The Tax Institute

VIC Tax Forum

Tax consequences of family breakdown

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Paul Hockridge, CTA
Hockridge Advisory

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1. Context

When suffering the trauma associated with the breakdown of a marriage or domestic relationship and the division of assets to support two households, the last thing people need is a minefield of tax issues. Unfortunately, typically, there is a minefield. The question is likely to be how many and how complex the tax issues will be, rather than whether there will be any.

There are a raft of general income tax and capital gains tax (CGT) issues as well as tax loss, bad debt, debt forgiveness, Div 7A, fringe benefits tax (FBT), superannuation, trust, GST and (stamp) duty issues.

As they are specialist areas, I will not deal with superannuation or GST. For the same reason, I will make only passing reference to duty and I will restrict that to Victoria but hopefully that will provide a “heads up” as to the sort of issue to look for in your jurisdiction.

1.1 Who is a spouse?

When I refer to a spouse I will have regard to the definition in s995-1 of the Income Tax Assessment Act 1997 (ITAA 1997). Essentially, this includes same and different sex relationships registered under a State or Territory law and individuals living on a genuine domestic basis in a relation as a couple.

I have not had occasion to resolve in detail how this might impact polygamous relationships but I expect that this will become a more common issue as migration increases from countries with recognize multiple spouse relationships.

In only a slightly frivolous way, I question whether parties can be living together on a bona fide domestic basis as a couple, if they are in a throuple relationship. The Supreme Court in New Zealand found that this could be the case, based on similar legislation to that found in Australia, in Mead and Paul [2023] NZSC 70.

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2. CGT on property settlements and transfers of business assets

One of the typical effects of a marriage or domestic relationship separation or breakdown is what might be described as a reallocation of the wealth of the parties, through property settlements (of property owned by one person, or owned jointly, or controlled through trusts).

Both personal assets and business assets, whether held as a sole trader or in a partnership, company or trust (or superannuation fund), may be the subject of a property settlement. It follows that a variety of income tax, CGT, and even FBT consequences may arise.

2.1 CGT consequences

Unless exempted, a capital gain or loss might arise where an interest in property (a CGT asset according to s108-5 of the ITAA 1997 is transferred from one person or entity for tax purposes (e.g. an individual, company or trust, see s960-100 of the ITAA 1997) to another, or from joint ownership to individual ownership, where that property was actually or was deemed to have been acquired post 19 September 1985.

The transfer of assets will often occur for no monetary consideration, therefore the market value substitution rules might determine the consideration on disposal (s116-30 of the ITAA 1997)) and on the corresponding acquisition (s112-20 of the ITAA 1997).

Having said that, neither CGT event A1 nor any other CGT event might happen if there is a transfer of an asset where you are the legal owner but it was never intended that you have any beneficial ownership – see private ruling authorization number 1052110592268.

2.2 Exemptions

An exemption from CGT, or a reduction in any assessable gain, may be available in limited circumstances.

2.2.1 Motor vehicles

The type of assets which may be affected by these provisions are broad (see s108-5 of the ITAA 1997), however limited exclusions may apply, for example in respect of many motor vehicles (see s118-5 and 995-1 of the ITAA 1997).

However, don’t forget the definition of the term car (as not all motor vehicles will be exempt from CGT) and do not forget about the potential income tax or FBT or GST consequences.

2.2.2 Collectibles and personal use assets

Collectibles and personal use assets may be exempt from CGT in certain circumstances (s118-10 of the ITAA 1997).

Collectibles are defined in s108-10(2) and include such things as jewellery, artwork and antiques.

Capital losses on collectibles can only be offset against capital gains on collectables (s108-

10(1)).

If they were acquired for $500 or less, or more precisely the first element of cost base is $500 or less, any capital gain or loss on disposal is disregarded (s118-10(1) and (2)).

Broadly, personal use assets are CGT assets (not being collectables) that are used or kept mainly for your or your associate's personal enjoyment (s108-20(2)(a)).

Any capital gain made from a personal use asset is disregarded if the first element of the asset's cost base is $10,000 or less (s118-10(3)).

You cannot make a capital loss on the disposal of a personal use asset (s108-20(1)).

If personal assets typically belong to a set, but you sell them separately to try to obtain the exemption, the set will be treated as a single personal use asset for CGT purposes (s108-25).

An issue to watch out for is that, under s108-20(2)(d), a personal use asset (on which a capital loss cannot arise – s108-20(1)), includes a debt arising other than in the course of producing your assessable income or from carrying on your business. As a result, it seems that an interest free loan made by other than a natural person could be a personal use asset and no capital loss could arise on its forgiveness.

2.2.3 Main residence exemption

There is an exemption for all or part of any gain on the disposal of a person's "main residence" as it is known under subdivision 118-B of the ITAA 1997. These provisions are extremely complex and are therefore only briefly considered here.

There is no definition of the term main residence, however it seems that a dwelling qualifies as a main residence. The term dwelling is defined (s118-115) to include, amongst other things, caravans, houseboats and mobile homes.

Query whether it includes the sort of expensive ocean going diesel powered luxury boat that you see in the media. Presumably, it could.

A main residence also includes adjacent land, i.e. land adjacent to the land immediately under the dwelling (provided that it is not sold separately), where the total of both parcels does not exceed 2 hectares, provided that it was used primarily for private or domestic purposes in association with the dwelling (s118-120).

An exemption might therefore apply upon the transfer of an interest in the family home to a spouse or partner.

Importantly, if you only have one dwelling the Act does not give you a choice, i.e. the exemption applies automatically (s118-100(1)). So, if you satisfy the criteria, the exemption applies (ATO ID 2003/257). This means that there is no opportunity to crystallize a capital loss or to get a step up in cost base when a main residence is transferred from one spouse to the other.

A general rule when considering the main residence exemption is that each couple may typically have only one main residence at a time. This is so even if only one spouse has an ownership interest in a dwelling.

An exception to this general rule occurs in the event of changing main residences whereby an individual or couple may have concurrent exemptions for both the old and the new home. The period for concurrent exemptions is 6 months (s118-140).

In addition, s118-170 provides an exception, where spouses are not living permanently separately and apart, and they actually have different main residences, such that they can nominate different main residences and reduce their respective exemptions to 50%.

Where the main residence is owned either by a company or a trust, rather than the individual(s), the main residence exemption is not available (s118-110(1)(a)).

If CGT marital breakdown rollover relief under subdiv 126-A is obtained for a dwelling that is transferred to an individual from a company or trust, it cannot be the main residence of the transferee during the period that it was actually owned by the company or trustee but it will be taken to be owned by the transferee during that period (s118-180).

It might be that a party to a relationship disposes of an interest in a main residence after ceasing to be an Australian tax resident. If so, the main residence exemption will be excluded by s118-110(3) if they are an excluded foreign resident of a foreign resident who doesn't satisfy a life events test in s118-110(5).

A person will be an excluded foreign resident (s118-110(4) if they are a foreign resident when the CGT event happens and they have been a foreign resident for a continuous period of more than 6 years (at that time).

A foreign resident could still be exempt if they have been a foreign resident for 6 years or less at the time of the CGT event if, broadly, they or their spouse or a child under 18 has a terminal medical condition or because the CGT event happens as a result of a matter listed in s126-5(1) (which is, broadly, about Family Law Act and similar agreements).

Private ruling authorization number 1052118155925 is a reminder that we "pick up" the cost base that our spouse has/had in a property (or an interest in a property) that passes to us pursuant to an order of the Court, in which case the transferee could face a nasty tax liability if the cost base of the asset for the transferor spouse is somewhat small.

In this instance, there was only a partial main residence exemption, as the property was originally rented out.

It is unclear to me why s118-200 was referred to, as that deals with deceased estates.

