



AUSTRALIAN TAX ADVISER

2201: JULY 2021

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SECTION 1 – PROFESSIONAL DEVELOPMENTS

TAX DEDUCTIONS FOR INTEREST EXPENSES

¶1.1 Introduction: What is interest?

Interest is not defined in the tax acts. As such, it takes its normal meaning, namely that it is a sum payable for the use of another sum (the principal) and is expressed as a percentage of the principal.

Interest is generally a revenue deduction under s8-1 provided the various criteria are satisfied. Section 8-1 says:

General deductions

- (1) You can deduct from your assessable income any loss or outgoing to the extent that:
 - (a) it is incurred in gaining or producing your assessable income; or
 - (b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.
- ...
- (2) However, you cannot deduct a loss or outgoing under this section to the extent that:
 - (a) it is a loss or outgoing of capital, or of a capital nature; or
 - (b) it is a loss or outgoing of a private or domestic nature; or
 - (c) it is incurred in relation to gaining or producing your exempt income or your non assessable non exempt income; or
 - (d) a provision of this Act prevents you from deducting it.

From the above, we can conclude that interest can be deducted provided there is sufficient nexus to the source of assessable income and provided also that it has been incurred. We'll explore these concepts in a moment. But, even if those two key criteria are met, the interest will not be deductible if one of the four negative limbs of section 8-1(2) are met:

- Interest is not generally capital but if it is, it will not be deductible.
- Interest incurred on borrowings to finance private or domestic expenditure (for instance, a new car, a holiday, or a new main residence) will not be allowable
- Interest incurred with a view to gaining exempt income or non-assessable non-exempt income is not allowable
- Interest is disallowed if it is prevented from being deducted by a different section of the tax acts (for example, the restrictions on holding costs for vacant land which we'll look at shortly)