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Divorcing the assets –

and almost everything else you wanted to **know about** **Tax and Family Law but were afraid to ask**

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Divorce is all about separating things. Some things are easy to separate, whilst others a little trickier.

When we think about divorce, we generally think first about the people involved. But as Family Lawyers know all too well, when people divorce, their assets must also be divorced. Just like divorce for some people is a simple and straightforward process, some assets are easy to divorce or separate between spouses. Unfortunately, just like some divorces are not simple, some assets can also be tricky to divorce and can come with unforeseen costs for those unaware of the tax consequences.

This paper was initially intended to just focus on the taxation implications of divorcing or separating assets from related entities. However, so many things in tax are inter-related and I felt it important to explain the fundamentals of some tax issues before getting into the specifics of how it impacts on Family Law matters. After all, I expect that taxation law was not a favourite subject for those studying with the intent of becoming a Family Lawyer. Therefore, the scope of this paper has grown over the course of writing it.

The intent is still not to cover every scenario possible, as that would be near impossible. However, I hope to be able to address most of the common issues that will arise in Family Law matters and importantly, highlight those situations that can easily result in unintended taxation consequences and how to avoid them. If something that is not covered that you think should be, please email me at nick.gaudion@cutcher.com.au and let me know so it can be considered for any future revisions of this paper.

I have divided the paper into the following sections:

1. **Divorcing the investment property:** This includes an overview of capital gains tax on property held by individuals. Family Law examples are provided to discuss who pays the tax if the property is to be sold, what are the implications where the investment property is transferred between spouses, what if one spouse uses the investment property as their main residence post separation and what if the investment property was previously owned by a trust or company.

2. **Divorcing the Partnership:** Are there any taxation issues to consider when the parties operated a business in partnership with each other, and only one spouse will continue to operate the business as a sole trader instead of a partnership?

3. **Divorcing assets or money from the Superannuation Fund:** This includes an overview of how earnings within a superannuation fund are taxed and how withdrawals from a superannuation fund are taxed. Family Law examples are provided to discuss when a party can take money or assets from a superannuation fund and what are the taxation implications when they do? When can a spouse access superannuation they receive as a result of a super splitting order? What are the tax consequences of splitting a SMSF and does it make a difference if an asset is transferred from a superannuation fund to an individual or another superannuation fund?

4. **Divorcing assets from a Trust:** What are the options when assets need to be separated from a trust and what are the taxation implications?

5. **Divorcing assets from a Company:** Before we transfer anything from a Company we must first understand what is Division 7A and what is all the fuss about. It is important to understand the "mischief" that Division 7A is trying to prevent as this assists in identifying when the proposed orders may trigger unintended taxation consequences. We'll then consider taxation implications with an example that includes loan accounts and transferring a motor vehicle and a property from the family company.

6. Tax issues arising from New Pooled Depreciation rates: Tax incentives for small business can mean that the book value of plant, equipment and other assets will be substantially less than the market value of those assets. If those assets were to be sold at their market value, this would crystallise a tax liability. How should that liability be considered in Family Law matters?

7. Did you mean to divorce your client's Family Tax benefits or increase their child support obligations? Family Tax benefits and child support calculations are not covered in detail. But as they are based on taxable income they deserve a brief mention as it's important that these issues are considered to avoid any unintended consequences.

If you are just looking for assistance on a particular issue, the paragraph numbers for each section begin with the paragraph numbers noted above. Alternatively, you could try using the search function of your pdf document reader.

It should be noted that this paper does not consider stamp duty which can vary from state to state. If you are dealing with property that is located in a state that you are not familiar with, then ensure you check any stamp duty consequences of proposed orders as they may be different to those in the state you normally practice.

References to ITAA36 are the Income Tax Assessment Act 1936 and references ITAA97 are the Income Tax Assessment Act 1997.

1.0 Divorcing The Investment Property

1.1 After the matrimonial home and superannuation, the investment property is one of the most common assets in Family Law proceedings. It is therefore important to have an understanding of the taxation implications on settlement and the taxation issues for your client on a go forward basis if they are going to retain the investment property. However, before going over some Family Law examples, I thought I'd go over some of the basics of Capital Gains Tax or CGT as it is often known and how it applies to residential property.

1.2 So what is Capital Gains Tax? CGT refers to the taxing of a gain made from buying an asset and then selling it at a later time and at a higher price. The Capital Gain is the difference between the Net Proceeds from the sale of the asset and the Cost Base of the asset.

1.3 The Net Proceeds is the selling price less the costs incurred in selling the asset such as legal fees and agent's commission.

1.4 The **Cost Base** is the purchase price plus the costs of acquisition such as stamp duty and legal fees. Some other costs incurred whilst holding the asset can also be included as part of the Cost Base, such as improvements, renovations and some costs of holding or protecting the right to the asset.

1.5 There are certain events that will trigger a Capital Gains Tax event. The two most relevant for Family Law are a sale of an asset and a transfer of an asset between related parties. Where the asset is sold to an unrelated third party, the capital gain is calculated based on the actual selling price. Where an asset is transferred between related parties, the capital gain is often calculated based on the actual market value, regardless of the consideration agreed between the parties. Therefore, prima facie, transferring an asset such as an investment property between spouses will trigger a capital gains tax event on which capital gains tax may be payable.

1.6 Where a capital gains tax event occurs, an amount will need to be included in the taxpayer's assessable income for that year[1]. The amount that is included in the taxpayer's assessable income depends on how long the asset has been held for. If the asset has been held for 12 months or less, then the whole of the capital gain is included in the taxpayer's assessable income and they will pay tax on that amount based on their marginal tax rates. Where the asset has been held longer than 12 months, then one half of the taxable income is included in the taxpayer's assessable income and they effectively only pay tax on one half of the gain at their marginal rates of tax. For example, if a capital gain of $70,000 was achieved on an asset that was held for more than twelve months, then only $35,000 would be included as income for the taxpayer. The tax payable would depend on their other income and their marginal rate of tax.

1.7 Certain assets are exempt from capital gains tax, such as assets acquired prior to 19 September 1985 (which are referred to as pre-CGT assets), motor vehicles and an individual's "main residence", and we will obviously focus on the latter exemption. A property that was purchased and was always used as an individual's **main residence** is exempt from CGT. But what about where a property has not always been used as a main residence and has a period where it is rented out as an investment property?

In such circumstances, a partial exemption applies, but how the exemption is applied depends on the exact situation. **It should be noted that a taxpayer and their spouse can generally only claim one property as a main residence at a time.**

[1] For CGT purposes, the date of the disposal of a residential property is the date on which the taxpayer was legally contracted or obliged to sell the property. Therefore, if contracts were exchanged on 25 June 2014 but payment not received until July, then the capital gain would be included in the taxable income for the year ended 30 June 2014.

1.8 Where a property was used as a rental property and then became a main residence, the capital gain exemption will be proportioned over the period as a rental property and main residence. For example, if the property was used as a rental property for 1,000 days and then a main residence for 2,000 days, then two thirds of the gain will be exempt. The remaining one third will be a taxable capital gain and as the property was held for more than twelve months, then one half of the taxable capital gain will be included as taxable income.

1.9 If the above property was first used as a main residence straight after it was purchased, then the property can be claimed as the main residence for a further six years after it physically stopped being a main residence – provided that the taxpayer is not wanting to also claim a second property as their main residence at the same time. This is because a taxpayer can generally not claim more than one property as a main residence at the same time[2]. If the property ceases to be a main residence and is used for income producing purposes, then the property would be valued and any gain past this date would be taxable [3]. There are further rules where a property has more than one period of being a main residence and a rental property, which can become more complex, but the important thing to remember is that a taxpayer can generally only claim one property as a main residence at the same time.

1.10 With the assistance of technology, the ATO is getting better at data matching to ensure that taxpayers are making correct disclosures in their tax returns. Therefore, given that data is maintained about the purchase and sale of properties, there will be the potential for the ATO to better ensure that all parties disclose the correct capital gains from the sale of properties.

1.11 Now when we start thinking about Family Law examples, it is important to note that spouses can generally only have one property between them that they claim for main residence exemption. This is explained in more detail in the example below. Although, in certain circumstances, spouses can split the main residence exemption across two properties, such that a 50% exemption applies to the gain on each property for the period that the exemption is shared.

1.12 So let's assume that Adam and Belle each had a property before they commenced cohabitation.[4] They got married and moved into Belle's property and rented out Adam's property. Four years later, they separated and Adam moved back into his property. Normally, Adam could claim the main residence exemption for the full period of ownership because it was first his main residence and he rented it out for less than six years.

However, Adam and Belle can only claim one of their properties as a main residence. Therefore, Adam will have a four year period when he cannot claim the full main residence exemption for his property. However, if Belle and Adam agreed, they could nominate different dwellings as their main residence. The effect of this would be that each of their properties would be deemed not to be their main residence for one half of the period of cohabitation. They would each have a future CGT liability when they sell their properties, but Adam's would only be half as much as it would have otherwise been if Belle had not agreed to split the main residence exemption for the period of cohabitation.

1.13 For another example, Roger and Jessica get married and buy a house together in joint names and immediately start living in that house. For tax purposes, they are each assumed to hold a 50% interest in the jointly held matrimonial home. At a later date, they buy an investment property in Roger's sole name and they rent out that property. When they separate, Roger moves into the investment property. From the time that Roger moved into the investment property, it could be argued that they are living permanently, separately and apart and therefore they could each claim their interest in the property they are residing in as their main residence. Any capital gain when Roger sells his property will be apportioned over the number of days that it was an investment property and his main residence.

1.14 Assuming Jessica was transferred Roger's interest in the matrimonial home and she continued to live in that property until it was sold, she would be able to claim her 50% interest in that property as her main residence for the whole period of ownership and she would not have a CGT issue in respect to that 50% interest. However, consideration must be given to the 50% interest that Jessica will acquire from Roger as Jessica will inherit Roger's history of use of the property. If Roger is living in and claiming what was the investment property as his main residence, then for the period from separation to the transfer of the property to Jessica, Roger's 50% interest in the property may not be eligible for the main residence exemption and the gain on that half of the property may be apportioned over the number of days it is held. However, it would be hoped that any gain would not be significant as the number of days between the time the parties started to reside in different locations and the completion of the Family Law proceeding may be relatively short in comparison to the total number of days the property was owned.

