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# THE CLIENT LIFE CYCLE: CHALLENGES AND OPPORTUNITIES

Your client tells you that they are separating from their spouse or de facto partner.

What do you do next?

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# ***1 Introduction***

## **Your client tells you that they are separating from their spouse or de facto partner. What do you do next?**

It is highly likely that at some point, you will have a client who is contemplating separating from their spouse or de facto partner. As you work with these clients on an ongoing basis, you are often the first professional they reach out to for guidance during separation.

Family law is a rapidly evolving and publically debated area of law. It covers issues such as property settlement, spouse or de facto maintenance and superannuation splitting. Having a basic understanding of family law will enable a tax adviser to better protect clients and their own practice.

This paper will detail the family law journey that each separating client may embark on. Further, it will highlight the key areas of overlap where a tax adviser may become involved in the client's family law journey.

## ***2 Does a client need both family law advice and tax advice?***

### **2.1 The duty to obtain specialist taxation advice**

In each profession, there is the phone call from a client that we never want to receive, and the prospect of receiving that phone call keeps you awake at night. For family lawyers, one of those phone calls comes from a client, whose matter settled about a year ago, and who has now realised that the 60% they received in their property settlement was not really 60%, when you take into account the tax bill they just received from the ATO!

In order to properly advise on the division of assets and changes to entity and financial structures, family lawyers must be aware of how tax may affect the bottom line and the true value of assets.<sup>1</sup>

From the perspective of the family lawyer, there is a clear duty to either advise clients on tax aspects of their family law matter or obtain the necessary specialist tax advice.<sup>2</sup> However, most family lawyers are not qualified to give accounting advice, and the standard of advice required by family lawyers does not extend to high risk tax advice.<sup>3</sup>

### **2.2 The relevant statistics**

In 2017, the Family Court of Western Australia received 5,341 divorce applications, and finalised 5,760. This is an increase of 7.8% in divorce applications received by the Family Court of Western Australia in 2013.<sup>4</sup>

The figures for de facto separation are harder to ascertain, however we do know that the marriage rate has generally decreased over the last 30 years, as parties choose to cohabit prior to marriage. In 2016, 81% of couples lived together prior to marriage, compared to 16% of marriages in 1975.<sup>5</sup>

Couples who separate after a de facto relationship tend to be younger and have shorter relationships whilst living together. As a result, only 4% of de facto couples report having net assets in excess of \$500,000 at separation, compared to 17.6% of married couples.<sup>6</sup>

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<sup>1</sup> Arlene McDonald (1998) "Tax and the Family Lawyer – Let's Be Practical", *TVEd.net.au*.

<sup>2</sup> "Clearly, the position is that solicitors have the duty to advise their clients on tax aspects of whatever matter they are acting in, or they must obtain, from other tax-competent practitioners, the necessary specialist tax advice for the benefit of the client." Robert O'Connor QC, "The duty of solicitors to give tax advice" (February 1998) 25(1) *Brief (WA)*.

<sup>3</sup> *Bayer v Balkin* (1995) ATC 4609.

<sup>4</sup> "Family Court of Western Australia Annual Review 2017" (2018) *Family Court of Western Australia*.

<sup>5</sup> "Marriage and divorce rates" (2018) *Australian Institute of Family Studies*.

<sup>6</sup> Qu, Weston, Moloney, Kaspiew, and Dunstan, "Post-separation parenting property relationship dynamics after five years" (2014) *Australian Institute of Family Studies*.

The median age that people divorce has also increased over the last 30 years. People are generally now separating in their early to mid-40's, rather than their early 30's.<sup>7</sup> From a financial perspective, we can infer that more people are experiencing divorce at a mature age when they have worked longer and established themselves financially. Parties with higher net assets (>\$500,000), are more likely to utilise formal court pathways and the assistance of lawyers, with 50.6% of high wealth clients using lawyers to reach a property settlement.<sup>8</sup>

## 2.3 The benefits of complementary family law and taxation advice

It is not sufficient for family lawyers to vaguely direct clients to obtain independent accounting advice, and revert back with the answers.<sup>9</sup> Unfortunately, it is not uncommon for this to occur.

In defence of family lawyers, one of the difficulties in convincing the client to get the specialist tax advice is the cost – especially when they are already coming to terms with the financial impact of their separation and paying for their family lawyers.

The art is, of course, in how we as family lawyers explain to our client what the benefit is of obtaining that specialist taxation advice, and in particular making them aware that without the specialist taxation advice, their 60% may not actually be 60%.

Just as family lawyers are unaware of what some of the taxation implications and solutions are, many accountants are not aware of what the legal options for property settlement are, and accordingly, may give accounting advice that does not properly consider all the settlement options. Our role together, is to give well-rounded advice that lays the financial framework for our clients to flourish even after enduring the financial effects of their divorce.

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<sup>7</sup> "Marriages and Divorces, Australia 2016" (November 2017) *Australian Bureau of Statistics*, Catalogue No. 3310.0.

<sup>8</sup> *Ibid.*

<sup>9</sup> *Hurlingham Estates v Wilde & Partners* [1997] 1 Lloyd's Rep 525; and *Briar Holdings Pty Ltd v Capolingua* (1997) 37 ATR 135.

### ***3 Navigating the collision of emotions and commerciality: unavoidable property settlement truths to keep in mind***

One of the odd things about property settlement is that soon after a separation, when emotions are still raw, parties are expected to act in a commercially sensible way regarding the division of their assets.

Part of our joint role as advisors to separating clients is to help them (respectfully and gently) move past their initial emotional reactions, and to come to terms with some of the unavoidable truths of property settlement. Here are my top four:

**You will not be in the same financial position before and after your divorce.**

Inevitably each parties' lifestyle and financial security is compromised by a separation. The standard of living and financial security is better together than apart.

**No one can give you 100% certainty about how much you will receive in your property settlement.**

I often hear mediators, some of whom are former Family Court Judges, say "you have 6 Judges in the Family Court, give them this case, and you might get 6 different answers". They often follow that up with "but an experienced family lawyer can usually predict a range within which the answer lies".

**While everyone wants to finalise their property settlement immediately, delay is inevitable if parties require the Family Court to decide their case.**

In 2017, the median time for a matter to proceed to trial in the Family Court of Western Australia was **97 weeks**, whilst the median time for financial-only matters was **91.5 weeks** (an increase of 18.8% from 2016).<sup>10</sup> The higher the asset pool for division, typically the longer timeframe to finalisation (70.9% of cases with net assets over \$500,000 take a year or longer to conclude, compared to 43.5% of cases with net asset pools under \$40,000).<sup>11</sup>

Litigating all the way to final trial is a lengthy and costly process. Pursuing the "principle" must always be weighed against the costs of litigation.

More importantly, even after property settlement, parties may be co-parents for life, and property matters should be conducted in a manner that will decrease animosity in the long term. Generally speaking, the lengthier the litigation, the greater the animosity.

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<sup>10</sup> Family Court of Western Australia Annual Review 2017 (2018) *Family Court of Western Australia*.

<sup>11</sup> Qu, Weston, Moloney, Kaspiew, and Dunstan, "Post-separation parenting property relationship dynamics after five years" (2014) *Australian Institute of Family Studies*.



## **4 De Facto Relationships**

### 4.1 What is a de facto relationship?

A de facto relationship is a “marriage-like” relationship between two persons who live together.<sup>12</sup>

The following factors are indicators of whether or not a de facto relationship exists between 2 persons, but are not essential —

- the length of the relationship between them;
- whether the 2 persons have resided together;
- the nature and extent of common residence;
- whether there is, or has been, a sexual relationship between them;
- the degree of financial dependence or interdependence, and any arrangements for financial support, between them;
- the ownership, use and acquisition of their property (including property they own individually);
- the degree of mutual commitment by them to a shared life;
- whether they care for and support children; and/or
- the reputation, and public aspects, of the relationship between them.<sup>13</sup>

A person may have multiple de facto relationships or be in a de facto relationship whilst being legally married to another person.<sup>14</sup>

### 4.2 Jurisdiction of the Family Court of Western Australia to make orders in relation to de facto financial matters

Married couples, and de facto couples in all states excluding Western Australia, are subject to the provisions in the *Family Law Act 1975* (Cth). Western Australia has retained separate State family law legislation, the *Family Court Act 1997* (WA), which prescribes the law in relation to relationship breakdown for Western Australian de facto couples.

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<sup>12</sup> *Interpretation Act 1984* (WA), section 13A(1).

<sup>13</sup> *Interpretation Act 1984* (WA), section 13A(2).

<sup>14</sup> *Interpretation Act 1984* (WA), section 13A(1).

#### 4.2.1 Circumstances where the Family Court of Western Australia may make orders

The Family Court of Western Australia may make orders for de facto property adjustment and/or de facto partner maintenance only where:

The parties have been in a de facto relationship for at least **2 years** (having consideration to any break in the continuity of the relationship); **or**

There is a **child of the de facto relationship under 18** and failure to make the order would result in serious injustice to the partner caring or responsible for the child; **or**

The person applying for property orders has **made substantial financial, non-financial, or homemaker and/or parenting contributions** to the acquisition and conservation of property or to the welfare of the family, and failure to make the order would result in serious injustice to them.<sup>15</sup>

#### 4.2.2 Geographical Requirements

De facto parties seeking financial orders is the Family Court of Western Australia must also demonstrate a geographical connection with Western Australia. The Court must be satisfied that:

One or both of the parties were resident in Western Australia on the day on which the application for property orders was made; **and**

Either:

- Both parties have resided in Western Australia for at least **one third** of the duration of their de facto relationship; **or**
- The person making the application has made **substantial financial, non-financial, or homemaker and parenting contributions** have been made in Western Australia.<sup>16</sup>

“Substantial contributions” is not defined in the *Family Court Act 1997*, however the Court has stated that “*substantial means something more than usual or ordinary*”, and must be “*exceptional circumstances*” where serious injustice may be caused if orders are not made.<sup>17</sup>

In the diversity of relationships that present before courts, what is “usual” or “ordinary” will be determined by reference to the facts of the case. Accordingly, what constitutes “substantial” contributions will be interpreted in the context of the parties’ financial position.<sup>18</sup>

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<sup>15</sup> *Family Court Act 1997* (WA), section 205Z.

