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BRIEFING

Family Law:

Tax, Accounting,
Superannuation and
Business Valuation Issues

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Presenters:

Hanh On
Andrew Fisher
Tim Olynyk





Superannuation

Hanh On | SMSF Partner



Splitting an SMSF Under the Family Law



Contents:

1. Processes
2. Reviewing the Trust Deed
3. Accounting
4. Taxation Implications
5. Transfer/Roll-Over

1. Processes

- **An Order or Agreement under the Family Law**

From the SMSF administrator perspective:

1. No action is taken until an Order or Agreement is received from the Family Lawyer
2. We will contact both parties (if the couple are both clients of Banks Group) to inform them of the receipt and advise them of the processes
3. Commence work on the file in accordance with the Order or Agreement

2. Reviewing the Trust Deed

- The SMSF Trust Deed provides governing rules for Trustees to comply with
- Trustees of the SMSF often refer to the Trust Deed to determine if the SMSF is permitted to enter into a particular commercial transaction, such as:
 - Borrowing in SMSF (Limited Recourse Borrowing Arrangement)
 - Investment in derivatives and options

3. Accounting

The fund administrator will process all the financial information up to specified date per the Order:

- Ensure the fund is up to date with ATO lodgement obligations, such as income tax returns, instalment activity statements and business activity statements.
- Ensure all income, expenses and ATO debts are paid or accounted for.
- Ensure all investments are reflected at current market values, such as direct shares, managed funds and direct property (both residential and commercial).

Unlisted investments, private companies and trusts can be difficult and time consuming in determining their market values.

The above process enables the Trustees to determine the members' individual benefits within the SMSF.

3. Accounting



There are two pathways in splitting the superannuation benefits:

1. The pathway under Div 7A.1A SISR

This pathway enables the trustees to create an intermediate superannuation interest called a “non member spouse interest”.

The pathway enables the trustees to determine the value of the interest at the point of the creation of the interest, not at the point of transfer to the new superannuation fund.

This means, the court has predetermined an amount from the member’s superannuation benefit to be transferred to the spouse’s superannuation fund.

With this pathway, it may not be required to bring the financials up to date.

3. Accounting



2. The pathway under Div 7A.2 SISR

The value of the interest for the non-member spouse under this pathway is not determined at the time of service of the Order, it is determined at the time of transfer.

Therefore, the longer the transfer is delayed, the longer the time period between the value for the purposes of court proceedings and the value for the purposes of transfer.

This pathway will require the financials to be up to date.

4. Taxation

There are taxation implications depending on what makes up the transfer value:

Cash Transfer

If the transfer is by cash and the SMSF is forced to sell investments to fund this cash transfer, the SMSF will be subject to capital gains tax on any capital gains made.

Assets Transfer

If the transfer is made up of assets (eg direct shares and property) which is classified as an in specie transfer, the SMSF is not subject to capital gains tax even though it is deemed as a disposal of assets in the financial accounts.

This is because of a CGT roll-over relief under S126-140(2) for asset transfer under a Family Court Order.

5. Transfer / Roll-Over

Once the accounts are prepared up to date and all parties have agreed on a super split amount, here are the last few steps:

- Check the complying status of the new superannuation fund, if it is a SMSF do a search of the SMSF's status on the Super Fund lookup website. Trustees are not allowed to release funds to a non complying superannuation fund.
- Obtain membership details for the new fund, prepare rollover documentation (ETP) signed by one trustee and issue a cheque payable to the new fund.
- Prepare transfer minutes to be signed by all trustees, these minutes will specify the reasons for the transfer and the final amount, including the tax free and taxable components.