1.15 Extra care should be taken with high value properties and/or lengthy periods from separation to transfer of the property. In such matters, it would be prudent to advise your client of possible CGT implications and suggest they obtain advice on that issue from their accountant. If this was likely to create a large tax liability for Jessica, it would be possible to have Roger agree to claim the matrimonial property as his main residence for up to six years after he moved out – but Roger will have a greater CGT liability associated with the investment property as he could not claim both the investment property and the matrimonial property as main residences at the same time.

[2] There are a limited number of circumstances when a taxpayer could claim more than one property as main residence, such as when a taxpayer buys a new dwelling that is to become their main residence and still owns the existing main residence, both properties may be treated as a main residence for up to six months if certain conditions are met – ITAA97 118-140.

[3] This assumes the property was first rented after 20 August 1996, otherwise the gain would be proportioned based on the number of days for each use.

[4] Refer Income Tax Assessment Act 1997, sections 118-145 and 118-170 as well as TD 92/174.

1.16 But what if Jessica moved into the investment property and Roger stayed in the matrimonial home, and the consent orders saw Roger retain the matrimonial home and Jessica retain the investment property. Prima facie, a transfer from one spouse to another spouse for CGT purposes is deemed to be a disposal of an asset at market value. However, section 126-5 of the Income Tax Assessment Act contains rollover provisions such that any capital gain is disregarded. That does not mean that there are no CGT consequences, but rather any CGT consequences have been deferred.

1.17 Based on the principles of the Full Court of the Family Court of Australia decision in Rosati v Rosati (1998) FamCA 38, the Family Court may often disregard the capital gains tax liability associated with an asset where there is no intention to sell the asset. This is in part because the CGT liability will not arise until the asset is sold, and the amount of any future CGT cannot be reliably determined as the future value of the asset and the future tax law at the time of the sale is uncertain. However, from my experience, the parties take a different approach and they generally want to ensure that any settlement appropriately accounts for any potential future CGT liabilities. Therefore, where the parties are concerned about future CGT liabilities, if the rollover relief will only defer the CGT issues, what will the future CGT consequences be for each of the parties?

1.18 Jessica will acquire the investment property at the date of the orders. She may be thinking that she will live in that property as her main residence and therefore not have a CGT liability. However, as a result of the CGT rollover relief Jessica acquired the property and all of its ownership history from Roger. That means that if the property was purchased by Roger prior to 19 September 1985 it will be a pre CGT asset in Jessica's hands and exempt from CGT when sold by her.

However, as the property was acquired after that date, she is deemed to have purchased the property at the cost and date it was acquired by Roger.[5] Jessica is also deemed to have used it as an investment property until the date that she acquired the property pursuant to the Court Orders, and thereafter she can claim it as her main residence. Any capital gain when Jessica sells what was the investment property will be proportioned over the number of days that it was an investment property (date acquired by Roger to date acquired by Jessica) and the number of days she used it as her main residence.

1.19 The period the property was an investment property will be the time from when Roger acquired the property until it is transferred to Jessica, even if she moved in earlier because she cannot claim the property as a main residence if she has no ownership interest in it.

1.20 As for Roger, assuming he continued to live in the matrimonial home until it was sold, he will be able to claim the matrimonial home as his main residence. As Jessica had lived in the matrimonial home and did not have an interest in another property that she could claim as her main residence, she could continue to claim her interest in the matrimonial property as her main residence. This would allow Roger to acquire Jessica's 50% interest along with a history of it always being her main residence and Roger would effectively have a property that was 100% main residence for the full period of ownership. However, at the time of finalising the property proceedings, Roger may wish to obtain a statement from Jessica saying that she agrees to treat the property as her main residence for the period of separation as this may be hard to obtain at a later date.

1.22 Now let's have a look at Bob and Helen. Their investment property was owned by their family trust and Bob moved into the investment property post separation. He wants to retain that property as his main residence. If he simply retains the trust and continues to live in the property, he will not be able to claim it as his main residence and have future gains exempt from CGT. Section 126-15 applies to transfers of property from a trust or company to a spouse and allows CGT rollover relief in the same way as the transfer from Roger to Jessica above.

The effect is that Bob will have inherited the property history from the trust, i.e., he will be deemed to have acquired the property on the date it was acquired by the trust and at the cost it was acquired by the trust. He will also inherit the history of use as an investment property and any gain will be proportioned based on the number of days as an investment property and main residence. See section 4 of this paper for further considerations when transferring assets from a Trust to an individual.

1.23 The CGT impact for Bob would be exactly the same as above if the investment property was held by a company as opposed to a trust. The big difference though is the transfer of the property from a company to a related party could be treated as a deemed dividend under Division 7A of the Income Tax Assessment Act 1936. The impact of Division 7A is explained in Section 5 which is about divorcing assets from a company.

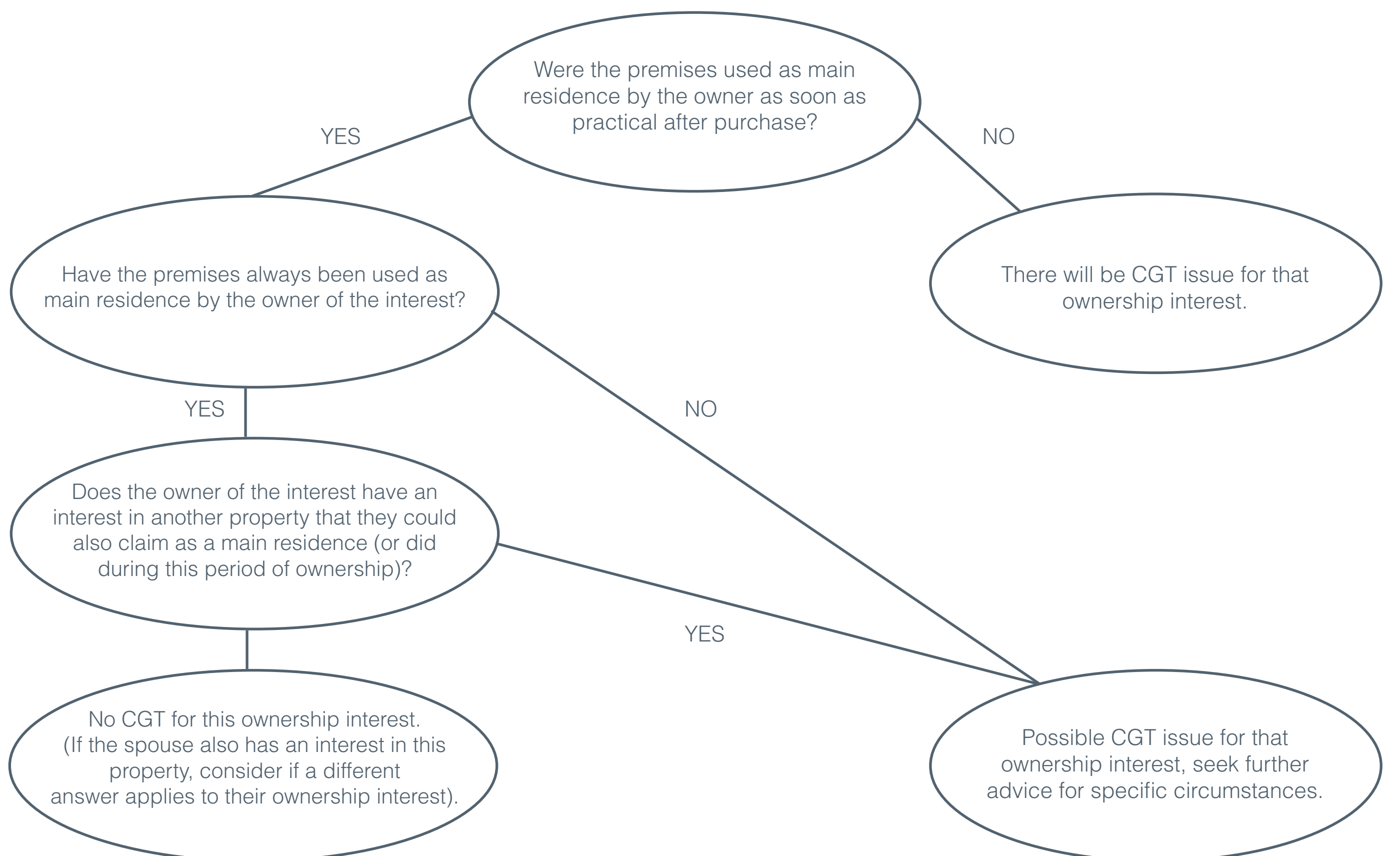
[5] Refer ITAA97 sections 126-5, 118-178 (or 118-180 if the property was transferred from a company or trust), 115-30, 115-140 and 115-150.

1.24 Note about capital losses: Where the net proceeds on sale of an asset are less than the cost base of the asset, a capital loss will arise. A capital loss can be used to reduce capital gains. It cannot be used to reduce the tax payable on other sources of income. However, the capital loss can be carried forward to future financial years and offset against any future capital gains. Where a capital loss has been incurred by one of the parties in the past, it may be appropriate to give consideration to the capital loss as it may assist in achieving a tax effective settlement or giving that party a future advantage, albeit uncertain in amount and timing.

1.25 Also, if the orders require a jointly held asset is to be sold which will realise a capital gain, each party is deemed to have a 50% interest in the asset and will therefore be attributed one half of the capital gain on which they will pay tax based on their personal circumstances. The capital gain will follow the existing ownership and not how the proceeds are distributed between the parties. If one of the parties has capital losses carried forward from prior years, then this could be used by that spouse to offset the amount of the capital gain and therefore pay less tax. Consideration could be given to making a cash adjustment between the parties so that they share equitably in the capital gains tax obligation. The Orders could include that the capital losses are to be used to reduce that spouse's capital gain and that there is to be a cash payment to equalise the capital gains tax paid between the parties. This would mean that this issue would not be resolved until after completion of their tax returns for the financial year when the property is sold. However, this will involve future costs in calculating the adjustment and enforcing the payment from one party to the other at a time probably more than a year after the proceedings or settlement. Therefore, consider asking the parties' accountant to make an estimate of the benefit of the capital loss taking into account the expected marginal tax rates and including that in the pool of assets. This will avoid the possibility of future disputes and the amount of the benefit and enforcement of any cash payment required.

