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NEWSLETTER NICHOLLES www.nicholeslaw.com.au



Message from our principal

This Newsletter is aimed to address financial matters and Family Law which will be relevant largely to financial advisors, accountants and corporate lawyers who are advising clients of high net wealth. We are touching on the following:

- Financial Agreements as an estate planning tool.
- New Changes to De Facto couples and financial matters.
- Superannuation splitting including issues pertaining to self managed funds.
- Child maintenance trusts.
- Capital gains tax issues.
- Stamp duty issues.
- Maintenance payments exemption for income taxation purposes.

If you have any queries in relation to these articles please do not hesitate to contact Sally Nicholes at sally@nicholeslaw.com.au

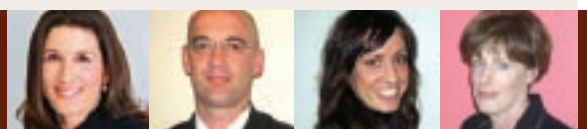
What's New

De Facto Couples and Financial Matters (Property Settlements) Federal Family Law Courts

On 25 June 2008 the Rudd government introduced legislation which will allow de facto couples to access the Federal Family Law Courts to resolve property settlements and spousal maintenance entitlements in relation to the breakdown of their relationships. The legislation is introduced through the Family Law Amendment (De Facto Financial Matters and Other Measures) Bill 2008 ("FLAB"), which will amend the Family Law Act 1975, and allow opposite-sex and same-sex de facto couples access to the same Courts to deal with their property and maintenance matters as married and separating couples. FLAB will give effect to an agreement between the Commonwealth, States and Territories which was made in 2002.

The legislation, which has not yet become law, will apply to de facto relationships that break down after the amendments commence, that is, the day on which the Family Law Amendment (De Facto Financial Matters and Other Measures) Act 2008 receives the Royal Assent.

Nadine Udorovic



Quarantining Family Wealth and Financial Agreements

Binding Financial Agreements (BFAs) have been developed in Family Law legislation as a tool for protective financial planning. Financial advisors to wealthy families where marriage or divorce is contemplated should be aware of the potential advantages of BFAs.

A BFA is enforceable in Australia in so far as contracting out of the Family Law Act 1975 ('the Act') is concerned. This allows assets to be prospectively quarantined from the marital asset pool, and therefore a BFA has the potential to be an excellent tool for asset protection if a marriage fails. However, recent Full Court decisions requiring strict statutory compliance confirm the need to be fully aware of legislative provisions when drafting or advising on BFAs.

What is a Binding Financial Agreement?

Despite being colloquially known as a 'pre-nuptial', a BFA is an agreement that can be entered into by parties before marriage, during marriage or after marriage. The BFA may deal with how the property of the parties is to be dealt with, as well as providing for the maintenance of partners and children and other ancillary matters.

Why suggest a Binding Financial Agreement?

A BFA will enable the preservation of assets for any of the following purposes:

- Consistency with inheritance expectations;
- Ensuring that children of a previous marriage (whether adults or minors) are provided for appropriately;
- Preservation of particular property interests such as business interests;
- Ability to allocate weight to a higher income earner or party bringing significantly more property to the relationship;
- Minimising or avoiding financial disputes upon dissolution of the marriage by enabling more certainty by allocation of assets and liabilities.

Formalities to be observed

For a BFA to be enforceable it is necessary that:

- The agreement is signed by both parties;
- The agreement includes a statement by each party that they have been provided with independent

legal advice regarding the effect of the agreement on their rights, and the advantages and disadvantages of making the agreement; and

- A certification is given by a legal practitioner for each party that such independent legal advice was provided.

The recent Full Court case of *Black and Black* [2008] FLC 93-357 confirmed there must be strict compliance with the above requirements, as these oust the court's jurisdiction to make property adjustment orders. Accordingly, the relevant statements and legal practitioners' certificates must each specify that independent legal advice was provided in relation to the matters set out in s 90G(1)(b)(i)-(ii). Agreements that fail to strictly meet these requirements can be set aside under *Black*. Moreover as such failure involves breach of statutory requirements relating to form, it is unlikely that it could be remedied through severance or the equitable remedy of rectification.