Perhaps an important takeaway, especially when we are dealing with a partial main residence exemption, is that s126-5 is silent on the date of acquisition of an (interest in an) asset pursuant to an order of the Court. However, s118-178 might enable the transferee to pick up the transferor's acquisition date for main residence purposes, if there has been a subdiv 126-A roll-over. A similar outcome arises for Div 115 purposes (s115-30(1) Item 1), as an asset subject to a subdiv 126-A roll-over would be subject to a same asset roll-over (s112-150 Items 1 and 2).

The ATO document, Consequences of the rollover, QC64895, says that the transferee is taken to have acquired what was a post-CGT asset (or share of an asset) at the time it was transferred from his or her spouse.

Why do I make this point? It is because I agree with the ATO. However, when I searched this question on a well known AI database, it was insistent that I was wrong and that the ATO position was the opposite of what I quoted above. So, be careful using AI.

2.2.4 Cash settlement exemption

CGT event C2 (which deals with the release, discharge, satisfaction, etc of rights) might happen as a result of a property settlement, e.g. the rights of a party to a settlement payment might have no CGT cost base but the party might receive a substantial payment, resulting in a capital gain.

Fortunately, s118-75 was introduced to disregard such gains and losses that relate to the breakdown of a relationship between spouses (defined in s995-1).

2.3 CGT concessions

In the absence of a specific marriage or relationship breakdown exemption under the CGT rules, concessional treatment or rollover relief might still be available on the disposal of certain assets or a business.

I mentioned the CGT main residence rules above.

There is also the CGT general 50% discount which can apply to reduce a nominal capital gain made by an individual or a trust (s115-10) by 50% (s115-100) on the disposal of an asset that was held for at least 12 months (115-25). A company, however, is not entitled to the CGT general 50% discount (s115-10).

If we apply the 50% discount, we cannot use indexation (frozen at 30 September 1999).

Where we have foreign or temporary non-residents the discount rules are more complex (subdiv 115-B). However, broadly, if a non-resident (or temporary resident) makes a taxable capital gain, e.g. on real Australian property not subject to the main residence exemption, s115-105 and following provide rules which reduce the usual 50% CGT discount. There are similar rules for trusts with discountable gains.

2.4 CGT roll-over relief

There are a number of types of CGT roll-over relief, including specific provisions dealing with the transfer of assets as a consequence of marital breakdown.

2.4.1 CGT roll-over relief – marital breakdown

Roll-over relief automatically applies under s126-5 and s126-15 of the ITAA 1997 (i.e. no choice or election is required or permitted) to transfers of assets by either a natural person to his or her spouse or former spouse, or by a company or a trustee of a trust to a spouse or former spouse of a person, where the disposal is made pursuant to, very broadly:

- an order of a court made under the Family Law Act (or under a corresponding law of another country); or
- a maintenance agreement approved by a court under s 87 of the Family Law Act (or an agreement approved by a court under a corresponding law of another country); or
- something done under a financial agreement or arbitral award under the Family Law Act (or an agreement approved by a court under a corresponding law of another country); or
- something done under a written agreement that is binding because of a State or Territory (or a foreign) law relating to the breakdown of relationships between spouses, where a court cannot make such an order.

Briefly, where the rollover provisions apply:

- any gain or loss the transferor makes on the disposal of the asset is disregarded (s126-5(4));
- pre-CGT assets of the transferor are taken to be pre-CGT assets of the transferee (s126-5(6)); and
- the transferee is deemed to have paid consideration for the acquisition of the asset equal to the cost base, or reduced cost of the asset to the transferor, as appropriate, at the time of transfer (s126-5(5)).

Application of the rollover rules - simply

So, (say) Paul might transfer assets to Barbara, or vice versa, without a CGT problem in light of s126-5 of the ITAA 1997, or one of their companies or trusts could transfer assets to either Paul of Barbara, and seek relief under s126-15, which (only at first glance) largely mirrors s126-5.

A delightfully simple outline of these rules can be found in private ruling authorization number 1052309021169.

Further, private ruling authorization number 1052269142272 reminds us that subdiv 126-A provides relief where there is an asset transfer between spouses, not when there is a sale to outsiders, even where the sale proceeds must be dealt with pursuant to a consent order.

It should be noted that neither section applies to transfers to children of either party, nor do they apply to transfers to child maintenance trusts.

Where assets rolled over under subdiv 126-A are subsequently disposed of within 12 months of the rollover, the 50% discount will still apply provided that the combined ownership period of the transferor and the transferee is at least 12 months (s115-30 Item 1).

Application of the rollover rules – where a company or trust makes a distribution

Now for a layer of complication. To start, we should remember that a distribution of money or property by a company to a shareholder could be an assessable dividend to the shareholder. Further, such a payment to an associate of a shareholder could be a deemed dividend under Division 7A of the Income Tax Assessment Act 1936 (ITAA 1936). We will return to Div 7A.

In addition, such a payment by a company or a trust could decrease the value of equity in or loans to the transferor entity.

As a result, we have s126-15(2)-(4). Under s126-15(4), the cost base the transferee will have in the shareholding/unitholding or loan to the company or trust will be increased by the amount assessable as a dividend to the transferee. Further, the cost base in such assets can be increased or decreased under s126-15(3) where they decrease in value as a result of the transfer. Even with the benefit of paragraph 132 and following of TR 2014/5, these provisions are hard to follow.

There are specific rules (s126-20) where the transferor is a CFC or non-resident trust which, being a specialist topic, I will not deal with.

Section 78 versus s79 orders of the Family Court

In determination TD 1999/48 the Commissioner says that under a s78 order the Family Court declares a spouse's interest in property, in which case no CGT event happens, as there is merely a recognition of that interest. On the other hand, the Commissioner says that if the Court makes an order under s79, there would be an alteration of interests in property and a CGT event would happen.

The Decision Impact Statement (of 21 December 2018) following ***Sandini Pty Ltd ATF Karratha Rigging Unit Trust & Ors v Ellison & Ors v Commissioner of Taxation & Ors [2018] HCA Trans 190 and [2018] FCAFC 44*** says that this determination and TR 2014/5 might be impacted in light of this matter.

In ***Sandini v Ellison*** the Family Court made consent orders that MIN shares be transferred by Sandini ATF the Ellison Family Trust to the wife. Sandini was not the trustee of that trust, it did however hold those shares ATF the Karratha Rigging Unit Trust. Further, Mrs Ellison asked that the MIN shares be transferred to the trustee of another family trust, rather than to her.

The majority of the Full Court held that the Family Court order did not result in a change in ownership of the MIN shares. The orders were ineffective.

Further, s126-5 could only be satisfied if the transferee was the wife, whereas the shares were transferred to the trustee of another trust.

In addition, the transfer was not "because of" (s126-5(1)) a Family Court order as the order was ineffective.

Perhaps more interesting was the fact that the Full Court accepted the Commissioner's argument that s103-10, which, broadly, says that Part 3-3 applies as if you received money or other property, if it has been applied for your benefit or as you direct, did not apply for these purposes.

When might s103-10 apply then? It seems that, according to the majority, we need:

i) A CGT provision that applies to a person who has received money or property;
ii) A person who has not received money or property but has had it applied for their benefit or as they direct; and
iii) It to be the case that the provision in i) above would not apply because the person hasn't received the money or property (unless s103-10 applies).

2.4.2 CGT roll-over relief generally, i.e. outside subdiv 126-A

Section 126-5 and s126-15 of the ITAA 1997, i.e. the rollover relief on marital breakdown rules, do not deal with transfers between or into non-natural person entities. If this is required, e.g. because we want to shift some assets out of the spouse's manufacturing trust into one of their companies, the general CGT roll-over provisions might provide some relief.

It is outside the scope of this paper to consider these rules in detail but we should recall that one or more of the following provisions could apply to individuals or trusts who or which (subsequently) transfer assets:

- Subdiv 122-A – transfers by individuals and trustees to wholly owned companies;
- Subdiv 122-B – transfers of partnership assets to wholly-owned companies.

There are of course numerous other rollover rules.

