2018: the biggest year in estate planning in a generation

by Matthew Burgess, CTA, Director, View Legal

Abstract: In light of ongoing changes to the taxation regime and the expanding wealth of Australia's ageing population, there has for many years been a growing need for estate planning to utilise appropriate structuring. Estate planning related areas have largely been outliers from radical simultaneous rule overhauls — indeed, the framework of the specific relevant laws have stayed largely unchanged for over 30 years. However, 2018 will likely be seen as an exception to this position, at least in recent years. Indeed, arguably, 2018 has seen more changes in key estate planning areas in a single year than each of the previous 30 years combined. With the post-baby boomer intergenerational wealth transfer wave gathering pace, it is argued that the 2018 changes mean that it is critical for tax and estate planning advisers to fully understand the impact of the changes and invest to monitor their ongoing impact.

Introduction

In light of ongoing changes to the taxation regime and the expanding wealth of Australia's ageing population, there has for many years been a growing need for estate planning to utilise appropriate structuring. That said, changes in the framework of the specific laws regulating estate and succession planning in Australia have stayed largely unchanged for over 30 years.

2018, however, has been an exception to recent history. Indeed, arguably, 2018 has seen more changes in key estate planning areas in a single year than each of the previous 30 years combined.

Potentially fundamentally important shifts in approaches across the following areas have made headline news in the tax and estate planning arena in the last 12 months:

- trust vesting;
- trust splitting;
- testamentary trusts and excepted trust income; and
- capital gains tax roll-overs on relationship breakdown.

Each of the above areas is addressed in turn below.

Final trust vesting ruling

In August 2018, the Australian Tax Office issued its ruling in relation to trust vesting with TR 2017/D10, finalised as TR 2018/6. The ATO also published details of its administrative approach.[1]

In theory, the combination of these publications, after what is understood to be extensive industry consultation, should be the definitive statement of all key issues with trust vesting. Arguably for many trust specialists, however, it is difficult to instead not be asking, "is that it" from the ATO on trust vesting?

Some history

One interesting aspect of the recent history in relation to the ATO's approach to trust vesting involves the trust at the centre of the (in)famous Rinehart dispute.

Given what has been disclosed publicly, there are many who believe that Ms Rinehart successfully obtained a private ruling from the ATO in relation to whether there were any CGT consequences of the trust vesting when Ms Rinehart's youngest child turned 25.

While it cannot be certain, it appears that PBR 1012254771092 relates to the Rinehart matter.

PBR 1012254771092 carefully considers whether CGT event E5 occurs on the vesting of a trust. CGT event E5 is said by the ATO to occur when a beneficiary becomes "absolutely entitled" to a CGT asset of the trust as against the trustee. The ruling then goes on to explore in some detail the broad position that the ATO adopts in these areas based on TR 2004/D25 (the "absolute entitlement ruling").

The ATO confirms that, while the absolute entitlement ruling remains in draft, so long as it is not withdrawn, it does represent its view of the law.

Based on the analysis of the absolute entitlement ruling, the (so-called) "Rinehart ruling" concludes that, because no beneficiary was able to call for any one or more of the assets to be transferred to them, they were not entitled to any assets as against the trustee, and therefore, CGT event E5 did not occur on the vesting of the trust.

In many respects, the Rinehart ruling appears to heavily inform TR 2018/6.

In combination, TR 2018/6 and the Rinehart ruling make it clear that the ATO explicitly acknowledges that the vesting of a trust will not, by itself, result in any CGT event in many circumstances.

Absolute entitlement ruling and TR 2017/D10

One key and often-raised concern with TR 2017/D10 was that it did not adequately explain the reasons for concluding that CGT event E5 will or will not occur on the vesting of a trust in different circumstances.

While TR 2017/D10 was broadly consistent with the ATO's position in the absolute entitlement ruling, the correctness of a number of points in the absolute entitlement ruling are the subject of significant conjecture, perhaps none more so than the ramifications of the trustee's entitlement to sell trust assets to satisfy its right of indemnity out of trust assets. This

point was tested in the decision of *FCT v Oswal*.[2]

Oswal (from which the High Court refused special leave to hear an appeal) was not mentioned in TR 2017/D10 and is also not mentioned in TR 2018/6.

Example 7 of TR 2017/D10 concluded that, where a trust vests with a sole capital beneficiary, that beneficiary becomes absolutely entitled to the trust assets and CGT event E5 occurs — the exact opposite conclusion to that reached in *Oswal*.

