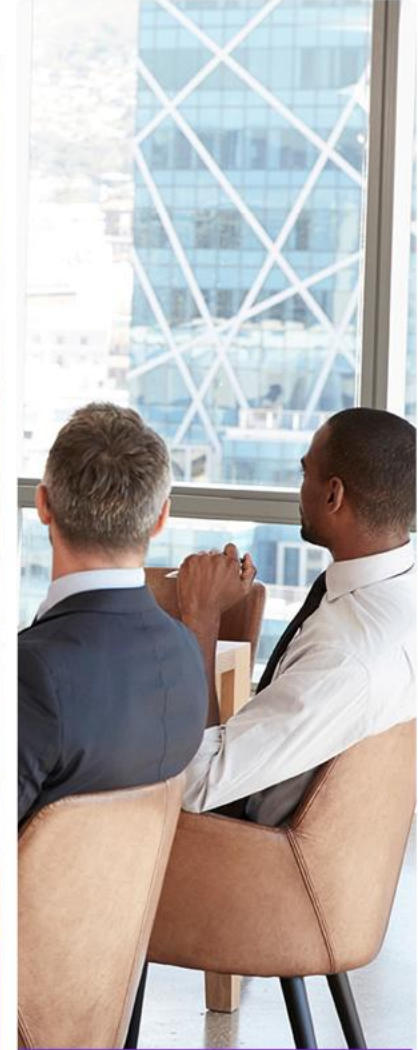


Welcome

Local Tax Club Geelong

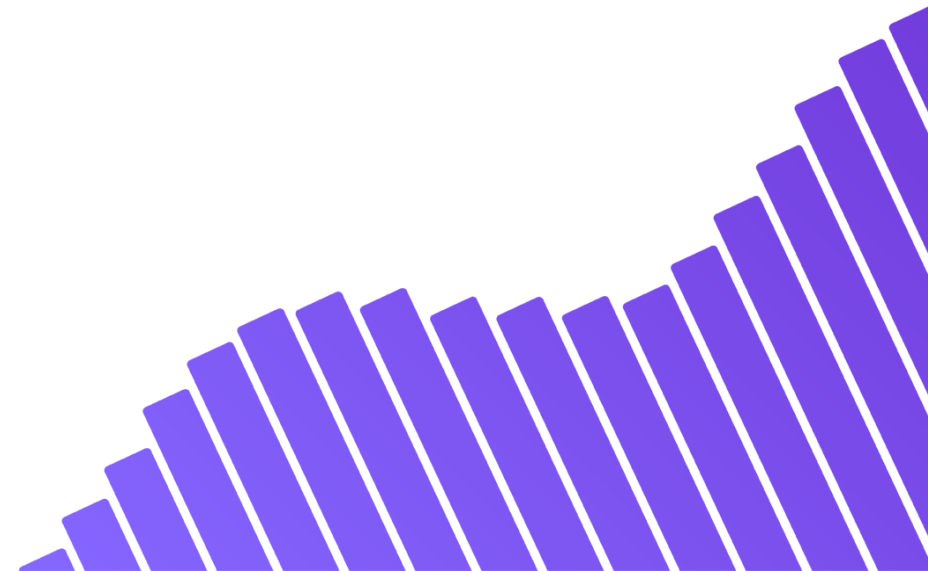
19 September 2025
Novotel Geelong



September Tax Update

Presenter:

