



***TD 2012/1 - Income tax: can Part IVA of the Income Tax Assessment Act 1936 apply to deny a deduction for some, or all, of the interest expense incurred in respect of an 'investment loan interest payment arrangement' of the type described in this Determination?***

 This cover sheet is provided for information only. It does not form part of *TD 2012/1 - Income tax: can Part IVA of the Income Tax Assessment Act 1936 apply to deny a deduction for some, or all, of the interest expense incurred in respect of an 'investment loan interest payment arrangement' of the type described in this Determination?*

 There is a Compendium for this document: [TD 2012/1EC](#) .



---

## Taxation Determination

---

Income tax: can Part IVA of the *Income Tax Assessment Act 1936* apply to deny a deduction for some, or all, of the interest expense incurred in respect of an ‘investment loan interest payment arrangement’ of the type described in this Determination?

**❶ This publication provides you with the following level of protection:**

This publication (excluding appendices) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner’s opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

### Ruling

1. Yes, provided that the interest is otherwise an allowable deduction. In the context of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936)<sup>1</sup> a taxpayer’s purpose of ‘paying their home loan off sooner’ or ‘owning their own home sooner’ does not prevent the application of section 177F to an ‘investment loan interest payment arrangement’ of the type described in paragraph 3 of this Determination.

---

<sup>1</sup> All legislative references are to the ITAA 1936 unless otherwise indicated.

# TD 2012/1

## **Date of effect**

2. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

---

**Commissioner of Taxation**

7 March 2012

---

## Appendix 1 – Explanation

**1** *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

### Explanation

#### ***Investment loan interest payment arrangements***

3. While investment loan interest payment arrangements may vary in the precise loan and security details, they all have similar financial and purported tax effects. An investment loan interest payment arrangement will exhibit all or a significant number of the features set out as follows:

- (a) The taxpayer(s) own at least two properties: one property is the taxpayer(s)' residence and the other is used to derive rent ('investment property').
- (b) The taxpayer(s) have an outstanding loan which was used to acquire the residence (or refinance an earlier loan used to acquire the residence) ('home loan'), an outstanding loan which was used to acquire the investment property (or refinance an earlier loan used to acquire the investment property) ('investment loan') and a line of credit or similar borrowing facility with an approved limit ('line of credit'). All three loan products are typically (but not always) provided by a single financial institution.
- (c) The respective interest rates on the home loan and investment loan are typically at or about the same rate. The interest rate on the line of credit is typically (but not always) higher by a small margin (for example, 0.15%).
- (d) The investment loan is typically an interest-only loan for a specified period with principal and interest repayments required thereafter, or the interest-only period may be extendable.
- (e) The line of credit typically has no minimum monthly repayment obligations provided the balance remains below the approved limit. Alternatively, it may require minimum monthly repayments equal to the accrued interest.
- (f) The home loan, investment loan and the line of credit are each secured against the taxpayer(s)' residence and/or investment property.
- (g) The line of credit is drawn down to pay the interest on the investment loan as it falls due. Where no repayments are required on the line of credit, the taxpayer(s) will generally not make any repayments, which results in interest on the line of credit being capitalised and compounded. Where monthly interest repayments are required on the line of credit, the taxpayer(s) meet such repayments from their cash flows.
- (h) Typically all or a significant proportion of the taxpayer(s)' available cash inflows (including that which the taxpayer(s) otherwise might reasonably be expected to use to pay the interest on the investment loan) are deposited into their home loan or an 'acceptable loan account offset account',<sup>2</sup> which has the effect of reducing the interest otherwise payable on the home loan.

<sup>2</sup> See Taxation Ruling TR 93/6 *Income tax and fringe benefits tax: loan account offset arrangements*.

- (i) If the line of credit reaches its approved limit before the home loan has been repaid, the taxpayer(s) may apply to increase the limit on the line of credit in conjunction with a corresponding decrease in the available 'redraw' amount in the home loan.

4. It is often said that taxpayers who enter into an investment loan interest payment arrangement do so for the purpose of 'paying their home loan off sooner' or 'owning their own home sooner'.

5. Taxpayers who have entered into an investment loan interest payment arrangement may be entitled to deductions for the interest incurred on the line of credit under section 8-1 of the *Income Tax Assessment Act 1997*.

