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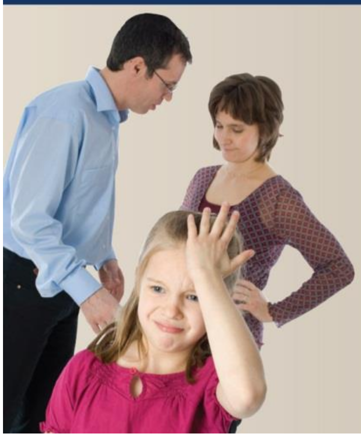

CGT – the sleeper in Family Law Property Settlements

Negotiating a Family Law Property Settlement involves calculating many elements including the contributions made by each party to the matrimonial property pool, the valuation of assets and the respective financial needs of the parties. One element that should not be overlooked in these calculations is the rollover of Capital Gains Tax liability upon the transfer of certain assets of the relationship.

What is Capital Gains Tax (CGT)?

In simple terms Capital Gains Tax (CGT) is a tax applied to the net capital gain made on the disposal of any asset purchased or acquired on or after 20 September, 1985 (CGT Event) with a number of specific exemptions. CGT operates by treating the net capital gain as taxable income to the asset holder in the tax year in which the asset is sold or otherwise disposed. While the taxpayer’s net capital gain is treated and taxed as income, any capital losses arising from the sale of an asset cannot be offset against normal income but can be offset against prior capital losses or can be carried forward indefinitely to be offset against future capital losses.

What Assets are subject to CGT?

All assets that have been acquired since the introduction of Capital Gains Tax on 20 September, 1985 are subject to CGT (CGT Asset), unless specifically excluded. Accordingly, unless an exemption applies, CGT is payable on the sale of assets such as:

- Real Estate
- Shares, units and similar investments
- Leases, business goodwill and licences
- Foreign currency
- Contractual rights
- Personal use assets such as boats, furniture, electrical goods and household items acquired for $10,000.00 or more each.
- Collectables such as paintings, sculptures, drawings, jewellery, stamps, coins or medallions acquired for $500.00 or more each.

19 Lawson Street, Penrith **T.** 02 4731 5899 **F.** 02 4721 4008 **www.batemanbattersby.com.au**

What Assets are Exempt from CGT?

Any asset acquired before 20 September, 1985 is not subject to the imposition of CGT upon its sale or disposal. Other assets that are exempt from CGT upon sale or disposal (CGT Exempt), and for which you also cannot claim a capital loss include:

- Your main home or residence (subject to some exceptions)
- Your car (provided it's designed to carry a load of less than one tonne and fewer than nine passengers) or your motor cycle
- Personal use items acquired for less than $10,000.00 each
- Collectables acquired for less than $500.00 each
- Compensation or damages received for any wrong or injury suffered in your occupation
- Winnings or losses from gambling, a game or competition with prizes

How is CGT Calculated?

In most CGT Events the net capital gain that will be subject to CGT is the difference between the 'capital proceeds' (being the sale or disposal price) of the CGT Asset and the asset's Cost Base. The Cost Base of the CGT Asset is largely what you paid for it together with other eligible costs associated with acquiring it, holding it and disposing of it. For any CGT Asset held for less than 12 months before the date of its disposal, CGT will be payable on 100% of the net capital gain. The taxpayer must include this 'gain' as income for the year in which the asset was disposed and pay tax on such amount at the highest marginal rate of tax applicable to them in that year.

For CGT Assets held for 12 months or more before the relevant CGT Event, taxpayers can choose to adopt the CGT Discount Method, or if applicable to them, the Indexation Method. The CGT discount method allows individuals to reduce the relevant net capital gain amount by 50% and complying superfunds to reduce it by 33.33% and accordingly CGT is only payable on 50% of the net gain for individuals and 67.67% of the gain for complying super funds.

If the CGT Asset was acquired before 21 September 1999 and held for 12 months or more before the relevant CGT Event the taxpayer can choose to adopt the Indexation Method which allows for the Cost Base to be increased by applying an indexation factor based on the Consumer Price Index (CPI) but only up until September 1999 after which the Discount Method may be applied for the ensuing years of the asset ownership. Any capital gain made after adopting the Indexation Method is similarly taxed at the taxpayer's highest marginal rate of tax in the year the asset was sold or disposed.

Generally, assets held in a trust or owned by a company are not entitled to apply the Discount Method and pay tax at their applicable rate on 100% of the net gain upon the sale or disposal of a CGT Asset. Some exemptions and concessions may however apply if the asset is used in a small business ("active asset") and the CGT Small Business Exemption provisions are satisfied.