2.4.3 Superannuation rollover

CGT roll-over relief is available in certain circumstances in respect of super splitting between complying superannuation funds but as mentioned earlier, that is outside the scope of this paper.

2.4.4 Small Business Rollovers

In addition to the CGT rollover relief on marital breakdown, the general CGT rollover rules and the 12 month holding 50% exemption from CGT, there are also the CGT small business concessions and exemptions.

Various concessions in Div152 of the ITAA 1997 may be available for small business owners provided that, amongst other things, the net value of the assets of the business, in addition to certain assets held by any related entities (including individuals) does not exceed $6M, or the $2m aggregated turnover test is satisfied.

The rollover will only apply to assets which qualify as “active assets”, that is, the asset is used, or held ready for use, in the course of carrying on a business. It will not apply to certain assets which derive passive income (s152-40)

Notwithstanding this, shares in a company or interests in a trust can qualify as active assets provided that the underlying assets are active assets and certain control tests are satisfied.

Briefly, the small business concessions are:

- The 15-year exemption (subdiv 152-B);
- The 50% reduction (subdiv 152-C);
- The retirement concession (subdiv 152-D);
- The replacement asset roll-over (subdiv 152-E).

A detailed consideration of the operation of these concessions is outside the scope of this paper but keep in mind that these rules are sometimes modified to account for family breakdown – see for example s152-45(2) and s152-115(2) which deal with the active asset and controlling individual tests respectively.

Having said that, it is useful to remember, when applying the replacement asset rollover rules, that the usual replacement asset rollover period of one year before and two years after a CGT event (s104-190(1A), can be extended by the Commissioner (s104-190(2)). In private ruling authorization number 1053306346194, the Commissioner exercised his discretion favourably where the failure to acquire a replacement asset within the usual timeframe was a direct result of divorce proceedings which prohibited him from disposing of or acquiring assets until the proceedings were concluded.

Further, the Commissioner exercised his discretion favourably in private ruling authorization number 1051812717931, to allow further time to make a choice under s103-25(1)(b), to apply the small business retirement exemption. In that instance, the business sale happened in the midst of separation and divorce proceedings and the funds were not able to be released until the parties agreed the settlement. Due to the distraction of the divorce proceedings, further consideration of CGT small business relief did not happen. The Commissioner granted further time to access the small business retirement exemption.

2.5 CGT “Transitional” Provisions

The transfer of assets under a marriage breakdown property settlement may also have CGT implications under the so-called transitional provisions.

2.5.1 Div 149 - continuity of majority underlying interest

The pre-CGT assets held in a company or trust may be taken to be post CGT assets under Div 149 of the ITAA 1997 where a 50% or more change in the underlying beneficial ownership of the entity by natural persons occurs.

Transfers of pre-CGT shares or interests as part of a property settlement might therefore have adverse consequences. For example, at first blush, if Paul and Barbara jointly own 100% of the shares in a company and Paul transfers his 50% interest to Barbara, there would be no continuity of ownership of greater than 50%

Where however the shares or interests have been rolled-over under subdiv 126-A of the ITAA 1997 Act, no such adverse consequences should arise (s149-30(3) and (4) of the ITAA 1997).

All the more reason to make sure that you satisfy subdiviv 126-A.

2.5.2 CGT Event K6 – post CGT assets equal 75% of NAV

Adverse tax consequences under s104-230 (CGT Event K6) of the ITAA 1997 may arise when pre-CGT shares in a private company, or interests in a private trust, are disposed of, where 100% of the market value of post-CGT property equals 75% or more of the net market value of the company or trust.

The effect of this provision should therefore be considered when determining whether pre-CGT assets of a company or trust should be transferred (as part of a property settlement) and in determining whether pre-CGT shares and units can be transferred CGT free.

A good rule of thumb is to expect that that the 75% threshold will be breached if Paul and Barbara's private company or private trust estate are active trading entities. The reason is that debtors, cash at bank, some plant, etc will all be post-CGT property.

Whether breaching the threshold results in tax being payable on disposal of the pre-CGT shares or units is another matter because that depends on how much of the proceeds on disposal of the shares or units are attributable to the underlying post CGT assets and how much those underlying post CGT assets have increased in value.

2.6 Life Insurance Policies

When a spouse transfers ownership of a life policy, the new owner would not be the "original owner" of the policy (s118-300 of the ITAA 1997). As a result, any proceeds paid to the transferee spouse would not be exempt under s118-300 Item 3.

Nonetheless, no CGT should be payable on any proceeds unless the new beneficiary gives money or other consideration to acquire the interest in the policy. Unfortunately, the ATO interprets the term consideration very broadly in this context, to include even promises.

It would be unsurprising therefore to find that the agreements reached in a divorce settlement resulted in their being take to be consideration provided, in which case any insurance proceeds would not be exempt from CGT under s118-300 Item 4.

The solution might be to take out a new policy, if that is feasible.

2.7 Transfer Which Assets?

Given all of the above, it may be prudent for the transferor of property to favor the transfer assets which produce the least CGT liability, if any, and for both parties to consider transferring pre-CGT assets which would not be “tainted” on transfer, i.e. assets that wouldn’t be converted from pre-CGT into post-CGT assets because marital or relationship breakdown relief is available under subdiv 126-A.

However, before we make that decision, we also must consider, amongst other things, the income tax consequences.

There would not be a continuity of greater than 50% ownership in a company of trust if there is a transfer of 50%, unless there is a subdiv 126-A rollover.

Also, CGT can arise on the disposal of pre-CGT shares where the value of post CGT property comprises 75% or more of the net asset value of the company (CGT event K6).

3. Income tax consequences

3.1 Bad debts (Companies)

The rules for the deductibility of bad debts are very complex but, broadly, under subdiv 165-C of the ITAA 1997, for the writing off of bad debts to be an allowable deduction for a company, it must pass the continuity of ownership test (COT), or if this is failed, then the business continuity test (BCT), must be satisfied (s165-120). These tests are similar to the tests for company loss purposes.

Broadly, for the write off to be deductible, there must be a continuity of ownership of shares by natural persons, carrying more than 50% of all dividends, voting and capital rights, throughout both the year which the debt was incurred and the year the bad debt is claimed and any intervening years (subdiv 165-C).

Where a company which operated the family business was owned 50/50 by the parties to the marriage, the transfer of all the shares of one spouse to the other as part of a property settlement will breach this test, as the continuing ownership required must be **greater** than 50%. No roll-over relief is available as it is in some circumstances for assets transfers under the CGT provisions.

The business continuity test might be able to be relied upon (so the bad debt deduction can still be claimed), however it might be difficult to pass this test, particularly if the new owner, unrestrained by their ex-spouse, “tweaks” the business.

3.2 Bad Debts (Trusts)

Similarly, with the introduction of the trust loss legislation, some debts which subsequently turn bad will only be allowable as a deduction where the trust satisfies a number of tests. The applicable tests will depend on which category the trust fits into. This legislation, in Sch 2F of the Income Tax Assessment Act 1936 (the ITAA 1936), is extremely complex and therefore outside the scope of this paper.

3.3 Losses (Companies – Revenue and Capital)

As with bad debts, a company may only deduct its carry forward prior year losses (and current year losses in particular circumstances) where a continuity of ownership test, or if this is failed then the similar business test, is passed.

I will not explore the complexities of these rules and especially where companies are owned by trusts.

Again, where a company was owned 50/50 during the marriage, the transfer of all the shares of one spouse to the other as part of a property settlement will breach this test, as the continuing ownership must be **greater** than 50%. No roll-over relief is available as it is in some circumstances under the CGT provisions.

3.4 Unrealised Net Losses in A Company

Where a change occurs in the ownership or control of a company that has an unrealized

net loss at the time that there is a change in the ownership or control, the company cannot utilize its capital losses or deduct its revenue losses in respect of CGT events that happen to assets owned at the time that control changed, unless it satisfies the business continuity test (subdiv 165-CC).

The potential losses lost are those unrealized at the changeover time.