1.26 As a Family Lawyer, in my view you're not expected to be to able to advise your clients of the taxation impacts of any proposed settlement. However, it will be of significant benefit to your clients if you are able to advise them when they might have an immediate or future taxation issue. We often think of CGT in terms of the underlying asset. However, we need to think of it in terms of each interest in the asset, and where an asset is held as joint tenants, they are deemed to hold the asset in equal shares. To assist you in considering if your client will have a future CGT liability in respect of a property, consider using the flow chart on the following page – making sure that you consider the questions for each ownership interest as opposed to each asset.

Separately consider the following in relation to the ownership interest of each of the Husband and the Wife:



2.0 Divorcing The Partnership

2.1 When a partnership is dissolved, the interests in the underlying assets are usually allocated between the partners. The interests in the partnership assets will often be held jointly between the partners to a partnership, in a similar way to how the matrimonial home is often held between the Husband and the Wife.

2.2 Therefore, when the Husband and the Wife have been operating a business as a partnership between them, dividing the assets of the partnership can usually be done in the same way, and with the same impact, as transferring other assets between the spouses. However, there is one exception to this that must be considered.

2.3 This is in relation to trading stock. ITAA97 section 126-5(3) states that there is no CGT rollover if the asset involved is trading stock. ITAA97 section 70-90 deems a disposal of trading stock of a business outside the ordinary course of that business to be at market value. The dissolution of a partnership is considered to be a disposal of trading stock at market value.

2.4 What does this mean from a Family Law perspective when the "Husband" and "Wife" partnership is dissolved? Let's assume that Bill and Ben operated a nursery in partnership with each other.[6] The stock of the partnership is recorded in the books of the partnership at $70,000. The stock has a market value of $150,000. As their relationship has ended, they had agreed that they would dissolve their business partnership. Therefore, prima facie, on dissolution of the partnership, the partnership is deemed to have disposed of the stock at $150,000 and must record the profit of $80,000 ($150,000 market value less $70,000 cost of the stock). This would result in an extra $40,000 of taxable income being recorded in each of Bill and Ben's tax returns (the $40,000 being one half of the $80,000 as they were equal partners in the business).

2.5 Bill is going to retain the nursery and continue to operate the business. As Ben is no longer part of the business, it doesn't seem fair to him that he should record and pay tax on an extra $40,000 when the stock was never sold at $150,000 and he will not receive a share of the additional cash that will be received by Bill when he sells the stock.

2.6 If you are acting for the spouse departing the partnership such as Ben and the partnership has trading stock, you should insist that the parties make an election pursuant to section 70-100 of ITAA97 such that, in this example, Bill will agree to continue to operate the business of the partnership and will account for the trading stock at the value it had in the hands of the partnership. The result for Bill is that when he sells the stock he will record the profit on sale at that time in just the same way that the original partnership would have and there is no effective disadvantage to him. The result for Ben is that he will not need to include the notional profit on the deemed disposal of trading stock at market value.

2.7 I note that a similar issue would prima facie exist on dissolution of a partnership with respect to depreciable assets such as plant & equipment and what is referred to as a balancing adjustment. However, section 40-340 of ITAA97 provides that in addition to the CGT rollover relief on marriage breakdown, there is also automatic rollover relief for any balancing adjustment that would have otherwise applied to depreciable assets such as plant & equipment. Therefore, no action needs to be taken in respect to the rollover of plant & equipment.

3.0 Divorcing Money Or Assets From The Super Fund

3.1 Before looking at the taxation implications of divorcing money or assets from a super fund, I thought I'd provide a brief overview of how superannuation funds are taxed.

3.2 When in the growth phase, earnings of a superannuation fund are taxed at 15%[7]. The earnings of a superannuation fund include employer contributions, salary sacrifice contributions and the interest or investment earnings. Capital gains are also taxable whilst in the growth phase. Whilst an individual receives a 50% reduction to the amount of the capital gain on which they are taxed for assets held longer than 12 months, a superannuation fund receives a one third reduction. For example, if a super fund sold an asset it held for more than 12 months and realised a capital gain of $30,000, then only $20,000 would be included in its taxable income and it would pay tax of $3,000 on the $30,000 capital gain ($30,000 less one third equals $20,000 times 15% equals $3,000). Where an asset held by a super fund is sold within 12 months of its purchase, the whole of the gain is taxable at 15%.

3.3 When in the payment phase, there is no tax paid on the earnings of a superannuation fund. Therefore, some super funds may adopt the tax effective strategy of delaying the sale of an asset with a large capital gain until the member/s commence a pension and therefore the super fund will not pay any capital gains tax when the asset is sold.

[6] The taxation impacts will generally be the same regardless of whether or not the parties were legally married, in a de facto relationship or same sex relationship.

[7] In respect to individuals who have a taxable income over $300,000, additional tax will be levied on them as individuals but they can request for this to be paid by the fund, making the effective tax on contributions more than 15%. Other penalties may also apply where certain regulations or limits are breached.

3.4 Before we discuss how payments to members are taxed, it is worth considering when someone can access the funds held in superannuation.

3.5 Superannuation is intended to provide benefits for the member's retirement. Therefore there are strict rules governing when amounts held within superannuation can be withdrawn.

3.6 There are four common times when the whole of a member's entitlements in a superannuation interest can be withdrawn from super. These are on death of the member, the member is totally and permanently disabled, the member has reached the age of 65 or if the member has permanently retired from the workforce after reaching their preservation age. Since most people do not plan on dying or becoming disabled, let's further consider what it means to be "retired after your preservation age" from a superannuation perspective.

3.7 The first thing to understand is what is meant by Preservation Age. This is the age that a member must reach before being able to retire and gain access to all of their superannuation interest.

The table below sets out the preservation age which is based on the member's date of birth:

Date of Birth	Preservation Age
Before 1 July 1960	55
1 July 1960 to 30 June 1961	56
1 July 1961 to 30 June 1962	57
1 July 1962 to 30 June 1963	58
1 July 1963 to 30 June 1964	59
After 1 July 1964	60

3.8 Given that the age at which we will be eligible for the age pension is set to increase to 70, we should be prepared for the preservation age to increase in the future as well.

3.9 In order to be considered "retired" from a superannuation perspective and be able to access their superannuation, a member must have reached their preservation age and have permanently retired from the workforce, i.e. have resigned from all paid employment and have no intentions of returning to work. If they satisfy this criteria, then they will be able to access all of the superannuation held in their name.

3.10 However, there are also circumstances when superannuation may be withdrawn prior to "retirement". In order to further explore this, I will explain the preservation characteristics of superannuation.

3.11 A superannuation interest is divided into one or more of three preservation categories. These are Preserved Benefits, Restricted Non-Preserved Benefits and Unrestricted Non-Preserved Benefits.

3.12 Unrestricted Non-Preserved Benefits, as the name suggests, have no restrictions and are not preserved. This means that the member can withdraw these funds from their superannuation at any time (with some exceptions, such as members of some defined benefit interests). They do not need to have reached their preservation age and they do not need to have retired from the workforce. Whilst the funds can be withdrawn, the member should consider any taxation implications before withdrawing any balances.

3.13 Restricted Non-Preserved Benefits will turn into Unrestricted Non-Preserved Benefits when the member satisfies a trigger event. The most common trigger event will be ceasing employment with the employer who was contributing to the fund. Once this occurs and the funds become unrestricted non-preserved benefits, they can be accessed at any time.

3.14 Most of the funds in superannuation will usually fall into the Preserved Benefit category. This is how we usually think of superannuation and this is the largest component of most superannuation interests. A Preserved Benefit means that the benefits must remain in superannuation until the member has "retired", i.e., reached their preservation age and permanently retired from the workforce.

3.15 The obvious question now is “How do I tell if a superannuation interest has any Unrestricted Non-Preserved Benefits?” There are three common ways that this can be determined:

a) The member’s annual member statement: The member’s annual statement will usually set out somewhere the amount of each of the preservation components. It is not usually on the front page, so you may need to look carefully over the statement.

b) The response to the Form 6 request: The fund must advise the amount of any Unrestricted Non-Preserved and Restricted Non-Preserved benefits on the Form 6 response. They do not need to advise of any preserved benefits, but it’s safe to say that anything else is a Preserved Benefit.

c) Ask the fund: Unless you have an authority from the member, the member will be the only person who can ask the fund. This request can usually be done either in writing, over the phone or on the internet for a fund with internet access for members. If requesting the information by phone, the fund will usually be able to send\ written confirmation.

3.16 There are other limited instances when funds can be withdrawn prior to retirement, such as under financial hardship or a transition to retirement pension. Preserved benefits will also become unrestricted non-preserved if a member over the age of 60 has a change in gainful employment which could include changing jobs or ceasing one of the two paid jobs/directorships that was held by the member. It may be appropriate to obtain specific advice where access to superannuation is crucial to the outcome of a matter and confirm the amount that will be able to be accessed by the member or by the non-member spouse in respect of any amount split to them.

3.17 Assuming the member can access some or all of their superannuation, what are the taxation implications?

3.18 From an individual’s perspective, where a member is over age 60 and takes money out of a superannuation fund, either by pension or lump sum, it will generally be tax free[8]. That means no tax will be paid. That seems pretty simple – and it is. But that’s where the simplicity stops.

3.19 For those under the age of 60, it is important to take note of the taxation components. Funds held in superannuation may be categorised as “Taxable”[9] and “Tax Free”. If under age 60, the member may pay tax on the taxable component, but will not pay tax on the tax free component. Unfortunately, you can’t just take the tax free component – the taxable and tax free components must be withdrawn in proportion. This is probably best explained with an example.

3.20 Let’s assume that the Wife has an accumulation interest with a balance of $100,000, she is under age 60 and is able to access $50,000 as it is unrestricted non-preserved. The taxation components of her interest are a taxable component of $70,000 (being 70% of the interest) and tax free component of $30,000 (being 30% of the interest).

