

# Prepay interest

...and reduce your tax.

## The strategy in a nutshell

### *Claim a tax deduction and save this year*

Prepay the interest on your investment loan now for the next 12 months and you may be able to claim a tax deduction for that interest in your current year's income tax return.

## THE STRATEGY

When you borrow money to make an investment that will generate assessable income, you're generally entitled to claim a tax deduction for the interest expense that arises.

In some cases the interest expense will be less than the income earned (positive gearing), in some cases it will be equal (neutral gearing) and in other circumstances the interest cost may be greater than the income return generated in that year (negative gearing).

The interest is generally deductible in the year it arises. However, if you have a geared investment portfolio in your own name, you may be able to prepay the interest expense on these loans for the next 12 months and receive the entitlement to the deduction this year.

You can choose to prepay the interest for a period of less than 12 months and still receive a deduction for this year's tax return, but it cannot be prepaid for a period greater than 12 months.

## WHY WOULD YOU PRE-PAY THE INTEREST?

Prepaying interest gives you the ability to bring forward the tax deduction to which you may be entitled in the following year into the current year. This may provide you with tax planning opportunities from one year to the next.

Additionally, by prepaying interest you are locking in the interest rate for the following year and some providers offer a discounted rate when you prepay interest. It's important to remember that in order to receive these benefits, you need to make the prepayment before 30 June 2011. Furthermore, once the payment is made, you cannot claw back any interest payments should the account be closed or repaid.

## CASE STUDY\*

Paul has an investment portfolio which will generate \$13,000 income this year. He has a \$100,000 loan in place which he has used to fund part of his investment portfolio. The loan has interest payable at 7%p.a. Paul has been making interest payments steadily through 2010-11 on this loan and has now been made aware of the ability to prepay his interest expense for the next 12 months. Paul earns \$78,000 in salary income every year.

The table below shows the savings Paul could potentially generate by prepaying his interest liability for the 2011-12 income year before 30 June 2011.

	No prepayments	With prepayment
Salary income	\$78,000	\$78,000
Investment income	\$13,000	\$13,000
Assessable income	\$91,000	\$91,000
Interest deduction for 2010-11	(\$7,000)	(\$7,000)
Prepaid interest for 2011-12		(\$7,000)
Taxable income for 2010-11	\$84,000	\$77,000
Tax payable for 2010-11 (including Medicare Levy)	\$20,290	\$17,805

By implementing the prepayment strategy, Paul has brought forward a tax saving of \$2,485.

\* For illustrative purposes only.