<sup>16</sup> *Family Court Act 1997* (WA), section 205X.

<sup>17</sup> *V & K* [2005] FCWA 80 at 21.

<sup>18</sup> *Harriott & Arena* [2016] FamCAFC 69 at 59 – 66. See also *Thorburn and Oswald* [2007] FCWA 43 at 54.

### 4.3 How does the law in relation to de facto financial separation differ to married parties?

Western Australian de facto couples who meet the above jurisdictional requirements set out in the *Family Court Act 1997* (WA) may apply to the Family Court of Western Australia for orders for property settlement<sup>19</sup> or de facto partner maintenance.<sup>20</sup>

The provisions for property settlement and partner maintenance for de facto couples under the *Family Court Act 1997* (WA) effectively mirror the like provisions for married couples under the *Family Law Act 1975* (Cth). Accordingly, de facto couples and married couples will have substantially the same rights and remedies in relation to financial orders.

However the difference in jurisdiction subsists, and the following key distinctions between de facto and matrimonial financial matters should be noted:

#### **The characterisation of superannuation entitlements as property**

De facto couples in Western Australia are unable to split their superannuation entitlements. The Family Court of Western Australia does not have the power to make orders in relation to superannuation interests by virtue of constitutional limitations on the Court's power.<sup>21</sup> For Western Australian de facto couples, superannuation entitlements will be characterised as a financial resource to be considered only, not as property available for division.

Married couples are able to split their superannuation interests in a property settlement, as superannuation entitlements are characterised as property under section 90MC of the *Family Law Act 1975* (Cth).

#### **Limitation Date**

Parties seeking financial orders must bring an application prior to their prescribed limitation date. Failure to do so may result in the Family Court of Western Australia declining to institute proceedings. Parties who seek to bring an application out of time must demonstrate that they would suffer hardship if leave to apply was not granted.

The limitation date for married couples seeking financial orders is **1 year** from the date their divorce was finalised.<sup>22</sup>

De facto couples seeking financial orders must bring an application within **2 years** from the date of final separation.<sup>23</sup> This may be problematic where parties disagree on the precise date of final separation.

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<sup>19</sup> *Family Court Act 1997* (WA), section 205ZG.

<sup>20</sup> *Family Court Act 1997* (WA), section 205ZC.

<sup>21</sup> *B and G* [2010] FCWA 33 at 6.

<sup>22</sup> *Family Law Act 1975* (Cth), section 44(3).

<sup>23</sup> *Family Court Act 1997* (WA), section 205ZB(1).

### Separation on a Final Basis

In *Stanford*, the High Court of Australia held that the Family Court has power under the Constitution to make orders in relation to the property of married couples who were not voluntarily separated.<sup>24</sup>

Conversely, the Family Court will not make orders for property settlement in circumstances where de facto couples are not separated on a final basis.<sup>25</sup>

## 4.4 Key Takeaway Points – How You Can Help

**Identify de facto relationship as early as possible.** Too many clients start living with their partner before understanding the potential financial implications. Your client will thank you for identifying the potential issue, referring them for advice and potentially saving them from unforeseen de facto property settlement claim.

**For wealthy parents, consider de facto relationships (or future de facto relationships) of their children, in the estate plan, business succession plan and wealth transfer plan.** Too often, wealthy parents become involved in property settlement disputes after short de facto relationships entered into by their children. What is the status of monies given to children – are they loans or gifts? What is the status of beneficiary loan accounts involving children? Can a child rely on a stream of income from a discretionary Trust? Does a child control a discretionary Trust? Early collaboration between the tax adviser, the estate lawyer and the family lawyer can help avoid this nightmare scenario for your client.

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<sup>24</sup> *Stanford v Stanford* (2012) 247 CLR 108 at 45.

<sup>25</sup> *Family Court Act 1997* (WA), section 205ZB(1).

## ***5 Family Law: Understanding the broad framework***

### **5.1 How does the Family Court decide a property settlement? The 4 Step Process**

The Family Court of Western Australia ordinarily approaches the division of matrimonial assets and liabilities in a manner commonly known as “*the four step process*”<sup>26</sup>. That process arises from relevant considerations prescribed under section 79 of *Family Law Act 1975*<sup>27</sup>, and is summarised as follows:

**The first step is to determine the net asset pool available for division.**

This step includes the identification and valuation of each asset and liability for which the parties have a legal or equitable interest.

**The second step involves assessing contributions made by the parties.**

This step involves ‘looking backwards’ at the contributions that each party has made to the acquisition, conservation and improvement of matrimonial assets. These contributions include contributions to property (direct and indirect financial and non-financial contributions) and contributions to the welfare of the family (homemaker and parenting contributions)<sup>28</sup>

**The third step involves considering the parties’ future needs**

This ‘looking forward’ considers specific factors, including respective earning capacities, age, health, and the care of any minor children.

**The fourth step is a consideration of ‘who gets what’ and whether the proposed orders are just and equitable in all the circumstances.**

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<sup>26</sup> Pursuant to the recent High Court decision in *Stanford v Stanford* (2012) 247 CLR 108, decision makers must first assess under section 79(2) of the *Family Law Act 1975* (Cth) whether it is just and equitable to make a division of property **at all** before embarking on the four step process.

<sup>27</sup> The equivalent provision applying to de facto property settlements is section 205ZG *Family Court Act 1997* (WA).

<sup>28</sup> The evaluation and comparison of the parties’ contributions in these two distinct categories is difficult, as detailed by the Full Court of the Family Court in *Ferraro v Ferraro* (1992) 16 Fam LR 1 at 30 – 50. The Full Court in *Ferraro* also found that the assessment of contributions to the welfare of the family will not be confined to personal assets, but will extend to business assets acquired by the parties.

## 5.2 How can the financial relationship be finalised?

There are essentially four ways to formalise a property settlement:

Form 11 Application for Consent Orders;

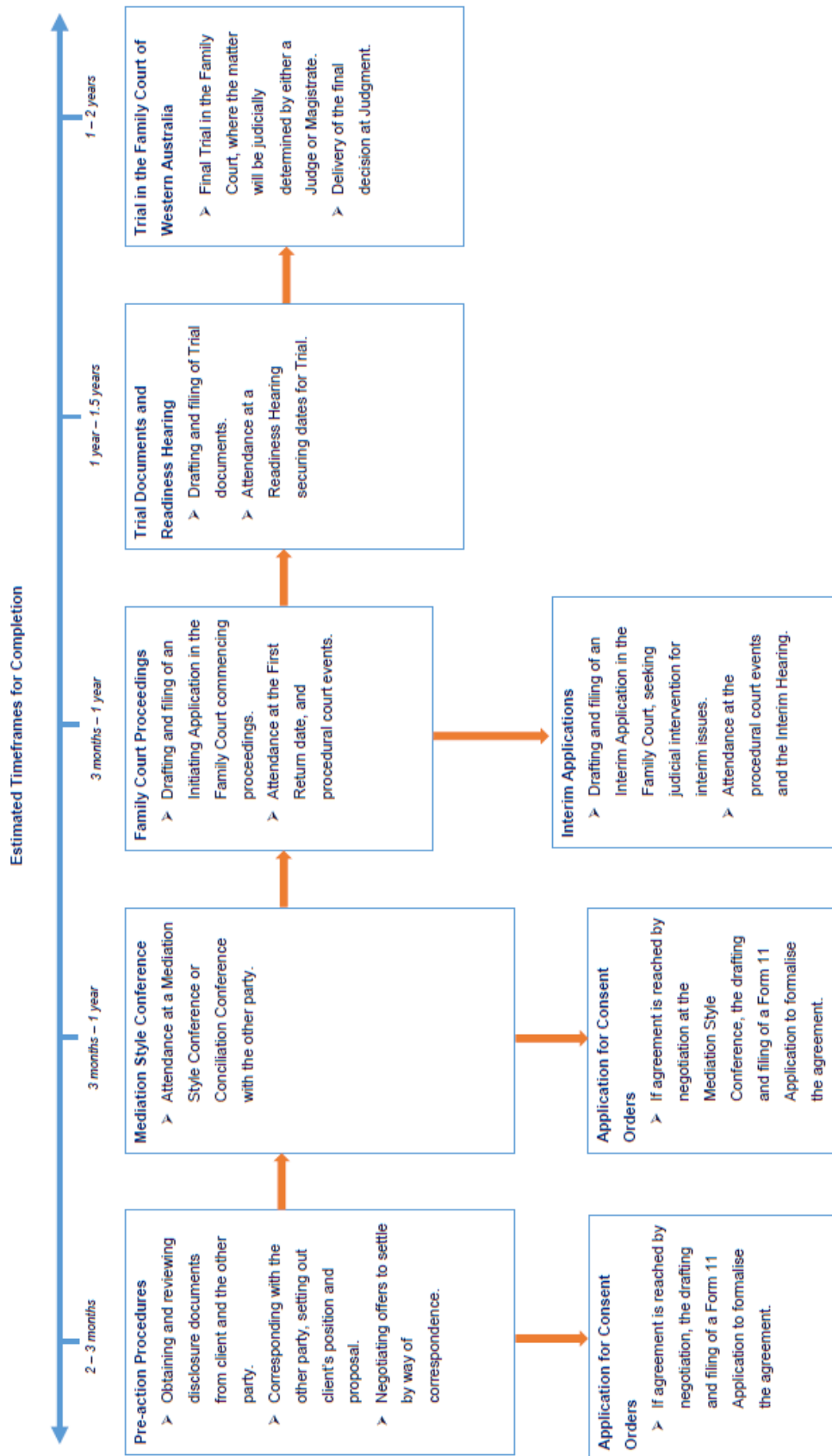
Minute of Consent Orders after commencing proceedings in the Family Court;

Judicial determination of Orders after a final Trial; or

Through private agreement (Binding Financial Agreement).

