


IT 2065 - Home loan interest rebates

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TAXATION RULING NO. IT 2065

HOME LOAN INTEREST REBATES

F.O.I. EMBARGO: May be released

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F.O.I. INDEX DETAIL

REFERENCE NO: SUBJECT REFS: LEGISLAT. REFS:

I 1115327 HOME LOAN INTEREST REBATES 159AZ-ZQ

PREAMBLE

The question has been raised as to the way in which the home loan interest rebate provisions (Subdivision AA of Division 17 of Part III) operate where interest is charged at a flat rate.

2. For a person to receive a tax rebate on home loan interest the interest must have been paid in the year of income - sub-sections 159ZJ(1) and 159ZNA(1). This applies to both of the home loan interest rebate schemes (the "first home buyer's" interest rebate and the "interest over 10 per cent" rebate) and to both "reducing balance" and "flat rate" loans. As a general practical rule, and putting aside different considerations to be taken into account when interest payments fall into arrears, it has been accepted that interest paid during a year of income can be taken as being equal to interest accrued during the year so long as the total payments on the loan during the year equal or exceed the interest accrued. The corollary of this is that if interest accrued in the year exceeds total payments the payments are treated as wholly attributable to interest paid.

3. Because, in the case of a "flat rate" loan, interest for the full period of the loan is typically charged at the time when the loan is made, lenders and borrowers generally have no cause to strike accounts so as to ascertain the amount of interest that accrues on such a loan in a given period. Nor, except when a loan is being paid out prior to the end of the agreed loan period, is there usually any need for the parties to know the balance of principal outstanding on such a loan at a particular time.

RULING

4. It has been decided that the "rule of 78" is an appropriate method for ascertaining the amount of interest accrued on a "flat rate" loan during a year of income for the purposes of both home loan interest rebate schemes and for ascertaining the opening and closing balances of a flat rate loan for the purposes of the "interest over 10 per cent" rebate scheme. The attachment to this ruling sets out the manner in which the rule of 78 may be used to determine these amounts. Other methods, including calculation on an actuarial basis, which rely on equivalence with the effective reducing balance

interest rate that the terms of a loan would equate with are also acceptable.

5. Where a rebate claim on an income tax return form includes sufficient information to indicate that a loan is at a flat rate and that a substantially smaller rebate is being claimed than would be available if the rule of 78 or other similar acceptable method of interest calculation were used, the claim will be adjusted and the additional rebate entitlement allowed on the basis of the rule. Conversely, excessive claims for interest paid will be reduced. A claim will not be reduced, however, if it is supported by an agreement between the lender and the borrower as to the manner of accrual of interest.

COMMISSIONER OF TAXATION
15 November 1983

APPENDIX

FLAT RATE OF INTEREST
USE OF THE "RULE OF 78" TO ASCERTAIN THE BALANCE
OF A LOAN OUTSTANDING AT ANY PARTICULAR TIME AND
INTEREST ACCRUED DURING A YEAR

Balance(B) = Principal(P) + Interest(I) - Repayments(R) - Unaccrued Interest(U)

Example: Loan of \$10,000 repayable over 5 years in equal monthly instalments at 9.5% flat:

Principal(P)	=	\$10,000
Total Interest "charged" at time of loan(I)	=	4,750
Monthly repayments	=	\$ 245.83 (\$14,750 + 60)
[Annual repayments	=	\$ 2,950 (\$14,750 +5)]
First repayment 1 December 1979		

I. Balance 30 June 1982 (after 31 instalments paid)
= \$10,000 + \$4,750 - \$7,621(R) - \$1,129(U)
= \$ 6,000

II. Balance 30 June 1983 (after 43 instalments paid)
= \$10,000 + \$4,750 - \$10,571(R) - \$397(U)
= \$ 3,782

III. Interest accrued 1982/83 = \$1,129 - \$397 = \$732

Calculation of (R) and (U)

I. R = Repayments to date
= monthly repayment x No. of repayments to date
= \$ 245.83 x 31
= \$7,621
U = $I \frac{j(j+1)}{n(n+1)}$
where I = total interest charged
j = no. of instalments yet to be paid
n = total no. of instalments
= \$ 4,750 $\frac{29(29+1)}{60}$

$$= \$ 1,129 \quad 60(60+1)$$

$$\begin{aligned} \text{II. } R &= \$245.83 \times 43 \text{ (repayments to date)} \\ &= \$10,571 \\ U &= \$ 4,750 \quad 17(17+1) \\ &\quad 60(60+1) \\ &= \$397 \end{aligned}$$

Check

$$\begin{aligned} \text{Principal repaid 1982/83} &= \$6,000 - \$3,782 = \$2,218 \\ \text{Interest accrued and paid 1982/83} &= \$1,129 - \$ 397 = \$ 732 \\ \text{Total Repayments 1982/83} &= \$2,950 \end{aligned}$$

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