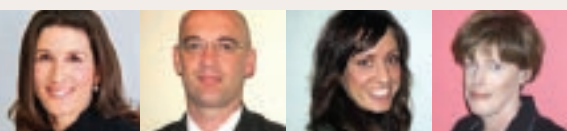
A BFA can be terminated or set aside on certain circumstances including:

- The agreement was obtained by fraud, including non-disclosure of a material matter;
- The agreement is void, voidable or unenforceable according to principles of law and equity applicable to contracts;
- In the circumstances that have arisen since the agreement was made, it is impracticable for the agreement or part of it to be carried out;
- After the agreement, a material change concerning a child of the marriage has occurred and as a result of the change, the child or a party to the agreement will suffer hardship if the court does not set the agreement aside;
- A party has engaged in conduct that was unconscionable in relation to the circumstances surrounding entry into the agreement.

Therefore it is essential that the parties seek legal advice before entering into such an agreement.

Binding Financial Agreements and child maintenance

A BFA may also make provision for the child maintenance. Such provision must specify the child or children for whom the maintenance is made, making it difficult to include child maintenance in BFAs that are entered before the parties have had any children. In these cases the BFA can only note the parties' intention



to have children in the future, and make maintenance provisions for 'any future children of the marriage'. A prudent approach may be to include in the BFA a child maintenance agreement as a separate attachment, and provide within the BFA that the parties are to sign the attachment upon the birth of any future children.

However given the strict interpretive approach confirmed by Black, it is imperative that you advise clients in such cases that if the parties' circumstances or intentions change before the children are born or the attached agreement is signed, you cannot guarantee that the child maintenance agreement will be enforceable. These strict compliance requirements also mean that an attached child maintenance agreement should include separate statements and certification of the provision of independent legal advice.

Binding Financial Agreement is not binding on heirs and executors

Despite the Act saying that it binds heirs and executors, BFAs do not operate in Victoria to protect assets in a deceased estate from a claim under the Administration and Probate Act 1958 (Vic.) for further provision out of the estate. Such claims, commonly known as Testators Family Maintenance (TFM) claims will take into account the entire pool of assets of a deceased at the date of death, and a BFA will be simply another factor to be considered by a Court in deciding whether a claimant should receive more from an estate than they would otherwise.

Accordingly, BFAs ought to be seen as a valuable addition to other more traditional financial and succession planning tools such as trusts, family companies, wills and testamentary trusts.

It is vital to take a holistic approach in protecting assets, and making your clients aware of this can enhance your role as a financial adviser.

Three steps to properly preserve your client's interests

To ensure that the assets of your client are protected and enhance the potential of these assets being distributed as desired, there are three important steps that should be considered:

1. **Suggest your client considers entering into or alters an existing BFA that quarantines the assets your client seeks to preserve**

Financial advice including future tax ramifications of the terms of agreement must be considered.

2. Confirm that your client has arranged a will that mirrors the terms of the BFA

Although you cannot prevent a TFM claim against a deceased estate, a BFA will assist in deterring such claims, especially if used in conjunction with other financial and succession planning tools so that the likelihood of success of a claim is reduced.

3. Ensure that the client's financial structure is properly arranged to give effects to intentions and withstand challenges to ownership.

It is a prudent exercise to address what assets will be remaining in the estate upon the death of your client which are susceptible to a claim or other challenge to ownership under a TFM application. Financial restructuring may be a desirable option to minimise the assets in an estate, and thereby reduce the likelihood of a TFM claim.

In Family Court proceedings, financial restructuring during the marriage and/or after separation often attracts the claim that the restructuring was intended to minimise or defeat another party's potential Family Court entitlement. Even if the Court finds that only one of the reasons for that restructure was to defeat a potential Family Court claim, the Family Court may reverse the transaction.

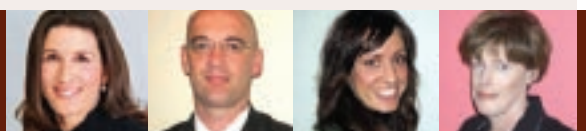
However, in circumstances where a BFA has been entered into prior to a restructure, the restructure may avoid challenge.

All of the areas discussed above are complex, and action should not be taken without first consulting your legal adviser. For further information about our Family Law services please contact our office.