In particular, in *Oswal*, Justice Edmonds found that CGT event E5 could not arise, because the beneficiaries could not become absolutely entitled to trust assets where the trustee had a lien over the assets in respect of its right to be indemnified for trust liabilities out of trust assets.

Adopting the Federal Court's view in *Oswal*, it seems the beneficiaries of a discretionary trust (even if there is a sole capital beneficiary) can never be absolutely entitled against a trustee when a trust simply vests, as the trustee will always have a common law right of indemnity out of trust assets, able to be satisfied via an equitable lien.

Instead of these conflicting outcomes being addressed specifically in TR 2018/6, all references to the absolute entitlement ruling have instead been deleted and example 7 amended to essentially avoid the issue.

Other changes to TR 2017/D10

Despite what we understand to be feedback made to the ATO on TR 2017/D10 for a range of issues to be addressed before the ruling was finalised, it appears that the abovementioned change to example 7 (and a consequential amendment of example 6) is the only substantive change in TR 2018/6.

Arguably, the only other change of note was to adjust wording to highlight that the ability to extend a vesting day will turn almost entirely on the power in the trust instrument (assuming that an application to court is not made) — in other words, abide by the "read the deed" mantra. A critical point no doubt. However, hardly indicative of a robust consideration of industry feedback.

Unanswered questions

Arguably, there is a range of important trust vesting questions that remain unanswered. In particular, TR 2018/6 does not attempt to even acknowledge (nor address) issues such as:

- In what situations will a power of variation be deemed to be too narrow to allow an extension of a vesting date?
- If a power of variation expressly permits retrospective amendments, why will this not allow a vesting date to be extended after it has passed (TR 2018/6 is blunt in its view that a trust vesting date can never be extended once it has passed)?
- If there are no default beneficiaries and a trust vests without the trustee being aware, will the trustee of the trust be taxed on all income and capital gains derived (at the top marginal rate, with no CGT discount) pending the assets of the trust being distributed?
- Alternatively, if there are no default beneficiaries, does the ATO instead believe that the assets of the trust pass on a resulting trust to the settlor?

> *"... the most important questions in relation to the tax consequence of trust vesting remain unanswered."*

- Whether the position in PBR 1012191260298 is still accepted as correct — in that ruling, the ATO confirmed that, where a bare trust that owned shares in a pre-CGT company had made all distributions of income to the same person when the trust vested to that same person, the beneficial interest was not taken to have changed. In other words, the vesting of the trust did not change the majority underlying interests in the company's assets for the purposes of the application of Div 149 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).
- Can a trustee resolve to amend the jurisdiction of a trust to South Australia, and thus have any vesting date essentially abolished?
- If an individual default beneficiary of a vested trust dies before the trustee distributes the assets to them, do those assets pass in accordance with their will, without tax consequence due to Div 128 ITAA97?
- What approach will the ATO have in relation to lost trust deeds, where it is impossible to confirm the date of vesting?

Ultimately, TR 2018/6 should be welcomed as it does provide some clarity to the ATO's views in relation to trust vesting. That said, the reality is that some of the most important questions in relation to the tax consequence of trust vesting remain unanswered.

Trust splitting

The ATO released its views on trust splitting in TD 2018/D3 in July 2018. There is a range of concerns with TD 2018/D3 for all trust advisers. A summary of the key issues is set out below.

Examples

The factual matrix provided in TD 2018/D3 is very specific and lists a number of line items that may, or may not, be a part of a trust splitting arrangement. Many of the arrangements we have seen historically have involved a change of trustee in relation to specific assets and few or none of the other features listed in the draft ruling (for instance, no changes to the appointors, right of indemnity or range of beneficiaries).

For example, the ATO appears to place significant weight on issues such as varying the trustee's right of indemnity and adjusting the range of potential beneficiaries together with a decision to change appointorship.

It is well settled law (and the ATO has long accepted — for instance, in the withdrawn statement of principles on trust resettlements and subsequently in TD 2012/21) that each of these changes in isolation do not cause any CGT event to arise. It would therefore seem critical for TD 2018/D3 to highlight what combination of changes, in the ATO's view, amount to a resettlement.

Flawed assumptions

Unfortunately, in concluding that trust splitting will cause CGT event E1, it appears that the ATO has ignored most case law and legislation in the area, and

indeed its most recent private ruling,[3] and earlier private rulings.

