

## Some good news for the ATO (and 1 taxpayer) as normal order is restored for family law CGT rollovers

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The recent appeal decision in *Ellison v Sandini Pty Ltd* [2018] FCAFC 44 (reported at para [387] of this *Bulletin*) provides clarity (pending any further appeal) 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 rollover relief on marriage breakdowns.

Amongst a range of technical issues, the case explored the requirements to access the CGT rollover relief contained in Subdiv 126-A of the ITAA 1997 for relationship breakdowns. In unwinding the original Court decision, which held that the rollover relief was available for assets transferred to a family trust controlled by 1 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 of the case were largely uncontroversial and are outlined in the original decision (published as *Sandini v FCT* [2017] FCA 287) ("Sandini") (reported at 2017 WTB 13 [401]).

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.
- 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 judgement explored a number of issues, including whether CGT event A1 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 rollover relief in Subdiv 126-A. The Federal Court held that (despite the Commissioner's arguments), s 126-15 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 3 main alternatives to achieving resolution of a property dispute under the Family Law Act 1975, namely:

- consent orders of the Court;
- a formal order of the Court; and

- 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 in determining the allocation of assets on marital breakdown.

Historically, it has generally been assumed that the availability of the CGT rollover 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 rollover 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**

Division 126-A of the ITAA 1997 sets out the particular rollover 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 ITAA 1997 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, then 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 rollover relief is available, then 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...*

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 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 a beneficiary of the order. It was by her direction that the 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 ITAA 1997. 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 trustee."
- In coming to this conclusion, the majority acknowledged the relevance of Subdiv 126-A's predecessor, the former s 160ZZMA of the ITAA 1936, which contained clearer language around the requirement for the former spouse to individually be the transferee.
- 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 (or, all's fair in love and war)***

There are some key lessons 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 rollover 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 both parties acknowledge and agree the intended tax outcome as part of the property settlement. This is important to avoid a situation where 1 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 rollover 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.
- Finally, the case shows the importance of ensuring 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.