

David Ingram's US/Canada Tax Services

Mortgage Interest as a Deduction in 2009 – dealing with GAAR (General Anti-Avoidance Rule)

You can find out how to make mortgage interest, car interest, boat interest and just about any other interest deductible on your CANADIAN Income Tax Return by going to www.centa.com and reading the November 2001 Newsletter in the top left hand corner.

I first conceived of this method in 1975/76 when a client of mine had a rental duplex and had a tenant who was injured in a car accident. It was at the time of the changeover from private insurance to ICBC and the injured single mother tenant was waiting for an insurance settlement.

My client allowed his tenant to stay in the half duplex for more than a year and to stay afloat himself; he borrowed money to pay the duplex bills. When doing his 1975 tax return, we deducted the interest paid on the loan because the purpose of the loan was clearly to fund the rental duplex.

When he finally got his cheque for more than \$5,000 from the tenant, it would have been all over if he had just paid the loan off and we had not thought about it. But my client, bless his soul, phoned and asked if he had to pay off the loan (which was deductible) or could he use the money for another non-deductible purpose.

My answer, after thinking about it for a day or so, was that he could use the \$5,000+ for any purpose he could think of. At the same time, I said this; I was also writing something for the

North Shore Credit Union and put my “new” method of making the mortgage interest deductible in this report which they published as part of an advertisement in the **North Shore News** about November 1976.

I expanded it and it was next published by **Hancock House Publishers** in my **Investment Guide** in 1979, 1980, 1985 and 1991 and in **Joe Martin's BC Business** magazine in 1979. Sometime in there, the **Ontario Dental Association** also ran it in their magazine. It then became part of the internet and can be found in the March 1997 and November 2001 newsletters.

I was pretty heavily involved in the Federal Conservative Party (ran for the North Shore Nomination in 1978) and am proud to say that we **got mortgage interest as a tax deduction on the 1979 federal income tax return**.

Unfortunately, **Joe Clark, the Prime Minister** at the time, did not count the number of yes votes and lost a non-confidence motion on Dec 12, 1979, and on Feb 18, 1980, **Pierre Trudeau** was re-elected as Prime Minister and even though there was a 4-page form and a line on the T-1 General that year, the deduction was killed retroactively by the liberal government and we no longer had this benefit for all without manipulating the paperwork.

In 1981, **Fred Snyder** was running a series of seminars and teaching my method to a lot of

different groups. In one seminar, he taught it to Realtors, McCauley, Nicolls, Maitland and Company and the manager **Fraser Smith** wrote Fred a letter thanking him for explaining the methods. In 1985, Fraser Smith then published the **SMITH MANOUEVRE** which explains the method in great detail and at the time, VANCITY Savings Credit Union was featured in the book and was very good at setting up the method.

Today, in 2009, Fred Snyder includes the cash flow analysis to make YOUR mortgage deductible with his FREE Written Financial Plan – Call (604) 731-8900 to make an appointment.

Then on Oct 27, 1988 John Singleton had approximately \$300,000 in his lawyer's capital account. He got permission to take the \$300,000 out (it was his but was being used as security in his law practice).

He used it to buy a house and then used the house as security to borrow \$300,000 which he then put into his capital account; this was all done in one day. Of course, since the money in the account was now borrowed for business purposes, he deducted the interest on his 1988 and 1989 returns and the Tax Department turned him down. He appealed and lost in the Tax Court of Canada but won in the Federal Court of Appeals. The CRA appealed to the Supreme Court and in October 2001, the Supreme Court of Canada found in favour of John Singleton in a 5 to 2 decision.

This case has now been quoted and cited in many other cases. In **OVERS 2006 TCC 26**, Mr. Overs paid back a shareholder-loan, which would have been included in his income. By doing what he did, coincidentally, the interest expense was made deductible.

Mrs. Overs borrowed funds to purchase shares of his holding company at their fair market value. However, **Mr. Overs** did NOT use a 73(1) rollover as Lipson did (*see below*). Therefore, no capital gain was realized but the attribution rules in section 74(1) worked to transfer the interest expense on the wife's borrowed funds – back to him.

Judge Little turned down the CRA's claim that tax benefits arose from this series of transactions. The taxpayer followed the *Income Tax Act* in repaying his loan and transferring the shares to his wife. Justice Little ruled that the transactions were NOT avoidance transactions and, therefore, GAAR did not apply. Judge Little ruled that none of the transactions could be considered "abusive tax avoidance".

And **Judge Bowman** ruled in favour of **Evans (2005 TCC 684)**. Judge Bowman found there were no avoidance transactions in what could only be described as a super complicated and very sophisticated series of business restructurings that ended up with a former shareholder receiving cash by using specific rules in the Act, including sections 85 (rollovers), 110.6 (capital gains exemption), 112 (tax free inter-corporate dividends), 74.5 (attribution) and ss. 84(3) (deemed dividends). **Judge Bowman** assumed that there "were" avoidance transactions. He then dealt with them on an individual basis to decide whether the avoidance transactions were "abusive". His final decision was that provisions of the *Income Tax Act* operated as intended and there could not be any abuse.

However, he was not of the same opinion with the **LIPSON Family** who lost in **Lipson v The Queen, 2006 TCC 148**.

Mr. Lipson owned a profitable business and:

1. The Lipsons contracted to buy a home in Forest Hills in Toronto.
2. Mrs. Lipson took out a demand loan to buy shares in the family business from her husband.
3. The shares were transferred to Mrs. Lipson as a section 73(1) rollover.
4. Mr. Lipson used the funds to buy the house.
5. They "both" took out a mortgage on the house to repay the demand loan.

Judge Bowman used the Section 245 GAAR provisions to rule that the Lipson family was guilty of Gross Abuse of the Tax system. Perhaps, if they had a business reason for the loan or had not used the Section 73(1) tax free rollover, he would have found in their favour as

he did with the EVANS 2005 DTC 1762 case. In the LIPSON case the wife's borrowing did not put income in her hands and it was unclear who had paid the interest.

In Jan 2009, **The Supreme Court of Canada confirmed the Lipson's loss.** **KPMG** has an interesting webcast on the subject which (after establishing a login) you can see at <http://webcast.streamlogics.com/audience/index.asp?eventid=18626040>

However, in ruling against the Lipson family's complicated transaction, the Supreme Court confirmed expense damming methods suggested in my Nov 2001 CEN-TAPEDE newsletter at www.centa.com (top left hand corner).

Finding a Mortgage Broker who understands the principle is Tough.
Glen Kelleway of Kelleway Mortgage Architects
at **(604) 476 0053** or **1 (866) 476 0053**
does understand how to make the interest deductible.