Arguably, TD 2018/D3 turns entirely on an assumption that, without any analysis, concludes how a court may respond to the application of an aggrieved beneficiary of a discretionary trust which is the subject of a trust splitting arrangement.

The assumption is unfortunately fundamentally flawed in at least three areas:

- despite a virtually identical factual scenario, TD 2018/D3 assumes that, in one instance, the court will be resistant to an application, and yet, in another instance, will support an application. There is no authority provided for either conclusion;
- more fundamentally, the paragraphs are based on a significant misunderstanding of the law in this area. There is substantive and longstanding case law confirming that the beneficiary of a discretionary trust does not have a proprietary interest in the trust assets and their rights against the trustee are limited. In particular, while a beneficiary has a right to proper administration and a right to be considered in relation to distributions of income or capital, a discretionary beneficiary does not have any legal or equitable right to distributions. TD 2018/D3 completely ignores this position; and
- finally, TD 2018/D3 fails to acknowledge that the mere amendment of a range of potential beneficiaries is highly unlikely to of itself cause a resettlement (as acknowledged by the ATO in TD 2012/21). Therefore, if a trust splitting arrangement takes place and, as part of the arrangement, the range of beneficiaries of the split trust is narrowed, the conclusions in the abovementioned paragraphs are irrelevant.

Furthermore, the conclusions in TD 2018/D3 are such that it would mean that every single change of trustee or even a change of appointor (or principal) of a family trust would be liable to trigger (if the ATO felt that the arrangement was not "usual'') CGT event E1 — a clearly unsustainable position. In particular, the logic of the ATO would imply that, at any time the trustee of a trust is changed, it automatically means that the new trustee (and their family) would benefit from the trust to the exclusion of the old trustee (and their family), and that a court would, with certainty, intervene if ever requested by a disgruntled beneficiary.

Frustratingly, TD 2018/D3 also contains long-winded paragraphs, unsupported with any authority, that some of these statements are indeed irrelevant to the subject matter. See, for example, the entire section under the heading "Settlement of assets on terms of a different trust'', and, in particular, the sweeping generalisations at para 28 about "practical problems'' with trust splits. A question to be asked: at what point did "practical problems" become a key factor in triggering CGT events?

Resettlement

Similarly, the ATO essentially ignores both High Court and Full Federal Court authority in decisions such as *FCT v Commercial Nominees of Australia Ltd*[4] and *FCT v Clark*[5] when making conclusions in TD 2018/D3 about resettlement.

In particular, both *Commercial Nominees* and *Clark* acknowledged that it is completely expected that, over the life of an 80-year discretionary trust, there will be changes, at times significant changes, in relation to the conduct of the trust. This is reflective of a continuing trust. Indeed, given current life expectancies of humans, it would be impossible not to have fundamental changes to the make-up of a trust over an 80-year period.

It appears that TD 2018/D3 is implicitly predicated on a belief that, despite superior court authority, a separate set of rules applies to discretionary trusts as compared to unit trusts and superannuation funds.

Such a belief is unsustainable in the context of both High Court and Full Federal Court authority, and in the context of the ATO's own publications. It is similarly unsustainable that steps as simple as changing an appointor, trustee and the potential range of beneficiaries could be said to amount to a resettlement.

This conclusion is further reinforced by a failure in TD 2018/D3 to coherently address why the specific tax exemption available for discretionary trusts on a change of trusteeship, that being the roll-over relief available under s 104-10 ITAA97, can be ignored. Nor is the requirement under s 102-25 ITAA97 mentioned, that is, that if there are multiple potential tax events, the most specific must apply.

Aside from the specific exemption for changes of trustee, applying the principles from *Commercial Nominees, Clark* and TD 2012/21, it is clear that at law, a change in the terms of any trust (ie including a discretionary trust) pursuant to the exercise of an existing power will not result in the termination or establishment of a new trust.

Therefore, it would seem that the example provided in TD 2018/D3 that the proposed amendment to appoint separate appointors and trustees of the sub-trust pursuant to an express power under the trust deed allowing the appointments to be made is incorrect.

