

## Divorce

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# Important

**This booklet is simply a collection of Newsflash articles relevant to divorce. The articles are transferred from Newsflash into this booklet so it is best read from the back page forwards to ensure you are reading the latest article on the topic first. Note that the information contained in this booklet is not updated regularly so it is important that you seek professional advice before acting on it.**

## Secret Plans and Clever Tricks – Divorce Rollover Relief

The rollover relief that is available, under CGT legislation, to couples facing divorce means that assets can be transferred by one spouse to the other without any CGT consequences. Rollover relief is not optional and if you are the spouse who receives the asset it is certainly not relief. Rollover relief is not available to same sex couples.

When a spouse receives an asset under the rollover relief provisions, he or she receives the asset at the cost base of the spouse giving the asset and the spouse giving the asset is not subject to capital gains tax on the transfer. Or if applicable, the asset will retain its pre CGT status. The transfer of pre 19-9-1985 assets is fine but any assets bought after that date transfer to the receiving spouse the transferring spouse's CGT liability so make sure that is taken into account when the value of the assets is calculated.

## Warning When Settling Property on Divorce

The following only applies if the assets subject to the settlement belong to a company. It is a horrible combination of Div 7A and the CGT roll over relief provisions.

The transfer of the asset out of the company into the hands of the spouse may create a debit loan account and if the transferee spouse is a shareholder, or not yet an ex spouse of a shareholder so considered an associate of a shareholder of the company division 7A would then apply. A dividend would be deemed to have been paid to the extent of the loan or the undistributed profits held by the company (note the legislation specifies undistributed surplus which has a much wider meaning than profits but I am trying to keep this simple).

The gravity of the ramifications varies depending how the company originally got its funds to invest. If the original investment was made by the shareholders loaning the company the money then there may still be a credit loan account to offset at least part of the debit loan account created by the transfer of the asset. How much is offset depends on whether all the assets originally purchased are transferred out. If the original investment was funded by buying a large number of shares in the company there would not be a credit loan account to offset and this is where there is more likely to be a large deemed dividend.

A deemed dividend under Division 7A cannot be franked with imputation credits for the tax the company has already paid on the undistributed profits. So to keep the example simple lets say there was \$70 in undistributed profits and the transfer of the property to a spouse who was also a shareholder created a debit loan account of at least that much. Because the undistributed profits are less than the debit loan account the deemed dividend is only the amount of the undistributed profits. To have that \$70 in undistributed profits the company must have earned \$100 and paid \$30 in tax. Then as a deemed dividend to a shareholder in the maximum tax bracket the \$70 would attract another \$32.55 in tax. So the original \$100 would have incurred \$62.55 in tax. In reality this means you probably have had to sell the asset to pay your tax bill and only got close to half of the property settlement that the courts credited you with.

Some relief may be gained by declaring a dividend that reduces the undistributed profits to zero. All shareholders of the same class must received the same dividend.

There is much more than this. Section 126-15 deals with how the cost base of the company shares and any loans to the company are affected. Also there may be FBT concerns if either of the spouses have been employees of the company, for example having to pay interest on the debit loan account created by this nightmare. The legislation leaves more questions than it answers and unfortunately has not yet been tested in the courts.

I apologize that I have not been able to put the above into my usual user friendly form as it is a complex issue with problems specific to the facts of each case. I have printed this article because all too often property settlements do not take the tax ramifications into account and as a result one party can be considerably worse off than they expected. The main message I want to get across, is, that if you are settling property that is held within a company make sure a tax specialist is involved in the decision and refer them to the sections quoted

above. Secondly think twice about investing through a company. If you are just doing it for the lower tax bracket a self managed superannuation fund maybe the way to go; though they have their own set of problems which will be addressed in a future edition.

## Transferring a Business on Divorce

Refer our CGT Booklet for details of the rollover relief that is available to assets transferred on the breakdown of a marriage. In short these provisions allow assets to be transferred between spouses without any CGT consequences. The following only addresses the issues that are unique to businesses.