### 5.3 Pathways to Resolution

## Pathways to Resolution for a Financial Matter



## 5.4 Interim Applications

Given the delay between filing an initiating application for final orders and Trial in the Family Court, parties may be required to seek orders for interim financial relief pending final settlement.

Types of interim financial applications that can be sought in the Family Court include interim or partial property settlement, interim spousal or partner maintenance, costs orders and litigation funding, child support departure orders and injunctive relief (such as restraints on use funds).



## 6 Disclosure

### 6.1 Duty of disclosure

Parties have a duty to the Court and to each other, to provide full and frank disclosure of all information and documents relevant to the case in a timely manner.<sup>29</sup>

The duty of disclosure is an ongoing obligation, commencing in pre-action procedures and only ending once financial proceedings are finalised.<sup>30</sup>

### 6.2 What documents are parties required to produce?

#### 6.2.1 Specific duty of disclosure in financial cases

##### **Disclosure of Financial Circumstances**

Rule 13.04 of the *Family Law Rules 2004* (Cth) states that a party must provide full and frank disclosure of their financial circumstances, including but not limited to:

Their income and earnings, including any income received by entities under their control;

Any vested or contingent interest in property, including in any entities partially or wholly owned by them;

Any financial resources;

Any interest in a trust of which they are an appointor, trustee, or beneficiary; and

Any property they have disposed of from the 12 months immediately before the separation of the parties to present without the consent or knowledge of the other party;

##### **Exchange of Disclosure Prior to First Court Date**

At least 2 days before the first court date in a property case, each party must, as far as practicable, exchange with each other party a copy of all of the following specific documents:

A copy of their 3 most recent taxation returns and assessments;

Documents about any superannuation interest they are entitled to, including:

- A completed superannuation information form for the superannuation interest; or

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<sup>29</sup> *Family Law Rules 2004* (Cth), Rule 13.01(1).

<sup>30</sup> *Family Law Rules 2004* (Cth), Rule 13.01(2).

- If the party is a member of a self-managed superannuation fund--a copy of the trust deed and the 3 most recent financial statements for the fund;

In relation to any companies they have an interest in:

- A copy of the financial statements for the 3 most recent financial years, including balance sheets, profit and loss accounts, depreciation schedules and taxation returns;
- A copy of the corporation's most recent annual return that lists the directors and shareholders; and
- A copy of the corporation's constitution;

In relation to any trusts they have an interest in:

- A copy of the financial statements for the 3 most recent financial years, including balance sheets, profit and loss accounts, depreciation schedules and taxation returns; and
- A copy of the trust deed;

In relation to any partnership they have an interest in:

- A copy of the financial statements for the 3 most recent financial years, including balance sheets, profit and loss accounts, depreciation schedules and taxation returns; and
- A copy of the partnership agreement;

Business activity statements for the 12 months ending immediately before the first court date (whether individual or for an entity);

Unless the value is agreed – a market appraisal or an opinion as to value in relation to any item of property in which a party has an interest.

Any other document relevant to an issue in dispute.<sup>31</sup>

### **Form 13 Financial Statement**

When filing an initiating or response application for financial orders, each party must also file a Form 13 Financial Statement.<sup>32</sup> The Form 13 Financial Statement is a prescribed form issued by the Family Court, in which parties must comprehensively set out their income, expenses, assets, liabilities, and financial resources.

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<sup>31</sup> *Family Law Rules 2004* (Cth), Rule 12.02.

<sup>32</sup> *Family Law Rules 2004* (Cth), Rule 13.05(1).

If your client is aware that the confines of the Form 13 Financial Statement form will not fully set out their financial circumstances, they must detail any further particulars in an Affidavit.<sup>33</sup>

## 6.3 Consequences of non-compliance with disclosure

Failure to comply with the duty of disclosure can have an adverse effect upon the presentation of a client's case and their credibility at Trial. Failure to disclose may disentitle a party to rely on undisclosed documents at Trial.

Further, where one party has consistently not complied with their duty of disclosure, the Family Court has discretion to make adverse findings against the innocent party. As stated by Justice Young in *Kannis & Kannis*:

*"Whether the non-disclosure is wilful or accidental, is a result of misfeasance, or malfeasance or nonfeasance, is beside the point. The duty to disclose is absolute. Where the Court is satisfied the whole truth has not come out it might readily conclude the asset pool is greater than demonstrated. In those circumstances it may be appropriate to err on the side of generosity to the party who might be otherwise be seen to be disadvantaged by the lack of complete candour."*<sup>34</sup>

In the event that property settlement is finalised and it subsequently comes to light that a party had not disclosed significant information, orders may be set aside or reopened on the basis of material non-disclosure.<sup>35</sup>

In the most extreme of cases, parties who show a flagrant disregard in ongoing non-compliance with their duty of disclosure may be punished for contempt of Court.

## 6.4 Use of disclosed documents

### 6.4.1 Statutory limitations and penalties for the improper use of documents

A person who obtains information and documents obtained in the course of proceedings is not permitted to use them for any other purpose other than the case at hand, nor disclose their contents to any other person.<sup>36</sup>

Section 121 of the *Family Law Act 1975* (Cth)<sup>37</sup> states that a party must not publish in a newspaper or periodical publication or by radio broadcast, television or other electronic means, or otherwise disseminate to the public or to a section of the public by any means:

The names of the parties;

<sup>33</sup> *Family Law Rules 2004* (Cth), Rule 13.05(2).

<sup>34</sup> *Kannis & Kannis* [2002] 172 FLR 464 per Young J. See also *Weir & Weir* (1992) 110 FLR 403 at 33.

<sup>35</sup> *Family Law Act 1975* (Cth), section 79A(1)(a).

<sup>36</sup> *Family Law Rules 2004* (Cth), Rule 15.27(2).

<sup>37</sup> For the Western Australian equivalent for de facto couples, see *Family Court Act 1997* (WA), section 243.

Any account of any proceedings;

Any part of any proceedings, that identifies:

- a party to the proceedings;
- a person who is related to, or associated with, a party to the proceedings or is, or is alleged to be, in any other way concerned in the matter to which the proceedings relate; or
- a witness in the proceedings.

Parties who share details, documents, or identifying information in relation their family law matter in breach of section 121 may face serious consequences, including imprisonment or fines.

The scope for what will constitute dissemination is broad, including electronically and “*by any other means*”. Clients must be cautious of what they post on social media, text or email to friends and family.

Section 121(3) sets out a broad list of when particulars will be “identifying”, which includes details of party’s address, workplace, alias (including nicknames), physical description, or relationships or associations (e.g. “*my ex-wife*”). In short, if any details are published which would result in a party to proceedings being identified, the publishing party will have committed an indictable offence.

If your client is concerned that the information or documents they are disclosing are sensitive in nature, or have reason to believe that the other party will misuse the information, they can seek Family Court orders limiting who may inspect the documents.<sup>38</sup>

#### 6.4.2 The *Harman* Obligation and Exceptions

The family law statutory limitations on improper use of documents mirror the common law principle in *Harman v Secretary of State for the Home Department* [1983] 1 AC 280.<sup>39</sup> The *Harman* principle states that parties in court proceedings enter into an implied undertaking not use documents and information for any purpose other than that for which it was given.<sup>40</sup> The *Harman* obligation also extends to third parties who are provided with information and documents, and know that the material was generated in legal proceedings<sup>41</sup>

Notwithstanding the above, exceptions to the *Harman* obligation will apply where it is inconsistent with other legislation, specifically where it is inconsistent with child support legislation and taxation legislation.

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<sup>38</sup> *Church of Scientology of California v Dept of Health & Social Security* [1979] 3 All ER 97.

<sup>39</sup> *Pedrana & Pedrana* [2012] FamCA 348.

<sup>40</sup> *Hearne v Street* (2008) 235 CLR 125 at 96.

<sup>41</sup> *Hearne v Street* (2008) 235 CLR 125 at 109.

## Child Support Agencies

In *Hearne v Street*, a mother who had disclosed documents obtained in family law proceedings to the Child Support Agency was in breach of the *Harman* obligation. However, the High Court stated that that the *Harman* obligation must “yield” in circumstances where it is inconsistent with the provisions for parents to disclose their income under the *Child Support (Assessment) Act 1989* (Cth).<sup>42</sup>

## Australian Tax Office

The principle in *Hearne v Street* similarly applies to referrals of disclosed information and documents to the Australian Tax Office.

