

CA Tax Bulletin

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High Court confirms that Part IVA applies to split loan arrangement – Hart's Case

The High Court has confirmed in a unanimous 5:0 decision that the general anti-avoidance provision Part IVA applied to the split loan arrangement in Hart's Case.

Broadly, the split loan arrangement provided the taxpayers with a home loan to finance their residence and an investment property. The borrowings were split into two accounts, with all repayments being directed to repaying the borrowings on the residence while tax-deductible interest on the investment property was capitalised and compounded. This had the effect of accelerating the repayment of the borrowings on the residence while the tax-deductible interest on the investment property was reportedly increased by \$170,000.

As the Commissioner of Taxation explains in a press release welcoming the decision on 27 May 2004, split loans were being marketed in the 1990's on the basis of the potential tax advantages. The ATO released Draft Ruling TR 97/D7, confirmed in Taxation Ruling TR 98/22, setting out the ATO's view that the extra interest that accrues on capitalised interest (effectively the interest over and above what would normally accrue on a conventional loan) was not deductible under the general deduction provisions or else denied by Part IVA.

This is an important decision in relation to the application of Part IVA, due to its in-depth consideration of how to define the scope of the offending "scheme". A more detailed discussion of Hart's Case is set out further below at Item 9.