**Depreciating Assets:** Generally the rollover relief under section 40-340(1) would apply. This would result in the transferring spouse not incurring any tax liability whether the asset's market value is more or less than the written down value for depreciation purposes, section 40-345. The spouse receiving the asset would continue depreciating the asset on the same basis and from the same written down value as the transferring spouse. If the transferee spouse later sold the asset the difference between the written down value and the selling price would either be his or her ordinary income or a deduction for income tax purposes.

**Trading Stock** - Rollover Relief is not available for trading stock but in a partnership if at least 25% of the ownership remains the same the trading stock can be transferred at cost price rather than market value but an election to do so must be made, section 70-100.

**Bad Debts** - In the case where a sole trader or partnership transfers the business to a spouse being the other partner or a total transfer of the business ownership from one spouse to the other, the right to recover the debts of the business should not be transferred. As a deduction for bad debts is not permitted to the new owner should any of those debts go bad.

## Divorce and CGT

Currently there is a bill before Parliament that will change many of the rules relating to the CGT rollover relief available to couples going through a relationship breakdown. While it is herald as extending the rollover relief there are a few items tacked on that take away more than it gives.

To encourage couples to settle outside of the courts, and save the Government money, the rollover relief that was once only available to property settlements that went through the courts is now available to all binding agreements on these matters. As you will see in the following it is not always to a taxpayers advantage to utilise the rollover relief yet it automatically applies to court settlements. If couples did not want rollover relief to apply to their circumstances they could enter into a binding agreement and settle out of court. When the new bill receives Royal Assent this option will no longer be available and rollover relief will apply to all binding property settlements.

Rollover relief means that a taxpayer can transfer property to their spouse without triggering a CGT event but the downside is that in most cases the CGT liability also transferred to the spouse who received the property so in reality they were not receiving as much as they thought, after the tax was paid.

Unlike single individuals or same sex couples, heterosexual couples are only allowed one main resident exemption between them. The little piece of incidental legislation tacked onto the bill removed what I thought was a way of compensating separating couples for this inequity. After all around 50% of couples will one day need two houses. Before the bill is passed if a taxpayer transferred a house that had previously been used as a rental to property to their spouse and the spouse used it as a main resident then no CGT would be payable by either party, due to rollover relief it is deemed to be a main resident the whole time of ownership. On the other hand if a taxpayer transfers their main residence to a spouse who uses it as a rental property no CGT is payable by the transferring taxpayer but the spouse will have to pay CGT when he or she sells and the cost base will be the cost base of the spouse that transferred the property to them. In other words they would have to pay CGT on the gain during the time it was their spouses main residence as well as during the time it was their rental property. Still not a real good outcome but at least the tax bill stayed with the person who could afford to use the property as a rental property so didn't hit a taxpayer's home.

The new bill will change this around to reflect the actual circumstances and coincidentally means that CGT will be more likely to apply. A taxpayer who transfers a rental property to their spouse will still not pay CGT but even though their spouse lives in the property as their own home, maybe for 80 years, the spouse receiving the property will have to pay CGT on a percentage of the gain when they sell the property and they will need to know their ex's cost base. Now there is a legal battle in itself and there is nothing in the bill requiring the

ex to provide this information. During the period of ownership the spouse who received the house will be required to keep all records necessary to calculate the cost base these include rates, interest, insurance, repairs, maintenance (ie light globes), improvements and costs of receiving the property. If these are not kept for the whole time of owning the house an ATO fine is applicable. By the time you add these to the cost base there may not be any CGT applicable but you still have to keep the records to do the calculation.

Now if this applies to you and you decide you do not want to be taxed on the inflationary gains on your home for the next 80 years, you may consider selling it and making a fresh start elsewhere. You will still be up for CGT when you sell the house you received as settlement so will have less with which to buy a new home and on top of that the Government will make a tidy stamp duty profit out of your misfortune.

On the other hand a spouse that receives their ex's main residence and uses it as a rental property will not be liable for CGT on the period of time it was their ex's main residence.

None of this applies to same sex couples. Nor do they need it as they are entitled to exempt a house each as their main residence even though they may only be living in one.

This bill was introduced by Mal Brough. Is this how he supports family values? By taxing the homes of sole parent families!

Now that I have had my say I should address more of the nitty gritty detail of the new legislation.