Clients should also be aware that where neither party or the Court refer tax fraud to the Australian Tax Office, an exception to *Harman* exists permitting the Commissioner to obtain documents used in the course of family law proceedings. In *Commissioner of Taxation & Darling*, the parties disposed of Family Court proceedings by consent, however the Commissioner was permitted to review the Family Court file for audit purposes.<sup>43</sup>

### 6.4.3 Referrals of Fraud to Government Agencies

As a federal court exercising Commonwealth judicial power, the Family Court of Australia has a public duty to protect the revenue of the Crown. Accordingly, the Family Court is able to take steps to ensure the Commonwealth is not defrauded by those who come before it in the course of litigation.<sup>44</sup>

Judicial officers of the Family Court have discretion whether to refer breaches of fraud or other offences to the relevant government bodies.<sup>45</sup>

## Australian Tax Office

In practice, judicial officers of the Family Court can, and do, refer breaches of taxation legislation to the Attorney-General or Australian Tax Office.<sup>46</sup>

The consequences of a referral to the Australian Tax Office may impact the outcome of family law proceedings, with tax liabilities and penalties altering the asset pool available for division.<sup>47</sup> Proceedings may also be adjourned for a lengthy delay until any investigation by the Australian Tax Office have concluded and all tax liabilities properly quantified.<sup>48</sup>

Parties who have not personally committed tax fraud are not necessarily immune from the consequences. Once referred to the Commissioner, any criminal penalties and any tax payable may

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<sup>42</sup> *Hearne v Street* (2008) 235 CLR 125.

<sup>43</sup> *Commissioner of Taxation & Darling* (2014) 285 FLR 428

<sup>44</sup> *T and T* (1984) FLC 91-588.

<sup>45</sup> *In the Marriage of P and P [Tax evasion]* (1985) 9 Fam LR 1100.

<sup>46</sup> *In the Marriage of P and P [Tax evasion]* (1985) 9 Fam LR 1100.

<sup>47</sup> *Malpass & Mayson* [2007] 27 Fam LR 288.

<sup>48</sup> *Family Law Act 1975* (Cth), section 79(5).

deplete the asset pool available for division. A spouse that has benefited from tax-free income throughout the relationship will not be quarantined once those tax liabilities crystallise.

Clients should be aware that the Family Court will generally not permit parties to benefit in family law proceedings where inconsistent information was provided to a government agency (e.g. where a party seeks a contributions adjustment for higher income throughout the relationship but has declared a lower income to the Australian Tax Office).

Conflict of interest issues may arise for accountants who have acted for a client referred to Australian Tax Office in family law proceedings.

### **Centrelink**

Similarly, parties who have committed social security fraud may be referred to Centrelink.<sup>49</sup>

Clients must be aware that any documents provided to Centrelink or other government agencies may be relied upon where their evidence is inconsistent. A common example of this is where a party has declared that they were separated to Centrelink to obtain benefits, and then seeks to argue they were not separated during that time in family law proceedings.

### **My client has committed tax fraud. What is the best way to proceed?**

If your client has defrauded a government agency, they should seek legal advice from a family lawyer as soon as possible given the severity of potential consequences if they do not proceed with caution.

Parties may seek a certificate under section 128 *Evidence Act 1995* (Cth) from the Family Court, invoking privilege against self-incrimination in their family law proceedings. However clients should be aware that a certificate is not a “golden ticket” ensuring full protection from prosecution.<sup>50</sup>

## **6.5 How can you assist your client in meeting their disclosure obligations?**

### **6.5.1 Presentation of information – the obligation to disclose documents in a way that is clear and understandable**

Parties have a duty to present disclosure in a form that is easily understandable.<sup>51</sup> Accountants can be of great assistance in our mutual clients’ family law matters in this regard, by:

Clarifying complicated transactions; and

Explaining the meaning of complex financial documents.

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<sup>49</sup> *Vasilias & Vasilias* (2008) 217 FLR 134.

<sup>50</sup> *Vasilias & Vasilias* (2008) 217 FLR 134.

<sup>51</sup> *Pendleton & Pendleton* [2017] FamCAFC 108 at 47 and 58.

### 6.5.2 Limiting fees for clients – avoiding doubling up of tasks

Providing copies of any pre-existing Assets & Liabilities Schedules;

Providing any Entity Maps or clarifying notes in matters where there are multiple entities with complex relationships; and

Providing electronic copies of relevant disclosure documents on hand, including financial statements and tax returns, so that solicitors do not double up on the process of collating disclosure.

## 6.6 Key Takeaway Points – How You Can Help

**Remind your client that there is no way around the duty of disclosure.** The sooner your client understands that, the sooner their matter may settle. With their consent, assist all relevant parties to understand complex financial positions and structures, and provide all relevant documents electronically.

**Remind your client that litigation may have unintended consequences.** There are many reasons to avoid litigation – cost, time and stress are the most commonly cited reasons. Referral of fraud to government agencies, and the use of Family Court documents in an ATO audit, are often overlooked.

## 7 Subpoenas

### 7.1 What is a subpoena?

A subpoena is an *ex parte* order for a third party to provide evidence. There are three types of subpoena:

A subpoena for production of documents;

A subpoena to give evidence; and

A subpoena for production of documents and to give evidence.

The Family Court of Western Australia only accepts subpoenas in the form of the Form 14 Subpoena prescribed by the Court. The rules and requirements relating to subpoenas are set out at Part 15.3 of the *Family Law Rules 2004* (Cth).

The scope of the subpoena can be far reaching, but should be limited to an issue in dispute. If documents are sought that relate to third parties to the case, notice should be given to those parties.

### 7.2 Key Takeaway Points – How You Can Help

**Once you are aware that a client is separating, beware that all documents on file may be subpoenaed.** Keep a separate file for family law litigation related communication. That gives your client the best chance of having those documents excluded from a subpoena. An email (produced under subpoena) between an accountant and a client that talks about a scheme to minimise the other parties family law claim, does not bode well for the client's credibility in the Family Court.

**Once served with a subpoena, speak to the family lawyer regarding objections.** There are limited circumstances within which you can object to the production of documents. A family lawyer can explain those objections to you.



## 8 Identifying and Valuing the Asset Pool

Under section 79 of the *Family Law Act 1975* (Cth), the Family Court has power to make orders it considers appropriate “*in the case of proceedings with respect to the **property** of the parties to the marriage or either of them, altering the interests of the parties to the marriage in the property...*”<sup>52</sup> Section 205ZG(1) of the *Family Court Act 1997* (WA) makes similar provision with respect to the alteration of property of de facto partners.

As the Family Court may only make orders dividing property, what constitutes “property” for the purposes of a family law property settlement is critical in determining what kind of orders the Court has power to make.

It is important to ensure that all interests of separating parties are properly characterised and that property is distinguished from a financial resource, or a mere expectancy, when identifying the asset pool available for division.

### 8.1 What is “property” for family law purposes?

Section 4(1)(a) of the *Family Law Act 1975* (Cth) defines “property” as follows:

*“in relation to the parties to a marriage or either of them — means property to which those parties are, or that party is, as the case may be, entitled, whether in possession or reversion.”*

As property must be a present entitlement, contingent interests do not constitute property for family law purposes.<sup>53</sup> Similarly, a mere expectation of income is not property, irrespective of how real or imminent it may be.<sup>54</sup>

The Family Court has maintained a broad interpretation of what property includes, noting that it includes real property, personal property, and choses-in-action.<sup>55</sup> Assets are likely to be characterised as property where:

The entitlement is vested or presently existing (e.g. not a future, contingent or potential interest);

They are legally capable of ownership; and

They have value not merely personal to the individual.<sup>56</sup>

<sup>52</sup> *Family Law Act 1975* (Cth), section 79(1).

<sup>53</sup> *Crapp & Crapp* (1979) 24 ALR 671 at 99.

<sup>54</sup> *W & W* (1980) 6 Fam LR 538 at 22.

<sup>55</sup> *In the Marriage of Duff* (1977) 15 ALR 476.

<sup>56</sup> *Marlowe-Dawson & Dawson (No 2)* [2014] FamCA 599 at 67 and 71.

The *Family Law Act 1975* (Cth) further specifies that for the purposes of property settlement, property includes a debt owed to a party of a marriage,<sup>57</sup> and superannuation entitlements held by spouses.<sup>58</sup>

### 8.1.1 Discretionary Trusts - The Decision in *Kennon v Spry*

A trustee of a discretionary trust only holds bare legal title to the trust assets. A beneficiary of a discretionary family trust holds no more than a potential beneficial interest, amounting to a mere expectancy or hope that the discretion will be exercised in their favour.<sup>59</sup> In *Kennon & Spry*, the High Court plurality held that a beneficiary's right to due administration and consideration under a discretionary trust may constitute property for the purposes of a section 79 property settlement.<sup>60</sup>

The majority held that trust assets will amount to property where the trustee spouse has a duty to consider distribution, and a spouse may be appointed the whole of the trust assets.<sup>61</sup> Chief Justice French considered the issue more broadly, following the principles in *Kelly, Ashton* and *Goodwin*,<sup>62</sup> stating that in circumstances where trust assets would have been considered the property of the marriage if the trust had not existed, coupled with a spouse's power to make distributions, trust assets will be property of the marriage.<sup>63</sup>

Accordingly, the central concept in determining whether trust assets are property for the purposes of family law proceedings is **control**.<sup>64</sup> Where a spouse has the ability to control discretionary trust assets, the Court will have jurisdiction to attribute those assets to the parties, and treat them as if they are assets of the parties.<sup>65</sup>

Factors to be considered in determining the degree of control that a party has over a discretionary trust may include:

Examination of the Trust Deed, including:

- The scope of trustee/appointor power;
- The intention of the settlor;
- The intended range of beneficiaries;<sup>66</sup>

<sup>57</sup> *Family Law Act 1975* (Cth), section 90AD(1).

<sup>58</sup> *Family Law Act 1975* (Cth), section 90MC.