5. Transfer / Roll-Over

If it involves an existing member leaving the fund as a result of the transfer, Trustees must:

- Prepare relevant documentation to cease membership
- Prepare minutes to resign a trustee
- Review Trustee status, that is:
 - To appoint another individual as the trustee as a SMSF must have two individuals for a single member Fund.
 - Incorporate a company to act as the corporate trustee of the SMSF where the single member is also the sole director of this company
 - If there is a change of the Trustee, then the Fund must inform all share registries, banks, fund managers and/or SRO if the Fund owns a property

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Accounting and Business Valuations



Andrew Fisher | Partner – Audit and Assurance

Valuations – single expert

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- Accountants can prepare valuations for various reasons
- In family law, a business operated by either party constitutes part of their property for an equitable settlement
- A single expert may be jointly appointed, saving time and costs

Family Law Rules

Single expert valuers need to be aware of:

- Part 15.5 (and more) of the Family Law Rules
 - i. Unbiased professional opinion on a significant matter
 - ii. Everything in writing and available to both parties
 - iii. Full & frank disclosure
 - iv. Include methodology and reasons for conclusions
 - v. Fees paid jointly
- APES 225 (standard on valuation services)
 - i. Outlines types of valuation engagement, and the member's responsibility for objectivity, independence and due care

Documents required

- We generally need to look at the following:
 - i. Nature and history of the business
 - ii. Legal structure
 - iii. Financial data – accounts, tax returns, client base
 - iv. Budgets or business plan
- Sometimes it is necessary to investigate undisclosed assets or income (then we would apply APES 215 on Forensic Services)

Main valuation methods

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- Firstly, confirm whether we are valuing the business or the company
- Then – decide whether to apply an earnings-based method, an assets-based method, or a market-based method

Earnings-based methods

- A DCF (discounted cash flow) calculation is possible, but it is very rare to have the data
- The capitalisation of earnings approach is very common
- You need two things: FME (future maintainable earnings) and a suitable multiple
- Some standard add-backs: firstly, arrive at EBIT or EBITDA, and then look at normalisations (e.g. market rate salary package for directors, arm's length rent, other one-offs or abnormal items)

Earnings-based (cont)

- Once you have the FME, you gross it up with a suitable multiple, giving the enterprise value
- The multiple is highly subjective and dependent on experience. Factors to consider:
 - i. Risk of the industry
 - ii. Level of competition and ease of entry
 - iii. Nature of clients – recurring or one-off projects
 - iv. Pattern of results and strength of net assets
- Business value newsletters provide market stats for a range of industries and business sizes

Earnings-based (example)

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- Here's a simplistic example:

	FY2017	FY2016			FY2017	Surplus	Net
Profits	125,000	130,000	FME	150,000	Debtors	140,000	140,000
Adjustments	27,000	19,000	Multiple	3	Stocks	230,000	230,000
	152,000	149,000			Investment	50,000	50,000
						420,000	370,000
FME estimate:		150,000	Business value	450,000	Creditors	70,000	70,000
					Net assets	350,000	NBA = 300,000
					Value		450,000
					Goodwill		150,000
					Overall value = NA plus goodwill		500,000

- In this example, we calculate business goodwill by comparing the result to net business assets
- Any surplus assets are added to overall value

Asset-based methods

- If a business is underperforming, or not generating enough return on its assets, we can use an assets method
- Using the above example, if the earnings valuation came out as 3 x \$60,000, the value of the balance sheet would exceed the outcome. So we fall back on the balance sheet
- Can also adopt a forced realisation basis (e.g. when liquidation is expected) – unlikely in a family law scenario

Market-based methods



- Naturally we examine stats from actual business sales, e.g. the quarterly RMIT report by industry:

		Micro Business (Turnover less than 500k)			Small Business (Turnover 500k to 1 Million)			Medium Business (Turnover 1 to 5 Million)			Middle Market (Turnover 5 to 15 Million)		
		Low	Mean	High	Low	Mean	High	Low	Mean	High	Low	Mean	High
A	Agriculture, Forestry and Fishing	-	-	-	-	-	-	-	-	-	-	-	-
B	Mining	-	-	-	-	-	-	-	-	-	-	-	-
C	Manufacturing	0.58	1.52	3.50	1.31	2.26	2.95	1.03	2.15	3.96	3.16	3.66	4.17
D	Electricity, Gas, Water and Waste Services	-	-	-	-	-	-	-	-	-	-	-	-
E	Construction	-	-	-	-	-	-	-	-	-	-	-	-
F	Wholesale Trade	0.51	1.68	5.09	0.79	1.75	3.52	0.75	2.59	4.49	2.38	3.04	3.70
G	Retail Trade	0.31	1.36	6.00	0.44	1.37	4.52	0.43	1.58	3.35	1.24	2.95	7.06
H	Accommodation and Food Services	0.29	1.17	3.83	0.34	1.27	4.15	0.36	1.65	4.07	1.25	3.61	6.32