Rob Warnock, CTA, Harwood Andrews

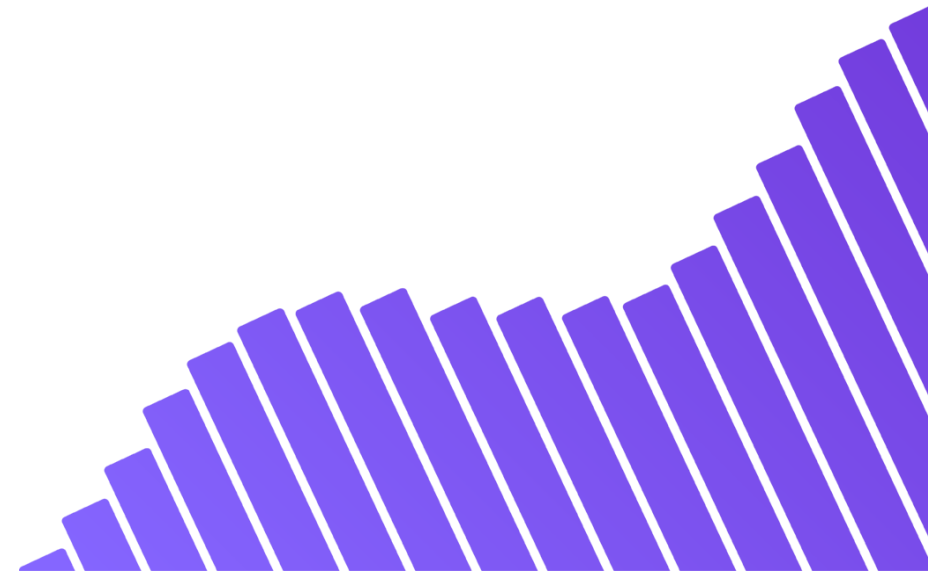


The hidden tax consequences of family law

Presenter:

Andrew Henshaw, CTA, Velocity Legal

Rohan Kelly, Velocity Legal



Agenda

- property settlement framework
- status (who is a de facto spouse)
- dealing with Division 7A
- applying CGT rollovers
- small business CGT concessions issues
- discretionary trusts
- the ‘bank of mum and dad’

The Property Settlement Framework

Identify the Property Pool

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

Valuation is **at the date of the negotiation or the date of hearing, not at the date of separation.**

The Property Settlement Framework

Consideration as to Contributions

To the acquisition, conservation and improvement of property including:

- Financial/non-financial:
 - Direct/indirect
 - Initial contributions
 - External Contributions
- Homemaker and parent contributions

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 be 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.**

The Property Settlement Framework

Consideration of Current and Future Circumstances

- what adjustments should be made to the contributions-based-assessment, having regard to the parties' respective current and future circumstances including income, age, health, earning capacity, care arrangements of any children under 18, child support, financial resources (including interests in Trusts), the effect of family violence, the effect of material wastage and any other fact or circumstances which, in the opinion of Court, the justice of the case requires to be taken into account.

KEY: This is a discretionary jurisdiction, a 'weighing of factors'

Justice and Equity

Dealing with Division 7A

- payments / loans / debt forgiveness
- 'associate' of a shareholder
- capped at distributable surplus
- generally unfranked (s109RC allows franking)
- status of historical and existing loans from the private company to marital parties:
 - have those loans been compliant with Division 7A?
 - do written loan agreements exist that are compliant with section 109N?
 - have minimum yearly repayments been made in accordance with those terms?
 - is there any potential that deemed dividends have arisen in prior years?
 - is the Commissioner within his Period of Review to assess those deemed dividends?
 - should corrective action be undertaken and the Commissioner's discretion under section 109RB be sought?

Division 7A: Company Funded Settlements

- s109RC: permits franking of a deemed dividend that arises due to a “family law obligation”
- s109J: payment made to discharge ‘an obligation of the company’ will not be treated as a dividend.
- Taxation Ruling TR 2014/5: Family Court orders can never enliven section 109J, because the ‘obligation’ arises only out of the non-arm’s-length connection with the shareholder.
- *...but what if no one realises?*

Case study—Lacey & Lacey [2020] FamCAFC 73

- parties married in 1973 and finally separated in 2010
- husband controlled a long-standing private company that operated the family business
- Trial: ordered the husband to pay—or *cause the company to pay*—the wife roughly \$3 million within four months
- No evidence led re tax consequences
- Wife: primary judge could not be satisfied that the final orders were ‘just and equitable’ in circumstances where the method of payment may trigger significant tax liabilities, without evidence of those tax consequences.

