Williams Financial Management

Deducting Interest: When Can it be Done?

In Canada, interest expense on money borrowed to produce income from a business, investments or property is deductible against all sources of income. However, interest paid on money borrowed for personal consumption, home mortgages and Registered investments is not deductible. For many people, tax savings can be achieved by restructuring their debts and assets. Here are some ideas:

1. **Don't invest in your business**. When people start a new business venture they often need to invest capital in the business. Some businesses require cash injections for many years and owners take their personal funds and either invest in the company or loan funds to the company. But at the same time they have personal debt that is non-deductible or they let their personal debt grow. It is far better to borrow specifically for the business using separate loans or lines of credit. By doing this, the interest on these loans becomes fully deductible.
2. **Re-mortgage your home**. Many individuals biggest debt is their mortgage. Over time, as their income increase, they begin to invest for the future. It is not uncommon for families to have a mortgage and at the same time have non-registered assets saved for retirement or some other purpose. One effective strategy is to sell all the assets, pay off the mortgage, then re-mortgage the home and re-acquire the assets. By doing this, the interest borrowed is now deductible against all income.
3. **Re-mortgage your home Two.** If you can deduct home office expenses you may want to maximize your interest expense on your mortgage. For instance, if you own a home and cottage both with mortgages you may want to re-mortgage the home and use the funds to pay down the debt on the cottage. This will maximize the interest related to the home that is partially deductible.
4. **Pay the minimum amount on student loans**. There are tax credits on interest paid on student loans. These credits effectively reduce the actual after tax cost of these loans. For many people it will make sense to pay off other debt or save instead of paying off the loans and losing the tax credit.
5. **Pay only interest on investment loans**. If you have an investment loan only pay the interest. This allows the investment loan and its interest to stay the same over time. It is better to use the extra cash flow this creates to pay off non-deductible loans.
6. **Get paid your investment income and gains**. Some individuals have margin accounts for their investments. The interest on these accounts is deductible. But the dividends, income and gains often goes back into the account to reduce the debt and interest expense. Consider removing all income and gains from the account to maximize the interest expense that is deductible.
7. **Get a car loan**. If you are able to deduct part of your automobile expenses use a loan to buy a car instead of cash. This makes part of the interest on the loan deductible. Use the cash to pay off non-deductible interest or for investment purposes.
8. **Work with a Professional**. The tax rules are complex and change every year. Working with a professional can ensure that you minimize all taxes payable.

By careful planning, record keeping and professional assistance you can reduce your taxes and maximize your income.

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