

Retaining an investment property after separation

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This blog will explore the capital gains tax ("CGT") implications of keeping an investment property as part of the overall family law property division. Whilst the Family Law Act 1975 (Cth) ("the Act") provides the Court with the powers to alter property interests, caselaw has shaped how the Court deals with CGT liabilities.

Understanding the CGT implications that may flow when dealing with an investment property may make a significant difference to the outcome of your property settlement.

The 4-step process for property settlements

Under Section 79 of the Act, the Federal Circuit and Family Court of Australia has the power to alter property interests between married parties who are separated. The Court's power for de facto parties that are separated is found in section 90SM of the *Family Law Act 1975*.

Under these provisions, the Court will follow a four-step process:

1. Identify and value the asset pool - determine all property and debts/liabilities owned by both parties, including real estate, superannuation, investments, and loans.;

2. Assess financial and non-financial contributions - evaluate each party's financial and non-financial contributions to the relationship, such as income, homemaking, parenting etc.;
3. Consider the future needs of the parties - take into account factors like age, health, income-earning capacity, and care responsibilities to assess each party's future financial needs;
4. Decide if the proposed settlement is just and equitable in all the circumstances.

Where the property pool also includes an investment property, additional issues arise where the potential for a capital gains tax liability is also considered should the property be sold in the future. CGT is not automatically payable at the time of property division but is classed as a notional or contingent liability which lies with the party who takes the associated asset.

Case law - the principles of *Rosati v Rosati* (1988) FLC 92-804

In *Rosati and Rosati [1998] FamCA 38,* the Full Court stated that where the sale of an investment property is inevitable, or is reasonably likely to occur in the near future, the CGT should be considered as a liability in the overall property pool. Where the sale is not inevitable, then it becomes a matter of discretion.

Accordingly, if one party retains an investment property and it is likely that they will soon sell the property, the Court may discount the value of the asset by the anticipated CGT. However, the Court may either partially discount or not take into account at all the CGT on the basis that the liability is speculative.

Practical implications for parties retaining an investment property after separation

Where there are two properties of similar value in the asset pool, one being the former matrimonial home and the other being an investment property, it can be tempting to agree that each party takes one property each and the value of the mortgages (if applicable) are adjusted in accordance with the overall percentage division of the net asset pool each party is retaining.

Before agreeing to this, it is crucial to understand:

1. CGT relief is not automatic. If you are retaining the investment property, you may also be retaining the entirety of the CGT liability when the property is sold in the future.
2. The Court may adjust the property division to reflect a potential CGT liability, but only if it is foreseeable and likely. This is not an absolute. As this calculation will only be an estimate, you may still be left with a liability even after the CGT liability is included in the asset pool division.
3. There is tax rollover relief which may apply under section 126-5 of the *Income Tax Assessment Act 1997* (Cth), which allows for the deferral of CGT in the event of a marriage or relationship breakdown. This means that if the property is held in joint names and is being transferred to one party’s sole name, then CGT is not payable at the time of the transfer but is deferred to when the property is sold or otherwise a CGT event occurs.

Get help from a family lawyer

Dependent on your personal circumstances, the CGT liability associated with the investment property may result in an unexpected expense at the time of the sale.

Accordingly, **before** agreeing to any division of the asset pool which has an investment property or other CGT-related investments, it is essential to obtain legal and taxation advice during the negotiation phase, before a final settlement is reached. Proper planning and advice can prevent any costly surprises in the future.

Contacting E&A Lawyers

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