Case law

In some instances, TD 2018/D3 refers to the decision in *Commissioner of State Revenue v Lam & Kym Pty Ltd*.[6] However, reference to this decision is not helpful to the ATO's arguments. In particular:

- *Lam & Kym* involved an express declaration of trust over specific assets, which does not appear to be the case in the factual scenario considered in TD 2018/D3;
- in any event, *Lam & Kym* was a Victorian Supreme Court case which has been largely superseded by the High Court in *Clark*; and
- *Clark* confirmed, as acknowledged by the ATO in TD 2012/21, that a variation of a trust by the trustee in accordance with an express power in the trust instrument can generally not result in the establishment of a new trust.

Furthermore, while the case of *Oswal*[7] is referenced, it again is not helpful to the position that the ATO is trying to sustain as *Oswal* specifically related to assets being held for the benefit of one beneficiary of a trust — in the author's experience, it is never the case that a trust split occurs in the manner that is analogous to the *Oswal* decision.

The ATO reaches the quite extraordinary conclusions, without any supporting argument in relation to the case law or legislation in this area, that despite an identical trust instrument applying, there are somehow circumstances that lead to the conclusion that the trust powers of the split trust are suddenly distinct.

Even relying on the well-known legal principle from the 1997 film *The castle* ("it's the vibe")[8] would fail to support such a conclusion. Indeed, there would appear to be no legislation or case law which would support the conclusion reached.

The ATO also concludes that trust splitting occurs by declaration of trust, without any

attempt to justify its conclusion. Another concerning assumption given that the author is unaware of any trust splitting that takes place in a manner other than by way of a change of trusteeship.

To argue that a change of trusteeship amounts to a declaration of trust over assets is nonsensical — the whole commercial framework of the change of trusteeship is that the existing trust remains in place and there is simply a change in the legal owner of the trust assets, with that trustee being completely bound by the terms of the original trust instrument.

Furthermore, to reach these conclusions, again without any reference to the legislative position outlined above and the specific CGT exemption available for changes of trusteeship, is inappropriate.

Retrospective

The ATO states that the ruling is to apply on both a retrospective and prospective basis. To issue a ruling with retrospective effect when there have been positive rulings issued by the ATO over an extended period is arguably irresponsible and will likely cause unnecessary and significant taxpayer and industry backlash.

Concluding comments

As noted above, there are private rulings previously published by the ATO (as recently as 2016) confirming that trust splitting arrangements on similar terms did not constitute an E1 event.

It is extremely concerning that the ATO is purporting to now retrospectively change its approach to a longstanding, and tax benign, arrangement.

TD 2018/D3 also fails to explain why the change in approach by the ATO was not implemented when the trust cloning exemption was abolished for discretionary trusts by the government without warning on 31 October 2008.

Trust splitting was extremely prevalent at the time of the removal of the trust cloning roll-over relief. Indeed, a cursory level of research would have demonstrated that leading tax specialists recommended trust splitting as the preferred approach to trust cloning for years before and after 2008 due to its effectiveness from a stamp duty perspective in some states.

2018 federal Budget attack on excepted trust income

The announcement in the 2018 federal Budget that "the concessional tax rates available for minors receiving income from testamentary trusts will be limited to income derived from assets that are transferred from deceased estates or the proceeds of the disposal or investment of those assets" was, for many, a surprise.

As is usually the case with Budget announcements attacking perceived arbitrage revenue opportunities, the exact impact of the changes will revolve almost entirely around how the legislation is crafted — the 2017 Budget changes to the small business CGT concessions[9] being a recent a high-profile example of what appeared at announcement to be a narrowly focused change that, in fact, has proven to be significantly wider.

Thus, advisers in the estate planning industry should likely be concerned as to what the government means by suggesting that the mischief to be addressed is "that some taxpayers are able to inappropriately obtain the benefit of (a) lower tax rate by injecting assets unrelated to the deceased estate into testamentary trusts".

In turn, the Budget statement that the "measure will clarify that minors will be taxed at adult marginal tax rates only in relation to income of a testamentary trust that is generated from assets of a deceased estate (or the proceeds of the disposal or investment of these assets)" also has the distinct prospect of having much wider consequences than might otherwise be expected.

Excepted trust income rules currently

One of the author's previous articles in this journal[10] explained that, pursuant to Div 6AA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) and, in particular, s 102AG(2)(a)(i) ITAA36, excepted trust income is the amount which is assessable income of a trust estate that resulted from a will, codicil or court order varying a will or codicil.