Sally Nicholes

Superannuation Splitting

This is an issue regularly dealt with by family lawyers, since the amendments to the Family Law Act in 2002. The effect of those changes was to treat superannuation as property rather than as a financial resource of the



owner of the fund. The dramatic shift has been in the power to split the parties' superannuation, and either rollover a splittable payment into the non-member spouse's fund or ADF, or leave the splittable payment in the existing fund but in an account for the non-member. There are a number of machinery provisions for Orders or Superannuation agreements to be given effect. They are now routine for practitioners seeking Orders or drafting Superannuation Agreements, which are often included in BFAs.

Particular Challenges

Valuations of funds, and the contributions which have been made to them are problematic questions for family lawyers. Accumulation funds are the most common, and do not present problems with valuations. For other funds, such as the defined benefit funds exemplified by government and military schemes, valuation can be problematic, and expert valuations are required. There are a number of funds which have special methods and factors for valuations, but depending on the age of the member, the valuations based on life expectancy for receipt of part or whole pensions creates unreal values. There is no agreement about how these funds should be split, and the lawyers view must necessarily vary according to whether acting for the member or non-member.

Pensions in Payment Phase defy a formula approach. If the pension is based on a capital sum, that can be identified and valued. However, such a pension may never be commuted into a lump sum. If a pension is not based on an identifiable lump sum, and is in the payment phase, it really cannot be valued. In effect, in these cases the Court is left with the option of recognizing the pensions as a financial resource under s.75(2), but cannot make property orders under s.79. One might consider attempting to "split" a weekly pension payment other than by a splitting order. It is theoretically possible for a spouse to accept a weekly split by agreement, and this may be in partial satisfaction of a lump sum. The danger is that upon the death or remarriage of the member, such payments may cease. There is also the issue of enforceability. However, in a situation where this is the only asset, there may be nothing to lose.

Splitting Self Managed Funds can be difficult, depending on the nature of the assets held by the

fund, and the parties may have to remain trustees of the fund for some time. There may be transfers of assets required, and if this cannot be achieved evenly the parties will require advice about holding or folding. There is also the problem that the transfers may not attract rollover relief from CGT. (See Nadine Udorovic's article below)

In assessing contributions to superannuation, the West and Green formula is arguably not dead. West and Green was decided in 1993 Before the new laws, and as the Husband was within a few years of retirement, the property application was adjourned until after his retirement and receipt of his superannuation. The fund was divided by the years in the fund divided by the years of marriage. This is rather a crude approach, and the better position is to assess the value of the fund at the start of the relationship if this can be done. However, West and Green was given oxygen in Coghlan's case in 2005, and it really has the effect of giving greater value to pre-marriage contributions than the reality, as most growth in funds is in the later phases.

Marguerite Picard

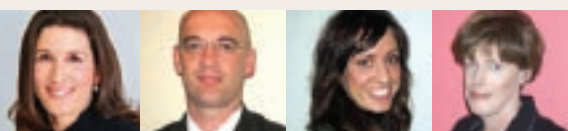
Splitting - Self Managed Superannuation Funds

A self managed superannuation fund, which in family law matters, generally sees both husband and wife as beneficiaries and trustees of the superannuation fund. The following documents need to be gathered in preparing to split the parties' superannuation:

- The Trust Deed;
- The Register of Complying Superannuation Funds search;
- The last three (3) years Financial Statements; and
- Member Statements (recent).

Self Managed Superannuation Funds are exempt from the valuation methods in the Family Law (Superannuation) Regulations 2001. A suggested approach to be used in valuing a Self Managed Superannuation Fund:

- Valuation should be as at the date of the hearing;
- Valuations of the assets of the Fund (i.e. real estate, shares and cash) need to be up to date;



- Value of each members entitlements (i.e. husband and wife) should be the amount referred to in the Financial Statements for the Fund;
- Disputes in relation to the value of the assets of the Self Managed Superannuation Fund should be resolved on the same principles as those adopted to value such assets in family law matters (i.e. in the case of real estate appoint a single expert to prepare a sworn valuation of the real property the subject of the dispute);
- If the Super Fund appears to be non-compliant, higher tax liability may need to be taken into account; a
- Unrealized capital gains tax should be considered in accordance with Rosati's case (1998).

