# Many Keys, One Kingdom

What is taxation? Taxation refers to compulsory or coercive money collection by a levying authority, usually a government; and applying to all types of involuntary levies from income to sales to capital gains.*. In Canada, the concept includes tax compliance and reporting, tax-planning and implementation strategies for both individual and corporate taxpayers.

In advance of upcoming tax deadlines, this document walks through a method - using interest paid as a tax deduction - to reduce the taxes payable. The Canada Revenue Agency released an updated folio publication on the topic of interest deductibility in 2015.

Per Canada Revenue Agency (CRA), there are four general principles for interest deductibility.

1. Interest must be paid or is payable in a taxation year to qualify.
2. There must be a legal/contractual obligation to pay the interest amount.
3. Money must be borrowed, for the purpose of earning income, from an asset, business or property. This 'purpose test' is applicable even if the income does not occur and a loss happens. To satisfy the 'test', the taxpayer is expected to demonstrate how the funds were used
4. Deductible amount must be reasonable for the circumstances.

Leveraging concepts are key to increasing wealth and business expansion. Borrowing money is a key aspect of capital growth and appreciation and the efficiency of tax deductions are important in calculating after tax returns. Record keeping is very important, especially if funds are borrowed and income-producing assets are bought and sold repeatedly over the course of many different taxation years. The taxpayer must be able to trace the use of the original borrowed funds to show an eligible purpose. If the purpose of the second, third and fourth properties is to produce income then the loan interest continues to be tax deductible.

CRA's Folio S3-F6-C1 looks at different purposes for borrowing and gives some clarity.

Example 1 interest on money borrowed to purchase an annuity is only deductible when that annuity is subject to annual accrual taxation. If regular payments have started, then the deduction is limited to the amount of income included in the taxpayer's income

## Example 2
borrowing to buy common shares. According CRA the purpose test is met for interest deductibility when the common shares are for a company that has a reasonable expectation to pay dividends on those shares. If the company has an expressly stated policy to not pay dividends, the purpose test is not met and there is no interest deductibility. The purpose test can be met if the company does not have an expressly stated policy in not paying dividends.

## Interest

When it comes to compound interest, there is a specific provision that denies the deduction of compound interest until it is actually paid. In this case compound interest is interest arising on a balance of interest from borrowing funds. CRA will allow the interest deductibility of a second loan incurred to pay the interest on the first loan. Generally, interest expense is considered a capital expenditure and is deductible when it meets the specific requirements of the Income Tax Act.

In an effort to reduce the taxes we pay there must be planning and an understanding of what is required. We can help you build that team to take advantages of different wealth building and business expansion protocols.

(*Investopedia)

To have a deeper conversation about how this subject will affect you or your business, please contact us directly:


Mandie La Montagne MA, CHRP
mandie@theintuerigroup.com
C: 604 644 0177

Sean Farrell BA, CFP, CHS
sean@theintuerigroup.com
C: 604 760 7205

www.theintuerigroup.com