- A 'rule of thumb' may also apply in some industries

Rule of thumb

- The Rule of Thumb is limited to a few specific industries, and takes a number of cents in the dollar of a business's turnover as its value
- This needs care, as similar businesses can have very different profit profiles
- Examples: some professional practices with a commoditised product; newsagencies; childcare or aged care facilities, with a typical revenue per place or bed

Other considerations

- Minority interest – when the shareholder only holds a small percentage and does not exercise control, it is normal to discount the value
- Value to owner (higher than the fair market value) – a premium may be applied if the owner cannot be construed as a willing seller
- Special value – the owner may have possibilities of business synergies due to future plans, mergers
- Personal goodwill – may not equate to commercial goodwill, and is separated out as earning capacity

Interesting cases

- A challenging case was for a guy running three different businesses, including a licensed taxicab business – how to value the licences?
- We had to value a superannuation auditor who had a large number of clients with relatively small fees per head. Here we took a rule of thumb approach.
- Hydroponic equipment sales – the spouse admitted that 90% of his sales were to marijuana growers

Lowball values

- A lot of the businesses we value for family law purposes tend to be going downhill, which reduces their value. It could be due to marital distractions...
- Be alert for possible manipulation – have sales been deferred, or put through another vehicle? Have expenses been inflated, or have assets been expensed inappropriately thus depressing profits?
- It may make sense to request interim figures or BAS reports, to check how the business is going now

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Tax

Tim Olynyk | Tax Partner



The issues for consideration?

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Property settlements lead to the reallocation of wealth between spouses. It is this reallocation of wealth that leads to tax issues and tax opportunities.

What are the issues?

- Capital Gains Tax (CGT) / tax rollover
- Stamp duty
- Division 7A
- Other

Capital Gains Tax

- There are automatic CGT rollovers provided under Subdivision's 126-A and 126-B of the ITAA97 to avoid CGT.
- These rollovers are designed to ensure that (i) no CGT exposure arises from the reallocation of assets between the parties; and (ii) the transferee party inherits the same tax attributes relating to the asset as was held by the transferor party.

Subdivision 126-A rollover

CGT rollover applies where:

1. CGT assets are transferred from one spouse to the other spouse or from a company/trust to a spouse;
2. Transfer occurs pursuant to court order, maintenance agreement or a binding financial agreement; and
3. The transfer of the asset would ordinarily result in CGT Event A1 or CGT Event B1 applying.

(If transferor is a company, cost base adjustments may be required to shares in transferor).

Subdivision 126-A rollover

- Where the transferor held the asset as a pre-CGT asset, the transferee spouse will inherit the pre-CGT status of the asset.
- Where the transferor held the asset as a post-CGT asset, (i) any resulting capital gain to the transferor will be ignored; and (ii) the transferee spouse will inherit the same tax cost base and tax attributes associated with the asset as was held by the transferor.
- If the asset is a main residence, the transferee will inherit the PPR attributes of the property as previously held by the transferor.

Subdivision 126-A rollover

Where conditions are satisfied, Subdivision 126-A rollover is automatic. However, if parties do not want to apply CGT rollover, the asset transfers could be undertaken outside of court order/maintenance agreement/binding financial arrangement.

Why might automatic rollover not be desired?

- Crystallise a capital loss on the transfer
- Would prefer to crystallise capital gain but apply CGT discounts to reduce/eliminate capital gain so as to obtain market value tax cost base of asset.

Extension of CGT rollover following Sandini?

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In *Sandini*, an order was made to transfer certain shareholdings from a trust to Ms Ellison. However, subsequent to the order but prior to the actual transfers occurring, Ms Ellison requested that the shares instead be transferred to a trust controlled by herself.

Issue – did Subdivision 126-A rollover apply given that the shares were not transferred to a spouse personally.

