it was deemed that those amendments were entered into to defeat the property claim of the Wife.

Takeaway

Where a party controls trustee/appointor functions and enjoys the benefit of trust assets, the Court may treat the assets as property of the parties for s 79/s 90SM purposes.

6.3 *Harris & Dewell and Anor*

In the Full Court decision of *Harris & Dewell and Anor*:

- The Husband treated the E Unit Trust as his own during the marriage. Examples of the Husband's conduct included:
  - Purchasing a property in the name of the corporate trustee for $1.2M which was never included in the accounts of the E Unit Trust;
  - Executing contracts on behalf of Trust;
  - Intermingling of trust funds with matrimonial funds;
  - Representing he was the legal unit holder and proprietor of the E Unit Trust in loan/finance applications
  - Signing a Statutory Declaration declaring he was a beneficiary of the E Unit Trust.
- These transactions were completed without the knowledge of Father.
- Based on Husband's conduct, the Wife asserted the Husband's high level of control in using the E Unit Trust resulted in his Father being a "mere puppet". Put another way, the Wife argued the Trust was an alter ego.
- The Full Court held that despite high level of control, the Husband was not the "puppet master" of the E Unit Trust. The Judge found that since 2002 Husband used assets of the Trust as his own. Whilst the Husband will inherit trust assets on his Father's death, his Father is the ultimate legal owner and the units were not considered property.
- The Husband's Father had consented to him utilising the Trust assets but always remained the beneficial owner.
- Although Wife was unsuccessful in having Trust assets regarded as matrimonial property, she did receive a significant adjustment of 17.5% in the matrimonial asset pool in her favour, equating to an additional $2.8M in her favour
- This future needs adjustment was based upon the Court inferring that the Husband had the ongoing unfettered use of the assets of the Trust.

- Therefore the adjustment to the Wife was an amount equivalent to 56% of the value of the Trust assets of $5M.

Takeaway

Where trust assets are not property of the parties they still can be deemed a financial resource when assessing current and future circumstances for s 79/s 90SM purposes

6.4 Summary of Factors to Consider

- **Degree of control** - Is the trustee a mere ‘puppet’ or an alter ego of a party to the relationship?
- **Shams** - Has the Trust been created as a device to assist one party to evade their obligations under the Family Law Act?
- **Does the appointor/trustee have unfettered discretion?** e.g. Inheritance received by 3 siblings, all joint appointors/trustees – no unfettered discretion to distribute trust assets so deemed a financial resource
- **Pattern of distributions** e.g. Husband Appointor - Trust deed prevented Husband from being a beneficiary. Historically trust distributed funds to grandchildren and Wife, however these funds then paid over to the Husband. Held: the Trust is “the creature” of the Husband

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3471-0107-4750, v. 2

7. Gift v Loan – Intergenerational Wealth Transfers

7.1 Why does it matter?

Parental assistance to adult children, most commonly to help acquire a first home, now features in a large proportion of family law matters.

What appears to be a simple family advance routinely becomes a determinative issue on separation: is it a gift (a contribution on behalf of one party) or a loan (a liability to be repaid “off the top” before division)?

Two themes recur in the caselaw:

1. Presumptions and proof at the time of transfer. Equity’s presumption of advancement generally treats a parent-to-child transfer as a gift, unless the contrary intention is shown on the balance of probabilities by contemporaneous evidence.

2. Substance over form. Courts will interrogate what the parties actually did: were there loan documents, repayment terms, any repayments, security, consistent accounting treatment, or statements to banks/regulators calling it a “gift”?

Once the parties separate, ex post facto documents carry little weight.

7.2 The presumption of advancement and how to rebut it

At general law, a parent-to-child transfer is presumed a gift (the “presumption of advancement”). The High Court in *Bosanac v Commissioner of Taxation* [2022] HCA 34 emphasised that courts assess objective intention at the time of the advance, drawing inferences from contemporaneous communications and conduct. The presumption is rebuttable.

Rebutting the presumption

Courts look for loan indicia present at or near the time of the transfer:

1. Written agreement (loan deed or contract) signed by both spouses if funds benefit the couple. This agreement should be executed before or contemporaneously with the advance of funds.

2. Definite repayment obligation (date/event; on demand alone can be problematic if never invoked).

3. Is the loan on commercial terms for example does it require the repayment of interest?

4. Security (registered mortgage or caveat over the property; priority arrangements if there is a bank).

5. Repayments (even token or interest-only) and consistent accounting treatment as a loan.

6. Third-party representations consistent with a loan (e.g., not describing it as a “gift” to a lender/government agency).

7. If the loan agreement is on commercial terms, have these terms been complied with and in any event, is it likely to be enforced?