### **Can Part IVA apply?**

6. Part IVA is a general anti-avoidance rule. Part IVA gives the Commissioner the power to cancel a 'tax benefit' (or part of a 'tax benefit') that has been obtained, or would, but for section 177F, be obtained, by a taxpayer in connection with a scheme to which Part IVA applies.

7. In broad terms, Part IVA will apply where the following requirements are satisfied:

- there is a scheme<sup>3</sup> (see section 177A);
- a taxpayer has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme (see section 177C); and
- the dominant purpose of a person who entered into or carried out the scheme, or any part of the scheme, was to enable the relevant taxpayer to obtain a tax benefit in connection with the scheme, or to enable the relevant taxpayer and another taxpayer or other taxpayers each to obtain a tax benefit in connection with the scheme (paragraph 177D(b)).

8. The application of Part IVA depends on a careful weighing of all the relevant facts and surrounding circumstances of each case. Therefore, in the absence of all relevant information it is not possible to state definitively whether a particular arrangement or transaction will attract Part IVA. However, an investment loan interest payment arrangement of the type described in paragraph 3 is capable of attracting the operation of Part IVA.

9. The precise description of the scheme for the purposes of Part IVA will depend on the facts of the particular case. However, in the context of considering whether Part IVA applies to an investment loan interest payment arrangement the scheme would normally include some or all of the elements described in paragraph 3 of this Determination.

---

<sup>3</sup> The scheme must have been entered into after 27 May 1981, or carried out, or commenced to be carried out, after 27 May 1981 (other than a scheme that was entered into on or before that date): see section 177D.

10. In relation to this type of scheme it might reasonably be expected that if the scheme had not been entered into or carried out, the taxpayer(s) would have met the interest payments on the investment loan out of their own cash flow rather than use the line of credit. Thus, the taxpayer(s) would not have incurred any interest, or would have incurred less interest, on the line of credit. Consequently, the taxpayer(s) would not have been entitled to any deductions in respect of any such interest or would have been entitled to a smaller deduction. Accordingly, the relevant tax benefit obtained by the taxpayer(s) in connection with the scheme under paragraph 177C(1)(b) is (or includes) either:

- the whole amount of the allowable deduction for interest incurred on the line of credit; or
- the difference between the otherwise allowable deduction for interest incurred on the line of credit and the amount of interest incurred on the line of credit that would have been an allowable deduction if the scheme had not been entered into or carried out.

11. A key question, for Part IVA purposes, is whether the identified scheme was entered into or carried out by a person for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme.

12. Paragraph 177D(b) requires the drawing of a conclusion about purpose from the eight objective matters identified in that provision. The conclusion to be reached is the conclusion of a reasonable person.<sup>4</sup> The provision does not require, or even permit, any inquiry into the subjective purpose or motive of the relevant taxpayers or others who entered into or carried out the scheme.<sup>5</sup>

13. Further, an objective purpose of the taxpayer(s) of 'paying their home loan off sooner' does not prevent Part IVA from applying to an investment loan interest payment arrangement. As was noted in the joint judgment of the High Court in *Spotless*:<sup>6</sup>

A particular course of action may be...both 'tax driven' and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine the answer to the question whether, within the meaning of Part IVA, a person entered into or carried out a 'scheme' for the 'dominant purpose' of enabling the taxpayer to obtain a 'tax benefit.

14. Further, Gleeson CJ and McHugh J of the High Court noted in *Hart*<sup>7</sup> that:

...a transaction may take such a form that there is a particular scheme in respect of which a conclusion of the kind described in s 177D is required, even though the particular scheme also advances a wider commercial objective.

15. Callinan J in *Hart*<sup>8</sup> similarly distinguished between objectives that are 'entirely irreproachable and proper' and the 'means adopted to achieve these results'.

16. Therefore, the means by which the taxpayer(s) achieve their objective of 'paying their home loan off sooner' may result in the requirements of Part IVA being satisfied.

<sup>4</sup> *FC of T v. Spotless Services Ltd & Anor* (1996) 186 CLR 404 at 421; 96 ATC 5201 at 5210.

<sup>5</sup> *FC of T v. Hart & Anor* [2004] HCA 26 at [65]; 2004 ATC 4599 at [65].