Assuming that the Wife withdrew the $50,000 that was unrestricted and she was below her preservation age, the table below sets out how this would be taxed:

Taxation Component	Percentage of Interest	Amount	Tax
Taxable	70%	$35,000 ($50,000 times 70%)	Maximum of 20% plus Medicare
Tax free	30%	$15,000 ($50,000 times 30%)	Nil

[8] There are a small number of superannuation funds where the earnings in the fund are not taxed at 15%, being the rate applicable to most funds as noted in this paper. Some of the Commonwealth government superannuation funds are an example of such funds. Payments from these funds are from an untaxed sourced and the taxpayable by the member will generally be higher. For those funds which are taxed differently, the payment of superannuation funds to the member after aged 60 may result in tax being payable by the member.

[9]There are two types of taxable components, being those payments made from a taxed source and an untaxed source. Where tax was paid on the contributions made to a fund during the growth phase, the payments made from the fund will be categorised as being from a taxed source. Most super funds will make payments from a taxed source and the examples given in this paper assume the payments are being made from a taxed source. Higher tax may be payable where the payments from the super fund are considered to be from an untaxed source.

3.21 If the member has reached their preservation age but not yet age 60, the rate of tax is reduced to 15% plus Medicare. However, there is also a lifetime limit where lump sums from superannuation and eligible termination payments may be received tax free. This lifetime limit is $195,000 for the year ended 30 June 2016. Therefore, if the Wife in the above example was 58 and had not previously used any of her lifetime limit, then she would not pay any tax on the withdrawal as the amount withdrawn was less than her lifetime limit.

3.22 Similar to the discussion on accessing superannuation, the obvious question now is "How do I tell if a superannuation interest has any Tax Free amounts?" There are three common ways that this can be determined:

a) The member's annual member statement: The member's annual statement will usually set out somewhere the amount of taxable and tax free components. It is not usually on the front page, so you may need to go looking carefully over the statement.

b) The response to the Form 6 request: The fund must advise the amount of the taxable and tax free components and these will be set out on the Form 6 response.

c) Ask the fund: Unless you have an authority from the member, the member will be the only person who can ask the fund. This request can usually be done either in writing, via the internet or over the phone. If requesting the information by phone, the fund will usually be able to send written confirmation.

3.23 I note that different tax rules apply where the superannuation is paid out by way of pension prior to age 60, such as transition to retirement pensions. However, those rules are more complicated so I do not propose to discuss them in this paper.

3.24 It is my suggestion that where the tax payable on a withdrawal from a superannuation fund is likely to have a significant impact on the outcome of a matter, that specific advice is obtained.

3.25 Where a superannuation interest is split, the preservation and taxation components will also be split in proportion. For example, assume the Husband held a superannuation interest with a balance of $200,000 and the parties proposed a $100,000 split to the Wife. The Husband's superannuation interest comprises $160,000 (80%) of preserved benefits and $40,000 (20%) of unrestricted non-preserved. The taxation components are $150,000 (75%) taxable and $50,000 (25%) tax free. As these characteristics would be split in proportion, the split of $100,000 to the Wife would comprise $80,000 (80%) preserved and $20,000 (20%) unrestricted non-preserved and $75,000 (75%) taxable and $25,000 (25%) tax free.

3.26 As the Wife has $20,000 of unrestricted non-preserved superannuation, she would be able to withdraw this $20,000 immediately, regardless of her age and work status. If she withdrew the $20,000, 25% or $5,000 would be tax free and 75% or $15,000 would be taxable. If she was under her preservation age, the maximum tax payable would be 20% plus Medicare, being $3,225 ($15,000 of taxable component at 21.5%).

3.27 Where the superannuation interest is held in an industry or public offer fund, there will generally be no specific individual assets attributable to the member's balance as their interest will be part of a managed pool of superannuation interests. However, when dealing with Self Managed Superannuation Funds, there will be specific assets held in these funds and this is when it is important to understand how to divorce assets from a superannuation fund. The following is in respect to self managed superannuation funds.

3.28 Eric and Ariel are separating after many years of marriage. Eric is 64 (turning 65 in three months) and Ariel is 53. They have a self managed superannuation fund with a value of approximately $3,000,000. Eric's member balance is $2,400,000 and Ariel's is $600,000. The assets of the fund currently comprise three properties worth $1,000,000 each. They have agreed that they will split Eric's super and transfer a base amount of $400,000 to Ariel such that she will have $1,000,000 of super. In order to retain the other assets he wishes to, Eric must also pay to Ariel a cash adjustment of $500,000 but he is not sure how he can fund this and he does not wish to borrow any money as he is about to retire.

3.29 Assume that Ariel is going to set up her own self managed superannuation fund and she will roll her balance out.

3.30 In order to enable Ariel to roll out $1,000,000, the choices available to Eric and Ariel are for one of the properties to be sold within the fund to the value of $1,000,000 and transfer the cash, or to transfer one of the properties to Ariel's new fund in specie. If Ariel said she only wanted a cash payment, the property would need to be sold within the fund so that there is enough cash in the fund to roll out to Ariel's new fund. However, as neither Eric nor Ariel have commenced a pension, there may be capital gains tax payable on the sale of the property.

3.31 Where assets are sold to fund a rollover, it is important to note that the tax will be paid by the existing fund. This means that as the remaining member of the fund, Eric will be left to pay this liability. Eric obviously wants to avoid this. So what are their options:

a) The obvious solution is to transfer the asset in specie. As the transfer is from one self managed superannuation fund to another self managed superannuation fund as a result of a marriage breakdown, the transfer will be eligible for CGT rollover relief.[10] That means that tax may be payable by Ariel's fund when she goes to sell the property.

b) Another option available would be for Eric to commence an eligible pension and the property segregated to fund that pension. The property will then be an asset held to fund a pension and as there is no tax on the income on assets held to fund a pension, when the property is sold there will be no tax payable on any capital gain.

3.32 Now what about the remaining $500,000 that Eric is to pay Ariel? How will Eric fund this? Eric would like to be able to transfer to Ariel an extra $500,000 in super. However, Ariel doesn't want to have that money locked up in superannuation such that she can't touch it as she is thinking about doing some renovations to the former matrimonial home.

3.33 If the parties are willing to wait until Eric retires or turns age 65, then the whole of his interest will become unrestricted non-preserved. This will provide them with more options.

a) Once age 65 or past his preservation age and permanently retired, Eric will be able to commence a pension and sell one of the properties. Because he has commenced a pension, the fund will not pay any tax on the capital gain from selling the property. Further, because he is over age 60, he will not pay tax on the money he withdraws to fund the payment to Ariel. He could then withdraw $500,000 and pay it to Ariel.

b) Instead of making the cash payment to Ariel, the super split to Ariel could be increased by $500,000. If done after Eric has retired or turned age 65, then the whole of his interest will become unrestricted non-preserved. This means that the amount split to Ariel will come to her as an unrestricted non-preserved amount. This will allow Ariel to be able to withdraw the funds if she needs to and if she doesn't, any earnings on those funds will be taxed more effectively within the superannuation fund. However, consideration should be given to the fact that if Ariel does withdraw the funds from her superannuation interest, she may pay tax on those funds as she is under age 60.

c) If Ariel has not made any contributions to superannuation in the last three years, then the preferred approach could be to start by completing option a). After Ariel had completed any renovations, she could contribute the remaining balance to superannuation. Any earnings on this balance would then be taxed at the lower superannuation tax rate. Further, as the funds were contributed from an after tax source, they would be considered tax free[11], potentially reducing any tax payable from future withdrawals.

3.38 Whilst dealing with an invalidity pension is not going to be common, where the parties need to find some more cash to fund a settlement, then consider if there is any unrestricted preserved component available to be withdrawn, or any other options with their superannuation interests.

4.0 Divorcing Assets Out Of A Trust

4.1 In Family Law proceedings, it is common for the parties to consider settlement options based on the underlying assets but pay little attention to the entities that may hold those assets. However, at some stage, consideration must be given to how an asset can be removed from an entity if one spouse is to retain the asset and the other spouse is to retain the entity that previously held that asset. This section looks at what to consider if that entity was a trust and section 5 looks at what to consider if that entity was a company.

4.2 When looking to transfer an asset out of a trust, the first thing to consider is what is allowed based on the terms of the trust deed. For example, is the proposed recipient of the asset a beneficiary of the trust? If not, does the asset first need to be transferred to the spouse who is a beneficiary and then transferred to the spouse who wishes to retain the asset? If the trust is a unit trust instead of a discretionary trust then the trust deed may impose different requirements to remove an asset from the unit trust.

4.3 When transferring an asset of a trust to a beneficiary, it would often be done by way of a capital distribution as opposed to a distribution of income. However, it should be noted that some trust deeds have a different definition of beneficiaries for capital distributions as they do for income distributions. Therefore, just because the recipient spouse has been eligible to receive income distributions in the past does not necessarily mean that they are eligible to receive a distribution of capital. Should an asset be distributed to a person not otherwise eligible to receive a capital distribution, then this could become a deemed settlement of the trust or have adverse tax and other consequences.

[10] ITAA97 section 126-140 provides for CGT rollover relief from a self managed superannuation fund to another complying superannuation fund. The rollover relief only applies if the transfer is to another superannuation fund and not directly to an individual spouse, company or trust.

[11] Where an employer contributes to a superannuation fund for an employee, the employer can claim a tax deduction for their contribution. Therefore, this contribution forms part of the taxable component of the member's balance and tax may be payable on that balance when withdrawn. Where a member makes a contribution from funds held by them on which any tax has already been paid (and no one is eligible to claim a tax deduction for the contribution), such as Ariel making the contribution from money held personally by her, this will form part of the tax free component and no tax will be payable on those funds when they are withdrawn. This ensures money on which tax has already been paid and contributed to super is not taxed again when it is withdrawn from super.

This is why it is always important to review the trust deed to ensure that the proposed recipient spouse is eligible to receive an in specie distribution. The following examples assume that any recipient of an asset is eligible to receive a distribution of capital where an asset of the trust is transferred to them.