Case study—Lacey & Lacey [2020] FamCAFC 73

- 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
- takeaways:
 - if a company funded settlement is contemplated, cogent tax evidence is required (and required to be understood by all parties, including the Court)
 - distributable surplus scenarios?
 - how does this interact with section 109J and TR 2014/5?

Subdivision 126-A

- section 126-5: 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 spouses)
- requires a qualifying FLA instruments (court order, arbitral award, or financial agreement)
- mandatory (not a choice)

Subdivision 126-A: Issues in Practice

- must be because of a qualifying FLA instrument
- *Ellison v Sandini*: recipient must be the spouse/ex-spouse personally.
- transferee spouse inherits the cost base and history (and unrealised gains).
- main residence - includes whether the transferring spouse occupied the property as their main residence (section 118-178 of the ITAA97).
- does **NOT** determine other tax outcomes (transfer duty, Division 7A).

The Main Residence Trap

- Bob sets up B&B Pty Ltd (**BBCo**) in 1990 as its only shareholder and is married to Betty.
- BBCo owns a residential property.
- the property has been used as Bob and Betty's main residence at all relevant times.
- the property has a cost base of \$200,000, and a current market value of \$2 million.
- BBCo has no other assets or liabilities.
- BBCo has no franking credits.
- BBCo has issued share capital of \$200,000.
- Bob and Betty are now going through a divorce, and are considering the following:
 - **Scenario A:** selling the property and extracting the funds;
 - **Scenario B:** transferring the Property to Betty.

The Main Residence Trap - Analysis

	Scenario A	Scenario B
CGT - BBCo	Capital gain arises (\$1.8M) Timing of CGT event?	Subdivision 126-A applies
Tax Payable – BBCo	\$540k (30%)	\$Nil
Bob's Consequences	\$200K return to Bob (return of share capital)	No CL - \$200K cost base adjustment
Shareholder Tax	Dividend or Deemed Dividend (\$1.8M) Tax of \$360k (if fully franked)	Deemed Dividend (\$1.8M) Tax of \$846k (unfranked)
Implications going forward	Cost base: \$2M MR Acquisition date: 2025	Cost base: \$200K MR Acquisition date: 1990 MR Occupancy date: 2025

A Fair Outcome?

- TR 2014/5EC
- *“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.”*

Small Business CGT Concessions

- sale to third parties as part of the FL settlement;
- later disposal by the spouse who retains the asset;
- later disposal by the spouse who receives the asset; and
- transfer of assets relating to FL settlement where Subdivision 126-A does not apply.

Small Business CGT Concessions

- Subdivision 126-A - Preserving SBC:
 - active asset history (152-45(2) – *optional*)
 - 15-year exemption history (152-115(2))
 - choosing not to preserve?
- Preferring a No-Rollover Path?
 - transferor satisfies MNAV, but transferee not
 - transferor is a small business CGT entity, but transferee not
 - asset currently satisfies active asset test, but may not in future
 - clean separation without having to factor in future unrealised capital gains

Adjusting for future CGT liabilities

- Rosati v Rosati (1998) FLC 92-804:
 - Court ordered / inevitable sale / probable near future / 'special circumstances' – allowance for CGT
 - If no on the above – may be taken into account as a factor
- Marlin & Henson [2025] FedCFamC1A 71:
 - Investment properties
 - estimated \$3.3M tax liabilities for sale in coming 3-5 years
 - potential CGT liabilities not taken into account

When is a FL obligation a liability for MNAV?

- MNAV Test: as at date of CGT event. Liabilities may reduce NAV.
- *FC of T v Byrne Hotels Hotel Qld Pty Ltd* [2011] FCAFC 127
- *...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”. ...*
- Taxation Determination TD 2007/14: term does not include ‘provisions for a possible obligation to pay damages in a pending lawsuit
- ***When is a FL obligation a liability?***

What is a De Facto Relationship?

A person is in a de facto relationship if, having regard to all the circumstances of their relationship, they have a relationship as a couple living together on a genuine domestic basis.



