

**Court Orders and Financial Agreements:
A Comparative Analysis**

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Court Orders & Financial Agreements: A Comparative Analysis

It is almost 6 years since financial agreements replaced maintenance agreements in the *Family Law Act*. During this time we have become more familiar with them, although the absence of reported decisions on interpreting them, means that advice and drafting is still done in a vacuum.

Legislative change, rather than judicial decision making, has impacted on their use. For example:-

- Until 17 December 2003, the requirements on solicitors certifying that independent legal advice had been given, were overly restrictive and discouraged the making of financial agreements
- Transfers under financial agreements are not eligible for the CGT rollover relief which transfers under court orders receive. The bill to change this was introduced to the House of Representatives on 22 June 2006 (*Tax Laws Amendment (2006) Measures (No 4) Bill 2006*). In rare circumstances, if parties want the capital gain to crystallise, financial agreements are the preferred option.
- Superannuation splitting and flagging were introduced in December 2002. Clauses directly dealing with superannuation can be included in Financial Agreements as well as in Court Orders.

After separation, parties have the choice of formalising any agreement as to property and spousal maintenance in one of the following ways:-

- Consent orders
- Financial agreement
- Consent orders and a financial agreement

Advantages and disadvantages

The advantages of financial agreements over court orders include:

- Can be used before marriage or during a marriage, not just after separation
- Can give greater protection against spousal maintenance applications. This is discussed in more detail later in the paper.
- Avoid court. Parties may want to avoid Court scrutiny for a number of reasons, such as:-
 - One or both parties may not want an unjust and inequitable deal to be scrutinised by the Court. Despite its unfairness, the parties may believe there is little risk of a party applying for the agreement to be set aside later. Emotional and financial constraints and risks seem to prevent people trying to apply to set them aside
 - There may have been tax evasion
 - Privacy, particularly for people in the public eye
- Parties can deal with superannuation differently than under court orders. Regulations 22, 27 and 37 *Family Law (Superannuation) Regulations 2001* requires the value of

superannuation to be determined in a particular way if there is a splitting order. The parties may agree that this is unfair. For example, if the husband in *BAR and JMR (2005)* FLC ¶93-231 conceded that his date of retirement was likely to be earlier than age 65, the parties could have agreed on a different value for the husband's superannuation. Parties can also use a different valuation method, or a different splitting method or provide for other idiosyncrasies such as the rolling out of superannuation entitlements over time to reduce the CGT implications for a self managed superannuation fund.

- A SMSF, particularly a non-compliant or possibly non-compliant fund, may be dealt with far less intrusively and with more flexibility in a financial agreement than in consent orders.

The disadvantages of financial agreements include:-

- Currently, there is no CGT rollover relief for transfers under financial agreements
- A transfer or transfers under a financial agreement which result in a party becoming insolvent is an act of bankruptcy by that party (s 40(c)(o) *Bankruptcy Act 1966*)
- Absence of reported judgments means there is a great deal of uncertainties about them.

This is discussed in more detail in the next section of the paper

- Property acquired after divorce cannot be dealt with (s 90B(2)(4), 90C(2)(a) and 90D(2)(a)). If a party acquires significant property after divorce, such as in *Farmer and Bromley (2000)* FLC ¶93-060, where the husband won \$5 million in a lottery, a financial agreement cannot be used to adjust the property interests of the parties although it is probably still a barrier to a further s 79 property claim. Section 75(2)(p) adds a further

deterrent to any claims by requiring the Court to consider the terms of any financial agreement that is binding on the parties.

Uncertainties about Financial Agreements

The absence of case law to guide the drafting of and advising on financial agreements means that it can be difficult to recommend a financial agreement rather than court orders or vice versa.

The major legal uncertainties about financial agreements are:

- The circumstances under which an agreement can be set aside, for example for duress or unconscionable conduct.
- The effect of s 90H. Section 90H provides that a financial agreement continues to operate despite the death of a party to the agreement and operates in favour of, and is binding on, the legal personal representative of that party. How does this relate to wills and probate legislation in Victoria? Does the state legislation cover the field?
- How much disclosure is required? Should Form 13 Financial Statements be annexed or the equivalent details included? Is a summary of the parties' financial positions sufficient?
- What if each party merely states that they have been provided with disclosure by the other party and acknowledge that it is adequate? This is probably dangerous for the solicitor, if not the client, as the extent of the disclosure is unclear on the face of the agreement. Evidence of disclosure may still be required. As time passes, the amount of evidence retained by one or both parties will usually fall dramatically.

