

Contamination of Investment Loans

Care is required when using the redraw facility on loans or line of credit loans that have been borrowed for investment purposes. The law focuses on where the funds are expended in order to establish whether the interest on the loan is deductible. Accordingly if a redraw or line of credit account is used to provide funds for a holiday the interest on this portion (at the point of withdrawal) of the loan will not be allowable from that date. Should a repayment be made at a later date to cover the cost of the holiday it will be allocated to the whole loan not just the holiday portion.

Example:

The balance of a loan outstanding is \$50,000 and a redraw facility is used to fund a \$50,000 holiday. Sometime after the holiday \$50,000 is repaid to the loan.

	<i>Interest Deductible</i>	<i>Interest Non Deductible</i>
Balance	50,000	Nil
Redraw for holiday		50,000
Repayment	-25,000	-25,000
Balance of loan	25,000	25,000

To avoid this adverse outcome offset accounts or subsidiary loans should be used. This will enable private funds to be accumulated beside the main investment loan (offset account) and used for private purposes when required. A subsidiary loan enables repayments to be directed toward specific loans and maximise deductible interest expense by accelerating repayments toward the loans used to provide funds for private use.