SLOAN GROUP

HELPING YOU TAKE IT THE NEXT LEVEL

DISCUSSION PAPER #3

HOW TO DEDUCT THE INTEREST ON YOUR MORTGAGE

Your Mortgage

If you are like most Canadian home-owners, you have a mortgage on your humble abode. Many of us feel like we are renting our homes from the Bank when we consider how much of the monthly payment actually reduces the balance we owe. The principal portion of the payment is very small for a long time. In fact, until year 17 of a 25 year mortgage, the interest portion is more than half of the total payment! To make matters even worse, you pay your mortgage with “after-tax dollars”. In other words, if you are in a 40% tax bracket, you have to earn $1.65 for every $1.00 you need to pay your mortgage.

This is because the interest you pay on your mortgage is “not deductible” for income tax purposes. Since your home is a personal asset and any gain on it is not taxable, there is no tax write-off for interest paid to finance the mortgage on your principal residence.

Interest is Interest is Interest (or is it?)

There is no tax write-off for interest paid to finance the mortgage on your principal residence. BUT, if you borrow money to buy securities or invest in a business, the interest IS deductible in computing your taxable income. So, the Canada Revenue Agency (CRA) thinks that there is a difference between the interest paid to earn income and interest paid on money borrowed for personal purposes. We do too. The tax law states that any amount paid out for the purpose of earning income is deductible, so the interest on money used for investment can be written off. No question!

So, can we change the nature of mortgage interest to satisfy CRA? Well, let’s say that you had earned or saved some money (or got a nice bequest from your beloved Granny) and bought some blue chip securities (like Bank stock!). Then you decided to settle down a bit and buy a great condo. You don’t want to sell the stock since the dividends represent a nice return. You get a mortgage on your condo and the payments are “affordable”. But the interest is not deductible!

Hmmmm……. Let’s say, hypothetically, that you had purchased the condo with YOUR money and then borrowed for investment. Well, then the interest would be deductible. But, you didn’t. And <u>now</u> you need some advice.

In Your Best Interest

OK, you have your investment and you have your condo. And your mortgage. CRA has your tax dollars. Let's do some tax planning.

First, you sell your investment in the bank stock. Then you take the proceeds and pay down your mortgage. You still want the investment. The bank knows you and how much equity you have in your condo. *Remember, you just paid down your mortgage*. You ask for a loan for investment and you use your condo for security. After they give you the money, you buy back the investment you sold a few days before and ***PRESTO***, the interest is now ***DEDUCTIBLE***. Yes, it works and it's legal.

Some Cake with That?

The bank will still like you since you are still paying them interest. You will still have your dividend income, but your interest payments will be deductible and you'll pay off your loan faster than you would have paid off your mortgage before you rearranged your financial affairs. Just like eating oatmeal "It's the right thing to do".

Your Situation

You will have to speak to a tax professional to discuss your individual situation. Your actual circumstances may be somewhat different from what we have described and may require some planning to fit your requirements.

Please feel free to contact one of the Partners at Sloan Group.

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