There are two types of splitting orders applicable to a Self Managed Superannuation Fund. They are:

- Where a fixed base amount is allocated by a Court Order to one party; and
- Where a percentage is allocated to each splittable payment to one party.

Nadine Udorovic

Child Maintenance Trusts

These trusts are set up to receive child maintenance payments. They are attractive because they provide tax effective income splitting to the beneficiaries.

Payments received by a minor beneficiary in a CMT are given the benefit of ordinary tax treatment. The beneficiary has the benefit of a tax free threshold, of \$6,000, and the marginal tax rates for payments in excess of the tax free threshold. (I am checking whether this threshold is to increase with the increases to the tax free threshold for earned income).

Normally, trust income to minors only enjoys a tax free threshold of \$417, increasing to 66% for payments up to \$1445 and 47% above \$1445.

The other benefit for payers, is that the payments in a properly structured CMT are made from pre-tax income of the payer.

The trust must have arisen as a result of a family

breakdown, must be consistent with current child support obligations, and it must be recognized that the transfer of property to a CMT may give rise to CGT and stamp duty.

Marguerite Picard

Capital Gains Tax (CGT) Issues in Relation to Family Breakdown

The transfer of property between spouses and partners is a common outcome of relationship breakdown. There are often CGT consequences to be dealt with, and sometimes this can be a positive moment for some financial planning, but also has potential for unhappy surprises at a later date.

ACCOUNTING/FINANCIAL ADVICE

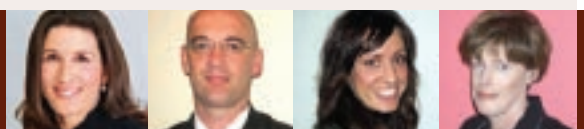
There are numerous sections of the Taxation Act which intersect with Family Law settlements, applications and orders. We would always advise a party to obtain specialist advice from an accounting professional about general taxation and CGT consequences of division of matrimonial property.

This article addresses some of the more common, but not necessarily widely known, situations where CGT issues arise; but it is not exhaustive. In particular, this does not address the CGT events in trusts. It must also be borne in mind how quickly taxation and superannuation laws change, and up to date advice is always the best protection.

ROLLOVER RELIEF

Rollover relief defers CGT which would otherwise be payable on the transfer of assets, or in the case of pre-CGT assets, allows retention of their pre CGT status.

Rollover relief applies automatically when property which is the subject of the relief, is transferred between spouses pursuant to a Court Order, including Consent Orders, or a Binding Financial Agreement. For domestic partnerships, relief will apply pursuant to a Court Order. In some states relief also applies to transfers pursuant to a Termination Agreement under state Property Law Acts. In Victoria the relief is only available pursuant to



Court Orders. This distinction may alter in the life of the present parliament, under the proposal to legislate for property laws in domestic partnerships to be dealt with by the Family Court.

There are times when rollover relief is not desired, for example when a spouse has CGT gains, and wishes to offset losses. As the rollover relief is automatic when it applies, any transfers which are required to be without rollover relief will have to be dealt with outside of Court Orders or agreements.

THE FAMILY COURT AND CGT

A transferee of any property in a family law settlement or proceeding, should be alert to the possibility of inheriting a CGT liability. The Court will take the view, after Rosati's case, that if there is no immediate prospect of selling an asset, the CGT liability can only be taken into account in a limited way, that is, as a consideration under s.75(2). This section permits the Court to adjust under s.75(2) (n), (o) (p), which relate to the general power to make a property order, a matter which should be taken into account, or the terms of a BFA. A BFA being taken into account by the Court may, for example, only contain a superannuation agreement, or deal with only part of the property.

If the asset to be transferred is to be sold immediately or in the short term, the CGT liability can be calculated and taken into account by the Court, and therefore in any negotiations between the parties the same consideration ought apply.

RECORDS

The transferee will generally inherit the cost base of the transferor spouse, and will make a gain or loss on sale according to that cost base. The transferee spouse should ensure as part of negotiations or Orders, receipt of the appropriate records to enable the cost base to be calculated when the asset is sold.