There are however, special rules that might provide relief, e.g.

- companies (together with certain related entities) with a net asset value of $6 million or less are exempt (same test as in s152-15)(s165-115A(1)); and
- assets acquired for less than $10,000 may be excluded (s165-115A(1B).

Again, these rules are a specialist topic so I will not consider them in detail.

3.5 Losses (Trusts – Revenue)

Tests for deductibility of revenue losses must also be satisfied under the trust loss provisions. A change in unitholders in a unit trust or a change in beneficiaries of a discretionary trust may make it difficult to pass the required tests (Sch 2F of the ITAA 1936).

It is often the case that a trust will elect to be a family trust in order to claim current year deductions, bad debts (considered above) and recoup prior year revenue losses.

An issue in the event of divorce is that where the test or primary individual (s272-80(3) and s272-90(1) of Sch 2F of the ITAA 1936) is, for example, Paul, is whether Barbara (the former wife) is no longer eligible to be a member of the family group (section 272-90 and section 272-95 of Schedule 2F). Any distribution outside the family group would subject the trust to family trust distribution's tax, being tax at the top marginal rate plus Medicare Levy.

Fortunately, s272-90(2A)(a) of Sch 2F now provides that members of the primary individual's family group includes a person who was the spouse of either the primary individual or the primary individual's family before the breakdown in the marriage or relationship.

It is also worth noting that Family Trust Elections (FTEs) can be varied or revoked in accordance with s272-80(5A) to (6A) of Schedule 2F.

S272-80(5A) allows us to vary an FTE to specify a different individual as the individual whose family group is to be taken into account (for the purposes of s272-80(3)), if:

- the new individual was a member of the family of the individual originally specified in the election at the election time; and
- any conferrals of present entitlements and distributions of income or capital of either the trust or an interposed entity while the FTE has been in force

have been made to the new individual of persons who would have been members of the new individual's family group at the time of that conferral or distribution.

Such a variation can only be made once (s272-80(5B)).

S272-80(5C) provides much broader relief in the event of marriage or relationship breakdown, if an order, agreement or award of the kind mentioned in paragraphs 126-5(1)(a) to (f) of the ITAA 1997

results in a new individual or group comprising that individual and their family having control of the trust. Control is defined in s272-80(5D).

In this case, there is no limit on the number of times such a variation can be made.

An important takeaway is to consider these rules before having orders drafted.

Alternatively, under s272-80(6), the trustee of a fixed trust (s262-65) may revoke the election if, at the start of the specified income year the individual specified in the election, their family or another trust with the same specified individual, in some combination, had fixed entitlements to all of the income and capital of the trust but at a later time another individual (not of a kind just mentioned) has a fixed entitlement to income or capital of the trust.

Again, in the fixed trust case, there is no limit on the number of times such a variation can be made.

Further, there is no limit on when an FTE can be varied under the marital or relationship breakdown rule in s272-80(5C) or revoked under the fixed trust rule in s272-80(6).

There is one other revocation rule in s272-80(6A), which applies to trusts, not to trusts of a particular type. It permits revocation unless while the FTE was in force, broadly:

- tax losses were used that would not have been able to be used but for the FTE; or
- a deduction was claimed for bad debts in the same circumstances; or
- a beneficiary benefitted from the flow through of franking credits in the same circumstances

A variation under 272-80(5A) where a new individual is specified, or a revocation under s272-80(6A), can only be made by the end of the fourth year after the year specified in the election (s272-80(6B)).

3.6 Forgiveness of Debts

As part of a property settlement, orders may be made for the waiver of debts between spouses or of debts between family companies or trusts and spouses, or loan offsets might be made amongst a number of entities in order to tidy up the affairs of the parties. It is also possible that debts may be assigned from one spouse to the other.

Consideration must be given as to whether each transaction has implications under the commercial debt forgiveness (CDF) provisions in div 245 of the ITAA 1997.

Briefly, a commercial debt is a debt upon which interest is or would be an allowable deduction to the debtor under section 8-1 of the ITAA 1997 if it was charged, even if a deduction would be denied because of another provision (e.g. the thin capitalisation rules)(s245-10).

It follows that the forgiveness of debts between spouses should often not be subject to the CDF provisions if they are of a private or domestic nature.

However, where a private company forgives a debt (whether it be a commercial or private debt) owed by a shareholder (or associate), the forgiven amount may be treated as an unfranked dividend (s109F in Div 7A of the ITAA 1936). Deemed dividends are considered further, later.

It should be remembered that Div 7A does not require that a debt be a commercial debt, merely that it be forgiven.

Similarly, debts involving companies and trusts or personal debts used to fund income-

producing property (e.g. loans to fund a share portfolio or a rented holiday house) may give rise to consequences under the CDF rules.

Where the debtor who benefits from the forgiveness is an employee and the forgiveness is in respect of employment, there might be both a Div 7A deemed dividend and an FBT liability but for s109ZB(2) of the ITAA 1936 which allows Div 7A to operate and paragraph (n) of the definition of fringe benefit in s136(1) of the Fringe Benefits Tax Assessment Act 1986, which excludes amounts that are deemed to be dividends under the ITAA 1936.

The CDF rules ought to be excluded if either Div 7A or the FBT rules apply (s245-40 of the ITAA 1997).

If the CDF rules do apply, s245-35 tells us when a debt will ordinarily be taken to be forgiven, including on expiry of the statutory limitation period and s245-36 tells us that a debt can be taken to be forgiven when it is assigned.

Perhaps perversely, the CDF rules are excluded when debts are forgiven for reasons of natural love and affection (s245-40(e)) but not in the event of marital or relationship breakdown.

Where the commercial debt forgiveness provisions apply, certain tax attributes of the debtor party may be reduced. These tax attributes are, in order, carry forward revenue losses, carry forward net capital losses, certain deductible expenditure (including the depreciable value of plant and equipment) and the cost base of assets for CGT purposes. Grouping rules, deemed market value rules and other exemptions may apply.

3.7 Dividends

When transferring assets out of companies as part of a property settlement, consideration must be given to s44 of the ITAA 1936, which applies to dividends paid by a company out of profits.

This is because the definition of a dividend is very broad and it includes any distribution made by a company (to a shareholder out of profits), whether it is in the form of money or property.

If part of a property settlement includes the transfer of property out of say Paul and Barbara's family company, to Barbara, for example, if Barbara is a shareholder and there are sufficient profits, the value of the assets transferred would be an assessable dividend to her.

The dividend might of course be paid as a franked dividend (provided that the directors recognise that the transfer is a dividend, resolve to frank accordingly and the necessary distribution statement is provided.

It has been suggested that a way to avoid this would be to remove Barbara as a shareholder before any such transfers of property are made, but see s109C(1)(b), s109D(1)(d)(ii) and s109F(1)(b) of the ITAA 1936, which apply (to enliven the deemed dividend rules in Div 7A), where a reasonable person would conclude that the amount is paid, lent or forgiven because the person has been a shareholder or associate.

Also, the deemed private company dividend rules in Div 7A must still be considered where the recipient or beneficiary was never a shareholder (in the private company) but they are or were an associate of a shareholder.

3.8 Deemed Dividends

3.8.1 Payments

Briefly, Div 7A of the ITAA 1936 deems the payment of an amount (including the transfer or use of property) to a shareholder (or associate) of a private company to be a dividend, where the payment represents a distribution of profits of the company.

At first blush, the dividend is taken to be unfranked. However, s109RC allows deemed

dividends under Div 7A to be franked (and it treats associates as members to allow franking

to happen).

The deemed dividend provisions may still apply where the property transferred was subject to CGT roll- over relief.

Notwithstanding the fact that the Family Court can compel third parties such as a company or a trust to make a payment to one of the spouses, the Commissioner considers that s109J does not operate to exclude payments under s109C from Div 7A (TR 2014/5).

S109J is the provision that excludes payments that are no greater than are required to discharge a company's obligation to pay an amount calculated as if the parties were dealing at arm's length.