What is a De Facto Relationship?

To make an order for property and maintenance issues, the Court must be satisfied that:

- the period, or the total of the periods, of the de facto relationship is at least **2 years**. The 2-year period can be cumulative and does not need to be a continuous period; or
- there is a **child born of their de facto relationship**;
- a party to the de facto relationship made a **substantial contribution** of a kind identified in Section 90SM (which can be summarised as financial and non financial contributions towards the acquisition, conservation or improvement of any of the property of the parties or either of them and/or contributions to the welfare of the family), and a failure to make an order or declaration would result in a serious injustice.
- that the relationship is or was registered under a prescribed law of a State or Territory

Factors the Court Considers

In determining whether a de facto relationship existed, and when a de facto relationship commenced, the following factors will be relevant to the Court:

- the duration of the relationship;
- the nature and extent of the parties common residence;
- whether a sexual relationship exists;
- the degree of financial dependence or interdependence, and any arrangements for financial support, between them;
- the ownership, use and acquisition of their property;
- the degree of mutual commitment to a shared life;
- the care and support of children; and
- the reputation and public aspects of the relationship.

This is not an exhaustive list, and the combination of the above, and the weight attached to such factors will be determined by the Court based on the evidence of the parties.

Factors the Court Considers

What is important is that the parties' relationship constituted a **“merger of two lives”** into a couple or a **“substantial mutual commitment to a shared life”**.

The definition of “de facto relationship” does not require exclusivity and makes it clear that such relationship can be established even if one or other of the parties is married or in another de facto relationship, or indeed engages in multiple other casual liaisons.

Parties who engage in extra-marital affairs risk being a party to litigation with their former spouse (in the event of separation) as well as their de facto mistress or paramour!



