IT 166 - Interest on money borrowed to acquire an income producing asset

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TAXATION RULING NO. IT 166

INTEREST ON MONEY BORROWED TO ACQUIRE AN INCOME PRODUCING ASSET

F.O.I. EMBARGO: May be released

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I 1101897	INTEREST	51(1)
	INCOME PRODUCING ASSET	62AA
	INVESTMENT ALLOWANCE	

PREAMBLE Consideration has been given to the deductibility of interest on money borrowed to construct an income producing asset, such as a block of flats, where the interest is paid during the construction period during which no revenue is being received from the asset.

RULING 2. Generally speaking, interest incurred in these circumstances should be allowed as a deduction under section 51 so long as the case is one in which there is no room for doubt that the asset under construction is being erected solely and exclusively for the purpose of producing assessable income.

3. The matter has arisen in cases where oil companies have sought to treat interest during the construction period as part of capital costs of oil refineries so as to increase the amount which may be claimed as an investment allowance under section 62AA. It was decided that interest incurred in these circumstances is deductible under section 51 and, accordingly, it should not be taken into account in calculating the cost of a new asset for investment allowance purposes.

4. An exception to this general proposition is to be found in the type of case, of which the decision of the Taxation Board of Review No.2 in 16 TBRD Case R74; 13 CTBR(NS) Case 4, provides an example, in which an individual taxpayer not obviously engaged in business purchases or constructs a building in ambiguous circumstances which leaves room for doubt as to whether his true intention is -

(i) to use the property for the purposes of producing assessable income by way of rents;

(ii) to use it for his own private purposes; or

(iii) to use it for the purposes of profit making by sale.

5. In rejecting the claim for interest, in Case R74, Case 4 members of the Board made comments which might be thought

to involve acceptance that the interest incurred prior to the production of assessable income is of a capital nature. However, the decision in the particular case could equally well have been supported on the basis that the interest was not incurred in the production of assessable income, in that the taxpayer held the properties for some years without using them for income producing purposes.

6. Claims of this nature should be carefully scrutinised because there is always a temptation for taxpayers who are building homes with the intention of living in them to claim that it is their intention to rent them with the object of obtaining the deduction for interest. If there are reasonable grounds for assuming that the taxpayer intends to use the property for renting as soon as it is completed and to continue to do so for an indefinite period, the interest during the construction period could be treated as deductible under section 51. Where, however, it is believed that the taxpayer's dominant intention is to sell the property or use it ultimately as a private residence, interest should be allowed only to the extent that it relates to the periods (if any) during which the property is actually let.

7. Where deductions claimed for interest are disallowed in such cases, the assessments will be defended primarily on the ground that the interest has not been incurred in the production of assessable income and, if the taxpayer objects, efforts should be made (e.g. by enquiring as to the taxpayer's negotiations with the bank or other authority from which he borrowed the money) to establish that the property was not acquired with the dominant intention of being used in the production of assessable income. Where such cases come before a Board of Review, the Board's attention could be invited to the decision in the case referred to in para 4. It should be explained, however, that the Commissioner does not, in practice, regard that decision as preventing the allowance of deductions for interest in cases where it is clear that the taxpayer's intention in erecting property was to use it exclusively in the production of assessable income.

COMMISSIONER OF TAXATION