<sup>6</sup> *FC of T v. Spotless Services Ltd & Anor* (1996) 186 CLR 404 at 416; 96 ATC 5201 at 5206.

<sup>7</sup> *FC of T v. Hart & Anor* [2004] HCA 26 at [16]; 2004 ATC 4599 at [16].

<sup>8</sup> *FC of T v. Hart & Anor* [2004] HCA 26 at [96]; 2004 ATC 4599 at [96].

17. In the context of applying paragraph 177D(b) to an investment loan interest payment arrangement the following general observations can be made:

- (a) In respect of arrangements that include all, or a significant number, of the elements set out in paragraph 3 of this Determination the manner in which the scheme is entered into or carried out is generally explicable only by the taxation consequences. For instance, apart from the purported availability of additional tax deductions, it appears to make little (if any) financial sense for the taxpayer(s) to, in effect, fund repayments on a home loan using a line of credit that has the same or a slightly higher interest rate than the home loan.
- (b) In many of these arrangements a careful analysis of the terms and conditions indicates that the interest rate on the line of credit is both notionally and in substance higher than the interest rate payable on the home loan.
- (c) Apart from the purported availability of additional tax deductions, the taxpayer(s)' financial position under the scheme is generally no better (and possibly worse) than it would have been if the arrangement had not been entered into. The increase in the line of credit balance is matched by an equal reduction in the balance (or effective balance) of the taxpayer(s)' home loan.
- (d) A key feature of the investment loan interest payment arrangement is the use of the line of credit to pay the interest on the investment loan. This results in all or most of the interest on the investment loan, in effect, being capitalised. That is, the payment of the investment loan interest is deferred. This deferral has the economic effect of allowing the taxpayer(s) to repay the home loan at a faster rate than would otherwise be possible: the taxpayer(s) are able to pay an amount equivalent to the deferred investment loan interest on the home loan.
- (e) In many of these arrangements a careful analysis of the all the facts (including the taxpayer(s)' financial circumstances and the relevant terms and conditions of the relevant agreements) indicates that the investment loan interest payment arrangement will have only a limited lifespan. The circumstances often demonstrate that the arrangement will only last for the period during which the taxpayer(s) have non-deductible interest expenses (for example home loan interest), and that once the debt that gave rise to the non-deductible interest expense is repaid the taxpayer(s) are likely to revert to making the payments on their investment loan out of their cash flow rather than using the line of credit. In many cases the taxpayer(s) are simply reverting to what they were doing prior to entering the arrangement.
- (f) If the taxpayer(s)' residence is used as security for either the investment loan or the line of credit, the taxpayer(s) will not actually own an unencumbered home any faster under the scheme than would have been the case if they had not entered into the arrangement.

18. Accordingly, it would be open for a reasonable person to conclude, having regard to the matters in paragraph 177D(b), that one or more of the parties that entered into or carried out the scheme did so for the dominant purpose of enabling the taxpayer(s) to obtain a tax benefit in connection with the scheme. If a reasonable person would reach such a conclusion then Part IVA applies to the scheme and the Commissioner would be entitled to cancel under paragraph 177F(1)(b) the tax benefit. That is, the relevant interest incurred on the line of credit would not be deductible to the taxpayer(s).

## References

---

*Previous draft:*

TD 2011/D8

*Related Rulings/Determinations:*

TR 93/6; TR 2006/10

*Subject references:*

- borrowings & loans
- cancellation of tax benefits
- deductions & expenses
- expenses of borrowing
- interest expenses
- Part IVA
- rental property loan interest expenses
- schemes & shams
- tax benefits under tax avoidance schemes
- tax planning, avoidance & evasion

*Legislative references:*

- ITAA 1936
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177C(1)(b)
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1936 177F
- ITAA 1936 177F(1)(b)
- ITAA 1997 8-1

*Case references:*

- FC of T v. Hart & Anor [2004] HCA 26; 2004 ATC 4599; (2004) 55 ATR 712
- FC of T v. Spotless Services Ltd & Anor [1996] HCA 34; (1996) 186 CLR 404; 96 ATC 5201; (1996) 34 ATR 183

---

*ATO references*

NO: 1-38NS0XC

ISSN: 1038-8982

ATOlaw topic: Income Tax ~~ Deductions ~~ borrowing expenses  
 Income Tax ~~ Deductions ~~ interest expenses