3.8.2 Loans

Loans advanced to shareholders (or associates) in private companies can also give rise to deemed dividends if they remain unpaid by the lodgement day (s109D and 109E) and the company has a sufficient distributable surplus (s109Y).

Loans that are subject to complying loan agreements (s109N) are excluded.

Any such deemed dividends would be frankable as outlined above (s109RC of the ITAA 1936 and s202-45(g)(i) of the ITAA 1997).

3.8.3 Debt Forgiveness

Whenever there is a restructuring or redistribution of wealth within a family group, we can expect that there will be old loans or debts that need to be "cleaned up".

Section 109F of the ITAA 1936 makes it clear that the forgiveness of a debt by a private company to a shareholder (or associate), constitutes a deemed dividend, provided that the company has a sufficient distributable surplus at the end of the income year.

A note of caution. S109F(3) tells us that a debt is taken to be forgiven for Div 7A purposes when it would be taken to be forgiven under s245-35 or s245-37 of the ITAA 1997, where subdiv 245-C to G might apply (which are in the CDF rules).

However, s109F(5) goes further to include debt parking, i.e. where a creditor transfers a debt to an associate or another party under an arrangement and a reasonable person would conclude that the new creditor will not exercise the assigned rightS109F(6) goes even further to deem a forgiveness to happen if a reasonable person would conclude that a private company

simply won't insist on repayment.

An important exclusion can arise where a debt is forgiven for reasons of natural love and affection. If so, s245-40(e) of the ITAA 1997 can exclude the operation of subdiv 245-C to G.

The Commissioner's current view can be found in TD 2022/1. It contemplates that the creditor will ordinarily be a natural person as only a natural person can feel natural love and affection and while a natural person could be a trustee or partner the relkevant constituent document is unlikely to permit the trustee or partner to forgive a debt for such a reason.

The Commissioner goes on to express the view that the debtor need not be a natural person for this exclusion to apply, e.g. a creditor might forgive a debt owed by a company which is wholly owned by a natural person, for reasons of their natural love and affection for the shareholder.

3.9 Unpaid Present Entitlements

Whilst Div 7A is primarily aimed at distributions out of private company profits, it can also apply to payments made, loans advanced and debts forgiven by a trust where a corporate beneficiary has an unpaid present entitlement owed by that trust (s109XA of the ITAA 1936).

These rules will apply where the trust makes a payment (but not a loan or debt forgiveness) in discharge or reduction of a present entitlement owed to the shareholder which is attributable to an unrealised gain and the company is or becomes presently entitled to an amount from the net income of the trust prior to the earlier of the actual lodgement date and the due date for the lodgement (s109XA(1)).

However, if the company receives payment of its present entitlement prior to the earlier of the actual lodgement date and the due date for the lodgement of its tax return, no deemed dividend will arise.

A deemed dividend will also arise where a trust makes a loan (s109XA(2)) or forgives a debt (s109XA(3)) to a shareholder (or associate) of a private company and the company is or becomes presently entitled to an amount of the trust's net income prior to the earlier of the actual lodgement date and the due date for the lodgement.

The deemed dividend may be avoided if the trust pays the present entitlement or repays the loan prior to the earlier of the above dates.

The shareholder may also enter into a Div 7A complying loan agreement before the earlier of the above dates.

As discussed above, the amount of any deemed dividend will be subject to the company's distributable surplus.

If such a deemed dividend arises, it will at first blush be unfranked but see above in relation to possible relief provided under s109RC.

The Commissioner's recent pronouncements on Div 7A are a specialist topics and therefore somewhat outside the scope of this paper but I note that TD 2022/11 is often helpful.

3.10 Interest Deductions

Careful consideration must be given to the deductibility of interest on borrowings:

- incurred to fund the acquisition of income producing assets which later pass in whole or in part to a spouse or other entity; or
- to fund the acquisition of assets from a spouse or other entity.

Broadly, the ATO takes the view that a trustee cannot claim a deduction for interest incurred on funds that are borrowed to merely discharge an obligation unless that borrowing satisfies the "refinancing principle" established in the ***Roberts & Smith*** case (TR 2005/12).

So, if say the Paul and Barbara Family Trust is required to make a capital payment to Paul and the trustee has to borrow funds to do so, a deduction for the interest on those borrowings might not be deductible. It might be different if Paul had contributed capital to the trust, or if there were unpaid present entitlements from prior periods.

Further, in private ruling authorisation number 1051710727660, a husband unsuccessfully sought a deduction for interest on a loan taken out to buy his spouse a business. Given that the "use test" was clearly failed, the Commissioner's response was hardly surprising.

3.11 Plant and Equipment

The capital allowance rules are now nightmarishly complex, particularly given the changes to permit temporary full expensing, the transitional rules and the various qualifiers. As a result, I will make some simple observations and it will then be important to check whether the following applies in your fact situation.

Transfers of depreciable assets will typically be taken to occur at market value (s40-300 of the ITAA 1997).

However, roll-over relief might be available (see s40-340(1) Item 3) where there is roll-over relief under subdiv 126-A in the event of marriage or relationship breakdown (and s40-345 of the ITAA 1997 explains what roll-over relief means for capital allowance purposes. Essentially, the transferee steps unto the shoes of the transferee).

3.12 Trading Stock

Transfers of trading stock not in the ordinary course of business will be taken to occur at market value under section 70-90 of the ITAA 1997.

We are still left with the uncertainty as to what is meant by the term market value.

The better view seems to be that market value for these purposes means that value at which such items could be sold or transferred in these circumstances or as if there was say a "walk-in-walk-out" or clearing sale, which is likely to be at cost or similar, rather than at the value that the items would be sold in the ordinary course of business, which might instead be referred to as market selling value ***(Australasian Jam Co Pty Ltd v FC of T (1953) 10 ATD 217.***

3.13 Employment Termination Payments

It may be possible to make an employment termination payment to a "retiring" spouse and take advantage of the concessional income tax treatment.

Similarly, contributions into a complying superannuation fund might be maximised.

3.14 Private or domestic arrangements

Private ruling authorisation number 1052130653288 directs us to ruling IT 2167. It reminds us that a parent might enter into a family arrangement with an adult child (going through a divorce), whereby the child makes regular deposits into an account which might be used to cover holding costs, not the personal use of a parent, without those deposits constituting income of the parent.

Put another way, we should remember that not all regular receipts of money constitute income.

3.15 50/50 co-owners and a different income/expense split

Private ruling authorisation number 1051454611685 seems consistent with ruling TR 93/23. In both the Commissioner said that income and expenses were to be split according to the legal interest in the property. Further, where a co-owner forgoes their share of the income and/or pays for all of the expenses (as happened in this case where the spouses were estranged), that is a private arrangement between the parties which does not change the tax outcome.

3.16 Assessability/deductibility where title changes

Private ruling authorisation number 1051551111015 is a useful reminder that even though income and deductions are usually split between parties according to their legal ownership of property, it might be the beneficial owner who is assessable or entitled to deductions from the date of the order, if the order provides that they are the trustee from that date.

Private ruling authorisation number 10514674684431 reflected the same reasoning and outcome where there was a delay in transfer of the relevant property, i.e. all of the income and expenses “belonged to” the transferee under the court order, from the date of the order.

4. Child maintenance trusts

4.1 Taxation of maintenance payments

The taxation consequences of the payment of maintenance to a spouse or child may be summarised as follows:

- the payer of maintenance will not be entitled to an income tax deduction for such payments;
- the recipient of the maintenance payments may be exempt from income tax, see below; and
- certain non-exempt payments to minors may be subject to penalty rates of income tax under Div 6AA of the ITAA 1936.

Exemption for Maintenance Payments

Maintenance payments will be exempt from income tax where the amounts paid are (s51-50 of the ITAA 1997):

- a periodic payment in the nature of maintenance;
- which are made by an individual or attributable to payments by an individual (the maintenance payer);
- which are made to another individual who is or was the maintenance payer's spouse or are made for the benefit of the children of the maintenance payer or of the maintenance payer's spouse or former spouse.

