

# Plant & Associates

## Interest deductibility on your investment property loan

Most loans for investment properties have redraw facilities that allow you to withdraw funds available that are above the minimum repayments obligations. Don't assume that redrawing the extra funds from the facility will not affect the deductibility of interest incurred relevant for income earning purposes. Your chance of using the funds for private purposes and still claiming 100% of the loan interest in your tax return is most likely NIL!



### How can I avoid interest apportionment hassles for mixed-purpose loans?

Consider setting up an interest or mortgage offset account. These types of accounts are deposit type accounts where you do not receive interest on monies deposited. Instead the interest incurred on the existing loan account is reduced. This allows for your money deposited into the offset account to reduce the interest payable on the investment loan whilst you still use the funds for private purposes as you require. You can then claim the full interest as a deduction for the rental property.

#### **For example:**

*John and Daisy acquired a \$500,000 investment loan with an interest offset account to purchase a rental property on a 50/50 split basis. A year after acquiring the property, Daisy received \$50,000 from her aunt's estate. She deposits this into the offset account. Six months later John and Daisy decided to redraw \$10,000 to go on a holiday. The remaining amount in credit in the interest offset account will still be reducing the amount of interest payable on the loan and therefore the loan's purpose is still solely for the purpose of an income-earning activity.*

### What if I take out \$5,000 for private purposes and I repay the same amount a month later?

In a recent case, it was held that the repayment for a loan without an offset account which was partly used for private purposes does not apply directly back to private withdrawal and therefore it must be apportioned against each private/income producing purposes of the loan balance. Only the interest that accrues on the outstanding loan balance that is relevant to the rental property is deductible.

### What's a solution to the repayment problem?

One planning technique you can utilise is to refinance the mixed-purpose loan by borrowing an equivalent amount under two separate loans or sub-accounts separated by the portion for private/income producing purposes. This way you can direct your repayment to the separate private sub-account and reducing the non-deductible interest for this loan. The investment sub-account will be accepted by the ATO to have full interest deductibility. BEWARE! Always consider the termination loan fees such as interest penalties, loan discharge fees etc before jumping to this solution.

It is always best to set up your loans with sub-accounts or interest offset accounts right from the start if you are intending to use it for mixed-purposes. Your finance provider will be able to advise you on the type of accounts they have available for this purpose and of course, always speak to your accountant or your financial adviser before purchasing an investment property to get the best advice right from the beginning.



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