- If rollover available – No CGT for transferor and Ms Ellison receives shares with same tax attributes as held by transferor
- If rollover not available – Transferor crystallises a CGT event and Ms Ellison receives shares with benefit of market value tax cost base.

Extension of CGT rollover following Sandini?



Federal Court concluded:

- That the orders made resulted in “beneficial ownership” of the shares being transferred to Ms Ellison as of date of order.
- Alternatively, there was also merit in the argument that Subdivision 126-A rollover was satisfied on the transfer of the shares to a trust controlled by Ms Ellison on the basis that Ms Ellison was sufficiently “involved in the transaction”.
- Case has been appealed.
- Questions remain.

Non-CGT asset transfers

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- Transfer of depreciable assets also have automatic rollover under section 40-340 where the rollover conditions relating to CGT assets in Division 126 are otherwise satisfied.
- Transfer of trading stock can have tax implications as no specific tax rollover applies.

Division 7A lurks when private companies involved



Division 7A can result in loans, payments or debt forgiveness provided by a private company in favour of a shareholder or an associate of a shareholder to represent a deemed frankable dividend.

A spouse of a shareholder would clearly be an associate of the shareholder.

Division 7A lurks when private companies involved



In 2014, Commissioner of Taxation released Tax Ruling TR 2014/5 which sent shock-waves and which contradicted Private Binding Rulings previously issued.

TR 2014/5 concluded:

- Payments made from a private company to an associate of a shareholder of the private company will be subject to Division 7A and thus constitute a deemed frankable dividend.
- Payments made from a private company to a shareholder of the private company will represent an ordinary frankable dividend.

Division 7A lurks when private companies involved

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Prior to TR 2014/5, the ATO position was that where the private company was a party to the proceedings and a cash payment is required to be made by the private company to an associate of a shareholder, Division 7A will not apply as the payment can be considered a discharge of a pecuniary obligation.

TR 2014/5 has changed this position.

Division 7A lurks when private companies involved

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- A forgiveness of a loan by a private company can also trigger Division 7A implications if provided for the benefit of a shareholder or associate of the private company.
- For the above reason, spouses could instead consider re-assigning loans so that the spouse retaining the company retains the loan payable.

Stamp duty concessions

- Scope of duty exemption in Duties Act is different to CGT concessions in Income Tax Assessment Act 1997.
- Transfer must occur “solely because of the breakdown of a marriage or domestic relationship”.
- Transferor can be individual or trust or company. Transferee can be (i) individual; (ii) dependent child; or (iii) a trust.

Other tax considerations

- As a result of *Clark's* case, the variation of trust deeds should not result in any trust resettlement issues, as long as the Deed allows the variation to occur.
- The matrimonial / relationship breakup could also impact on trusts that have made Family Trust Elections as the “family group” of the Test Individual nominated in the Family Trust Election will change.

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Contact Us...

Melbourne

P +61 (03) 9810 0700
F +61 (03) 9815 1899

801 Glenferrie Road,
Hawthorn VIC 3122

Sydney

P +61 (02) 9299 2570
F +61 (02) 9299 2571

Level 4 V 56 Clarence Street,
Sydney NSW 2000

Perth

P +61 (08) 9486 2333
F +61 (08) 9355 4580

65 Burswood Rd, Burswood,
Western Australia 6100

Auckland

P +64 (09) 529 5033

9 Remuera Road, Newmarket
Auckland 1149, New Zealand

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banksgroup.com.au

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CONTACTS



Hanh On

Partner | Superannuation



+61 3 9810 0733



h.on@banksgroup.com.au



Andrew Fisher

Partner | Audit and Assurance



+61 3 9810 0710



a.fisher@banksgroup.com.au



Tim Olynyk

Partner | Tax Consulting



+61 3 9810 0785



t.olynyk@banksgroup.com.au

GET IN TOUCH

Banks Group | Accountants | Auditors | Advisers

Melbourne | Sydney | Perth | Auckland



+61 3 9810 0700



info@banksgroup.com.au



www.banksgroup.com.au



801 Glenferrie Road, Hawthorn VIC 3122

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