<sup>59</sup> The Hon. Diana Bryant AO, "Heterodox is the new orthodox—discretionary trusts and family law: a general law comparison" (2014) *Trusts & Trustees*, 20(7), 655.

<sup>60</sup> Paul Fildes and Justine Clark, "Discretionary Trusts in Family Law Property Proceedings" (2012) *LegalWise Seminar*, 2.

<sup>61</sup> *Kennon v Spry* (2008) 238 CLR 366 at 126 (per Gummow and Hayne JJ).

<sup>62</sup> *Kennon v Spry* (2008) 238 CLR 366, at 55.

<sup>63</sup> *Kennon v Spry* (2008) 238 CLR 366, at 81.

<sup>64</sup> John Glover "A Challenge to Established Law on Discretionary Trusts? – Re Richstar Enterprises" (2007) 30 *Australian Bar Review*, 70, 81.

<sup>65</sup> The Hon. Diana Bryant AO, "Heterodox is the new orthodox—discretionary trusts and family law: a general law comparison" (2014) *Trusts & Trustees*, 20(7), 657.

<sup>66</sup> *Webster and Webster* (1999) 24 FamLR 198.

- Identity of the trustee;<sup>67</sup> and
- Relationships between key individuals;<sup>68</sup>
- The corporate trustee, and who controls that entity;<sup>69</sup>
- How trust assets have been treated by the parties;
- History of trust distributions;<sup>70</sup>
- Past exercises of power;
- Degree of the spouse's affiliation with the trust, including personally with the trustee/appointor;<sup>71</sup>
- Circumstances surrounding acquisition of trust property;<sup>72</sup>
- Ability to borrow trust funds;<sup>73</sup>
- Contributions of the parties towards the trust property; and<sup>74</sup>
- Changes to the trust during marriage or since separation.

In summary, the decision in *Kennon & Spry* means that assets of a discretionary trust are likely to be treated as property of the marriage where there is:

**Trustee Control:** A party is either the trustee or appointor, controls the trustee, or has power to appoint or remove a trustee;

**Beneficiary Distributions:** The trustee may make distributions to a party (either directly or indirectly); and

**Genesis of Trust Assets:** If the trust entity did not exist, the trust assets would belong to spouse, either wholly or in part.<sup>75</sup>

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<sup>67</sup> *Choate & Choate* [2009] FamCA 525.

<sup>68</sup> *Kelly and Kelly (No 2)* (1981) 7 Fam LR 762.

<sup>69</sup> *Goodwin and Goodwin Alpe* (1990) 14 Fam LR 801.

<sup>70</sup> *JEL and DDF* (2001) 163 FLR 157.

<sup>71</sup> *Kelly and Kelly (No 2)* (1981) 7 Fam LR 762.

<sup>72</sup> *Kennon v Spry* (2008) 238 CLR 366 at 81.

<sup>73</sup> *Hall & Hall* (2016) 257 CLR 490.

<sup>74</sup> *Kennon v Spry* (2008) 238 CLR 366 at 81.

<sup>75</sup> The Hon. Diana Bryant AO, "Heterodox is the new orthodox—discretionary trusts and family law: a general law comparison" (2014) *Trusts & Trustees*, 20(7), 666.

## 8.1.2 Unpaid Present Entitlements and Related Party Loans

### The Legal Distinction between an Unpaid Present Entitlement and a Loan

In practice, tax law generally treats unpaid present entitlements as loans by the beneficiary to the trust estate. It should be noted that legally, an unpaid present entitlement is not the same as a loan.<sup>76</sup> An unpaid amount to a beneficiary is not a loan by the beneficiary to the trustee, but a vested equitable interest, to which a beneficiary is presently entitled. In *ATO ID 2013/15*, the ATO cited the New Zealand case of *Ward*, which stated:

*“...it is misleading to speak of a debtor/creditor relationship. The rights of beneficiaries here do not arise out of debt or contract. They arise out of the trust created by the deed...”*<sup>77</sup>

Accordingly, from a legal perspective, it is important to note that the amount held by the trustee in a beneficiary account is held by the trustee as a sub-trust, to which fiduciary obligations attach. Arthur Athanasiou suggests that the most accurate and appropriate way to present an unpaid present entitlement in a Financial Statement is to show it as a separate line item, following the trust capital and trust assets less its financial liabilities or net assets.<sup>78</sup> The unpaid present entitlement should not be treated as trust capital or a loan in the sense that it is a true liability in the hands of the trustee, which is presently vested property to the beneficiary.

### Clearing Unpaid Present Entitlements

All unpaid present entitlement accounts owing to the spouse exiting the trust must be cleared as part of final settlement. Failure to do so may result in the exiting spouse calling on the unpaid present entitlements after final settlement has been effected.

Orders must be carefully considered and properly drafted to ensure the beneficiary is *gifting* their entitlement back to the trust. To avoid deemed distribution tax liabilities, the unpaid present entitlements should be distributed to the beneficiary, and then transferred back to the trust. Each of these transactions must be thoroughly recorded to avoid disputes in the future.

## 8.2 Financial Resources

A financial resource is an interest which does not amount to a proprietary interest, but confers a financial benefit upon a party.<sup>79</sup> An interest that a party is likely to receive but has not yet vested is likely to be characterised as a financial resource. If a party has the ability to cash out or call upon the entitlement, it may instead be characterised as property.

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<sup>76</sup> *Pope v. FC of T* [2014] AATA 532.

<sup>77</sup> *Commissioner of Inland Revenue v Ward* [1970] NZLR 1.

<sup>78</sup> Arthur Athanasiou CTA, “Accounting for UPEs” (2014) *Taxation in Australia*, 534.

<sup>79</sup> *Kelly and Kelly (No 2)* (1981) 7 Fam LR 762.

Examples of financial resources have been held to include:

Long service leave that has not yet vested;<sup>80</sup>

An expected inheritance (provided that it is “not distant”, and the party has a realistic and substantial prospect of receiving it);<sup>81</sup>

Distributions from a discretionary trust not controlled by either of the parties;<sup>82</sup> and

Carried forward losses.<sup>83</sup>

As detailed earlier in this paper, superannuation entitlements of de facto couples in Western Australia are considered a financial resource.

Financial resources cannot be included in the asset pool for division in a property settlement (i.e. Step 1), however they will be considered under section 75(2) of the *Family Law Act 1975* (Cth) (i.e. Step 3).

Where there is a significant disparity in financial resources, clients with those resources should be aware that those assets will be considered by the Court under section 75(2), and a higher adjustment of the asset pool may be allocated to the other party.

## 8.3 Identifying and Valuing Assets

### 8.3.1 The approach prescribed by *Stanford v Stanford*

In *Stanford v Stanford*, the High Court held that the relevant date for identification and valuation of property is as at present.<sup>84</sup> Valuation of assets will not be backdated to the date of separation.<sup>85</sup>

All presently existing property of the parties must be included and considered at Step 1. Property cannot be excluded from the pool. This may surprise clients who often assume that property acquired post separation or prior to the relationship will be excluded from the asset pool for division.

The date and manner of property acquisition will be considered as part of the contributions assessment at Step 2. This is where a party’s initial, and post separation contributions will be weighted, and any resulting adjustment in their favour made.<sup>86</sup>

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<sup>80</sup> *Gould and Gould* (1995) 20 Fam LR 1.

<sup>81</sup> *White and Tulloch v White* (1995) 19 Fam LR 696.

<sup>82</sup> *Kelly and Kelly (No 2)* (1981) 7 Fam LR 762.

<sup>83</sup> *Cromwell and Cromwell* [2006] FamCA 1454.

<sup>84</sup> *Stanford v Stanford* (2012) 247 CLR 108 at 37.

<sup>85</sup> *Omacini & Omacini* (2005) 33 Fam LR 134.

<sup>86</sup> *Farmer & Bramley* (2000) 27 Fam LR 316.

### 8.3.2 Notional Property (“Addbacks”)

Where property has been unilaterally disposed of or wasted, parties may seek to “add back” the notional property to the asset pool for division. Practically, the notional property is added back to the asset pool to division, and allocated to the party who had the sole benefit of those funds.

Adding back notional property is not a matter of right, and the Family Court has a broad discretion whether to include notional property in the pool for division. As explained by Justice Murphy in *Challen & Challen*:

*“The decision whether to add back to the pool of assets property disposed of or money spent occurs against a legal framework where the general principle is that the court takes the property of the parties or either of them as it finds it at date of trial.*

*Financial losses incurred by the parties or either of them during the course of the marriage should be shared by them, although not necessarily equally. **Adding back to the pool is the exception, not the rule.**”<sup>87</sup>*

Common examples of addbacks include:

Paid legal fees;

Funds “wasted” by one party (e.g. gambling);

Funds transferred to third parties;

Property disposed of or used for the sole benefit of one party; and

Property not disclosed or accounted for.

### 8.3.3 How will property be valued?

Once all presently existing property has been identified, the value of each asset and liability can be ascertained through:

#### **Exchanging disclosure**

Documents such as bank statements and shareholding statements will record their present value on the face of the document. Once disclosure has been exchanged, parties may confer and determine which values are agreed.

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<sup>87</sup> *Challen & Challen* [2007] FamCA 1292 at 72 – 73.

### Obtaining expert evidence and valuations

If the parties cannot agree upon the values for certain assets, Part 15.5 of the *Family Law Rules 2004* (Cth) set out mechanisms for adducing expert valuation evidence, including for the appointment of a Single Expert Witness where values are disputed.