- Transactions under both court orders and financial agreements can be set aside under the *Bankruptcy Act*. Until September 2005 when the *Bankruptcy and Family Law Legislation Amendment Act 2005* commenced, financial agreements gave greater protection. Arguably, the lack of Court scrutiny means that financial agreements will be more closely examined by a trustee in bankruptcy than court orders.

Spousal maintenance

The best way to protect against future spousal maintenance claims in a financial agreement is to ensure that the property retained by or transferred to the possible maintenance claimant is sufficient for that party not to be eligible for Centrelink benefits and has sufficient to support themselves.

Section 90E states that a provision of a financial agreement that relates to the maintenance of a party to the agreement or a child or children is void unless the provision specifies:-

- (a) the party, or the child or children, for whose maintenance provision is made;
and
- (b) the amount provided for, or the value of the portion of the relevant property attributable to, the maintenance of the party, or of the child or each child, as the case may be.

Options when using s 90E include:-

- Rely on s 90E and specify a large lump sum spousal maintenance
- Rely on s 90E but only specify a small sum such as \$1 on the assumption that the amount makes no difference

The ability of parties to contract out of spousal maintenance or oust spousal maintenance rights was restricted retrospectively by the introduction of s 90F(1A) in December 2003. Under s 90F(1), a financial agreement cannot exclude or limit the power of a court to make an order in relation to the maintenance of a party to a marriage:

"if the court is satisfied that, when the agreement came into effect, the circumstances of the party were such that, taking into account the terms and effect of the agreement, the party was unable to support himself or herself without an income tested pension, allowance or benefit."

Legal Professional Negligence

The risks of a professional negligence claim are probably greater with respect to a financial agreement than property orders. Very specific and detailed independent legal advice is required for a financial agreement, putting a heavy onus on the legal practitioners. By contrast, court orders put a heavy duty on the Court (*Harris v Caladine* (1991) FLC 92-217).

Capital Gains Tax

Capital gains tax rollover relief is granted to transfers under court orders (s 160ZZMA *Income Tax Assessment Act 1936*). This is automatic and can only be avoided if an asset is transferred outside of the orders. For practical purposes, the transfer usually occurs before, rather than after the orders are made.

Other Issues

Sections s 90B(3), 90C(3), 90D(3) and 90E refer to financial agreements incorporating matters "incidental or ancillary to" property and spousal maintenance. In New South Wales, parties can include a release under the *Family Law Provision Act 1982*.

It appears unlikely that child maintenance or child support can be dealt with in a financial agreement. The Court's jurisdiction permanently retains jurisdiction to deal with these issues. There are public policy reasons why arrangements for children (whether welfare or financial matters) cannot be settled by the parents in such a way as to permanently oust the court's jurisdiction. In relation to child support agreements, s 97 *Child Support (Assessment) Act 1989* allows them to be varied by a subsequent child support agreement and ss 98(1) and 136(1) permit variation by court order.

Until the December 2003 amendments, the legal costs incurred for advice on and preparation of a financial agreement were probably greater than those associated with consent orders. The relaxing of the legal advice requirements for financial agreements and the continued expansion of the Form 11 Application for Consent Orders have brought the costs associated with each closer together. If the parties choose not to have detailed disclosure in the financial agreement, the costs of preparing the financial agreement, particularly in a complex case, will be less than under the consent order procedure. Of course, there may be a greater risk that the agreement will be set aside later.

Conclusion

Financial agreements are nearly 6 years old. They have grown up and matured. As they have aged they have become more flexible, more useful and a more viable post separation alternative to consent orders. It is, however, important to remember that they have only just started school. The Courts have not yet fully determined their skills, weaknesses and strengths, so they should be used cautiously and drafted with care. Over the next few years, we will have the opportunity to see them operate under test conditions in trials and appeal Courts.