CGT Rollover in Family Law Property Settlements

As assets are typically transferred between the parties in a Family Law property settlement following the breakdown of a relationship, it's essential that the parties consider the impact of CGT in their negotiations otherwise one or both parties may end up with a future CGT liability that wasn't anticipated. This is because when a CGT asset is transferred from one party to another or from both parties' names into one of the parties' names, there is usually an automatic 'rollover' of the CGT liability of the CGT asset.

This means that the party who transfers the asset can disregard the capital gain or loss that would otherwise arise if the CGT Asset was being disposed of other than pursuant to a Family Law property settlement. Consequently, the party who receives the asset will incur the capital gain (or loss) when they subsequently dispose of the CGT Asset in the future. The Cost Base of the asset is however also transferred to the party receiving the asset so that it and any subsequently accruements to it can be offset against the subsequent sale price of the asset.

The CGT rollover only applies if:

- The marriage or relationship ended on or after 20 September, 1985; and
- Ownership of the CGT Asset, or a share in a jointly owned CGT Asset, is transferred between the spouses or from a company or trust to one of the parties; and
- The transfer of ownership is as a consequence of a Court Order, formal agreement or award.

Importantly, if the above circumstances apply the CGT rollover is mandatory and the parties cannot choose whether or not it applies.

The CGT rollover also applies to CGT Events that occur after 12th December, 2006 pursuant to a Financial Agreement that is binding under Section 90G of the Family Law Act which generally do not require Court approval provided that at the time of the transfer of the CGT Asset:

- The parties are separated; and
- There is no reasonable likelihood of cohabitation being resumed; and
- The transfer happened for reasons directly connected with the breakdown of the marriage or relationship.

The CGT rollover does not however apply if the parties divide the property under a private or informal agreement and in these circumstances both parties must take into account any capital gain or loss made as a consequence of transferring the CGT Asset when completing their taxation return for the year in which the asset was transferred.

How to Protect Yourself from Unexpected CGT Liability

It's generally the case that the assets of any marriage or relationship will consist of both assets that are CGT Exempt such as the family home and those assets that would in the ordinary course of their sale or disposal constitute a CGT Event and therefore incur a CGT liability (e.g .investment properties, shares, collectables etc). It's therefore prudent when undertaking Family Law property settlement negotiations to distinguish between those assets of the parties in the matrimonial property pool that are CGT Exempt and those that comprise a CGT Asset as the failure to do so may result in a party incurring an unexpected future CGT liability.

As a simple example, Peter (57) and Lauren (55) are separated, have no dependent children or debt and their matrimonial property pool the subject of settlement negotiations is valued at $1.85m and consists of the following:

1. Their family home valued at $700,000.00 (CGT Exempt)
2. An investment property originally purchased for $150,000.00 and now valued at $550,000.00 (CGT Asset)
3. Cash held in a joint bank account in an amount of $100,000.00 (CGT Exempt)

4. Shares originally acquired for $50,000.00 and now valued at $150,000.00 (CGT Asset)

5. Peter's superannuation of $250,000.00 (CGT Exempt); and

6. Lauren's superannuation of $100,000.00 (CGT Exempt)

The parties enter into a Financial agreement under which Lauren retains the family home, her superannuation and the monies held in the jointly owned bank account totalling a value of $900,000.00 and Peter retains the investment property, his superannuation and the shares which total $950,000.00

On the face of it, the parties have retained and had transferred to them assets from the joint matrimonial property pool of roughly equivalent values. However, the assets retained by Lauren are all CGT Exempt and in particular she will incur no CGT liability upon any future disposal of the matrimonial home provided she continues to use it as her principal residence. Additionally, she is not liable for any future CGT liability payable on the transfer of the CGT Assets to Peter. As for Peter, the investment property and shares are both CGT Assets and accordingly the sleeper for him is that he will incur a CGT liability upon the sale or disposal of them based on their original acquisition price less the Cost Base rolled over to him at the time that the assets were transferred and any subsequent accruements to it. As a consequence, Peter is in effect receiving a lesser share of the parties' property assets after taking into account the CGT liability he will incur upon the disposal of assets transferred to him.

In view of the above, it's therefore imperative that appropriate taxation and legal advice is obtained when negotiating the division of matrimonial property assets following the end of a relationship. Most importantly, you should identify the jointly owned assets that are CGT Exempt and those that are CGT Assets and obtain advice about the amount of CGT payable on the disposal of the CGT Assets if they were disposed at the time the property settlement was finalised. This will ensure that any CGT liability is taken into account when calculating the net total value of assets retained by each of the parties.

At Bateman Battersby we have a number of experienced Lawyers that specialise in Family Law matters. If you need help sorting out the confusion about who gets what when a marriage breaks down and or the impact that CGT may have in your property settlement, please feel free to contact Oliver Hagan or Ken Gray on (02) 4731 5899 or email us at familylaw@batemanbattersby.com.au if you require further information or assistance.