4.4 In the simplest of examples, if the trust held cash assets, and the trust made a capital distribution to an eligible beneficiary, there would be no taxation consequences. However, if distributing cash then it may also be possible for this to be a distribution of income. Where money (and in some circumstances, distributions of assets) are made as a distribution of income, then the recipient will pay tax on that distribution whereas they will not pay tax on a distribution of capital of the trust. Therefore, if your client is to receive a payment or an asset from a trust, ensure that you give appropriate consideration as to whether they are receiving a distribution of income (on which they may pay tax) or a distribution of capital (on which no income tax will be paid assuming it is transferred pursuant to an order or agreement).

4.5 In section 1 of this paper, we looked at Bob and Helen who had a family trust that held a residential investment property. They were proposing that the investment property be transferred to Bob. ITAA97 section 125-15 applies to transfers of property from a trust or company to a spouse as a result of marriage breakdown. Where the transfer is pursuant to Court Orders or a binding financial agreement, section 125-15 provides automatic CGT rollover relief – the CGT rollover relief is not an election and must be applied if the asset is being transferred pursuant to an order or agreement.

4.6 The effect of this CGT rollover relief from the Trust's perspective is that any gain that would have otherwise been crystallised by transferring an asset to a related party will be ignored. From the recipient spouse's perspective, they will be deemed to have acquired the asset and used the asset in the same way as it was used by the trust. In the example of Bob and Helen, Bob will be deemed to have acquired the residential investment property on the date it was acquired by the trust and at the cost it was acquired by the trust. He will also inherit the history of use as an investment property and any capital gain will be proportioned based on the number of days as an investment property and any period he uses the property as his main residence.

4.7 It should be noted that where an asset is transferred from a trust or company, the CGT rollover relief only applies where the recipient of the transfer is either spouse. The CGT rollover does not apply where the asset is transferred from one trust to another trust, company to another company, company to trust or trust to company. Therefore, if Helen wished to retain the existing family trust but Bob wanted one of its assets and to hold that asset in a trust, CGT rollover would not apply if the asset was transferred directly from Helen's trust to Bob's trust.

4.8 However, careful tax planning could minimise the taxation implications as there are two options for when the CGT would be triggered. If the asset was transferred from the existing trust to a new trust, then the capital gain would be realised by the existing trust and the gain will be calculated based on the market value of the property as the asset was transferred to a related entity. If the asset was transferred to Bob first, CGT rollover would be applied to this initial transaction. When Bob then transfers the asset to his new trust, it will be a CGT event and he will pay tax. Once again, the gain will be calculated based on the market value of the asset as the asset was transferred to a related entity. Which is the better option will depend on any tax losses and marginal tax rates of Bob and other beneficiaries of the trust. Note: when choosing between the tax implications of different alternatives, do not forget to consider other implications such as stamp duty, the impact on government benefits and the impact on child support where such payments are based on taxable incomes.

4.9 But what about GST? If the trust is registered for GST, are there any GST implications on a transfer from a trust to an individual?

4.10 The Australian Tax Office has issued GSTR 2001/4[12] which provides a detailed analysis of the GST consequences of court orders and settlements in Family Law matters.

4.11 To provide a brief overview, in order for GST to be applicable, there must be a taxable supply which means there must be:

a) A supply for consideration;

b) The supply must be in course of or furtherance of an enterprise carried on by the trust;

c) The supply must be connected with Australia; and,

d) The trust is registered or required to be registered.

4.12 GSTR 2001/4 considered these issues in detail. However, it comes to the conclusion that the transfer of an asset for the purposes of a Family Law settlement is not in the course of or furtherance of an enterprise, and therefore the transfer of an asset from a trust to a spouse for the purposes of a Family Law settlement is not a taxable supply for the purposes of GST. Whilst in most cases, this will mean that there are no GST consequences, that is not always the case. Where there is a GST issue, it will be in respect to the trust and not the spouse, and therefore must be considered by the spouse retaining the trust if there has been an asset distributed to their spouse or themselves.

[12] Refer http://law.ato.gov.au/atolaw/view.htm?docid=GST/GSTR20014/NAT/ATO/00001

4.13 The overall concept of GST is that the cost of the GST will be borne by the end consumer. If the trust is registered for GST and has bought an asset for use in its enterprise then it will be entitled to claim a credit for the GST paid when purchasing that asset. However, if the Trust purchased an asset that was for the private purposes of a beneficiary, and not in the course of or furtherance of an enterprise, then it would not be entitled to claim a credit for the GST paid.

4.14 Where an asset was initially acquired in respect of the enterprise of the trust, but is then transferred to a beneficiary or used for private purposes of a beneficiary, then it is no longer being used in the "enterprise" of the trust. From a GST perspective, this is referred to as a "change in purpose" of the acquisition and an adjustment to the GST claimed by the trust must be considered. From a Family Law perspective, a distribution of an asset from a trust to a spouse could result in a change in purpose and a possible GST adjustment for the Trust.

4.15 In order for there to be a GST impact to the trust, the trust must have first claimed a credit in respect to the initial asset. Therefore, if there was no GST credit claimed there will be no need to make an adjustment. This may have occurred where the asset was bought for private purposes of the beneficiaries or there was no GST paid on the purchase, such as purchasing as existing residential property (i.e., not a new residential property). However, where a GST credit was claimed and the asset is now being transferred for private purposes, there may be a requirement to make an adjustment to the GST claimed and therefore this must be considered.

4.16 The method of calculating the adjustment can be complex, and therefore I do not propose to go through that in this paper. However, it is important to note that it is only necessary to make an adjustment for a certain period after the initial acquisition of the asset. If the transfer to the spouse is outside the relevant period, then there is no need to make an adjustment. The period during which it is necessary to make an adjustment depends on the initial cost of an asset. The table below summarises the relevant time periods[13]:

Value of the purchase (GST exclusive)	Period of adjustment
Below $1,000	No adjustment required
$1,001 to $5,000	June 30th following the 12 month anniversary of the purchase, plus 2 years.
$5,001 to $499,999	June 30th following the 12 month anniversary of the purchase, plus 5 years.
$500,000 or more	June 30th following the 12 month anniversary of the purchase, plus 10 years.

4.17 OK, so let's put this into an example. In Bob and Helen's example from section 1, assume the trust had purchased the residential property for $400,000 and the property was being transfer to Bob.

- If the property was purchased by the trust as an existing residential property, then the trust was not entitled to claim a GST credit on the purchase and no adjustment to the GST payable by the trust is required.
- If the property was purchased for less than $500,000 by the trust as a new residential property and the trust claimed a GST credit on the purchase, but the purchase occurred 8 years ago, then no adjustment to the GST payable by the trust is required as the change in purpose is outside the time limit for an acquisition of that cost.
- If the property was purchased as a new residential property and the trust claimed a GST credit on the purchase, and the purchase occurred 3 years ago, then the Trust will be required to make an adjustment to the GST payable and remit an additional amount of GST to the government. As noted above, the method of determining the GST adjustment is complex. In such situations and where you act for the spouse retaining the trust, it is suggested that you advise them to seek specific advice regarding the amount of any GST adjustment to ensure that they are aware of the issue, and then the quantum can be determined for their specific circumstances. However, it is worth noting the amount of the GST adjustment will generally reduce the longer the period that the asset was held by the trust before it is transferred, and the adjustment will never be more than the GST credit claimed on the initial purchase.

4.18 Other common assets to be transferred from a trust to a spouse will be a motor vehicle or a commercial investment property. In such situations, it will be necessary for the trust to make a GST adjustment assuming that the Trust was registered for GST, it claimed a GST credit on purchase and the transfer is within the time periods set out in the table above.

[13] Different limits and time periods apply where the asset being transferred was subject to business finance, refer https://www.ato.gov.au/Business/Bus/Making-adjustments-on-your-activity-statements/?page=5 for more details.

4.19 For the purpose of clarity, the above is potentially an issue for the spouse retaining the trust that has transferred an asset but there will be no GST issues for the spouse acquiring the asset. For the spouse acquiring the asset, they should be mindful of future CGT (capital gains tax, not GST) consequences that could arise on the sale of the asset by them.

5.0 Divorcing Assets Out Of A Company

5.1 Division 7A is often raised as an issue when transferring assets out of a company to a spouse, but what is all the fuss really about? What is Division 7A and what is the mischief that it is trying to prevent? Division 7A is not something that is just applicable to Family Law proceedings. It has a much wider application than that. However, it often raises itself as an issue in Family Law proceedings.

5.2 Before I discuss the implications of divorcing or transferring assets out of a company, I'll provide an overview of Division 7A because if the intent and purpose of Division 7A is understood, then it will be easier to identify when a possible transaction will breach the provisions of Division 7A. And before discussion about Division 7A, I'll use an example to give a brief overview of the taxation of companies and dividends payments from the company to its shareholders.

5.3 Will operates his business via his company called Black Pearls Pty Limited ("Black Pearls"). After paying Will a salary of $200,000, Black Pearls made a profit of $100,000. As a company, Black Pearls would pay tax of $30,000 with the company tax rate currently at 30%. This means that the company would have $70,000 of retained profits. Will would like to use those retained profits of the company rather than leave them sitting in the company.

5.4 One option for Will would be for Black Pearls to pay a dividend of $70,000 to him. If Black Pearls paid the dividend to Will, then Will would need to include the dividend as income in his tax return. However, Will not only includes the $70,000 as income, but also the imputation or franking credit of $30,000. The franking credit is the tax that was paid by the company. It has the effect of Will disclosing as part of his income the full $100,000 of profit that was earned by the company ($70,000 dividend plus $30,000 franking credit). Will does get a credit for the $30,000 of tax that has already been paid by Black Pearls. However, as Will has $200,000 of salary income, any additional income will be taxed at the highest marginal tax rate of 47% including Medicare (ignoring the temporary budget repair levy).

5.5 Therefore, he will have to pay additional tax of $17,000 on the dividend of $70,000. This is calculated as follows. He includes $100,000 of additional income in his tax return, being the $70,000 dividend plus the $30,000 franking credit. This $100,000 is taxed at 47% = $47,000. However, Will gets a credit for the franking credit of $30,000, being the tax paid by the company. Therefore, he will pay top up tax of $17,000 ($47,000 les $30,000).

