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Tax Benefits in the Right Orders

It is often the case that when a relationship breaks down, one party has to borrow further funds in order to "pay-out" the other party's interest in a business or real property.

It is often assumed that the interest incurred on those additional borrowings will be deductible. But this may not be the case if the order or agreement providing for the payment is not drawn correctly. Without the right orders in your family law matter you may put significant tax benefits at risk.

The basic principles of interest deductibility are that interest payments are generally deductible to the extent that the borrowed funds are used in gaining or producing assessable income or in carrying on a business.

For example, if a loan is used to purchase a home or an entitlement in the home, the loan is for a non-income producing purpose and the interest will not be deductible even if the loan is secured over income producing assets. Rulings from the ATO have denied deductibility of borrowings under Family Court orders or agreements if the wording requiring the payment did not specify that the funds were necessary to pay the former spouse for relinquishment of his or her share in an asset which needs to be income producing. Carefully drafted orders and agreements may overcome the problem of interest deductibility.

If the orders require that the income producing property be transferred in consideration for a cash payment, or that one party acquire an asset from the other for a particular sum of money, then the borrowing to make the payment should enable the interest incurred to be deductible.

The situation may be further enhanced if the orders require a party to borrow funds to make the payment in order to acquire the assets.

Fox and Thomas has the expertise in matters involving significant commercial or rural assets to ensure the preparation of properly drawn orders and agreements in family law settlements.

For more information on the whys and wherefores of the tax benefits in orders please contact any of the following:

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