HIGH COURT OF AUSTRALIA

Public Information Officer

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COMMISSIONER OF TAXATION v TRUDY AMANDA HART AND RICHARD MERALLES HART

Splitting a loan in two did not permit a tax deduction for compounding interest on the part used to pay off an investment property, the High Court of Australia held today. It unanimously allowed the Tax Commissioner's appeal and held that anti-avoidance provisions of Part IVA of the Income Tax Assessment Act enabled the disallowance of the Harts' additional tax benefit.

In 1996 Mr and Mrs Hart borrowed money to buy a house in Canberra and to pay off a mortgage on their existing home near Queanbeyan to keep it as an investment property. They obtained finance through a mortgage broker, Austral Mortgage, which promoted a loan arrangement called a wealth optimiser, designed to maximise tax benefits. The loan was $298,000, with $202,888 to buy the new house and $95,112 to discharge the mortgage on the old house which was then let. All repayments went to the first part of the loan, which the Harts paid off faster than they otherwise would. Compound interest accordingly accrued on the second part. The Harts claimed deductions for the unpaid interest in 1997 and 1998 but in 1999 the Tax Commissioner issued amended assessments for 1997 and 1998 disallowing the deductions for the interest which would not have accrued had the monthly repayments been spread between the two loan accounts.

When the Commissioner rejected the Harts' objections the Harts appealed to the Federal Court. The Court held that Part IVA applied to disallow the deductions. The Harts successfully appealed to the Full Court of the Federal Court, which held that Part IVA did not apply. The Commissioner then appealed to the High Court. He argued that the matters required by section 177D to be considered in determining whether someone had entered into a scheme to obtain a disallowable tax benefit led to the conclusion that split loans were a tax-avoidance scheme prohibited under Part IVA.

The High Court held that this was such a scheme. But for the wealth optimiser structure, the Harts would have borrowed on the basis that they would have made monthly repayments of principal and interest so that interest would have been spread over the total loan in the same proportion that the money was used to buy the new home and to refinance the old house. The structure depended upon tax benefits generated by arrangements between the borrowers and the lender. The Court held that the dominant purpose of entering into what was identified as the scheme was not the borrowing of money to buy a new home and refinance what was to become a rental property. The Court held that consideration of the eight criteria in section 177D supported the Commissioner's conclusion that the dominant purpose of the Harts entering into the scheme was to obtain a tax benefit.

The Commissioner had agreed to pay the Harts' costs in the High Court whatever the outcome.

- *This statement is not intended to be a substitute for the reasons of the High Court or to be used in any later consideration of the Court's reasons.*

Address: PO Box 6309, Kingston ACT 2604 Telephone: (02) 6270 6998 Facsimile: (02) 6273 3025
e-mail: fhamilton@hcourt.gov.au