Where income is excepted trust income and it is distributed to minors, those minors are taxed as adults, instead of the normal penal rates that otherwise apply to unearned income.

Currently, s 102AG(2)(a)(i) and (d)(i) make it clear that the provisions are not limited to income derived from estate assets.

Importantly, the subsections only prescribe how the trust estate is deemed to have arisen and do not place any limitations on the management of the trust estate, or on the assets which the trust may hold.

The fact that estate assets forming part of the trust estate may be realised and others may be acquired has no implications on the validity of a testamentary trust, nor the ability of the trustee of a testamentary trust to treat the income as excepted.

Similarly, if the trustee decides on behalf of the testamentary trust to borrow money and acquire assets which earn income, it has generally been accepted that Div 6AA applies to that income.

Current limitations

Section 102AG(3) currently contains an exception for non-arm's length arrangements. In particular, it provides that if any two or more parties to:

> "(1) the derivation of the excepted trust income mentioned in subsection (2); or
>
> (2) any act or transaction directly or indirectly connected with the derivation of that excepted trust income,
>
> were not dealing with each other at arm's length in relation to the derivation of income, or in relation to the act or transaction, the excepted trust income is only so much (if any) of that income as would have been derived if they had been dealing with each other at arm's length in relation to the derivation, or in relation to the act or transaction."

Furthermore, s 102AG(4) provides that an amount will not be treated as excepted trust income if it was derived by a trustee as a result of an agreement entered into for the purpose of securing that the income would be excepted trust income.

Furse's case

The Trustee for the Estate of the late AW Furse No. 5 Will Trust v FCT[11] is one of the few reported decisions dealing with Div 6AA. In this case, a will made in July 1974 established multiple testamentary trusts, each with capital of $1 after the testator passed away shortly after making the will. A trustee was then appointed over one of the testamentary trusts and proceeded to borrow small amounts of money and acquire a unit in a unit trust.

The ATO did not consider the income from the unit as excepted income and argued that the income derived by the trustee was not assessable income of a trust estate that "resulted from a will".

Justice Hill rejected the ATO's argument and held that it was only necessary that the parties be dealing on an arm's length basis, and that it was not necessary that they also be arm's length parties.

The court noted that, provided the trust estate was created by a will and the arm's length test was satisfied, any income of a testamentary trust would be considered as excepted trust income.

What might new rules attack?

Taken at face value, the new rules will simply create an obligation on trustees to track the source of assets in a testamentary trust and ensure that the income to be treated as excepted trust income is sourced from assets passing directly to the trust from the willmaker.

In theory, this type of probation would be similar to what is currently the case with post-death testamentary trusts (often referred to as estate proceeds trusts) set up to comply with s 102AG. Indeed, this style of tracking mechanism is analogous to that which trustees are meant to undertake in relation to ensuring that trust assets vest within the perpetuity period. Thus, any further assets gifted or settled on a testamentary trust, other than by the willmaker, would be segregated for excepted trust income purposes.

Depending on the drafting approach adopted, however, some areas that may be impacted on (potentially unintentionally) by the new rules include:

- Assets that form part of a testamentary trust that are not owned outright by the willmaker (that is, are subject to existing borrowings) — what happens as the level of debt changes?
- Even if assets that initially form part of the testamentary trust are debt-free, what are the consequences if further assets are acquired using the initially contributed assets as security?
- If an asset class at the date of death of the willmaker is cash at bank, does the tracing of the assets acquired continue indefinitely?
- If assets acquired using borrowings no longer generate access to excepted trust income, is it appropriate that tax laws also directly impact the investment decisions of trustees?
- If an asset acquired is itself tax advantaged (one obvious example in this regard being insurance bonds), how will the proceeds from the investment be treated?
- In relation to shares, how will dividend reinvestment arrangements be treated?
- How will assets that are acquired by the testamentary trust as a consequence of the willmaker's death, but are not directly from the willmaker, be treated, for example, will superannuation death benefit payments and insurance policy payouts to an estate be considered to be legitimate capital from which to source excepted trust income?
- Particularly for those in life spouse relationships, it is common for testamentary trusts to be established under each person's will and for there to be a subsequent merger of the trusts some years later. What will be the approach in relation to wealth that passes to a testamentary trust sourced from another testamentary trust?

