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Marmer Penner Inc. Newsletter

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The Closing of the Interest Deductibility Loophole

Back in the 1990's, we praised Mr. John Singleton ("Singleton") in his victory at the Supreme Court of Canada. Singleton is the Vancouver lawyer who needed to borrow $300,000 to buy a home. He knew that if he borrowed the money directly to purchase this personal-use residence, the interest on the mortgage would be non-deductible. Instead, Singleton caused his unincorporated law practice to incur the $300,000 debt to finance its operations that included the payment of draws to the owner. Immediately after borrowing the $300,000, the law practice paid Singleton a $300,000 draw. The law practice deducted the interest on the bank loan. Singleton had no personal debt on his home.

Prior to that decision, many Canadians had used a different financial plan to effectively deduct mortgage interest on their homes. Investors with paid off non-registered investments would liquidate these investments, use the proceeds to purchase a home and then borrow the money to repurchase the investments. Instead of borrowing to buy a house, they borrowed to buy investments. They were in the exact same economic situation, that is they owned a house and investments and owed a debt of a particular amount, but only in the case of the sale of investments and borrowing to buy them back was interest on the debt deductible.

A recent decision by the Federal Court of Appeal on an approach similar to Singleton's has cast doubt on its continued use. In this case, Earl and Jordanna Lipson needed to borrow about $560,000 to purchase a home. Earl already owned valuable shares of a privately held corporation. Instead of borrowing $560,000 from the bank to buy their new home, Jordanna borrowed $560,000 from the bank to buy some of Earl's shares. Earl used these proceeds to pay for the house. Jordanna, having borrowed to purchase shares, sought to deduct the interest on this debt.

Canada Revenue Agency attacked the scheme under the General Anti-Avoidance Rule and succeeded. As a whole, the court found the entire series of transactions was abusive.

If Singleton was a support-payer, his income may have been artificially reduced by this interest deductibility scheme. Notwithstanding paragraph 19(2) of the *Child Support Guidelines*, which states that the reasonableness of an expense deduction for the *Guidelines* is not governed solely by its deductibility under *The Income Tax Act*, we know that Line 150 is the starting point so the onus may have previously been on the recipient to argue why the interest deduction should be added back. Now the Singleton manoeuvre is looking less likely to succeed.

That's good news for lawyers representing support recipients. That's bad news for lawyers with big personal mortgages.