If the spouse that originally owned the property first used it as a main residence and then rented it out after 20<sup>th</sup> August, 1996 section 118-192 would still apply to reset the cost base to the market value when it was first rented out and it is this cost base that would become the receiving spouse's cost base. Further the spouse that originally owned the property can use the 6 year rule to exempt the property as their main residence after it is rented out and this advantage transfers to the receiving spouse though this sort of arrangement would have to be documented in the property settlement and the receiving spouse cannot not make this choice for their ex spouse.

All of the rules discussed above also apply to part ownerships of property so in the case of a jointly owned property the rules simply apply to each half depending on the circumstances.

The above makes mince meat of our Divorce, CGT and Solicitors Selection booklets, which will be updated after the bill has received Royal Assent.

## **The Gate Is Now Shut for Divorce Trick**

Before the end of 2006 the bill changing how rollover relief applies in divorce received royal assent. This means that CGT rollover relief will apply to all future property settlements without them having to be approved by the courts. Accordingly, rollover relief will be unavoidable.

The changes also mean that our trick of transferring a rental property to a spouse to use as their main residence so avoiding any accumulated CGT will no longer work. Both the use of the property before the transfer and after the transfer is taken into account. So be careful to consider the CGT implications on anything your spouse gives you in a divorce settlement as it will be you not them that is ultimately liable for the Capital Gains Tax.

## **Correction Re Marriage Rollover Relief**

In Newsflash 138 I announced that rollover relief would now apply to all marriage and de facto marriage breakdowns whether the couple wanted it to or not. This was misleading as the rollover relief would not apply if there is no agreement. For example the couple agree one gets the home and the other the investment property and they just transfer the title without drawing up a legally binding agreement that settles the property of the marriage. We certainly don't recommend that clients do this because the matter is not finalised in fact in a worse case scenario property acquired after the separation could still be considered matrimonial assets when one party decides they want a formal agreement.

Rollover relief is available if the court orders the transfer of the property as part of a marriage break down or de facto marriage break down hearing. In order to reduce the demands on the court system the new legislation adds that rollover relief also applies to binding financial agreements or arbitral awards under the Australian Family Law Act 1975 or corresponding foreign law and a written agreement that is binding via the various state and foreign laws on de facto relationships providing that the only reason a court could ever override the agreement is if it was unjust.

## Pre 12<sup>th</sup> Dec 2006 Divorce

When you sell a property that you received as part of a divorce settlement that was finalised before 12<sup>th</sup> December 2006, make sure the person preparing your tax return is aware of this date and realises the difference.

The law as it stands today requires you to pay any CGT on that property if your ex would have been subject to CGT before the property was transferred to you. This is the case even if you have used the property solely as your home from the day you received it. But for settlements made before 12<sup>th</sup> December, 2006 the CGT calculation only takes into account the way in which you have used the property.

The trouble is this fact does not appear clearly in the legislation. You have to refer to the history notes ie

S 118-178 inserted by No 168 of 2006, s 3 and Sch 1 item 2, applicable to CGT events that:

- (a) are trigger events for the purposes of Subdivision [126-A](#) of the *Income Tax Assessment Act 1997*; and
- (b) happen after 12 December 2006.

And then trace back to how the legislation was written before that date.

## Ask BAN TACS

For \$79.95 at Ask BAN TACS, <https://taxquestions.com.au/>, you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered. We will include ATO references to support our conclusion. There is also a notice board where some askbantac users have generously allowed their question and answer to be published. Lots of good real life information.

## More Information

Please make sure you continue to keep your knowledge up to date by [subscribe to our Newsflash reminder](#). There are many other booklets available on our web site <https://www.bantacs.com.au/media-library/booklets/> in fact the whole web site is full of useful information so also have a look around under topics.

## How to Make Sure Your Next Property Is a Good Investment

- Do you really know how much the property is going to cost you to hold?
- What name should the property be purchased in?
- Will this property fit your investment strategy and goals?
- What does the contract say about GST?
- How does the price compare with similar sales in the area?
- If it is negatively geared, how much capital growth is required before you breakeven?
- Do you know what records you need to keep and how?
- Are your financing arrangements maximising your tax deductions?
- What happens if interest rates rise?

.....and the list goes on!

To ensure you don't make a costly mistake with your next purchase make sure you see a BAN TACS Accountant before you sign



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