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How to Deduct Your Home and/or Cottage Mortgage Interest

by David Chong Yen (2004)

Who Benefits?

Individuals who:

- a. Have personal non-tax deductible debts, such as a home mortgage, and
- b. Own a practice, which operates as a proprietorship or partnership, and
- c. Have built up value in the practice.

Tax Saving:

You can get a tax deduction for interest expense on loans, which would otherwise have been personal non tax-deductible debt.

What is the Tax Savings?

For Example:

Loan	\$600,000
Interest rate (approximate)	6%
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Interest incurred	36,000
Tax bracket (approximate)	46%
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Annual Tax Savings	\$16,560

How to do it?

a) General Concepts:

1. Set up two (2) bank chequing accounts.
2. Expenses of practice are paid from first bank account, referred to as "Expense Account".
3. Revenues of practice are deposited into second bank account, referred to as "Revenue Account".
4. Loans from bank gets deposited into "Expense Account" and used to pay practice expenses.
5. Revenues are withdrawn from Revenue Account and used to pay off non tax deductible debt such as home/cottage mortgage.

b) Specifics:

Only business and capital expenditures (equipment, computers, office renovations) should be paid out of the "Expense Account".

Therefore, the "Expense Account" may pay any of the following provided they are reasonable:

- a) Dental/medical supplies and lab fees
- b) Salaries
- c) Rent
- d) Utilities
- e) Business taxes
- f) License taxes
- g) Equipment rental
- h) Legal and accounting
- i) Office expenses
- j) Maintenance and repairs
- k) Telephone
- l) Bank charges and interest related to the expense account
- m) Any other cost required to operate the practice

The expense account should **not** pay any of the following:

- i) The non-deductible portion of meals and entertainment and car expenses;
- ii) Draws to the dentist;
- iii) Any non-deductible fringe benefits paid to employees;
- iv) Any other expenditure, which are not deductible for business purposes.

Tax Department's Perspective:

Based on the Singleton case, since the loan was used and can be traced to business expenses, the interest on the loan should be tax deductible as such interest was incurred in order to earn income.

It is important that the audit trail is strictly adhered to, otherwise CRA, the Tax department, could deny the deduction. Please note that the recent Lipson case is contrary to the above. However, this case is currently at The Tax Court of Canada level, whereas the Singleton case went to the Supreme Court.

David Chong Yen, CFP, CA with an international firm background and more than twenty-four years of experience, advises healthcare professionals and owner-managers. Additional information can be obtained by phone (416) 510-8888, fax (416) 510-2699, or Email david@dcy.ca.

This article is intended to present tax saving and tax planning ideas and is not intended to replace professional advice.