Types of expert evidence commonly obtained in the course of family law proceedings include property valuations, business valuations, defined benefit superannuation valuations, and specialist accounting advice in relation to taxation liabilities.

## 8.4 Single Expert Witness Reports

Where parties cannot agree on the value of an asset or other issue in dispute, a Single Expert Witness may be appointed pursuant to Division 15.5.2 of the *Family Law Rules 2004* (Cth). The Single Expert Witness may be jointly appointed by the parties, or by the Court. The Single Expert Witness report must adhere to the requirements set out in Division 15.5.5 of the Rules.

Upon publication of the Single Expert Witness report, parties may issue clarifying questions to the expert within 21 days. If a party seeks to appoint an alternate expert, they may only do so with leave of the Court. Where there are 2 or more experts, the experts must conference to limit the issues in dispute.

In the valuation of a business, clear distinction must be made between commercial goodwill, and personal goodwill. Conflating these two forms of value will constitute appealable error. The Full Court of the Family Court has stated that personal goodwill is not transferable and will form part of the assessment in relation to a spouse's earning capacity under section 75(2).<sup>88</sup> The principles in *AJW and JMW* [1998] FamCA 2377 should also be kept in mind when obtaining a business valuation.

## 8.5 Locating Hidden Assets

If your client suspects that their former partner is not disclosing their true financial circumstances, the following mechanisms may assist in locating or accounting for hidden assets:

Making a specific request for disclosure setting out the documents your client considers to be outstanding;

Searching public databases, such as Landgate or ASIC registers;

Making an interim application in the Family Court seeking orders for the specific production of disclosure;

Issuing subpoena for production of documents; and

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<sup>88</sup> *Wall v Wall* [2002] 29 Fam LR 1.

In extreme circumstances, an Anton Pillar order for the *ex parte* seizure of property.

Failing the above, a party may seek an adjustment under section 75(2) of the *Family Law Act 1975* (Cth) (Step 3) on the basis of material non-disclosure.<sup>89</sup>

## 8.6 Cryptocurrency and blockchain in family law disputes

As society and technology changes, family lawyers and accounting professionals both need to be aware of what “property” encompasses when dealing with clients. The recent emergence and growth of cryptocurrencies such as Bitcoin have created new challenges for family lawyers attempting to ascertain and value the asset pool for division.

### Is cryptocurrency “property” for family law purposes?

Whilst the Family Court is yet to determine substantive case law in this area, it is highly likely that cryptocurrency will constitute property for family law purposes and must be included in the assets and liabilities schedule when ascertaining the property pool for division.

Further, any tax liabilities associated with the retention, sale, or transfer of cryptocurrency must be considered and factored into a family law property settlement.<sup>90</sup> The Australian Tax Office has determined that Bitcoin is an asset, subject to capital gains tax,<sup>91</sup> and that it is trading stock if held by a business for the purposes of sale or exchange in the ordinary course of business.<sup>92</sup> Similarly, if it can be proven that Bitcoin has been stolen or lost, clients may be able to claim a capital loss.

Income parties obtain from trading of cryptocurrency may be also be characterised as income for family law purposes when assessing child and spousal maintenance.

### Duty to disclose crypto assets

As with all property and income, all cryptocurrency assets and income must be disclosed and declared in a client’s Form 13 Financial Statement. As detailed earlier in this paper, clients should be aware that disclosure of cryptocurrency in family law proceedings may be subject to mandatory reporting to the ATO.

### Challenges of crypto assets

Unlike traditional assets and currency, Bitcoin operates without a central authority and are not regulated by any government or banking institutions. This means that cryptocurrency transactions are anonymous, unregulated, and untraceable.

Difficulties in dealing with cryptocurrency in family law disputes include:

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<sup>89</sup> *Kannis & Kannis* [2002] 172 FLR 464.

<sup>90</sup> Nathan De Silva, “The evolving tax treatment of cryptocurrencies” (2018) 52(7) *Taxation in Australia*, 372.

<sup>91</sup> Australian Tax Office, TD 2014/26.

<sup>92</sup> Australian Tax Office, TD 2014/27.



**Locating cryptocurrency:** Unlike traditional assets and currency, Bitcoin operates without a central authority and are not regulated by any government or banking institutions. This means that cryptocurrency transactions are anonymous, unregulated, and untraceable.

- If a recalcitrant party refuses to disclose crypto assets, options for discovering them are limited, if not impossible.
- There is also no ability (or utility) in subpoenaing the blockchain ledger.
- For the majority of people not familiar with blockchain, locating cryptocurrency assets is extremely difficult. Engaging an expert may be required.

**Jurisdiction:** In many respects, the decentralised nature of blockchain means that cryptocurrency is beyond reach of the law, and jurisdiction issues may arise.

**Transfers to Third Parties may be unrecoverable:** Transfers are anonymous, and there are no central agencies to enforce the return of crypto assets. Bitcoin could be transferred to offshore accounts of relatives or friends outside of Australia without a trace.

**Enforcement of orders:** The lack of regulation around cryptocurrency will present difficulties in enforcing orders relating to the cryptocurrency.

**Valuation Issues:** Bitcoin and other cryptocurrencies are notoriously volatile, with their value changing dramatically. If a person runs a business which accepts Bitcoin, there may also be difficulties in properly assessing the value of that business.

## 8.7 Key Takeaway Points – How You Can Help

Provide a schedule of assets and liabilities, an explanation of the relevant entities and any recent asset valuations.

Provide an explanation of how beneficiary loan accounts and / or UPE's have been historically treated.

Provide information to the Single Expert in a timely and impartial manner, and then help your client and their lawyer ask the right questions of the expert after their report is published.

## 9 *Third Parties*

The Family Court has wide discretionary powers which extend to binding third parties to the relationship.<sup>93</sup>

### 9.1 Joinder of Third Parties

Rule 6.02 of the *Family Law Rules 2004* (Cth), stipulates that:

*A person whose rights may be directly affected by an issue in a case, and whose participation as a party is necessary for the court to determine all issues in dispute in the case, **must be included as a party to the case.***

The jurisprudence in relation to joinder of third parties has further affirmed that joining all parties whose rights are affected by court orders is mandatory. In *John Alexander's Clubs v White City Tennis Club*, the High Court of Australia held that regardless of whether a third party may recover their interest in separate proceedings, if the orders sought affect a third party directly, they should be joined as a party so that all issues in dispute are resolved without the multiplicity of proceedings.<sup>94</sup>

The decision in Rule 6.02 and *Alexander's Clubs* suggest that if your client's family law matter directly affects the interests of a third party (including an entity), then the third party **must** be joined to family law proceedings.

Failure to properly join third parties to proceedings may result in orders being set aside.

### 9.2 Unsecured Creditors

In *Biltoft and Biltoft*<sup>95</sup> the Full Court held that rights of unsecured creditors are not necessarily prioritised before those of a spouse, however where the ability of a creditor or claimant to recover his or her debt or claim is likely to be affected, notice of proceedings must be given to that creditor or claimant. The creditor may be joined in the proceedings, and seek orders recognising their rights.

The effect of *Biltoft* is that in circumstances where a debt is owed by a spouse to a company or trust controlled by relatives of a spouse, that entity may be joined as a third party to Family Court proceedings seeking repayment of that debt.

Clients considering a third party joinder should consider:

Is the debt enforceable? Debts that are vague or unlikely to be called in are likely not to be enforced.

Are there proper loan documents between the entity and the debtor spouse?

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<sup>93</sup> *Family Law Act 1975* (Cth), section 90AE, and *Family Court Act 1997* (WA), section 205ZLF.

<sup>94</sup> *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1 at 131 – 137.

<sup>95</sup> *Biltoft and Biltoft* (1995) 19 Fam LR 82.

Is it commercial for the third party client to be joined to proceedings?

## 9.3 Companies

### 9.3.1 Accrued Jurisdiction of the Family Court

The Family Court has accrued jurisdiction to deal with matters associated with the family law matter, including proceedings under the *Corporations Act 2001* (Cth). Where matters involve parties to a marriage, in addition to disputes in relation to companies they have interests in, the Family Court may deal with both issues within the same proceedings for convenience.

### 9.3.2 Joinder of Companies as Third Parties

Many parties to family law proceedings have interests in a company, running family businesses. Where companies and their assets are wholly owned and controlled by the parties, a joinder may not be necessary if the Family Court is able to adjust the parties' proprietary interests in these companies through inter *partes* orders.

Notwithstanding the above, it is important to remember that companies have separate legal personhood. Accordingly, where orders are required binding the company itself, the company must be joined as a third party to family law proceedings.

Circumstances where it may be appropriate to join a company to family law proceedings include:

Where a party seeks specific orders compelling the company to act (e.g. orders that the company sell certain property);

Where the company, rather than a spouse, is required to pay the other party a sum of money, whether for structuring or tax reasons (e.g. orders that the company pay a non-shareholder Wife a sum of money in satisfaction of a UPE, rather than distributing to the Husband to subsequently pay the Wife);

Where a party seeks a transfer of property *in specie* from the company to a spouse;

Where a party seeks orders restraining the company from acting; or

Where the spouses are not the only Directors of the company, and the interests of other Directors may conflict with the spouse parties.

### 9.3.3 Service of Family Court Documents

When a company is joined as third party to family law proceedings, they must be served in compliance with section 109X of the *Corporations Act 2001* (Cth).<sup>96</sup> Service pursuant to section 109X may be effected by delivering or posting the sealed documents to the company's registered office, or delivering a copy of the document personally to a director of the company.