5.6 Now Will wants the money out of the company but doesn't want to have to pay the additional tax of $17,000. So he thought up a few ideas as to how he might be able to get this money out of the company without paying himself a dividend and he went to see his accountant, Jack at Sparrow Partners, to see if his ideas would work. The following is the conversation that took place:

5.7 Will asked "Jack, what if Black Pearls just pays me $70,000 as opposed to paying it as a dividend". Jack said "That's was a nice idea, but ITAA36 section 109C, which is part of what is referred to as Division 7A, would deem that amount to be a dividend. Not only that, the dividend would not be franked. Therefore, instead of paying top up tax of $17,000, you would pay tax of $32,900" ($70,000 deemed dividend with no franking credits at the marginal rate of tax of 47%).

5.8 Will then asked "What if Black Pearls paid the dividend to my wife Elizabeth instead of me, would it be any different because she is not a shareholder in Black Pearls". Jack replied "Sorry, but Division 7A captures payments to shareholders and associates of shareholders and therefore it would still be a deemed dividend. The only difference is that because the amount was paid to Elizabeth, it would be income to Elizabeth and she would have to pay tax at her marginal rate of tax".

5.9 Will tried a different approach by asking "What if Black Pearls just loaned me the money and then we just left it there as a loan and deal with it later". Jack replied "Black Pearls can loan money to you, but it will be a deemed dividend by Division 7A unless you have this documented by a loan agreement, there needs to be interest charged at a rate prescribed by the ATO and the loan must be repaid within seven years, unless the loan was secured in which case it could be repaid over 25 years."

5.10 Thinking on his feet, Will thought he had the solution. "So what if we did this loan agreement thing, and then Black Pearls forgave the loan so I didn't need to pay it back". Jack is impressed with Will's dedication, but again replies "Sorry, Division 7A also deems any loans to shareholders and associates that are forgiven to be deemed dividends. And before you ask, you can't loan the money to Elizabeth and then write it off either".

5.11 Will keeps trying. "What if Black Pearls loaned the money to my family trust, and then the family trust loaned the money to me. The family trust is not a company. Can we get around Division 7A this way?" Jack reply is the same. "Sorry, but Division 7A also looks at transactions where another entity is interposed between the company and the shareholder and it will still be a deemed dividend."

5.12 Will is almost feeling beaten. "OK, so this is my last try. I want to get a new boat. So what if Black Pearls bought the boat and then gives me the boat. It's not money that Black Pearls is giving me, it's a boat so surely that can't be a deemed dividend". Jack was not convinced it would be Will's last try so he decided to stop him before he comes up with another idea. "Look Will, Division 7A is designed to stop shareholders accessing the retained profits of a company without paying a dividend and avoiding having to pay the extra top up tax just like you are doing now. Division 7A will deem a benefit to a shareholder or their associate to be a dividend, whether that be a benefit in money or by transferring property. The best that you can do is enter into the loan agreement. It doesn't avoid the issue, but it does defer the tax as you can declare a smaller dividend each year, use the dividend as the loan repayment and you pay a little bit of top up tax each year for the next seven years".

5.13 So to bring this back to a Family Law perspective, what you need to keep in the back of your mind is this question. "Is any part of the proposed settlement or orders going to result in an amount or an asset to be taken from a company?" If so, you need to take a close look to ensure that it will not be a deemed dividend.

5.14 There are some circumstances when Division 7A will not apply. For example, where the shareholder has previously loaned money to the company, and the company pays money to the shareholder as a repayment of that loan, it will not be a deemed dividend.

5.15 The implications of Division 7A are often seen as harsh, because when it applies to deem an amount to be a dividend, the dividend will generally not be franked. This means more tax will be paid by the shareholder than if a normal dividend was declared and paid which would include the franking credits.

5.16 It should also be highlighted that regardless of whether the recipient is a shareholder or an associate of a shareholder, it is the recipient of the benefit that is deemed to have received the dividend and is required to pay the tax. Therefore, if a property was transferred by a company to a spouse, that spouse could be deemed to have received a dividend equal to the value of that property. This is the case even if they are not a shareholder in the company. Further, the deemed dividend also used to be an unfranked dividend. Thankfully, ITAA36 section 109RC now allows a deemed dividend to be franked if it is taken to be paid because of a Family Law obligation. Further, 109RC effectively allows a dividend to be paid to a spouse who is not a shareholder in the company, which can provide a more tax effective outcome if that spouse has a lower marginal tax rate.

5.17 One way around Division 7A in Family Law proceedings used to be to join the company as a party to the Family Law proceedings and obtain an order that the company pay an amount of money to a spouse. The payment set out in the order became an obligation of the company to pay an amount of money and payments of a company to satisfy an obligation are exempt from Division 7A under section 109J. However, Taxation Ruling 2014/5 looks at the second arm of section 109J that says the obligation of the company to pay an amount must not be more than the obligation had the company been dealing at arm's length with the recipient of the payment. The ATO takes the view that the company and the parties to the Family Law proceedings would not be acting on an arm's length basis and therefore section 109J does not apply to exempt the payment from being a deemed dividend.

5.18 Now let's fast forward a few years and come back to Will and Elizabeth. Will's company Black Pearls Pty Limited has been doing very well. It has now accumulated $2,000,000 in retained profits. It owns two properties worth $600,000 each. The cars driven by Will and Elizabeth are also owned by Black Pearls. Whilst Will's company has been going well, unfortunately his marriage to Elizabeth has soured and they are separating. Will has loans totalling $400,000 that he owes to Black Pearls.[14] Will and Elizabeth have roughly agreed how they will divide the assets between them. They know that Elizabeth will keep the matrimonial home, the boat, receive one of the properties owned by Black Pearls, the car she drives (that is owned by Black Pearls) and she also wants $200,000 in cash. Will is happy for things to be divided equally between them, but goes to see his accountant Jack for some advice about the implications of giving Elizabeth a property and car owned by Black Pearls and how to fund the payment of $200,000 to her.

5.19 I have summarised Jack's advice to Will below and separated it into the different assets or issues.

5.20 Matrimonial Home

5.21 The matrimonial home was purchased jointly while Will and Elizabeth were married and has only been used as the matrimonial home. Therefore, this is exempt from CGT. If it had been previously used as an investment property, then there would be CGT rollover relief and any CGT issues on its future sale would be borne by Elizabeth when she ultimately sells the property.

5.22 The boat

5.23 Will and Elizabeth used to enjoy sailing together. Now, they still enjoy sailing, just not together. They have agreed that Elizabeth will keep the boat. As a boat is considered to be a personal use asset, it is not subject to CGT. Therefore, regardless of whether the boat was owned jointly or just by Will, the transfer of the boat to Elizabeth's sole name would not have any CGT or other taxation implications. Consideration should be given to any possible GST issues (see motor vehicle example below) or stamp duty issues if rollover relief is not available for the state in which the boat is registered.

[14] The loans are subject to complying loan agreements and therefore the loans were not deemed to be dividends by Division 7A.

5.24 Car owned by Black Pearls Pty Limited

5.25 The car that is driven by Elizabeth is owned by Black Pearls Pty Limited. It was purchased by the company two years ago for $66,000. The company claimed a GST credit of $6,000. Transferring this asset from an enterprise asset to be a personal use asset means that there must be a GST adjustment (see GST issues in section 4 for more details). Effectively, Black Pearls must give back a portion of the GST it claimed. Jack said he would do the calculations for the GST adjustment, but told Will it would be less than $6,000.

5.26 CGT rollover relief under 126-A is only applicable to CGT assets. As any capital gain or loss on dealing with a car is disregarded under section 118-5, a car is not a CGT asset. Therefore, CGT rollover relief is not applicable to motor vehicles. A car is a depreciable asset and if being transferred to a related party will be deemed to have been disposed of at market value by a company. If the deemed market value is more or less than the book value of the depreciable asset when transferred, then the company will have to make what is referred to as a "balancing adjustment" to recognise the profit or loss between the market value and the book value.

5.27 Where a CGT asset is transferred from a company to a spouse pursuant to Family Court orders, any balancing adjustment will be ignored (ITAA 40-340). However, where the asset being transferred is not a CGT asset, such as a car, the balancing adjustment will not be ignored. If the market value of the car being transferred to Elizabeth was $40,000 and the written down book value was $30,000, then the company effectively records a profit on sale of the car at $10,000 which would be taxed at the company tax of 30%. This would result in an additional $3,000 of tax being paid by Black Pearls. If the book value was more than the market value, then there would be a tax benefit to Black Pearls.

5.28 Further, the transfer of this benefit to Elizabeth will be a deemed dividend to her, equal to the market value of the car, being $40,000. ITAA36 section 109RC will allow this dividend to be franked. If Elizabeth has high income, then she could be faced with paying top up tax, even if the dividend is franked. If Elizabeth has low income, then any tax payable may be minimal, or she could even end up with a tax refund. However, if you were acting for Elizabeth, you should also consider the impact of this taxable income on any income tested benefits such as Family Tax Benefit.

5.29 Consideration should also be given to any possible stamp duty issues if rollover relief is not available for the state in which the car is registered.

5.30 Property owned by Black Pearls Pty Limited

5.31 The property owned by Black Pearls that will be transferred to Elizabeth is a small factory that was purchased for $300,000 seven years ago. As the property is outside the time period for a GST adjustment, there is no need to consider any GST issues. If the property had been purchased within the last five years, then this would need to be considered. Note that the time period for GST adjustments depend on the initial cost of the asset. Refer paragraph 4.16 for details of the time periods for the different purchase costs.

5.32 Ordinarily, the property being transferred from a company to a related party would be a disposal for CGT purposes and deemed to be at market value. However, the CGT rollover relief of ITAA97 section 126-15 applies such that any capital gain will be disregarded by the company. Elizabeth will be deemed to have acquired the asset for $300,000 on the date it was acquired by the company. She will pay CGT when she sells the property.

5.33 The transfer of the property is a transfer of an asset to an associate of a shareholder and therefore could be a deemed dividend because of Division 7A. The amount of the deemed dividend would be equal to the market value of the property, and not the cost of the property. The market value of the property is $500,000. Therefore, if nothing is done, then Elizabeth would be faced with a deemed dividend of $500,000. Even if she had no other income and the dividend was franked, she would be required to pay tax of $94,976. If she had other income of over $180,000, then she would pay tax of $121,429 on the transfer of the property to her.