MINIMISING CGT ON SALE

If there is to be a sale of a CGT asset, consideration should be given to obtaining the rollover relief by transferring the asset to the spouse in the lowest tax bracket as a first step, prior to a subsequent sale as a CGT event, in order to benefit from the reduced tax rate of the lower income spouse. Any such prior transfer pursuant to a marriage or relationship breakdown in Victoria is stamp duty exempt.

RELATED ENTITIES

Rollover relief applies where there is a transfer of a CGT asset from a company or a trustee associated with the parties, to one of the parties pursuant to the marriage/relationship breakdown. However, the possibility of income tax arising from a deemed dividend to the recipient must be considered, in particular, under Division 7A a loan from a company, forgiveness of debt or non-dividend payment. The possible application of Division 149 of the Taxation Act must be considered.

SELF MANAGED SUPERANNUATION FUNDS

In self managed super funds, if an asset is to be sold to give effect to a splitting order, that sale will not attract rollover relief, and the entity which sold the asset will be liable for the CGT.

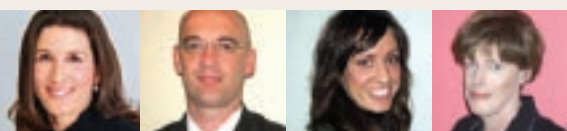
Rollover relief does apply in a complying superfund with five or fewer members to which the spouses both belong. In such a fund, an in specie interest can be transferred to a spouse without CGT consequences where the transfer is to another small super fund to which the transferee spouse belongs. The rollover relief will apply only to the proportion of the interest subject to the payment split.

PRINCIPLE RESIDENCE EXEMPTION

- A sale or transfer of a principle residence is immune from CGT in most but not all cases. Parties should beware the possibility of a CGT liability in the family home if the home:
 - Has not always been used as the main residence
 - Is owned by a company or has been used partly for business and income tax deductions have been made for its use by the business
 - If it is a farm property
 - Is on more than 2 hectares of land
 - Has an adjacent block of land not used primarily for domestic purposes
 - Has adjacent land which is being subdivided and transferred separately from the dwelling
- Section 118 of the Tax Act should be considered in any of these situations.

MORE THAN ONE RESIDENCE

Where there are two residences and either or both parties have lived in the second residence during the ownership of the main residence, and an election is made by the disposing party to treat the dwelling as the main residence when it was not used as such, that



election should be part of the agreement or Orders.

TRANSFeree NOT RESIDING IN HOME

If one party wants to acquire the residence but not live in it, it may be desirable not to obtain rollover relief, as that party will want a high cost base for subsequent sale.

TRANSFER OF PARTNERSHIP

If rollover relief is not invoked and there is a sale of an interest in a partnership to a spouse, the exiting spouse will generally be subject to CGT on the payout. The value of the payout will provide the CGT cost base for any future sale. If the rollover provisions are invoked, the spouse who retains the business will inherit the cost base of the exiting spouse for the purposes of any subsequent sale.

TAX LOSSES

In *JEL v DDF*, it was held that income tax losses were a future financial resource to the party who retains the entity with the losses, and can be adjusted for under s.75(2). They were not treated as property in *JEL v DDF*, due to the uncertainty concerning the utilization of the losses by the Husband's entity. In circumstances where there was an immediate or certain ability of the individual or entity to utilize the losses, the inference to be drawn from the judgment is that tax losses could be defined as property. There is no logical reason why this rationale would not apply to CGT losses, if the circumstances of the case were such that a sale of assets was imminent or certain, and that the party who would incur the losses could offset them against gains which would otherwise be made on assets retained. In either case, beware that the need remains for continuity of ownership of the business of the company, or no advantage can be taken of losses carried forward.

COMPANIES

Transfer of shares in a company is a CGT event. If rollover relief does not apply, pre-CGT assets may be converted to post CGT assets, and the cost base is the current market value at the time of the transfer.

If the automatic rollover relief is applied, the transferee inherits the pre-CGT status or CGT cost base of the company or trust, and the transferor does not make a gain. Care must be taken that any BFA contains a separation declaration to attract this relief, and note that it will not apply to a transfer pursuant to a

termination agreement in domestic relationships in Victoria.

