

June 2007 Newsletter

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Save over \$66,000 – same loan amount, same rate, same repayments just a different structure!

You may recall in my April newsletter that I discussed a loan structure, which involved someone buying an investment property without contributing a cent of their own money (i.e. borrowed the total cost plus the negative cash flow). In that newsletter, I suggested that you could not claim a tax deduction for interest incurred on previously unpaid interest. That is, you cannot allow interest to be added to a loan (because you chose not to make interest only repayments) and claim the higher interest charge (because the balance continues to increase). Subsequent investigations reveal that you may in fact be able to claim interest on interest.

This opens up a significant tax planning opportunity for anyone who has a home loan (non-deductible debt) and an investment loan (deductible debt). Some might choose to not make any repayments on their investment loan and instead divert all spare cash into their home loan (including rental income from their investment property). By doing so, they are able to repay their non-deductible debt a lot quicker. In return, their investment loan balance would increase each month because no repayments are being made. This results in a climbing interest cost (albeit tax deductible). This brings me to my question. Is it worthwhile to ignore your investment debt and allow it to accumulate while you focus solely on repaying your home loan?

It is very important to note at this stage that while I will cite tax rulings to support my assumptions, it is critical that everyone seeks their own personal taxation advice on these matters, as everyone's situation is always subtly different.

Is the deduction allowable?

Many people know about the Harts Case that went all the way to the High Court of Australia. The ATO denied a deduction for interest (which the Harts

claimed). The Harts established a loan structure which included a split loan with one split being used as a home loan and the other an investment loan. No repayments were made on the investment loan, so the interest was added to the balance. Each year, the balance would increase and so would the interest deduction claimed. There were two critical considerations the High Court took into account when they decided to support the ATO in denying the deduction. Firstly, the mortgage product advertising materials heavily promoted the product based on the potential tax savings it could deliver. Secondly, the Hart's used a split loan rather than two separate loans.



"Remember, son, these are your tax-free years.
Make the most of them."

The ATO issued Private Binding Ruling 69725 which applies to the financial year ending 30 June 2007. An edited copy of the ruling can be found on the ATO's website [here](#). The ruling assessed a situation where the person had a home loan

and a totally separate line of credit. The line of credit was used to invest in managed funds. The ATO lists a number of specific product features of the line of credit (this is important). The borrower chose to make no repayments on the line of credit and allowed the interest to accumulate (capitalise) in the loan. The ATO determined that the interest on the line of credit was fully deductible as they concluded that it did not contravene any anti-avoidance tax provisions, as the borrower did not enter into the loan structure with the dominant purpose of obtaining a tax benefit. The borrower simply did not wish to use personal funds to repay the interest on the line of credit.

Once again, I stress that there were certain considerations about the loan structure and product features which assisted them in reaching their conclusion. Therefore, before implementing a similar structure for yourself, you must get advice from a suitable trained professional (i.e. ProSolution!) to ensure you have the correct product and structure.

The result of the structure

This loan structure sounds like it might be a good idea for some people, but is it important to look closely at the numbers. I assess the following situation.

Home loan	\$350,000
Line of credit	\$475,000
Annual salary	\$150,000 p.a. gross
Rental income	\$310 per week
Dependants	Wife and two children
Living expenses	\$3,100 per month

I assessed two scenarios:

1. The borrower made interest only repayments on the line of credit and used all his remaining surplus cash to repay the home loan. This would be the most common arrangement.
2. The borrowers used all after tax income (rental and salary) to repay his home loan. The borrower made no repayments into the line of credit. In fact, he used the line of credit to pay for the investment property expenses as well. Once the home loan is repaid in full, he starts to make repayments on the line of credit.

Scenario two was the winner and resulted in the borrower paying \$65,882 less in interest. In scenario two, the borrower repaid his home loan in 52 months (4 years and 4 months) and then repaid his line of credit in 8 years and 6 months. Therefore, both loans were fully repaid in less than 13 years with a total interest cost of \$493,000.

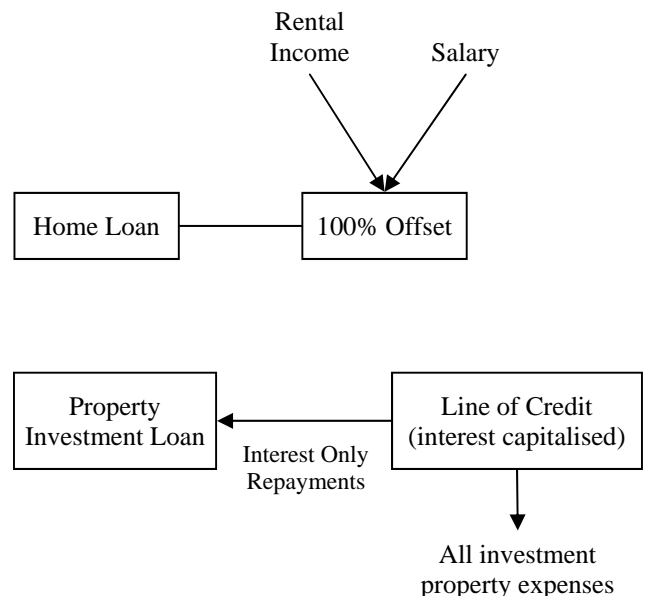
In scenario one, it took the borrower 8 years to repay the home loan and then a little over 7 years to repay the investment loan. All up, it took this borrower 15 years and 3 months to repay both loans with a total interest cost of \$559,000. Therefore, the borrower in scenario two saved \$66,000 in interest and repaid both loans 2 years and 2 months quicker than in scenario one.

Please get advice

There are two things you need to do if this sounds good to you. Firstly, you need to get your own independent financial and tax advice to ensure this is appropriate for your situation. Secondly, you need to engage us to implement this structure for you. I know this sounds like a shameless plug for business (and it is!), but it is absolutely critical that the person that sets up your loan structure has a

through understanding of lenders' products (particularly lines of credit) and the relevant tax determinations. I hope you find this advice of some benefit.

The winning Structure



7.15% Fixed Rate Offer Ends

We sent an email about a week or so ago advertising that St George was offering a special fixed rate of 7.15%. We were advised this week that the offer will expire on Monday 18 June 2007 which is a lot sooner than expected.

Our Best Interest Rates

Basic variable	7.24%
Offset	7.30% (0.77% ongoing disc.)
Offset (> \$500k)	7.27% (0.80% ongoing disc.)
Offset (> \$1 million)	7.17% (0.90% ongoing disc.)
1 year fixed	6.95%
2 years fixed	7.34%
3 years fixed	7.15%
4 years fixed	7.34%
5 years fixed	7.15%
10 years fixed	7.44%

Above rates are current as at 11/6/07 and are subject to change without notice. Standard lenders terms and conditions apply. Comparison rates are available upon request.