The exemption will not be available for payments connected with assets which have been divested by the maintenance payer in order to make such payments or which are payments which would otherwise have been assessable income of the payer. Payments are therefore only exempt where paid out of post-tax income.

Payments from companies (e.g. dividends) and trusts (e.g. distributions of trust net income)(for example where a family business has been carried on or investments made in such an entity), will typically be fully taxable.

4.1 Why Create Child Maintenance Trusts

Payers of maintenance are typically reluctant to make payments out of post-tax income. For example, in order to pay maintenance of $500 per week ($26,000 p.a.), a taxpayer, e.g. Paul, on the top marginal rate of tax (say 47% including Medicare) must earn over $49,000 p.a. of additional pre-tax income to fund such payments.

The payment of maintenance directly from earnings on investments and therefore out of pre-tax dollars is therefore, at first blush, very attractive to the payer.

However, the result for the payee, e.g. say Barbara, Louise or Sarah however, is the potential loss of the amount's tax free status.

This problem might be addressed in a number of ways, such as by ensuring that franked dividends are paid or by paying an additional amount to compensate for such tax.

Tax will not be payable, however, where the total yearly amount paid (when counted with all other income, if any) falls below the (resident adult) tax free threshold of $18,000, ignoring any low or medium income tax offset.

It is commonly understood that children suffer penalty rates of tax on most "unearned" income, as a result of Div 6AA of the ITAA 1936.

However, the establishment of a child maintenance trust (CMT) might effectively result in the payment of maintenance out of pre-tax income and it might avoid the operation of the Div 6AA.

4.2 Anti-avoidance: Division 6AA

Div 6AA often applies where minors ("**prescribed persons**") derive unearned income, e.g. interest, dividends rent or trust distributions. Broadly, this results in minors paying tax at the top personal marginal rate of tax, without the benefit of a tax free threshold or progressive rates.

A "**prescribed person**" is a person who on the last day of the year is under 18 years of age and is not an "**excepted person**" (s102AC of the ITAA 1936).

An "**excepted person**" includes (s102AC) a person:

- engaged in a full-time occupation on the last day of the year (subject to certain exceptions);
- in receipt of certain disability or social security benefits; or
- subject to a permanent disability which falls within specified categories.

These provisions apply whether the income is derived by the minor directly or as a beneficiary of a trust.

Division 6AA applies to the "**eligible assessable income**" of the minor. Essentially, this is the total assessable income of the minor less "**excepted assessable income**".

"**Excepted assessable income**" includes, amongst other things (s102AE(1)):

- employment or business income; and
- amounts derived from the investment of money or other property which was paid or transferred to the minor as the result of a family breakdown;

Div 6AA also applies to distributions of trust income to **prescribed persons**, if it is not "**excepted trust income"** (s102AG).

4.3 Excepted trust income

"**Excepted trust income**" (s102AG) includes the beneficiary's share of the net income of a trust estate to the extent to which it is derived by the trustee from the investment of

property transferred to the trustee for the benefit of the beneficiary as a result of a family breakdown (s102AG(2)(c)(viii)).

4.3.1 As the result of a family breakdown

A transfer of property will be taken to be as a result of a family breakdown (s102AGA(2)), which is a requirement under s102AE(2)(b)(viii) and s102AG(2)(c)(viii), where, broadly:

- a person ceases to live with another person as the spouse of that person on a genuine domestic basis;
- at least one of the persons is the natural parent, or the adoptive parent, or the step-parent or has legal custody or guardianship of the minor or the beneficiary;
- an order, determination or assessment of a court is made in respect of the cessation and a person becomes obliged as a result of this order etc to maintain, transfer or do some other thing for the benefit of the minor or beneficiary or one of the spouses; and
- the transfer of property is made to give effect to the legal obligation.

Section102AGA(3) extends the above to include minors and beneficiaries born when his or her parents are not living together as spouses.

4.3.2 Property transferred for the benefit of the beneficiary

Two of the requirements to be met are as follows.

First, “property” must be transferred to the CMT and secondly, this property must be held in the trust for the benefit of the child beneficiary(s).

Transferring property

Transferring property might be expected to be straight forward. The concept of property is broad and would include items such as cash, plant and equipment, shares and units.

In taxation ruling TR 98/4 the Commissioner says that cases have been identified where no property has been transferred to a CMT. Examples include where an existing trust pays amounts in accordance with a trustee agreement to exercise its discretion to distribute income for a set amount to the children each year.

It is also necessary that the transfer occurs as a result of a family breakdown. The alteration of an existing trust to provide for maintenance payments would not, by itself, satisfy this requirement.

Watch out for the CGT and (stamp) duty implications of transferring property to a trustee.

For the benefit of a child

A second requirement (that the property be transferred to the trustee for the benefit of the child) is met, according to the ATO, if the beneficiaries of the CMT (say Louise and Sarah) have an absolute vested interest in the property transferred, from the time of the inception of the trust (see TR 98/4 at paragraph 37). This would mean that each child would have to have an absolute beneficial interest in his or her or their own part of the trust property. In my

view, the Commissioner is probably correct.

That the beneficiaries must acquire the property when the trust ends is clear from s 102AG(2A).

Also, the ATO says in TR 98/4 at paragraph 33, that property must pass to the estate of the beneficiary, should the child die before the trust ends. In my view, this is less clear and it is not specifically stated in the legislation but it would seem to follow if the child's interest in the trust property is absolute and in any event, people probably won't resist the ATO.

The trust property may be applied for the benefit of the children during the term of the trust, however, where a beneficiary(s) is entitled to the capital and income of a trust, under the rule in ***Saunders v Vautier (1841) 4 Beav 115***, the beneficiary(s) may call for the winding up of the trust upon reaching 18 years of age and thereby obtain possession of the trust property.

This might not be considered desirable in the opinion of some maintenance payers. A possible solution may be to have a discretionary trust nominated as an income beneficiary of the CMT so that it is not possible for the trust to be wound up in this way. The ATO accepts, or rather does not reject, this mechanism in TR 98/4, at paragraph 45. The interest in the assets would still pass to the beneficiaries at the vesting time.

Another consideration might be to transfer wasting assets (as the property) to the CM T. The value of the assets might decrease over the time that maintenance payments are made so that the value of assets which ultimately pass to the children might not be such an issue. Examples of assets which might fit this description would be plant and equipment, for example, motor vehicles. Questions of the timing of the wasting of the assets will arise, to ensure sufficient income is produced to provide for the maintenance payments, however, if necessary, additional assets might be transferred into the CMT to produce further income – depending upon the terms of the court order. TR 98/4, at paragraph 33, specifically contemplates the use of wasting assets, in particular an annuity.

4.3.3 Income from the investment of property

Where cash or plant and equipment is transferred into the CMT, the requirement that income must be derived from the investment of the property transferred to the CMT should be easily met. Indeed, in TR 98/4, at paragraph 54, the ATO does not take a restrictive view of the meaning of the term investment.

In some arrangements, investment income of CMT's has been derived in a more indirect way, as follows:

- a CMT is established with children as beneficiaries (e.g. Louise and Sarah);
- a unit trust is also established and either an amount is transferred into the CMT to subscribe for units or units are directly transferred to the CMT;
- the unit trust is made a beneficiary of an existing discretionary trust (typically the existing family business entity), the trustee being the maintenance payer;
- the discretionary trust would make distributions to the unit trust each year of income sufficient to meet the maintenance obligations of say Paul, and the unit trust would in turn distribute this amount to the CMT for the ultimate distribution for the benefit of say Louise and Sarah.

In TR 98/ the ATO does not accept that this arrangement satisfies the requirement that there

is income from the investment of property, therefore such payments by the CMT will not be considered to be excepted – see TR 98/4 at paragraph 57.

4.4 Anti-avoidance Rules

There are two important anti avoidance rules which we must have regard to.

