Binding Financial Agreements in the Context of Preserving Family Wealth

Many clients in family law are seeking to ensure that their assets are protected from future claims by the other party. Further to this, many clients are seeking to protect future interests in family wealth from family law proceedings. At this time, the most beneficial way to protect assets from any future family law claim is to enter into what is known as a Binding Financial Agreement (BFA). As previously mentioned in this newsletter, there is a common misnomer that the best way to protect family assets is to tie them up in trusts, this is not necessarily the case.

BFAs can deal with how property and financial resources (including future interests) of parties are to be dealt with in the event of a breakdown of the parties' marriage or de facto relationship. It is important to note that parties to a de facto relationship have the same entitlements as married couples and that when living with a partner, you may be subject to a future family law claim. This includes claims to future inheritances of interest in family wealth.

BFAs are a complex area of family law and do require strict compliance with the *Family Law Act* 1975 (Cth). The most common cause of action in relation to BFAs is, in fact, against the solicitors providing the legal advice rather than against the other party as it is difficult to have them overturned. In circumstances where a party is seeking to quarantine assets, we would strongly advise that they be referred to a family law specialist for advice.

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#30 -- July 2013 Edition

NEWSLETTER
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Welcome

This edition of our Newsletter addresses a number of interesting and topical issues of a commercial and financial nature such as Capital Gains Tax liabilities, "Big Money" cases and the treatment of property held in Trusts.

Please don't hesitate to contact Nicholes Family Lawyers if you or anyone you know requires assistance with these or any other matters relating to Family Law.

Capital Gains Tax Liabilities

It is important for family law clients to seek accounting advice regarding any potential capital gains tax ("CGT") liability before entering into an agreement with their spouse or partner, or during the course of family law proceedings generally.

Under the Income Tax Assessment Act 1997, Capital Gains Tax (CGT) roll over relief is available where an asset is transferred pursuant to a Court order, or a Financial Agreement (under Part VIII and Part VIIIA

Contents

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of the Family Law Act 1975). This enables the parties to a relationship to have the benefit of roll over relief where the asset is transferred between them, or from a trustee or a company to a "spouse" (including same sex couples) as part of any overall property settlement.

This roll over relief means that the CGT liability will not be paid until the asset is disposed of, however it is important to note that the person receiving the asset is taken to have acquired it when the transferor did.

In the case of Rosati which decided in 1998, the Court confirmed that whether CGT should be taken into account in the asset pool available for division will vary from case to case. The manner in which the court deals with CGT will primarily depend upon whether the asset is likely to be sold in the foreseeable future, how the asset was acquired and the evidence presented by each party with respect to the asset. For example if neither party could afford to retain the asset and it needed to be sold, the liability is likely to be included in the asset pool.

The court will generally require accounting and financial planning advice as to the parties' respective financial positions and the calculation of any CGT, or discounts in tax in the event that an asset may not be sold for some time.

Royalties in Family Law Proceedings

In the recent case of *Pope & Pope* [2011] the Court considered music royalties and their impact upon a party's future earning capacity and their interest in the matrimonial asset pool.

In this case the husband had an interest in two (2) streams of royalty payments. One related to music copyright held by the husband (through a company owned by him) and the other he received personally from APRA (Australasian Performing Right Association) in relation to music and concerts performed on radio and television.

The husband disputed that his royalty income was considered property pursuant to s 79(4) of the *Family Law Act 1975* (Cth), and disputed the methodology the expert witness used to calculate the future income that he would derive from the royalties.

The expert explained that there was no accepted valuation methodology used in relation to future royalty streams, and adopted a discounted cash flow method. The expert assumed that royalties would continue to flow to him in perpetuity. In the absence of any forecast data as to the estimated amount of this future royalty

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party's legal or de facto control.

When dealing with discretionary trusts it is therefore important to determine whether the other party has legal or de facto control and determine what evidence is required to ground such a finding. If a party has de facto control and that can be established on the balance of probabilities, then the relevant assets of the discretionary trust will be treated as property of the parties for the purposes of Section 79 of the Act. In the event that the other party does not have legal or de facto control but merely a beneficial interest in the discretionary trust, the Court can take that interest into account as a financial resource.