If a share transfer in the company is substantially altered, that is more than 50% of shares are transferred, any pre-CGT assets will become CGT assets for the remaining shareholders. In a family company there is a fifty percent chance that is your client. Where there are non-spouse shareholders who suffer a loss of share value by the action of a director, who is perhaps your client, the question of the directors liability is food for thought.

Marguerite Picard

Maintenance Payments Exemption for Income Taxation Purposes

The Payee

Periodic payments are exempt from income tax in the hands of the recipient if payments are made or attributable by an individual, if such payments are made:

- To a person who is or has been a spouse (includes domestic partner) of the maintenance payer; or
- To or for the benefit of a child (whether adopted, step children or ex-nuptial) of the maintenance payer; or
- To or for the benefit of a child (definition as above) of the other party to the marriage.

NOTE: The exemption also extends to payments attributable to payments made by a maintenance payer (i.e. made through the CSA).

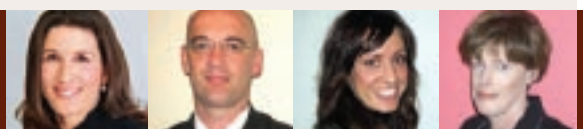
However the exemption is subject to the condition that the maintenance payer has not:

- Divested himself or herself of income producing assets;
- Diverted ordinary income or statutory income which would otherwise have been taxable to the maintenance payer.

What about the Payer?

Employing your spouse / child does not ensure deductibility

- Even if there is a proper employment relationship,



you cannot claim as a deduction salary or wages paid or due to a spouse or child under 16 if it is for maintenance of the spouse or child.

- Being married can make a difference!
However, such payments are deductible if made to a spouse who is legally married to the payer, but is permanently living separately from the payer, even if such reasonable payments are for the maintenance of that spouse, subject to other tests for deductibility.
- The importance of structuring payments
If expenditure or payments for the maintenance of children less than 16 years of age are paid through a child support or child maintenance Trust, they are deductible if such salary or wages are made in addition to payments for their maintenance.

Nadine Udorovic

Stamp Duty Exemptions and Family Law In General

A Deed or other instrument executed by a person for the purpose of, or in accordance with, an Order made under Part VII of the Family Law Act (FLA) is not subject to any duty or charge under any law of a State or Territory or any law of the Commonwealth that applies over to or in relation to a Territory.

By virtue of Section 90L of the FLA, none of the following are subject to any duty or charge under any law of a State or Territory or any law of the Commonwealth that applies only in relation to a Territory:

- A Financial Agreement;
- A Termination Agreement; and
- A Deed or other instrument executed by a person for the purposes of, or in accordance with, an Order or Financial Agreement made under Part VIIIA.

Australian State and Territories

Note that each of the Australian States and Territories in Australia have their own variations in relation to stamp duty exemptions.

In Victoria pursuant to section 43(3) of the Duties Act, no duty is chargeable in respect of a transfer of dutiable property from one person to another or from two people to one of them or from one person to themselves and another person if:

- The people are spouses or domestic partners of each other; and
- No other person takes, or is entitled to take, an interest in the property under the Transfer.

Additionally, if the transfer of dutiable property is necessary following a matrimonial or domestic separation, no duty is payable between the transferor (which can be a corporation or trustee of a trust of which one or both parties to the marriage / relationship are beneficiaries). Note though that in all cases, the transferee must be:

- A party to the marriage or domestic relationship and/or a dependant child of the marriage or domestic relationship; or
- A Trustee of a Trust of which no person is a beneficiary other than a person referred to above.

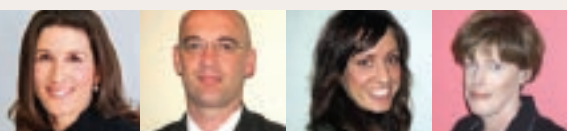
Note though that no other person must take or be entitled to take an interest in the property under the transfer.

There is a need to be mindful of other considerations if the transferor is a corporation, as the dutiable value of Transfer must not exceed the value of the interests of the parties to the marriage or domestic relationship in the corporation and, as a result of the Transfer, the value of the interests of the parties to the marriage or domestic relationship in the corporation must be reduced by the same amount as the dutiable value of the property transferred.

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