Arm's length rate of income

First, it is necessary to apply an arm's length dealing test. That is, if as a result of the arrangement the minor derives more income than they might reasonably have been expected to have derived had the parties to the arrangement been dealing at arm's length, then the excess over the reasonable amount will not be subject to concessional treatment (see s102AE(6) and s102AG(3)).

Agreement to be excepted income

Income derived by a CMT will not be excepted trust income if it results from an agreement entered into or carried out a purpose of securing that the income would be excepted income, unless the purpose is merely incidental (s102AG(4) and (5)).

An example of when the Commissioner considers that this provision will apply is provided in TR 98/4 at paragraph 36, i.e. where income from an existing trust is paid through new CMT arrangements to a child. It is argued that as the existing trust could have distributed income directly to the child, which would not have resulted in excepted income. It seems that the arrangements outlined above, i.e. setting up the unit trust structure, would also be caught by these provisions.

4.5 Distributions of Property to Beneficiaries

As outlined earlier, the interest in the property of a CMT must pass to the children at the vesting time. In some instances, the distribution in-specie of trust assets will trigger a capital gain or loss for the trustee (s104-75).

Query how these rules will operate if the children are always absolutely entitled to the trust assets as against the trustee?

5. Consolidations

Under the tax consolidations regime, wholly owned companies and in some cases certain trusts may form part of a consolidated group.

If spouses own the shares in the head company of a tax consolidated group, the transfer of shares in one of the members of the consolidation group will result in that entity leaving or exiting the consolidated group.

The exit rules are extremely complex and may lead to an inadvertent capital gain being crystalised if the leaving entity has a negative allocable cost amount (ACA).

In addition, the tax losses and franking credits stay with the head company.

A more detailed consideration of tax consolidations is outside the scope of this paper.

6. (Stamp) Duty

Limited exemptions from duty in Victoria may be available on the transfer of property, eg. under s44(1) of the Duties Act 2000, there might be an exemption where the transfer is:

- solely because of the breakdown of a marriage or domestic relationship;
- from individuals who are a party to a marriage or domestic relationship;
- or from a trustee of a trust of which a party is a beneficiary ,
- to a party to the marriage or relationship;
- or to a dependent child;
- or to a trustee of a trust of which no-one other than a party to the marriage or relationship or dependent child may benefit.

No other party can take an interest in the property.

Section 44(2) provides an exemption where there is a declaration of trust over dutiable property by a party to the marriage or domestic relationship and the type of requirements in s44(1) are satisfied.

Section 44(4) operates similarly where the party declaring the trust over property is a corporation.

Section 44(3) operates similarly to s44(1) but where the transferor is a company.

The exemptions might not apply to the transfer of property to, from or between a company(s) or a trust(s) as part of a property settlement, except to trusts and companies are referred to above, or below.

It follows from the above that an exemption might be available on the transfer of property from a spouse, a trustee or a company into a CMT.

There could be exemptions from duty on the vesting of property in a liquidator (s48) or the transfer of assets from trusts to natural person beneficiaries (s36 and s36A).

A duty exemption might apply at the time of vesting of the CMT (see s36 and s36A above), provided the property is transferred to the beneficiaries for whose benefit the property was originally transferred into the trust.

The exemption in s43, subject to s43A, for transfers of a principal place of residence, does not require marital breakdown.

You should of course check the rules applicable in the relevant State or Territory.

A more detailed consideration of duty is outside the scope of this paper.

7. FBT

Care should be taken to avoid the FBT rules wherever possible. You will recall that FBT applies if:

- a benefit, e.g. the transfer or use of property;
- is provided by an employer, or associate, or under an arrangement;
- to an employee or associate;
- in respect of employment.

The term “in respect of” (employment) is defined very widely, in subsection 136(1) of the FBTAA.

Furthermore, its meaning is (arguably) extended by section 148 of the FBTAA. In particular, paragraph 148(1)(a) provides that the provision of a benefit in respect of employment is a reference to the provision of a benefit whether or not it is also provided in respect of, by reason of, by virtue of, or for, or in relation directly or indirectly to, any other matter or thing.

Often however there will be no sufficient and material as well as causal link with employment, so FBT will not apply (see ***J & G Knowles and Assoc v FC of T* 2000 ATC 4151**).

So, be careful and consider the possible and probable application of these rules in practice.

This could impact liability for extra Medicare levy, or the denial of social security benefits, and it could result in an increased liability to pay child support.

8. Impact on estate planning and trust structures

Wills and estate planning generally must be revisited in the event of separation and divorce.

Aside from the CGT rollover provisions, other alternatives for restructuring have, at least in the past, included cloning or splitting a trust.

8.1 Trust Cloning

Where assets are required to be transferred as part of a property settlement, one option was to transfer some of the assets from an existing trust into a virtually identical trust.

These were commonly referred to as mirror or clone trusts.

However, there is no longer an exemption from CGT Event E2 for an asset transferred from one trust to a mirror trust (where the mirror trust has the same beneficiaries and the same terms as the existing trust), so trust cloning as an option has withered on the vine.

8.2 Trust Splitting

As an alternative, a trust may be split into two or more (sub) trusts with certain assets being allocated to either of the (two) sub trusts.

The process might involve splitting the trust by means of a deed of appointment whereby a trustee of the sub trust is appointed to hold specific assets of that trust. Where a trust is split it is argued that there are no changes to the beneficiaries or the powers of the trustee and that there is still only one trust

Trust splitting raises a number of, in my view, complex and unresolved issues that I, and others, have written on so I will touch on it only briefly and recommend that you do not go down this path unless you are quite expert in this area and/or have sought expert advice.

Issues include whether one or more new trusts are created, whether a trust split will give rise to the need to amend the trustee's right of indemnity so that it relates to the assets of the particular sub-trust only, whether there is a resettlement (and therefore CGT disposals), you might consider the mechanics of preparing and lodging one income tax return for 2 sub-trusts, how s97 of the ITAA 1936 operates if there is only one trust, applying for TFNs and ABNs, lodging BASs, how the capital allowance, trading stock and GST rules work, etc.

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9. S100A reimbursement agreements & s99B – the terrible twins

9.1 S100A reimbursement agreements

Why might s100A of the ITAA 1936 apply when dividing up trust assets?

It seems that a fundamental tax question arises when a beneficiary who or which is not under a legal disability becomes presently entitled to trust income (s100A(1)).

That is, is there an agreement (s100A(13)) for the payment of money or the transfer of property or the provision of services or other benefits (which includes a loan) to a person other than that beneficiary (s100A(7))?

If there is, was one of the purposes to reduce the tax otherwise payable by someone (s100A(8) and (9))?

The s100A(13) definition of the term agreement excludes agreements, arrangements and understandings entered into in the ordinary course of family or commercial dealings (OFCD).

However, perhaps it is not enough to simply point to a divorce as the reason for a particular transaction and say that it must therefore be an OFCD and not caught by s100A.

Paragraph 25 and following of TR 2022/4 (which replaced TR 2022/D4) ask whether the transactions are explicable as aimed to achieve normal familial or commercial ends. Query whether, if the steps taken to achieve a particular outcome are artificial and contrived, the OFCD test might not be satisfied.

The other recent pronouncement from the ATO on s100A, which was also released on 8 December 2022, is PCG 2022/2, which replaced PCG 2022/D1.

I will simply note the above, as I consider further consideration of s100A to be a separate, specialist topic.

9.2 S99B application of trust property

There is then s99B of the ITAA 1936, a provision that must be considered where property of a trust estate is applied for the benefit of a beneficiary. There are of course exemptions but the scope of s99B is still largely unexplored judicially, which is why we have pronouncements such as PCG 2024/3, TD 2024/9, TA 2021/2 and TD 2017/24.

Again, I will simply note the above, as I consider further consideration of s99B to be a separate, specialist topic.