The decision of the Full Court in *Harris & Harris* [2011] is an example of the evidence required before the Court to grant a finding that the other party has legal or de facto control on a discretionary trust.

In the decision of Harris, a family trust was established by the husband's father and on his death the husband's mother became the appointor of the trust. Since the establishment of the trust, there had been various trustees and at separation the corporate trustee was a company whose directors included the husband's mother, the husband's son from a previous marriage and long spending friend of the husband. The most significant asset of the trust was a business run by the parties worth approximately $1,500,000. The principal beneficiaries of the trust were the husband's parents and the husband and his sister. Throughout the marriage the trust made distributions to the husband's mother, the husband and the wife and a company established by the husband, although the wife and the company were not beneficiaries pursuant to the Deed. Upon separation, distributions to the wife ceased.

At first instance, Justice Bell concluded that the trust formed part of the property pool on the basis that the husband had legal and de facto control of the trust, evidenced by the distributions made from the trust to the company established by the husband and by the fact the distributions to the wife had ceased after separation.

On appeal to the Full Court, it was found that the wife was unable to point to any evidence which supported the finding that the husband's mother is his "puppet" and that it is through her or perhaps otherwise that he exercises a de facto control of the trustee company and of the trust. On the evidence, the best the Court was able to do was determine that the trust was a significant financial resource for the husband.

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factors to ascertain the level of control that a party has over the Trust. If it is found that the party has control over the trust, for example by creating a company to act as Trustee/Appointer over the Trust and that party is the sole shareholder of the new company, then that Trust property will be considered under the control of the party and pulled into the asset pool for distribution in family law proceedings.

If however, it is found that the party has little to no control over the Trustee or Appointer of the Trust, then that Trust property will be considered a mere financial resource of the party and will not be considered an asset for family law purposes. It may however have implications as to the parties' future needs and earning capacity.

It is important to remember that not all accountants have expertise in family law. Accordingly we would recommend that a party should obtain legal advice before transferring assets post separation.

How does the Family Court treat discretionary trusts in Property Settlements?

The power of the Family Law Courts to make Orders under Section 79 altering the property interests of the party to a marriage are broad.

When dealing with discretionary trusts in a property settlement, the Court needs to determine whether the trust is property of both or either of the parties; a financial resource of both or either of the parties; or a mere expectancy.

Determining the nature of the parties' interests in the discretionary trust is a question of fact. The Court will have regard to a number of circumstances when determining whether one or both parties have control of the trust. The questions the Court will ask include:

- Has the party or parties benefited from the trust?
- What historical distributions has the trust made?
- Does the party have capacity to borrow trust funds?
- How have the parties previously treated the trust?
- How was the trust property accumulated?
- Who are the beneficiaries of the trust when the trust vests?

Under part VIIIAA of the *Family Law Act* 1975 the Court has the power to make Orders and injunctions binding third parties in circumstances where an interest in a discretionary trust is found to be the property of either party to the marriage as a consequence of a

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stream or the likely lifespan of such royalties, the expert used the husband's life expectancy as to the extent of future cash flow with a straight line reduction.

The Court held that the husband's royalties were property pursuant to s 79(4) of the Act, and that the husband's musical group's success and profile meant that it was likely that he would continue to receive royalties for many years to come. The court was satisfied that the company expert's opinion regarding the value of the royalty streams was sufficiently reliable for it to be included in the property pool. However, it is not clear whether the popularity of the musical act was a crucial and influencing factor in the decision to accept the methodology and could be used as a differentiating factor in future cases.

Post separation contributions to property

The current delays in the Court system means that it can take 12-18 months before a matter is allocated a final hearing before a Judge. The relevant date for the valuation of assets for a property settlement is the date of the final hearing. This may lead to you ask, what happens to those assets that may have been accumulated in the period following separation but prior to a final hearing?