> *"... the 2018 changes mean that it is critical that estate planning advisers fully understand the impact."*

Some further questions

Testamentary trusts (and, in turn, access to excepted trust income) only arise because someone has died. Traditionally, in Australia, death has not been seen as a tax planning strategy. The Budget announcement arguably changes the position in this regard.

If there is, in fact, widespread abuse of the existing rules in this area, it must be asked why there is essentially only one reported case in the area that is now over 25 years old and remains unchallenged, and, in turn, what aspects of the offensive arrangements are not already addressed by s 102AG itself or, in the alternative, Pt IVA ITAA36?

Family law CGT roll-overs

The decision in *Ellison v Sandini Pty Ltd*[12] provides clarity for tax practitioners assisting clients involved in a relationship breakdown. In particular, the split decision of the Full Federal Court has reconfirmed the generally accepted historical position in relation to CGT roll-over relief on marriage breakdowns. In September 2018, the High Court refused leave to appeal the Full Federal Court decision.

While perhaps not directly related to estate planning, given that the majority of family groups endure at least one relationship breakdown, it is an area that specialist estate planning advisers must have a working knowledge of.

Among a range of technical issues, the case explored the requirements to access the CGT roll-over relief contained in Subdiv 126-A ITAA97 for relationship breakdowns. In unwinding the original court decision, which held that the roll-over relief was available for assets transferred to a family trust controlled by one of the parties, the Full Federal Court confirmed that relief is only available where the asset is being transferred to the spouse personally.

Background

The facts in *Ellison v Sandini Pty Ltd* were largely uncontroversial and are outlined in the original decision (published as *Sandini v FCT*[13]). In summary:

- the former wife, Ms Ellison, obtained an order from the Family Court requiring mining shares to the value of $2.5m held by a company named Sandini Pty Ltd to be transferred to her as part of a property settlement with her former husband, Mr Ellison;
- a week after the Family Court orders were made, Ms Ellison emailed Mr Ellison to request that the shares be transferred to the corporate trustee of a family trust which she controlled, rather than to her personally; and
- Mr Ellison complied with the request and the shares were transferred by Sandini Pty Ltd to the family trust nominated by Ms Ellison.

The original judgment explored a number of issues, including whether CGT event A1[14] occurred "because of" the making of the Family Court order and whether the change of "beneficial ownership" alone was sufficient to trigger CGT event A1.

From a tax perspective, however, arguably of most interest was the court's comments in relation to the roll-over relief in Subdiv 126-A.[15] The Federal Court held that (despite the Commissioner's arguments), s 126-15 ITAA97 did not require the former spouse to be the transferee of the shares. Instead, Ms Ellison's direction to Mr Ellison to transfer the shares to the family trust

was sufficient "involvement" to obtain access to the CGT relief.

This conclusion, at least according to the ATO, was an unsustainable interpretation, hence the appeal.

Property settlements

There are three main alternatives to achieving resolution of a property dispute under the *Family Law Act 1975* (Cth), namely:

(1) consent orders of the court;

(2) a formal order of the court; and

(3) a binding financial agreement.

Generally speaking, any of the orders or agreements above will often result in transfers of assets on the dissolution of a marriage and will be deemed to be disposals for CGT purposes. As a result, it is essential that CGT is taken into account when determining the allocation of assets on marital breakdown.

Historically, it has generally been assumed that the availability of the CGT roll-over relief was relatively limited. Best practice is therefore that the parties determine to what extent any CGT will be payable and by whom before any agreement is reached in relation to asset allocation.

In particular, where an asset is owned via a family trust or company, the ATO's view (as articulated in *Sandini*) is that roll-over relief is only available where the relevant asset is transferred from the entity to a spouse of the relationship. Therefore, relief is not available where the asset is transferred to an entity (such as a company or trust) that the spouse controls.

Subdivision 126-A

Subdivision 126-A[16] sets out the particular roll-over provisions available to spouses in the event of a CGT event being triggered due to a marriage breakdown. The provisions operate automatically regardless of the wishes of the parties and therefore no election is required.

The ITAA97 divides the CGT events applicable on a marriage breakdown into "disposal cases" and "creation cases".

In situations where an asset is disposed of pursuant to a court order or a court-approved agreement and the relevant asset was acquired by the transferor on or after 20 September 1985, the cost base (or reduced cost base) of the transferee spouse is equal to the cost base of the transferor at the time of the disposal.

In situations where the transferor acquired the asset on or prior to 19 September 1985 and the roll-over relief is available, the transferee will also assume the transferor's position, that is, the asset will retain its pre-CGT status.