**Consider whether the company should obtain separate legal representation.** If the interests of the company are not aligned with the spouse party you act for, it may be necessary for the company to obtain separate legal representation, and you should consider whether referring the Directors to a family lawyer is appropriate. Specific instances where this may be appropriate include where the company is not held solely by the spouses and a non-spouse Director or shareholder interest is materially affected by the orders sought, where neither of the spouse parties have a controlling interest in the company, or high conflict between Directors is affecting operation of the company.

Further, if the matter is factually or legally complex, it may be worthwhile for the company to obtain independent legal advice to determine whether it is necessary or worthwhile for them to participate in proceedings.

## 9.4 Key Takeaway Points – How You Can Help

Broadly consider who may be affected by the Family Court proceedings, and advise parties early of those potential third party interests.

Be particularly aware of any conflict of interest issues that may arise for you if the parties and related entities are involved in a dispute.

Be particularly aware of any confidentiality issues when third parties may become involved in proceedings (ie... sharing of documents, correspondence and information between parties).

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<sup>96</sup> *Family Law Rules 2004* (Cth), Rule 7.11.

## ***10 How does the Family Court deal with taxation liabilities?***

It is important to remember that the party who is going to retain the liability almost always seeks to have the liability included in the asset pool (i.e. at Step 1). That ensures the debt is accounted for fully in the overall percentage split.

The party who is not retaining the liability often seeks to have the liability considered as a future needs factor (i.e. at Step 3). The difficulty being that at Step 3 the tax liability is considered along with other future needs issues, and is rarely accounted for on a precise dollar for dollar basis in the final settlement.

### **10.1 Does the taxation liability form part of the net asset pool available for division?**

#### **10.1.1 The Principles in *Rosati v Rosati***

In *Rosati*, the Full Court of the Family Court assessed how a capital gains tax liability should be treated in a property settlement. The following general principles arose:

Whether capital gains tax should be taken into account in valuing a particular asset varies according to the circumstances of the case, including the method of valuation applied to the particular asset, the likelihood or otherwise of that asset being realised in the foreseeable future, the circumstances of its acquisition and the evidence of the parties as to their intentions in relation to that asset.

If the Court orders the sale of an asset, or is satisfied that a sale of it is inevitable, or would probably occur in the near future, or if the asset is one which was acquired solely as an investment and with a view to its ultimate sale for profit, then, generally, allowance should be made for any capital gains tax payable upon such a sale in determining the value of that asset for the purpose of the proceedings.

If none of the circumstances referred to above apply to a particular asset, but the Court is satisfied that there is a significant risk that the asset will have to be sold in the short to midterm, then the Court, whilst not making allowance for the capital gains tax payable on such a sale in determining the value of the asset, may take that risk into account as a relevant s 75(2) factor, the weight to be attributed to that factor varying according to the degree of the risk and the length of the period within which the sale may occur.

There may be special circumstances in a particular case which, despite the absence of any certainty or even likelihood of a sale of an asset in the foreseeable future, make it appropriate to take the incidence of capital gains tax into account in valuing that asset. In such a case, it may be appropriate to take the capital gains tax into account at its full rate,

or at some discounted rate, having regard to the degree of risk of a sale occurring and/or the length of time which is likely to elapse before that occurs.<sup>97</sup>

In *Rosati*, the Court did not include the CGT liability in the asset pool, however made an adjustment for the obligation to pay the liability when assessing the future needs factors (i.e. at Step 3).

The principles in *Rosati* have since been expanded beyond the confines of CGT, and applied to Division 7A loan liabilities.<sup>98</sup>

### 10.1.2 Application of the *Rosati* Principles

Following the decision in *Rosati*, it is unlikely that a taxation liability will be included in the net asset pool (i.e. at Step 1) if:

There is vague evidence about the possibility of future tax liability, which may or may not eventuate, for a quantum that cannot even be predicted.

A prospective tax liability relates to a property, and it is unclear whether a sale of that property will (if ever) be made.<sup>99</sup>

A taxation liability may be included in the net asset pool (i.e. at Step 1) if:

The relevant party or entity has already received a notice of assessment. On that basis it is difficult to suggest the liability does not at least 'exist'.

As a result of the orders being made, a tax liability must arise. For example, orders are made for the sale of an investment property that significantly appreciated in value during the relationship (N.B. to properly handle this situation see again paragraph 3.4 of this paper).

It is likely that a taxation liability will be considered in the future needs assessment i.e. at Step 3) if:

If the obligation to pay the liability is clear, notwithstanding the quantum of tax or circumstances of payment are not.

Proper evidence is raised that the saleable asset was purchased as an investment and has since substantially increased in value.<sup>100</sup>

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<sup>97</sup> *Rosati v Rosati* (1998) 23 Fam LR 288 at 6.36.

<sup>98</sup> *Rodgers & Rodgers (No. 2)* [2016] FLC 93-712.

<sup>99</sup> *Carruthers v Carruthers* (1996) 21 Fam LR 12. See also *Campbell v Cuskey* (1998) 22 Fam LR 674.

<sup>100</sup> Jeanette Swann, "A Tax Roadmap for Family Lawyers" (2015) *Foley's List*.

Clients need to be aware that if they retain an asset subject to a CGT event in the future, and there are no other provisions made in orders, they will incur the entire CGT accrued throughout the relationship upon the liability crystallising at sale.

As to the wisdom of a post-separation crystallisation of debt to 'bring forward a tax liability', lawyers and accountants should both think through the immediate and long-term implications.

It should not be assumed that applying the rollover provisions to CGT liabilities are necessarily commercial to the client. The effect of a rollover provision simply **defers** tax liability. Accordingly, when a rollover occurs, the spouse retaining that asset retains it with an inherent CGT liability.<sup>101</sup>

It may be preferable that a rollover provision is not used where:

There are capital losses that can absorb capital gains; or

Funds are presently available to pay any capital gains tax, but such funds may be low in the future when it is anticipated that the asset may be sold.

## 10.2 Should the client act to 'crystallise' the debt before settlement occurs?

Clients should be advised if they are retaining in settlement assets or liabilities (personally or through an entity) that, when sold or paid out after settlement, for which they are solely responsible for. The most common examples are retaining an investment property as part of settlement, or having a Division 7A loan that needs to be repaid via issued dividends in the future.

Upon hearing about the principles in *Rosati*, a perceptive (and perhaps vindictive) client might simply seek to sell an asset or discharge a loan post-separation so that a tax liability they may incur individually in the future, is now 'crystallised' and undisputedly part of the identifiable liabilities of the parties.

It is worth noting that any action taken by a client post-separation that significantly alters the pool of assets, should be done with notice to the other party. The other party should have a chance to respond and object to the proposed course of action. If your client does not give notice they could be open to criticism at Trial, and the judicial officer may even consider the client's actions to be reckless, and decide that they solely bear the burden of their decision.<sup>102</sup>

I have acted for a client who, post separation, received advice from his accountant that he 'could' issue a one off dividend to pay out the entirety of his almost \$500,000 division 7A loan liability. He issued the dividend, lodged his tax return and a received an assessment that he owed \$150,000 (which of course would have been higher if he did not have the full complement of franking credits). The client then got into a payment arrangement with the ATO. At Trial the wife did not call her own expert to give evidence about whether there were more commercially sensible options for dealing with or deferring the tax liability, and the loan was included in the asset pool.

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<sup>101</sup> Arlene McDonald (1998) "Tax and the Family Lawyer – Let's Be Practical", *TVEd.net.au*.

<sup>102</sup> See *Grier v Malphas* (2016) 55 Fam LR 107 at 56 – 57, and 128 – 132.

If the husband did not 'crystallise' the debt before trial, he would have had to adduce expert evidence about the effect of carrying a \$500,000 division 7A loan, and how that affects his future income stream.

### 10.3 The Family Court's duty to consider tax consequences of orders

Putting aside the question of how the Family Court will handle tax liabilities, there is absolutely no doubt that the Court must at least consider tax liabilities.

*Elgin*<sup>103</sup> is a very important recent Full Court decision about an appeal being allowed because the Trial Judge failed to consider taxation liabilities which were likely to accrue (and did accrue prior to the appeal).

In *Elgin*, the Trial Judge failed to consider and make orders in relation to significant taxation liabilities. The Single Expert Witness provided evidence that tax implications had not been factored into her report, and would need to be accounted for in the event orders were made requiring that assets be sold or transferred.

Neither party brought the issue of taxation liabilities to the Judge's attention during the trial. On appeal, the husband argued that the non-inclusion of tax liabilities amounted to appealable error.

The Court criticised the husband's failure to raise the issue of tax liabilities, stating that he was 'obviously an astute business person' and had been legally represented by a 'sophisticated legal team' throughout the entirety of proceedings. Notwithstanding the husband's failure to properly conduct his case, the Trial Judge's omission of the taxation liabilities amounted to an appealable error. The Court held that orders failing to account for significant tax liabilities, and ordering the husband to be solely liable for them, could simply not be held to be just and equitable.<sup>104</sup>

## 10.4 Impact of Recent Decisions of the Full Court of the Family Court

### 10.4.1 Rodgers & Rodgers (No. 2)

In *Rodgers*<sup>105</sup>, the parties were the directors and shareholders of M Pty Ltd, and B Pty Ltd. M Pty Ltd was the corporate trustee of a family trust, through which the parties' business operated. Further, M Pty Ltd was the trustee of the Rodgers Investment Trust. B Pty Ltd was a bucket company, described as 'a repository of funds earned by M Pty Ltd, as trustee of the Trust that operated the tourism business. Funds paid to B Pty Ltd from M Pty Ltd were drawn down by the parties, constituting Division 7A loans owed by the parties.

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<sup>103</sup> *Elgin v Elgin* [2015] FamCAFC 155.