8. Have the loaning parents taken steps to enforce the loan, for example have they intervened in the Family Court proceeding to secure the repayment of the loan?

9. Is the loan forgiven in the parent's wills? Forgiveness in wills may suggest conditional intent to enforce only in limited circumstances (such as separation), which weakens the claim it was always a genuine loan.

10. Intention to create a legal relationship can be identified from the above characteristics. Consider appointing solicitors to draft the agreement and encourage the spouses to seek independent legal advice with respect to the loan they enter into to.

By contrast, vague, undocumented "understandings", open-ended advances with no schedule and no repayments, informal moral obligations to repay funds, and post-separation deeds rarely defeat the presumption.

7.3 Building a loan that survives scrutiny

Documentation and parties

1. Loan deed (or loan agreement) with clear repayment terms, events of default, and (ideally) interest.

2. Keep emails/letters from the time of transfer explaining intention. Keep bank statements linking transfer to settlement; issue loan statements; record interest and payments.

3. If funds benefit the couple, have both spouses execute the loan as co-borrowers (or obtain a spousal guarantee supported by independent legal advice). Independent legal advice for both parties could also be beneficial.

4. Record the purpose (e.g., deposit, renovations) and tie the funds flow to settlement statements.

Security

1. Registered mortgage over the property (or at least a registered caveat with an underlying equitable mortgage or charge).

2. Priority deed with the bank where necessary. Security not only improves enforcement but also signals intention at the outset.

Commerciality and performance

1. Charge interest (even modest), require regular interest-only or token principal payments

2. Keep ledgers, issue statements, and ensure tax reporting aligns (lender declares interest income; borrowers account for outgoings—though private home interest is not deductible).

3. Avoid mixed messages: do not call it a "gift" in lender or agency paperwork.

4. Comply with the terms of the loan in full.

Limitation periods

In Victoria, a simple contract/unsecured loan is typically subject to a 6-year limitation. Without acknowledgements or part-payments, claims can become statute-barred. To overcome the statute of limitations use periodic acknowledgements, interest notices, or refinancing to refresh time.

7.4 Binding Financial Agreements (BFAs)

A BFA is an agreement, which in complying with the strict requirements of the FLA, ousts the jurisdiction of the Family Court and governs how the property, financial resources and/or maintenance of spouses are dealt with upon the breakdown of the relationship. A BFA can be entered into before, during or after marriage/relationship breakdown.

A BFA (Pt VIIIA for marriages; Pt VIIIAB for de facto) can pre-agree how a parental advance is treated upon the separation of spouses. This may involve:

a. Quarantining a gift to benefit a specific party and determining how the increase in value of the gift or the asset purchased with the gift is dealt with; or

b. Confirming the existence of the loan and that the loan is to be treated as a legitimate liability in the division of the asset pool. The BFA can also specify who is responsible for the repayment of the loan or if the loan must be repaid upon separation and from what assets this repayment is to be made from.

It has become common for families with generational wealth to require a BFA to be executed by spouse parties, prior to agreeing to advance significant funds. This is the most effective protection.

7.5 Hypothetical scenarios

7.5.1 Example 1: Gift dressed as loan

Parents transfer $200k for a deposit. No document. They later email “repay us when you can.” No repayments or interest. To obtain bank finance, the couple signs a gift declaration. After separation, parents produce a fresh loan deed.

Outcome: likely a gift; presumption not rebutted; post-separation paperwork discounted; parents’ claim disregarded. The child still gains contribution credit, but there is no liability reducing the pool.

7.5.2 Example 2: Loan that survives

Parents lend $300k. Loan deed drafted by solicitors signed by both spouses; registered second mortgage; interest-only quarterly at modest rate; priority deed with the bank; acknowledgements every two years. Interest payments made from joint bank account of parties.

Outcome: recognised as a liability and repaid at settlement. Contributions and s 79(4) factors then applied to the net pool.

7.5.3 Example 3: Company-funded "loan"

Family company advances $150k directly to the child for renovations; no Div 7A-compliant agreement; no interest or repayments.

Outcome: in addition to family law outcomes (potentially similar to Example 1). potential deemed dividend exposure (and penalties).

7.6 Conclusion and Key Takeaways

For the "Bank of Mum and Dad", the battle is not only won or lost at the start but in the conduct of all parties throughout the relationship.

In consideration of the above, it is important that parties understand that:

- If you intend a loan, document it at the time of the monies being advanced, ensure both parties to the relationship are aware of and acknowledge the loan, include commercial loan terms, obtain security and ensure compliance with the terms of the loan.
- You should ideally formalise the gift or loan in BFA rather than a loan agreement.

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