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### **TAX SHOCK ON MARRIAGE BREAKDOWN (PART 2)**

We have previously written about this issue however in the latest development, the ATO has recently confirmed its view on the adverse tax outcomes for matrimonial property or cash settlements involving companies in the final Taxation Ruling TR 2014/5.

In short, any payment or transfer of property under a Family Court order to a husband or wife from a private company will be taxed either as an ordinary dividend or a "Division 7A" deemed dividend.

If the payment or transfer is made to a shareholder of the company, it will be considered as an ordinary dividend paid out of the company's profits (if any) and is frankable provided there are enough franking credits in the company. If the party receiving the cash or property is not a shareholder, they will be deemed an associate of a shareholder and taxed on the cash or property as a deemed dividend under Division 7A.

Where a deemed dividend arises under Division 7A, the ATO accepts that the associate can be treated as if they were a shareholder and enables the company to fully frank the deemed dividend. The franking credit is then included in the associate's assessable income and they are entitled to claim a tax offset equal to the amount of that franking credit.

Where there is a transfer of property, rollover relief may be available to defer any potential Capital Gain Tax ("CGT") consequences to the private company until the property is eventually disposed of by the husband or wife. The cost base of the shares in the company is then reduced by the fall in market value of those shares caused by the property transfer.

In the past, the ATO had adopted a more generous interpretation of this issue and did not seek to apply Division 7A to the payment, provided the payment or transfer was pursuant to the

terms of the Family Court Order. The ATO has acknowledged its “U-turn” on the issue and, accordingly, will not actively seek to review any orders made **before 30 July 2014**.

However, the ATO will apply its view in accordance with the Ruling for any such matters brought before the ATO for consideration, such as a private ruling application, effective 30 July 2014 even if the actual payment or transfer occurred before that date.

Where a matrimonial settlement involves the payment of cash or transfer of property from a private company, professional advice should be sought to legitimately minimise the potential impact of the Ruling.

For example, where the transfer of property is required, consideration should be given to the availability of the roll-over relief and the appropriateness of the roll-over in the particular circumstances. Alternatively, consideration should be given to treat the payment or transfer as a fully franked dividend and only pay the top-up tax (if any).

If you would like to discuss the ATO’s new ruling and how it may affect you, please contact Nigel Kingston.

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## **ATO AND RENTAL PROPERTIES**

The ATO announced last week that it is increasing its focus on rental property deductions. It says common errors made by rental property owners include:

- claiming rental deductions for properties not genuinely available for rent;
- incorrectly claiming deductions for properties only available for rent part of the year such as a holiday home;
- incorrectly claiming structural improvement costs as repairs when they are capital works deductions, such as re-modelling a bathroom or building a pergola;
- overstating deduction claims for the interest on loans taken out to purchase, renovate or maintain a rental property.

The ATO has also released a series of short videos which explain the tax implications of buying, owning and selling a rental property.

It is understandable that the ATO continues to focus on claims made, predominantly by individuals, for rental properties given the negative gearing benefits that can be achieved by PAYG taxpayers. It is important to consider what can and cannot be claimed with regards the five areas noted above.

### **1. Available for Rent**

In general, the rental property must be available for rent before deductions can be claimed. That is, it must be in a state capable of being lived in and the owner must be advertising the property for rent. The only exception to this rule is in respect to interest where under the principles adduced from "Steele's case", interest can be deductible on money borrowed to acquire, renovate or construct a rental property before it is available for rent provided you can prove it is your intention to rent that property as soon as it is habitable. The onus of proof, as always, lies with the owner.

## **2. Part Year Rentals**

Where a rental property is only available to rent for part of the year and is used for private purposes on those occasions, the deductions claimed must be apportioned to account for this. If the owner withdraws the property from rental at any time (for example, the Christmas or Easter breaks, or School Holidays), the deductions for the property must be apportioned to account for these non-income producing periods.

## **3. Repairs**

Deductible repairs include the restoration of property to a condition that it previously had, such as the making good of any wear and tear or other damage that has occurred as a result of renting the property. However a repair must not improve or enhance the function of the item being repaired. Therefore capital improvements will not be repairs and you can expect the ATO to consider large repair claims very carefully.

## **4. Interest**

Interest expenses are typically the largest expense claimed against a rental property and therefore one of the first areas the ATO review. As we noted above, the property needs to be "available for rent" firstly, or for properties under construction or renovation, there needs to be a clear and demonstrable intention to rent the property. Furthermore the use of equity loans with redraw facilities, the treatment of repayments against mixed loans and refinanced loans will generally also require some kind of apportionment of interest claims made by rental property owners.

If you require any assistance in reviewing your clients rental property claims, please contact Peter Hong or Sean Pearce.

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## **DATA MATCHING PROGRAMS FOR BANKS**

The ATO has released details of a data matching program through which it will request and collect the account details of customers from specified banks in order to identify Australian resident taxpayers with offshore bank accounts which may evidence undeclared income and/or gains from the income years ended 30 June 2012 to 2015 from the following sources:

- Australia and New Zealand Banking Group Limited
- Bank of China (Australia) Limited
- Bank of China Limited
- Credit Suisse AG
- Deutsche Bank Aktiengesellschaft
- HSBC Bank Australia Limited
- Hongkong and Shanghai Banking Corporation Limited
- Investec Bank (Australia) Limited
- Macquarie Bank Limited
- Rabobank Australia Limited
- Rabobank Nederland
- UBS AG
- Citibank, N.A.
- Citigroup Pty Limited

The ATO are not sure as to the total number of offshore records that will be obtained under this program, however, they anticipate there will be approximately 50,000 records.

These records will be electronically matched with certain sections of ATO data holdings to identify non-compliance with registration, lodgment, reporting and payment obligations under taxation laws.

This program is called the Banking Transparency Strategy data matching program and its purpose is to identify taxpayers who are not complying with their taxation obligations by comparing data reported by taxpayers with data on offshore accounts provided by financial institutions.

Its objectives are to:

- Assist the ATO to build an understanding of taxpayer behaviour in international dealings, develop compliance profiles and improve fraud detection models
- Identify taxpayers who are not reporting all of their income
- Identify Australian resident taxpayers who may be outside the tax system
- Increase transparency of the worldwide dealings of Australian resident taxpayers
- Help to develop and implement administrative strategies to improve voluntary compliance through education, audit, lodgment enforcement and debt collection activities
- Promote voluntary compliance and strengthen community confidence in the integrity of the tax system.

Should you have any queries on this initiative please contact Nigel Kingston.

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## **MKT'S PREMIUM ACCOUNTANTS NETWORK**

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If you would like to enquire about joining the 36 firms already in our Premium Accountant's Network, and the additional services it can provide for you, please visit our website or contact Sean Pearce on 08 9481 8448 or via email: [sean@mkttax.com.au](mailto:sean@mkttax.com.au).