

Turning non-deductible debt into deductible

Normally, the interest you pay on debts is not tax deductible. For example, the interest paid on your mortgage or an RRSP loan can't be deducted from your income for tax purposes. However, when funds are borrowed for the purpose of earning investment income or to invest in a business, it's a different story. Here are two powerful strategies that can turn regular debt into an opportunity for significant tax savings.

Make non-deductible, deductible

The strategy of switching non-deductible debt for deductible debt was recently condoned by the Supreme Court of Canada in the *Singleton Case*.

In 1988, Mr. Singleton, a Vancouver lawyer, drew \$300,000 from his firm's capital account to help finance the purchase of a home. He then borrowed \$300,000 from the bank to replace the funds borrowed from the capital account. In effect, this converted a non-deductible mortgage into a deductible business loan. Although the Canada Revenue Agency (CRA) fought it all the way to the Supreme Court, the court ruled that the transaction of borrowing to invest in the business was legal and related to earning income from a business. This monumental decision clears the way for Canadians to liquidate their portfolios to pay down non-deductible debts such as mortgages, then reborrow to repurchase their portfolios and deduct the interest costs.

Borrow to invest, even for modest income

The Supreme Court of Canada has also recently ruled on the feasibility of deducting the interest on a loan to invest in shares of a corporation.

In the *Ludco Case*, Ludco Inc. borrowed money to invest in common shares that paid a small amount of dividends. Ludco attempted to write off all of their interest costs above and beyond the amount of the dividends received. CRA denied the claim on the basis that there was not enough income to justify the write-off. In their view, the company had not borrowed the funds for the exclusive purpose of earning income from property (capital gains do not count). The Supreme Court disagreed, saying that a reasonable expectation of at least some property income was all that was needed, and that earning property income need not be the exclusive purpose of the investment. This ruling opens up even more opportunities for Canadians who wish to borrow to invest, and write off their interest costs.

A ScotiaMcLeod advisor has the knowledge, resources and team of experts to identify the deductible debt opportunities that will work with your financial and tax plan.

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