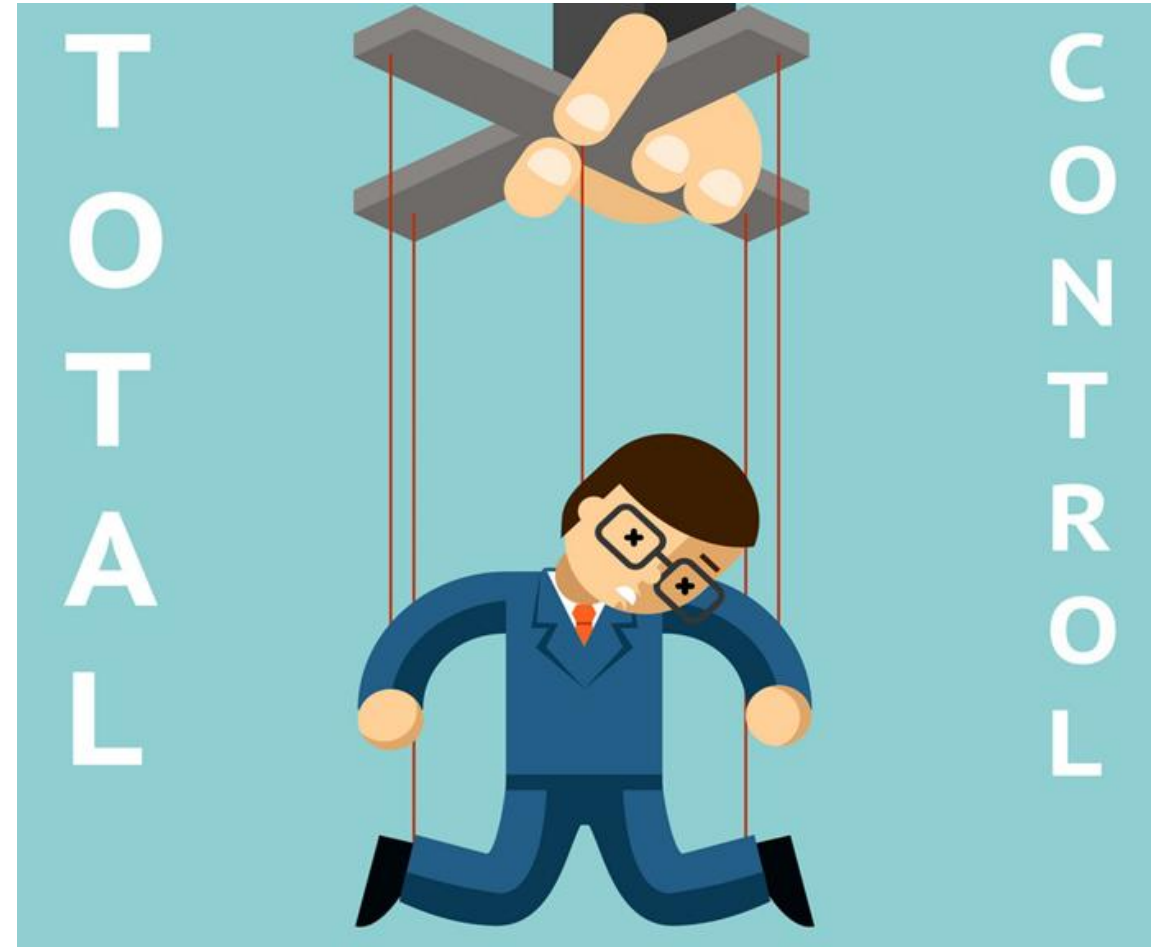
Treatment of Trusts Assets / Income

1. Property; or
2. Financial Resource; and/or
3. A fact or circumstance which, in the opinion of the court, the justice of the case requires to be taken into account



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



Kennon v Spry 2008



- Trust was established 10 years prior to marriage. Approximately 10 years into the marriage during a rocky patch the Husband varied terms of the Trust to remove himself as beneficiary after another 10 years. The Husband remained appointer of all trusts.
- Post separation, the Husband established four trusts in favour of the children – distributes \$1M to each.
- 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.

Kennon v Spry

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.



Harris & Dewell and Anor

FACTS

- Husband & Wife separated after 24 years
- Parties' matrimonial net asset pool was \$16M
- Wife sought to include the E Unit Trust assets in the property pool, which amounted to a further \$5M
- Husband opposed the inclusion of the Trust assets
- Husband's Father established the E Unit Trust in **1981**
- Husband and Wife commenced relationship in 1986 (5 years after E Unit Trust established)
- E Unit Trust had a corporate trustee, the Husband's Father eventually becoming the sole unit holder over time
- Husband was **never** a unit holder
- Husband was a shareholder in a corporate trustee, ceased being director 2011



Harris & Dewell and Anor

FACTS CONTINUED

- 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 Stat Dec declaring he was a beneficiary of the E Unit Trust
- These transactions were completed **without the knowledge of Father**



Harris & Dewell and Anor

- 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 H’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**
- The Court inferring that the Husband had the ongoing unfettered use of the assets of the Trust. Adjustment Wife received equivalent to 56% of \$5M



Gift v Loan – Intergenerational Wealth Transfers

Gift: remains in the **property pool**; treated as a **contribution** by or on behalf of the donor's child.

The parents have **no repayment right**. The contribution is weighed with all others and there is **no dollar-for-dollar quarantining**.

Loan recognised as a **liability**; it **reduces** the net pool before division.

Gift v Loan – Intergenerational Wealth Transfers

- Presumption of Advancement (Rebuttable presumption)
- Commercial Loan Terms entered into with both parties
- Security
- Conduct post loan consistent with terms of the Loan
- **Best Protection: Financial Agreement**



Thank you

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Upcoming Events

Local Tax Club

17 October 2025 – Novotel Geelong

Topic: State Taxes – The current landscape

Speaker: Megan Bishop, Piper Alderman & Simon Tisher, CTA, Victorian Bar

Next Generation Tax Discussion

25 September 2025 – Velocity Lega

Regional Masterclass

9 – 10 October 2025 – Mineral Springs Hotel, Daylesford



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