10. Conflict of interest

A common issue but one which perhaps some tax agents might pay less regard to than they should, is the matter of the conflict of interest which arises when an advisor has acted for more than one party and they then separate.

Given that this could be the subject of a whole paper, I will consider it only briefly.

A fundamental issue is that even if the advisor continues to act for only one party, they are armed with knowledge about the other party and their financial affairs.

The registration of tax agents is governed by the Tax Agent Services Act 2009 and an important element of that regime is the Code of Professional Conduct. A number of the principles in the Code touch on such a conflict and it specifically says that a registered tax entity must “have in place adequate arrangements for the management of conflicts of interest”. Query how we can continue to act for either party to a relationship if we have been acting for both.

Various professional bodies have their own rules. For example, CA ANZ issued a helpful Conflicts of Interest Guide in November 2021, reminding members that they are bound by the requirements of the Code. Example 4 in the Guide deals with divorce, where the accountant has acted for both parties and they insist that he continues. Once a conflict of interest was identified, the accountant was required to cease acting for both parties.

This is a timely reminder that we can’t necessarily continue to act for both parties as if nothing has changed, even if both parties ask us to, nor can we simply choose one party over the other.

11. The effect of tax liabilities on Family Court orders

While this is a family law issue it has its roots in tax, so we might consider whether and when the Family Court might take tax into account when making orders. It is then for the lawyers to advise on what the Court might decide.

A useful starting point is ***Rosati and Rosati [1998] FamCA 38***, where, on appeal, the Full Court considered, amongst other things, whether CGT on the sale of assets to satisfy orders should be taken into account in determining the asset split between the parties.

At 6.36 the Court said

" *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."

So, it seems that immediately after **Rosati** there was no simple rule or bright line test. Rather, it was necessary to weigh up the facts in each case.

I note that in ***Taffner & Taffner [2021] FamCAFC 68*** an ex-husband went back to court seeking an order that a best estimate of CGT should be taken into account in an asset division calculation, where a property could not be refinanced and had to be sold.

On the other hand, it seems that sale costs and CGT were not "inevitable" in ***IABH & HRBH (2006) FamCA 379***. In that case the Court distinguished between trading stock, the disposal of which might

have been inevitable, and the disposal of capital assets, even where the husband had successfully bought and sold real estate "his whole life".

The issue of both selling costs and CGT arose in ***Pfenning & Snow [2016] FamCA 29***. The Court applied **Rosati**, amongst other cases and found that where there was no evidence of proposed sales by either spouse in the foreseeable future or short to mid-term, so such costs were not taken into account (see para 107 and 109 in particular).

Adjusting for "catch-up tax" tax on dividends was also considered in ***Pfenning & Snow*** (in particular at para 116). Distinguishing between such tax where a dividend is a clear consequence of an order, the Court said that it would be inconsistent with **Rosati** to deduct notional taxation at the valuation stage when it might never be paid, it might be paid at a different rate or it might be minimised by other tax minimisation measures.

A latent CGT liability on an investment property retained by a wife which might be sold within 2 years was to be taken into account according to the Full Court in the appeal ***in Shnell & Frey [2021] FedCFamC1A 55***.

What about tax losses? This arises in the context or determining the financial resources as well as the financial assets of the parties. In ***JEL and DDF [2000] FamCA 1353***, at first instance, the Court found that tax losses (valued at approximately $2.16M at the corporate rate) should not be taken into account in light of the uncertainty as to their utilization. The Court also found that CGT should not be deducted as it was not clear whether such costs would ever arise (paragraph 91) and realisation costs should only be included in relation to assets transferred pursuant to orders of the Court (also paragraph 91). On appeal, it seems that the wife was allowed $200K in relation to the tax losses but it is difficult to determine the science behind this amount. Perhaps it will be a battle between the experts as to the likelihood of utilization of the losses and if so, when?

In ***Cromwell & Cromwell [2006] FamCA 1454***, on appeal, the Full Court considered the value of tax losses. Kay J, at paragraph 13, quoted from the original decision where the judge at first instance said:

"Reference was made earlier in these decision to the husband's carried forward losses. The evidence is less than clear as to how that will impact upon the husband's income in the foreseeable or more distant future, but the reality is there is no doubt in such fashion and at such time as he is advised, consistent with the income tax laws of this country, the husband will reap the benefits of those carried forward losses in a tangible way. It is not without relevance that the losses appear to have been substantially accumulated during the years of cohabitation between the parties. In all the circumstances, to fail to have regard to this resource as it may be considered, would be unfair to the wife. This should feature in the determination of an appropriate section 75(2) adjustment in the wife's favour".

Kay J continued at paragraph 14:

" I should say at this point, the reference there that his Honour refers to was earlier in the judgment. His Honour said at par 147:

147. One other financial resource of the husband ought to be mentioned. That being his carried forward tax losses of some $834,000. Whilst not property, the losses carried forward are valuable in the husband's hands. If you remember that the losses were accumulated in large measure during the time the parties were cohabiting, it can reasonably be inferred that the accumulation of losses of that magnitude is the consequence of trading losses, the effect of which is that the parties' income was reduced over the period in which the losses were being incurred. To the extent that such losses caused the overdraft to increase, that increase is included in the current balance of the account. To

allow the husband to have the sole benefit of losses which accumulated in the main while the parties were together and jointly missing out on income would be unfair to the wife.

148. The Court proposes within the context of section 75(2) in the consideration of the husband's financial resources to have regard to the availability of those carried forward losses although the evidence implies that the 2003/2004 profit would greatly reduce the quantum of those losses. Few people in the community however would dispute that the ability to receive $700,000 of income in one tax year and not to actually pay out money in relation to it is other than a substantial benefit.

Kay J then said, at paragraph 15:

" Finally, in par 149, when his Honour was determining the manner in which his proposed orders should be carried out, his Honour returned to the issue of the tax losses, saying:

If the husband were to pay one half of the balance of the cash to which the wife should be entitled approximately $750,000 on or before 1 December 2006, and the other half on or before 1 December 2007, the husband would have the opportunity during that period to generate substantial income from cattle sales with some proportion of that income possibly being tax free, and the wife would have been paid within a not unreasonable time."

What can be drawn from this? It seems to me that evidence as to the availability of tax losses and the ability to use them in the short to mid-term, as was considered in Rosati, in a different context, could be critical.

12. The ATO is here to help?

12.1 Record keeping

You might wish to rely on a concession or exemption, or seek a reduction in penalties, but the quality of your records might reflect the stress of the marital breakdown and let you down.

Simply put, recognising the possible/likely problem, you might identify what records might be required and start doing your utmost, as soon as possible to, to achieve your objective.

12.2 Compromised tax records

Where there is a risk that MyGov or tax records might be compromised, you might inform the ATO's Client Identity Support Centre on 1800 467033.

Examples of concerns include that a spouse might have been used as a dummy director or a participant in a tax scheme implemented by their spouse.

12.3 ATO's in-house facilitation

I am a cautious fan of the ATO's facilitation (having used it just once) and have heard pros and cons from colleagues.

dispute arose due to marital breakdown. This might be seen as an option to help resolve a dispute with the ATO, rather than between the parties, about a tax issue.

13. Conclusion

It follows that in planning for divorce there is a complex balancing required between CGT, income tax, FBT and duty considerations. This is complicated further by the limited CGT roll-over concessions and the overlap and inconsistency between the income tax, CGT and duty rules and the uncertainties in the FBT and CMT rules. Then, there is the added complexity of GST.

In the end we need to list all of the assets, and consider the tax cost of dealing with each, while balancing the very real personal issues involved. On this last point, in my experience, optimal tax outcomes are sometimes not achieved because the parties will not work together to maximise the tax position of either or both parties.

14. Disclaimer

This paper was produced for general discussion purposes. It is not advice and should not be relied upon. The Commissioner or the Courts may hold a different opinion and the law might change. You should therefore seek specific advice in relation to your particular circumstances and ensure that that advice remains up to date. The author accepts no responsibility for any errors or omissions.