The weight to be given to post separation contributions can be difficult and is determined on a case-by-case basis. Parties who have made significant financial contributions can argue that an asset be quarantined or excluded from the assets available for division.

In the case of *Mackie & Mackie* (1981) the Court held that where one party saves money or accumulates assets following separation, and the other party made no direct or indirect contribution towards those assets, they should be credited to that party. In that particular case the husband won $200,000 in a lottery after separation. Although the wife made no claim on these funds, the Court found that might have been able to do so as she had continued to care for their significantly handicapped child.

There are many cases that indicate that post-separation contributions will be off-set by the role of the homemaker and parent (*Williams and Williams* (1984)), although it is unclear as to whether financial contributions are given greater weight post separation than homemaking and parent

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contributions.

This area of Family Law is very complex. Therefore, in circumstances of prolonged proceedings or large asset pools, it is recommended that parties seek specialised legal advice.

Property Settlement in "Big Money" Cases: Is it different to a modest pool?

Drawing on various Australian authorities big money cases involve a net asset pool in excess of $4 million dollars.

Division of the property following the breakdown of a marriage is generally more complex where big money cases are involved. Parties are in certain circumstances able to argue that they have made a "special contribution", which should adjust the property settlement in their favour. The notion of "special contribution" has proved controversial because "special skills" are only given weight for financial contributions and not for homemaking contributions.

Section 79(4) of the F*amily Law Act* 1975 sets out the matters which Courts must take into account with respect to an order regarding the division of property of parties to a marriage. Reference is made to 'financial contributions' made 'directly or indirectly'.

The Court then must consider what is 'just and equitable in all of the circumstances of the particular case'. This section gives the Court broad discretionary powers to make orders and '...to do justice according to the needs of the individual case, whatever its complications might be': *Norbis v Norbis* (1986) 11 CLR 513 at 520.

That necessarily involves an acknowledgment that the circumstances of each marriage are different and that it is to those particular circumstances to which the discretion must be applied.

There is little legislative or guidance by the Full Court as to how to approach big money cases in Australia, and as a result Australian Courts often refer to large financial matters in the United Kingdom. The authorities in both jurisdictions look at contributions that may be regarded as "special", "extraordinary" or "stellar", which may impact the respective distribution of assets between the parties to the marriage.

Most recently in Australia, there are two Full Court cases, namely *Kane & Kane* [2011] and *Smith & Fields* [2012] for which we are still awaiting judgment.

In *Kane & Kane* the parties were married for 29 years and the asset pool was $4,200,000. The wife argued that her contributions were equal to that of her husband. In this matter the trial judge found that the husband's skill in selecting and pursuing the investment in shares of a particular company constituted a "special contribution".

In *Smith & Fields* the parties had also been married for 29 years and the pool was between $32,000,000 and $40,000,000. In this case the trial judge was critical of the terms "special skill" and "special contribution" and instead based his reasoning on the "nature, form and characteristics of the contributions of varying types made by each of the parties". His Honour referred to the husband's "ingenuity and stewardship".

In prior decisions of the Full Court, there has been recognition that there is a potential for discrimination of the homemaker when comparing non-financial and financial contributions, however the Court has generally gone on to rely on the "special contributions" argument and awarded the husband a greater percentage.

The Full Court in *Ferraro* when they were reviewing trends referred to Mallet's case and outlined that:

"Gibbs CJ referred to the circumstances that Parliament had not provided that a wife's homemaker contribution and the husband's financial contribution are deemed to be equal. There is, we think an evolving social background which gives greater emphasis to the equality and partnership concepts in a marriage and no doubt, this evolutionary process will continue."

Whether it has continued to the point where the concept of "special contributions" is unlikely to have any significant place in future big money cases remains to be seen. We await the Full Court's decision in *Kane & Kane* and *Smith & Fields* to see whether the wheel has turned.

Trust Property

There is a common misconception that as long as money or other property is held on trust, it cannot be touched in family law proceedings. This is not necessarily the case. If a party to family law proceedings is a beneficiary to a Trust or Trust property, then the Court will look at a range of

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