<sup>104</sup> *Ibid* at 156.

<sup>105</sup> *Rodgers & Rodgers (No. 2)* [2016] FLC 93-712.



The parties had agreed that the husband would retain the business, and the wife would be removed as a director and shareholder, and indemnified in relation all future liabilities, including tax liabilities.

The evidence tendered by the Single Expert Witness (who valued the business) was that the loans should not be forgiven. The parties' accountant provided a schedule of potential tax amounts payable, ranging between \$438,552 and \$718,401. Counsel for the husband sought that the mid-point value of \$517,137 be included as a liability in the asset pool (i.e. at Step 1).

Counsel for the wife submitted that the liability did not arise from the Division 7A loans, but rather by the manner in which the loans were met in the future (declaration of dividends). Accordingly, the wife submitted that the tax liability was contingent, and should not be included in the asset pool.

At first instance, the Trial Judge agreed with the wife that the liability was uncertain, and accordingly excluded the liability from the asset pool. Her Honour applied the *Rosati* principles, and considered that the tax liability should be dealt with in the future needs adjustment (i.e. at Step 3).

The husband appealed the Trial Judge's decision.

The Full Court upheld the first instance decision, stating that the Trial Judge did not err in not treating the Division 7A loans as a liability of the parties. The Full Court made clear that there is no mandatory treatment of liabilities. Whether the liability will be included relies upon:

The nature of the liability;

The circumstances surrounding its accrual; and

The dictates of justice and equity.

The Full Court further stated that: “[*]liabilities that are vague, uncertain, unlikely to be enforced and the like might be treated differently because those circumstances might, in the circumstances of the particular case, render it unjust and inequitable for liabilities to be deducted in that manner.”*

The uncertainty surrounding the quantum and manner of repayment of the loans resulted in a proper exercise of discretion deeming them a contingent liability.

However, the Full Court found that her Honour erred in the section 79(4)(e) assessment (i.e. future needs / Step 3 assessment) by failing to:

assess in real terms the future needs adjustment by reference to the conclusion reached on contributions; and

the Trial Judge did not “pay due regard” to the future taxation liability, in that she failed to attempt to give numerical meaning to the Division 7A loans.

The Full Court re-exercised the discretion of the future needs adjustment under section 75(2) when considering the husband's obligation to repay the loan.

## 10.4.2 Atkins & Hunt and Ors

In *Atkins*<sup>106</sup>, the parties each held the following loan accounts with N Pty Ltd:

Husband: \$588,178

Wife: \$805,190

The experts both agreed that the loans should be treated as liabilities of the parties for the purposes of valuation. At trial, an order was made that the wife assign her loan to the husband, and he was required to indemnify her.

Counsel for the wife asserted that the loans should not have been included as liabilities, as their inclusion understates the value of the husband's interest in N Pty Ltd. The wife submitted that the husband had "ultimate control" of N Pty Ltd, and therefore had complete discretion to pay himself dividends, declared at such time and manner as he might solely decide.

However, this argument was raised on appeal, not before the Trial Judge. The evidence before the Trial Judge was the expert business valuation, which included both loan accounts as liabilities. No factual foundation had been laid before the Trial Judge, and the parties were bound by the conduct of their case.

The wife's ground of appeal in relation to the loan accounts was dismissed, and the loans were included as a liability.

## 10.4.3 Tax Professionals: Pitfalls, Opportunities and Tips from Senior Counsel

In two similar sets of submissions, *Rodgers* and *Atkins* had very different outcomes in the inclusion of the parties Division 7A loans, or prospective tax liabilities connected thereto.

Clear evidence should be led in relation to:

Is there discretion in how Division 7A loans will be paid?

Who will have control over the issue of dividends?

What is the factual history of how a loan account was managed during the relationship?

What is the real dollar amount of the tax liability (or range of dollar amounts)?

While Trial Judge may be in error if they do not consider a tax liability, clear evidence about the tax liability is what assists your client in achieving the most favourable outcome.

The principle that parties will be bound by the conduct of their case should not be forgotten.<sup>107</sup>

<sup>106</sup> *Atkins & Hunt and Ors* [2017] FamCAFC 79.

<sup>107</sup> *Metwally v University of Wollongong* (1985) 60 ALR 68.

# ***11 Providing Tax Advice on Family Court Orders***

## **11.1 Identifying taxation issues in the proposed settlement**

### **11.1.1 Commonly overlooked tax consequences**

Most family lawyers can produce a schedule showing the value of assets and liabilities retained by each party. Unfortunately though, some overlook the tax consequences of the proposed settlement. Here are some matters commonly overlooked:

Have all tax returns been lodged?

Has the treatment of unpaid present entitlements and loans been included in the drafting of final orders?

Have the orders been properly drafted identifying the owner of each asset, the transferee or transferor entity, and associated tax liabilities?

Are personal assets or liabilities included in the Financial Statements of entities? Have they been properly disentangled in settlement?

Have all tax liabilities been discharged in the proposed orders?

### **11.1.2 Tips for accountants providing tax advice in a family law matter**

It is becoming more and more common for family lawyers to brief an accountant, on behalf of their client, to review a suite of possible settlement options and advise broadly on the tax consequences of each option. In those circumstances you may not be presented with the exact proposed orders. To cover yourself, it may be safer to suggest that your advice may need to be altered once you review the specific orders sought.

Where the brief is to review a precise set of orders and advise on the tax consequences, it is always helpful to set out the assumptions you might be making in giving your advice, and even thinking more laterally about possible issues that have not been considered. You may say that is not the brief, but when the brief is as broad as 'the tax consequences of the orders sought', it may be hard for you to know how broad the scope of your advice should be. For example, your advice may include:

I assume the parties understand that the husband will have a debt after lodging his next individual tax return.

I assume the parties are aware that the wife has a loan to the company she is retaining, which must be repaid. There are multiple ways in which she can issue dividends to repay

the loan, and accordingly the overall cost to her of repaying that loan cannot be predicted with certainty.

I assume there is a complying Division 7A loan agreement in relation to the wife's loan to the company, but I have not reviewed it.

I assume that the entity the husband is retaining control of, holds assets that are not of a personal nature, and which do not now need to be disentangled.

I assume the beneficiary loan accounts in the Trust accurately reflect the historic Trust Resolutions as to distribution of Trust income, the capital (if any) introduced by the beneficiary and the amounts actually paid to the beneficiary.

I have not reviewed the calculation of percentages, and how they may alter if the taxation liabilities end up being different to what is predicted.

## 11.2 Have all assets, liabilities, and financial resources been included in the proposed orders?

It is imperative that orders are properly drafted to deal with all assets, liabilities, and financial resources of the parties. Examples of how failure to properly draft orders can result in unintended consequences include:

If unpaid present entitlements and loans have not been included in the drafting of final orders, the beneficiary spouse may call on payment after final settlement;<sup>108</sup> and

Consent Orders made by the Family Court may in some circumstances not preclude a party enforcing a right to payment of a chose in action in the District Court.<sup>109</sup>

Once the Family Court has made final financial orders, those orders are taken to be the final determination of the financial relationship between parties, subject only to an application to set aside the orders pursuant to section 79A of the *Family Law Act 1975* (Cth), or by agreement. Do not rely on being able to amend or set aside orders to cure defects or add forgotten liabilities between the parties.

### 11.3 Getting the form of orders correct

Even if parties reach agreement on a percentage split, they may not know the exact value of a certain asset until it is sold (i.e. a property), or the exact value of a liability that has not crystallised (i.e. a tax debt that will crystallise upon subsequent lodgement of a tax return).

Take this example:

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<sup>108</sup> *Mrowka v Format Finishing* [2009] 240 FLR 1at 93.

<sup>109</sup> *Ibid.*

Parties agree to split their identified net assets of \$1 million on a 60/40 basis in the wife's favour.

The only unknown is the tax debt the husband will have after he lodges his individual tax return. The parties agree that the debt should be accounted for in the settlement because it refers to income earned for the benefit of the family during the relationship.

Option 1: The husband's lawyer says lets go 60/40 on the \$1 million, and just draft orders to split the tax debt 50/50 whenever we find out what it is, because really the income that the tax debt refers to is income they both equally benefitted from.

Option 2: The wife's lawyer says no, let's go 60/40 on the \$1 million, and draft orders that the tax debt is borne 60% by the husband and 40% by the wife, because 'that will ensure the overall percentage is still 60/40'.

If the tax debt ends up being \$100,000, the overall split under Option 1 is that wife receives \$550,000 (\$600,000 minus her \$50,000 contribution to the tax debt) of a net pool of \$900,000 (\$1 million minus the \$100,000 tax debt). The effective percentage split is 61.1% to the wife.

If the tax debt ends up being \$100,000, the overall split under Option 2 is that wife receives \$560,000 (\$600,000 minus her \$40,000 contribution to the tax debt) of a net pool of \$900,000 (\$1 million minus the \$100,000 tax debt). The effective percentage split is 62.2% to the wife.

You can see why the husband would not be happy if his lawyers didn't advise him that his real percentage could be 37.8%, not 40%. As you know, the bigger the pool of assets, the more that is at stake when the calculations are 1-2% off.

The preferred option is to attach the schedule to the orders, and then divide the tax debt (with reference to the agreed schedule) in such a way that it effects an overall split of 60:40 in the wife's favour.

Orders must be drafted in a way which accommodates variations in values but which also preserves the underlying percentage entitlements of each party.<sup>110</sup>

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<sup>110</sup> *Lovine v Connor* (2012) FLC 93-515 at 122. See also *Trask v Westlake* (2015) 55 Fam LR 153 at 33 – 48.