The key requirement of Subdiv 126-A which was in contention in *Sandini* was s 126-15, which provides:

> "There are roll-over consequences in section 126-5 if the trigger event involves a company (the ***transferor***) or a trustee (also the ***transferor***) and a spouse or former spouse (the ***transferee***) of another individual because of … a court order under the *Family Law Act 1975* …"

The ATO argues that the reference to "a spouse or former spouse (the transferee)" requires that the individual spouse is the personal recipient of the assets, rather than a trust or company that the spouse controls.

The original decision in *Sandini* held that s 126-15 merely required Ms Ellison to be "involved" in the transfer, which was clearly satisfied by virtue of her direction to Mr Ellison to transfer the shares to the family trust.

Appeal decision

On appeal to the Full Federal Court, the ATO (and Ms Ellison) were successful in arguing that the requirements of Subdiv 126-A were *not* met by the transfer. As a consequence, presumably, Sandini Pty Ltd (controlled by the former husband) would be subject to CGT on the parcel of shares that were transferred and Ms Ellison (via the nominated trust) would receive a market value cost base for those shares, at the date of the transfer.

The decision

The key points from the Full Federal Court decision in relation to the CGT aspects can be summarised as follows:

- all of the judges agreed that CGT event A1 had occurred;
- in his dissenting and concise judgment, Logan J felt that the appeal should be dismissed and agreed with the reasoning around Subdiv 126-A outlined in the original decision. In particular, Logan J said: "The Commissioner's submission that a transfer must be to a spouse or former spouse has no textual support in s 126-15 … on any view, Ms Ellison was involved in that event. She was the beneficiary of the order. It was by her direction that her desired registration of the shares occurred. That is involvement in a CGT event … These circumstances constitute sufficient 'involvement' in the CGT event for the purposes of s 126-15 of ITAA97. Thus, rollover is available";
- in contrast, the majority found that s 126-15 did, in fact, require the transferee to be the former spouse personally. Jagot J observed: "In my view, s 126-15 means that a spouse or former spouse is involved in the trigger event in one capacity only, as transferee from a company or a trustee";
- in coming to this conclusion, the majority acknowledged the relevance of Subdiv 126-A's predecessor, the former s 160ZZMA ITAA36, which contained clearer language around the requirement for the former spouse to individually be the transferee; and
- the court was largely unconcerned by procedural irregularities regarding the transfer, including that, by transferring the shares to the family trust rather than Ms Ellison, the transfer was not, in fact, in accordance with the terms of the order.

Some lessons

There are some key lessons that all advisers should take from this case, as highlighted by the appeal decision. In summary:

- the decision starkly confirms the ATO's long-held view that roll-over relief under Subdiv 126-A is only available where the assets are transferred to a former spouse personally (and not to a company or trust they control);
- the outcome also highlights that it is prudent to ensure that both parties acknowledge and agree the intended tax outcome as part of the property settlement. This is important to avoid a situation where one spouse (here, Ms Ellison) has competing interests from the other spouse and, arguably unusually, actively sides with the ATO. Here, a tax windfall has essentially been triggered for Ms Ellison's trust (being that it receives a market value cost base for the shares, rather than inheriting Sandini Pty Ltd's cost base) and the ATO (in that tax will be collected where CGT roll-over could have been easily obtained), all to the detriment of Mr Ellison (via Sandini Pty Ltd);
- to this end, advisers allowing clients to enter into property settlements without specific tax advice and inclusion of

appropriate indemnities in the orders are arguably on notice as a result of this case, even if it is appealed; and

- finally, the case shows the importance of ensuring that any court orders or binding financial agreements are drafted in a competent manner and are complied with strictly in accordance with their terms, given many aspects of this litigation would simply not have arisen but for the "procedural" errors.

Conclusion

In modern estate planning, significant complexities from the interaction between the legislation relating to tax, trusts, bankruptcy, family law and superannuation have been omnipresent.

Ongoing changes to the superannuation regime aside, estate planning has largely been exempt from radical simultaneous rule overhauls. 2018 will be seen as an outlier to this position, at least in recent years.

With the post-baby boomer intergenerational wealth transfer wave gathering pace, the 2018 changes mean that it is critical that estate planning advisers fully understand the impact of the changes and invest to monitor their ongoing impact.

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View Legal

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