ASK THE EXPERT

Offset Accounts

smatsgroup since 1995

Q *I am thinking of paying off some of my Australian investment property loan to save some interest, is this a good idea?*

A If you are fortunate enough to have some spare funds to reduce the loan on your Australian property you should resist the temptation to actually pay off the loan. Not because it is a bad idea, but it can have consequences later that are very disadvantageous. These include:

- Trapping your equity in that particular property so that if you want it back later (perhaps to buy your future home) the lending would be likely to not have a tax deductable status if it was used for private expenses such as your residence.
- Debt in the wrong place is a big concern in Australia and greatly impacts on your cash flow and tax status. Loans for investment property are fully tax deductable whereas loans for private property that you live in (now or in the future) or land are not an income tax deduction. As such you need to reduce loans only for property that you intend to live in not ones that you don't as any dollar you pay off a pure investment property loan is one that you may have to borrow back to buy your family home.
- Diminishing your tax deductions as the interest cost now reduces. This can greatly impact on the investment performance as well as the tax cost of your property. Remember when living abroad your starting tax rate is 32.5% of any profit on your rental, so this is quite high and if it can be legally reduced through sensible debt levels then it should be encouraged.
- Future Tax Protection from the build up of annual tax losses will reduce which may lead to greater capital gains tax cost or higher taxes on return to Australia.

If you have spare funds and are determined to reduce the interest cost, a much better option is to consider an "Offset Account". This works in a similar way to reducing the loan, but instead of actually paying the money off the loan you pay it into a separate savings account and the bank links the savings account to your loan and only charges interest on the net balance.

So if you have a loan of A$300,000 and have A$40,000 in your Offset Account then you only pay interest on A$260,000. Effectively as if you had reduced the balance.

Importantly though, if you want your money back for whatever reason, the loan remains intact so if you take out funds from the offset it will just increase the net balance and result in a higher interest cost that is fully deductable against the rental property that the loan was originally used for.

Building up funs in your offset will ensure you pay the least interest and logically you would keep the money there unless you feel you could achieve a better return than the actual interest saving without too much risk. If you had an investment opportunity that would outperform the interest saving simply take the funds from the Offset Account and invest them, if not leave the money there and enjoy the savings.

Offset Accounts are available with all Australian Banks and are a very simple and effective solution to managing your money during time of investment uncertainty.

Our unique Property Tax Estimator on our website can quickly assess the merits of reducing your loans by comparing different borrowing levels and you will be very surprised at how the reduction of your loans quickly becomes disadvantageous. You do want to eventually be debt free on your home, but not until you move actually move in, so save up for this as much as you can and use the Offset Account as a valuable tool in preparation of this.

Steve Douglas is the co-founder and Managing Director of Australasian Taxation Services (ATS), established in Singapore in 1995. ATS provides specialist taxation services to people of any nationality investing in Australian property, as well as Australian expatriates living overseas. Areas of specialisation include the Australian taxation aspects of property investment, as well as expatriate and migration planning.