5.34 So the question then becomes, what can be done to avoid the triggering of this deemed dividend?

5.35 The transfer of an asset to a related party is not a deemed dividend if consideration equal to the value of the asset is paid to the company. The amount of the deemed dividend can be reduced by the amount of consideration that is paid for the asset being transferred out of the company. While transferring cash or other assets back into the company to the value of $500,000 would eliminate the deemed dividend, just like in most Family Law proceedings, Will doesn't have any other assets that he can transfer into the company as consideration.

5.36 Another form of consideration could be for Will to enter into a Division 7A complying loan agreement with Black Pearls for $500,000 and effectively borrow $500,000 from the company and then use the funds of the loan to pay Black Pearls consideration for the property transferred to Elizabeth.

5.37 This would mean that there would be no Division 7A issues for Elizabeth, which is what she wants, but it would leave Will with Division 7A loan agreements totalling $900,000 (his existing $400,000 plus a new loan of $500,000). The implications of this to Will are discussed further below.

5.38 Payment of $200,000 to Elizabeth and retained profits of Black Pearls

5.39 Given that most of the value of the assets Will is going to retain is tied up in Black Pearls, plus he wants to find some money to be able to fund the purchase of a property to live in, Will thinks that his only option to be able to fund a payment of $200,000 to Elizabeth is to take the money from Black Pearls. From his previous discussions with his accountant Jack, Will knows that he can only take the $200,000 from Black Pearls via a Division 7A complying loan agreement. He also knows from his discussions with Jack that this does not eliminate the issue of the top up tax, but just defers it for future years when the loan must be paid back.

5.40 So Will goes to see Jack and explains that he thinks he needs to create a Division 7A loan agreements totalling $1,800,000 as follows:

Amount	Reason for loan
$400,000	This is the balance of Will's current Division 7A loan that was in existence prior to separation
$40,000	This is the loan that could be entered into to avoid a deemed dividend being attributed to Elizabeth on the transfer of the motor vehicle owned by Black Pearls to Elizabeth.
$500,000	This is the loan that could be entered into to avoid a deemed dividend being attributed to Elizabeth on the transfer of the property owned by Black Pearls to Elizabeth.
$200,000	This is the loan that could be entered into to avoid a deemed dividend if Will was to take $200,000 from Black Pearls to pay to Elizabeth.
$660,000	Will has seen a property that he would like to buy and the total cost is estimated to be $660,000, which he could take from Black Pearls if he entered into a Division 7A loan agreement for that amount
$1,800,000	This is the total of all proposed loans.

5.41 Jack's advice to Will is that the above is possible, and it will avoid any immediate taxation issues. However, Jack reminds Will that he will need to repay these Division 7A loans in seven years. In order to meet those repayments, Black Pearls will need to declare dividend payments of over $250,000 per annum on which top up tax of approximately $60,000 per year will be payable.

5.42 Will's mind starts to tick and then he realises something. Based on her proposal, Elizabeth is going to get one half of the assets, but little in the way of ongoing tax issues. However, due to the above loan agreements Will is going to be left with having to pay an extra $60,000 per year in tax for the next seven years. So he asks Jack if there is anything he can do.

5.43 So Jack proposes that Black Pearls declares a dividend of $1,800,000 now. Jack tells Will that "This will mean that you will have to pay top up tax of $437,143 when you complete your tax return for this year. However, if you do this, it will crystallise this tax debt now which is significant and something that you might have otherwise deferred. But given the likely outcome of the Family Law proceedings, it is something that must be paid over the next 7 years. If the dividend is declared now, then it is a liability that must be paid now and by paying that liability now it reduces the value of the pool of assets and the amount that Elizabeth would otherwise receive. You still get the same assets, but perhaps you no longer need to pay $200,000 to Elizabeth because there is now a $400,000 liability that needs to be taken into account."

5.44 Now, the extent to which you like and agree with Jack's proposal to declare a large dividend now probably depends on whether you act on behalf of Will or Elizabeth. I'll leave what outcome is just and equitable for Will or Elizabeth to the barristers and the Court to determine. But hopefully that above example highlights the tax issues when dealing with a company in Family Law proceedings. Not just from the perspective of avoiding Division 7A and other tax issues, but for the potential for the party retaining the company to be left with lingering tax issues from Division 7A loan agreements that could otherwise be eliminated if a Dividend was declared prior to finalising the Family Law proceedings.

5.45 Let's assume that the final agreement reached between Will and Elizabeth includes that Will is to pay Elizabeth $200,000 and the consent orders state that Will is to pay Elizabeth $200,000. But we know that Will does not have any significant cash amounts outside of that held by Black Pearls. What if rather than Will paying Elizabeth, the payment was made directly from Black Pearls bank account to Elizabeth. Prima facie that would be a payment from a company to an associate of a shareholder and therefore could be a deemed dividend to Elizabeth on which tax would be payable by Elizabeth.

5.46 You might think to yourself *"That's ok if that happened, because I put in an order that the Husband indemnify the Wife of any taxation implications"*. But an indemnity still means that the Wife would need to recover any funds from the Husband, which may or may not be easy. Therefore, isn't prevention better than the cure? So how can we avoid or reduce the risk that Elizabeth will need to pay tax on the amount that Will was meant to pay personally?

5.47 Rather than just having the standard type orders that say something to the effect of *"The Husband pay or cause to be paid to the Wife by way of final property settlement the sum of $200,000 within 28 days"* an order like the following could be used:

The Husband[15] pay to the Wife by way of final property settlement the sum of $200,000 within 28 days. The payments are to be made in a manner that will not cause any tax liability to the Wife. In the event that the Husband causes the payment to the Wife to be made directly from an entity under his control, the Husband will take all action necessary to ensure that the records of that entity record the transaction as a payment for the benefit of the Husband for the purpose of fulfilling his personal obligations to the Wife.

5.48 In some matters, the parties may be amicable and anticipate that a future payment could come from an entity under the control of one of the parties. However, the party receiving the funds wants to ensure that they do not have an unforeseen tax liability and end up receiving less then anticipated. Then the following could be added to the above order or schedule of future payments:

In the event that the Husband wishes to make a payment via a company or trust that could result in a tax liability to the Wife then he must obtain her written consent prior to doing so and ensure that the net amount to be received is at least equal to $200,000 [OR] the relevant payment listed in the schedule below:

5.49 Consideration of non-family law tax restructuring

5.50 When dealing with Family Law matters and achieving a tax effective outcome, much consideration is often given to the various types of relief that are specific to Family Law matters. However, that does not mean that you can't use the normal restructuring relief that is available in any other circumstance as this can sometimes provide a more tax effective solution.

5.51 The following example is a real life example of clients of Cutcher & Neale who are going through a very amicable separation. Peter and Wendy are separating after many years of marriage. They have a company, The Lost Boys Pty Limited ("The Lost Boys") which has $20,000,000 of retained profits. The assets of The Lost Boys include some properties and a large amount of cash. The shareholders of The Lost Boys are set out in the table below:

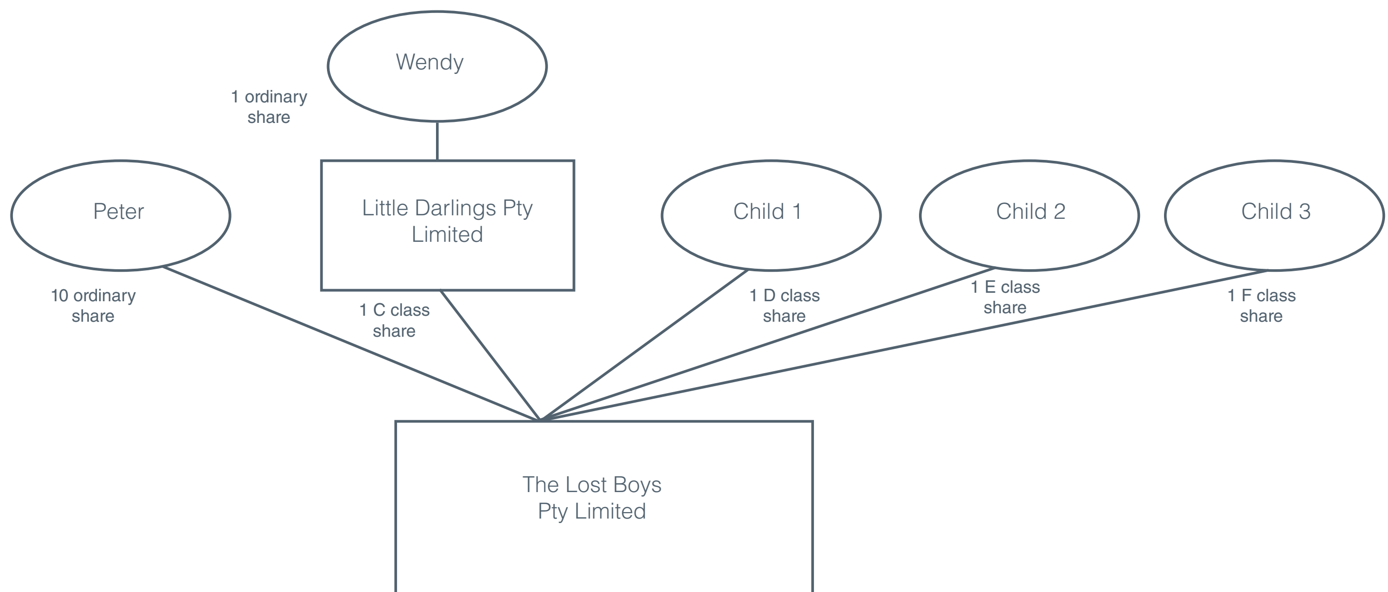
Shareholder	Number held	Class of share
Peter	10	Ordinary
Wendy	1	C Class
John	1	D Class
Michael	1	E Class
George	1	F Class

5.52 Peter and Wendy have broadly agreed that they would like to split The Lost Boys so that they each have $10,000,000. One way to achieve this would be to pay a $10,000,000 dividend to Wendy. However, this would result in Wendy paying top up tax on the dividend of $2,428,571 (assuming a tax rate of 47% and all dividends franked). Therefore, Wendy would end up with $7,574,429 after tax and Peter would keep the company with $10,000,000 of assets. Wendy obviously doesn't think this is fair.

