

One Thing You Must Know Before Getting A Loan

Note: This is only general advice. You should seek the advice of a professional adviser before acting on any information. The adviser needs to apply any concepts here to your personal circumstances. Also the law is constantly changing. Written in March 2008

Tax Deductibility of Interest

The basic premise is that interest on a loan is deductible only if the money that was borrowed was used to derive assessable income (this is a general statement). If so then the interest is deductible against that income.

The tax deductibility of interest depends on what the funds borrowed were used for. It doesn't depend on what security is used.

EXAMPLE:

- Two people currently renting accommodation.
- Both went to the bank to get a home loan buy their own houses to live in.
- The first one Mr Offset applied for a loan that had an offset facility.
- The second one Mr Redraw applied for a loan that had a redraw facility.
- They both had \$150,000 of their own money and they borrowed \$250,000 and bought a home each for \$400,000.
- They both saved hard and paid off an extra \$180,000 of the capital of their respective loans. They were ahead in their repayments.
- They then later found bigger homes that they really liked and decided to buy and move into the new properties. They also both wanted to also keep their respective first properties and rent it out and claim the interest against the rental income..

Mr Offset could claim interest on \$180,000 more than Mr Redraw. That could be equal to around an extra \$16,200 or around \$7,000 extra tax refund each year.

The only difference between the two is that Mr Offset originally took out a loan that had a true offset account while Mr Redraw took out a loan with a redraw account.

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Refer next page for references

References:

Taxation Ruling (refer especially Example 3 at end)

[http://law.ato.gov.au/atolaw/view.htm?dbwidetocone=07%3AAATO%20Rulings%20and%20Determinations%20\(Including%20GST%20Bulletins\)%3ABy%20Type%3ARulings%3ATaxation%3ADraft%3A1999%3A%2305010030000%23TR%201999%2FD3%20\(Finalised\)%20-%20Income%20tax%26c%20deductibility%20of%20interest%20on%20money%20drawn%20down%20under%20line%20of%20cre...%3B](http://law.ato.gov.au/atolaw/view.htm?dbwidetocone=07%3AAATO%20Rulings%20and%20Determinations%20(Including%20GST%20Bulletins)%3ABy%20Type%3ARulings%3ATaxation%3ADraft%3A1999%3A%2305010030000%23TR%201999%2FD3%20(Finalised)%20-%20Income%20tax%26c%20deductibility%20of%20interest%20on%20money%20drawn%20down%20under%20line%20of%20cre...%3B)

Appeals case discussing loan interest deductibility and redraw accounts (Refer especially paragraph 31. This paragraph refers to the essential difference between a redraw account and an offset account.)

<http://www.austlii.edu.au/au/cases/cth/aat/2004/815.html>

Detailed forum thread discussing loan concepts including loan offset accounts and interest deductibility

<http://www.invested.com.au/3/loan-recommendations-16659/>