

Tax Office targets investment property loans

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to “pay off their home loan sooner”. The arrangements generally involve two loans — one for a home, the other an investment property — and a credit facility. The home owner diverts all cash inflows to the home loan or an offset account, while using the credit facility to pay interest on the investment loan, effectively “capitalising” that interest. The taxpayer claims a deduction for the credit facility interest as an investment cost.

It is this credit facility that has attracted the taxman’s wrath: without it, the Tax Office notes in its determination, it “might reasonably be expected” that the taxpayer would have made the interest payments using cash. Instead, they had effectively funded home loan repayments using a line of credit with a higher interest rate; a strategy that made “little (if any) financial sense” apart from the tax benefit. Accountants said the Tax Office had long viewed such schemes as vehicles to avoid tax, but its renewed tough approach could catch investors unaware of the view.

Deloitte Private partner Spyros Kotsopoulos said the ruling would force those with arrangements in place to re-evaluate whether they could justify it, without “hanging their hats” on the argument that they were simply trying to pay off their home loan quicker.

He said banks would have to revisit their product offerings to clarify the

Under scrutiny

An example of the ATO’s concern



Family home \$ Taxpayer directs income from all sources into home loan or offset account. Home loan repayments are not tax deductible.

Investment property \$ Taxpayer has a second loan for investment property.

Payments on investment property are from line-of-credit funds (also tax deductible)

\$ Investment loan payments are interest only and tax deductible

\$ Credit facility (line-of-credit) usually with no minimum repayment



Purported result: Interest is capitalised on the investment loan while the home loan is paid off faster, reducing the (home loan) non-tax deductible interest bill.

Tax Office: “We will be monitoring products currently being marketed or utilised that are claimed to allow those with both business and personal loans to use their business income to pay off their personal loan.”

SOURCE: ATO, FINANCIAL REVIEW

associated benefits, tax or otherwise.

“A lot of the banks will offer different types of variations of these things,” said Mr Kotsopoulos, with small businesses particular users.

The Tax Office was essentially imputing a different purpose to that put forward by the taxpayer, he said.

“All they’re trying to say is, we’re going to impute a different purpose, being ‘you’re trying to change non-deductible interest to deductible interest.’”

He suggested the ruling could be a bit clearer. “If you’re going to draw a line in the sand, can you make it a bit brighter?”

Institute of Public Accountants senior tax adviser Tony Greco said the latest spate of arrangements was a “twist” on a typical split loan.

Heavily marketed in the late 1990s, split loans were snuffed out when the Tax Office won a landmark battle in the High Court in 2004.

Mr Greco said most tax agents would view the latest arrangements,

Maybe the unwary are being exposed to these strategies.

Tony Greco, Institute of Public Accountants

which followed the “hard and fast rule” to reduce non-deductible interest, as tax avoidance.

“Maybe the unwary are being exposed to these strategies which, if they went to any tax agent, they’d quickly realise they’re not effective.”

HLB Mann Judd partner Greg

Mascaro said the scheme was marketed by “a number of financiers and brokers” who would now be under pressure to look at other measures.

He said if the Tax Office applied anti-avoidance provisions, it would usually result in a cancellation of the tax benefit.

Mortgage Choice broker John Manciameli said that if people were investing in the schemes, it was certainly not through him. “I have heard just recently that some of my clients have been approached by organisations that have been promoting this. I just said do whatever you want, but I’m not going to do it.”

Financial planner Paul Moran said he too was wary of the scheme. He would encourage clients to seek a private ruling, given the uncertainty.

He said short-term reasons for capitalising interest, beyond home loan repayment, could be justified, such as while a property was being built.

The Tax Office’s compliance program, released on June 30, targeted split loans “currently being marketed or utilised” to facilitate taxpayers’ use of “business income to pay off their personal loan”.

The Tax Office said an increase in private requests prompted the latest determination.

Resi chief executive Lisa Montgomery said certain companies and organisations did promote these types of loans. “I think it’s going to really send a message to the marketplace that the ATO is not interested in the deliberate manipulation of certain products,” she said.