5.53 Whilst CGT rollover relief would be applicable to any assets transferred from The Lost Boys to Wendy, this would still trigger the deemed dividend provisions of Division 7A, and therefore would have the same top up tax issues.

5.54 However, one possible solution to the above could be to create a new entity, Little Darlings Pty Limited ("Little Darlings") in which Wendy is the sole shareholder and interpose that entity between Wendy and The Lost Boys. The effect is that Little Darlings would hold the C class share previously held by Wendy and Wendy would be the sole shareholder of Little Darlings, as set out in the chart below.

[15] Where an order says something to the effect that "the Husband is to pay or cause to be paid", the phrase "cause to be paid" could be seen as allowing the Husband to cause the payment to be made from the company (with resulting taxation implications) as opposed to being made by him or at least on his behalf.



5.55 With the above structure, The Lost Boys can pay a $10,000,000 dividend to Little Darlings. Because the dividend from The Lost Boys is fully franked, there will be no top up tax payable by Little Darlings. This is because as a company, the tax payable by Little Darlings on the dividend received from The Lost Boys is equal to the franking credit on the dividend. The end result is that Peter will retain The Lost Boys with $10,000,000 of assets and retained earnings and Wendy will retain Little Darlings with $10,000,000 of assets and retained earnings. The above effectively defers, but does not eliminate, the top up tax that would have been payable if a $10,000,000 dividend was paid to Wendy without the restructure. Wendy and Peter can them pay themselves dividends from the respective companies when they wish to access the assets in their respective companies and each will pay any top up tax independently of the other when a dividend is paid by each of their companies.

5.56 Division 122 of ITAA97 considers CGT rollover relief for the disposal of assets to, or the creation of assets in, a wholly owned group. This division is designed for normal corporate restructures and not specifically for Family Law matters. However, it can also be used for Family Law matters and Division 122-A was used to achieve the above.

5.57 When considering any restructuring such as the above, always keep in mind Part IVA of ITAA36 which deals with schemes to reduce income tax. If the Tax Commissioner deems the dominant purpose of the restructure or scheme is to reduce tax, then the transactions will be deemed tax avoidance or evasion and significant tax penalties could be imposed. The more complex and involved the set of transactions, the greater the possibility that the dominant purpose could be seen as reducing tax. There could always be an argument that the dominant purpose of the restructure or transactions is to achieve a settlement for Family Law purposes without costly litigation. However, it is recommended that where any tax savings or deferral is significant, that the parties should obtain a private ruling from the Australian Tax Office.

5.58 A private ruling is effectively a request to the tax office for them to provide their opinion about a proposed set of events or transactions. This can be requested prior to the events and transactions being put into effect. The important aspect to note about a private ruling is that the decision set out in the response from the ATO is binding on the ATO. Therefore, if the ATO accepts the proposed events and transactions their effect, then there is no need to consider any contingent taxation issues from that proposed method by which you plan to achieve a tax effective settlement – assuming that are no changes to what was planned in the private ruling approved by the ATO.

6.0 Tax Issues Arising From New Pooled Depreciation Rates

6.1 Over recent years, the Australian Tax Office has been changing the rules regarding depreciation for small businesses. A business with less than $2,000,000 of annual sales will generally be considered a small business. It used to be that the ATO didn't want business depreciating assets at high rates because that would increase their expenses, decrease their profit and therefore pay less tax. The political message more recently has been that small business is the engine of our economy and we need to help small business grow by methods such as offering incentives for small business to invest in assets that will make them more productive.

6.2 One of these incentives relates to the pooling of depreciating assets. Prior to any of the asset pooling options which were first introduced in 2001[16], assets were depreciated individually based on a depreciation rate for that class of asset. Small businesses were then given the option to pool assets into a general pool and a long life pool, with the long life pool having a lower depreciation rate. The changes introduced from 1 July 2012 combine both pools and most depreciating assets that cost more than $1,000 or more (regardless of their effective life) can be pooled under the simplified depreciation rules. The depreciation that can be claimed is 30% of the balance of the pooled assets held at the start of the year and 15% for the first year in which any new assets are purchased (and thereafter they form part of the opening balance of pooled assets and depreciated at 30% in the year after purchase).

6.3 Further, when an asset is sold, the proceeds from the sale are deducted from the carrying value of the pool of assets. The result is that assets will often by depreciated at a faster rate than their actual value declines and the carrying value of the pool can be much less than the current market value of the assets in the pool.

6.4 The values in this example are from an actual of a valuation that I completed recently, although I have changed the names to continue with the example of Will, Elizabeth and Black Pearls Pty Limited.

6.5 The equipment had by Black Pearls was valued at $1,600,000 by a single expert. However, the book value of the equipment was only $600,000. This was in part because the assets were pooled and the depreciation rate applied reduced the book value more than the actual value of the equipment declined.

6.6 If that plant & equipment was sold for $1,600,000, then Black Pearls would have a tax liability of $300,000. Therefore, the issue that arises is, should this tax liability be allowed as a liability and therefore reduce the value of Black Pearls by $300,000?

6.7 If you were acting for Elizabeth, you would no doubt argue that there is no intention to sell the equipment in the immediate future and therefore the notional tax liability should not be included as an actual liability.

6.8 However, hearing this argument, Will decided to go back to see his accountant Jack, who raised a number of arguments as to why the $300,000 should be included as a liability when considering the value of Black Pearls Pty Limited.

6.9 Jack thought it was first important to consider how a potential purchaser would view Black Pearls.

6.10 A purchaser could establish a New Company and cause the New Company to purchase the business and the plant & equipment from Black Pearls. New Company would then hold the plant and equipment at a cost of $1,600,000. New Company would be able to claim a tax deduction for depreciation based on this value. If New Company did not want to continue trading or sells the plant & equipment for some reason, then there would be minimal taxation issues associated with selling the plant & equipment by New Company.

6.11 Alternatively, a purchaser could acquire the shares in Black Pearls, in which the plant & equipment is recorded at a book value of $600,000. This would mean that the purchaser could only claim a tax deduction for depreciation based on this amount. Given the lower tax deduction, its annual tax payable on its profits would be higher. Further, if the purchaser did not want to continue trading or sells the plant & equipment for some reason, then the sale of the plant & equipment would cause the unrealised tax liability to be payable.

6.12 Therefore, on a market value basis, a purchaser would not be willing to buy the shares in Black Pearls without an allowance for the unrealised tax liability associated with the plant & equipment.

6.13 As Will was not intending to sell Black Pearls, Jack also considers what it would mean to Will assuming he continues to operate Black Pearls.

6.14 Assuming Black Pearls continues to operate the business, Black Pearls will be able to claim a depreciation expense of $180,000 in the following year based on 30% of the book value of $600,000. If the book value of the plant & equipment for tax purposes was $1,600,000, being the actual market value assessed by the single expert, then the depreciation expense would be $480,000. If the company was able to claim a depreciation expense of $480,000 instead of $180,000, then its tax liability would be $90,000 less. There would be similar but reducing differences in future years.

6.15 It can therefore be seen that having a book value of plant & equipment for tax purposes of $600,000 in comparison to an adopted value of $1,600,000 will result in higher future annual tax payments regardless of whether or not any items of plant & equipment are sold.

6.16 Jack's arguments support there being some allowance for the $300,000 future tax liability as it will be incurred by Will if he sold all the equipment or continues to operate the business. However, it may need to be acknowledged that the cost of this to Will, will be incurred over a number of future years even where there are no sales of plant & equipment.

[16] The rules relating to the pooling of assets for depreciation were optional and with the changes over the years have generally become more favourable.

6.17 I noted earlier that this example was based on an actual case. These issues were not argued before the Court. I anticipate that these issues will become more common. Therefore, should you have a matter where these issues are argued before a court I would greatly appreciate you contacting me to discuss the matter.

7.0 Did You Mean To Divorce Your Client's Family Tax Benefits Or Increase Their Child Support Obligations?

7.1 For many Family Law settlements, the immediate focus is on the settlement and the immediate issues that this might create. However, I fear that sometimes little thought is given to the ongoing implications of the settlement.

7.2 Whilst not directly related to this issue of a Family Law settlement, to highlight the importance of giving consideration to future implications I will tell you about a call I received from a financial planner a few years back. The financial planner had done some restructuring for his client as the client was approaching retirement. This involved the client withdrawing over $100,000 from his superannuation. The advice provided by the financial planner was sound and logical, apart from one issue. The withdrawal of $100,000 was included as part of his client's taxable income. The client had ongoing child support obligations which were based on his taxable income. Therefore, the advice of the financial planner resulted in his client having to pay significantly more in child support for that year than he planned.

7.3 I use this as an example to highlight the impact that taxable income can have on other obligations and benefits. Government benefits such as Family Tax Benefit, Child Care Benefits, Child Care Rebates, Parenting Payments, Newstart allowances and Health Care cards can all be impacted by a person's taxable income.

7.4 I sometimes wonder if the parties focus on the immediate taxation implications of the settlement, without consideration of what other future impacts it may have. For example, if Will and Elizabeth had children, the payment of a dividend to eliminate the Division 7A loan agreements to affect the Family Law settlement could also increase Will's future child support obligations. From Elizabeth's perspective, if she sold the property transferred to her from Black Pearls and crystallised the CGT liability, that would increase her taxable income and could impact the amount of the various government benefits that she would have otherwise been entitled to that year.

7.5 These types of government benefits are complex and forever changing. However, you should still be mindful of them and advise your clients to consider how any future actions will impact their obligations or benefits.

8.0 Summary

8.1 If you've taken the time to read the whole of this paper, you will appreciate that as a Family Lawyer, you probably need to know more about tax than you thought you would at the start of your Family Law career. It's important to at least have a basic knowledge of tax so that you can identify opportunities to create a tax effective settlement and see the red flags to make sure that your client does not receive any hidden surprises in their settlement. It's also important to obtain specific assistance and advice in appropriate matters, such as those that are more complex, where there are many entities involved, or a large number of assets being transferred, particularly where the taxation implications have the potential to be significant.

8.2 I'd also like to repeat something that I said at the start of this paper. If there is something that is not covered that you think should be, please email me at **nick.gaudion@cutcher.com.au** and let me know so it can be considered for any future revisions of this paper.

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