

YOU ASK, WE ANSWER

Can we borrow, lend, invest and deduct?

Financial planner David Phipps tackles a complex question

BY GIGI SUHANIC

Question: My wife and I have a home equity line of credit at prime which we would like to use for an investment account in her name. Her income has always been very low and mine is higher so we would like to pay the capital gains taxes at her tax rate. Does CRA allow her to borrow from

the credit line directly or do I have to borrow it and make a spousal loan to her and charge her the CRA interest rate?

Answer: Let's start with borrowing from the home equity line of credit (HELOC).

According to David Phipps, a certified financial planner and advisor with Assante Capital Management in Ottawa, any income from the investments you make will be taxable in the hands of the person who services the loan.

Assuming the HELOC is held jointly by you and your wife, if you borrow from it and make an investment in your wife's name, as

long as she pays the interest and principal from her income then the investment income will be taxed at her lower marginal rate.

However, if you borrow from the line of credit, the investment is made in her name but you pay the interest and principal, then any profit will be taxed at your higher rate. In a nutshell, taxation will be decided by who services the loan.

While your plan makes sense, there are a couple of pitfalls to be aware of.

The interest on the loan may be tax deductible. (Interest on loans for RRSP purposes are not tax de-

ductible, however.) If the loan is serviced by your spouse, that means you won't be able to deduct the interest from the loan on your taxes at your higher marginal rate. You need to sit down with an advisor or do some number crunching yourself and figure out where the most benefit lies for your family.

But Mr. Phipps says there is a larger issue. He is worried the Canada Revenue Agency in the near future will disallow the deduction of loan interest.

"I am not out there doing investment loans with my clients today because I am concerned that the

tax rules are going to change. They (CRA) have hinted at changing these tax rules such that interest is no longer tax deductible," Mr. Phipps says.

Where your question gets muddled is when you ask whether your wife can borrow from the line of credit or do you need to borrow and then make a loan to her at the prescribed CRA interest rate.

Interspousal loans are "a legitimate income splitting strategy," Mr. Phipps says.

CRA doesn't really care what is the source of the loaned money.

The way interspousal loans usually work, though, is that the higher income spouse has the cash available to make a loan to the lower income spouse who then pays the prescribed interest rate as set by the CRA.

"It's always based on the premise that the spouse lending the money has money to lend," Mr. Phipps says.

You have to ask yourself whether there is any benefit in borrowing money at 4.5% and then lending it at 3% (the prescribed rate).

Either way you go, Mr. Phipps says you need "to keep the paper trail clean," including having separate chequing accounts.

Use the HELOC only for investment purposes. Start a second line of credit for other borrowing needs.

"Make sure there's no possibility of someone misinterpreting what happened."

Financial Post
Need an answer to a question
about money? E-mail
investing@nationalpost.com