



Wealth
Management

When is RBC Credit Access Line tax deductible?

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One common question we receive about RBC Credit Access Line, offered through Royal Bank of Canada and RBC Bank (Georgia), N.A., is the deductibility of interest. Most people are aware that some level of interest may be deductible on a margin loan, but what about interest paid on non-purpose loans collateralized by marketable securities, such as RBC Credit Access Line?

While the rules can be complicated depending upon the situation, there are some general high-level guidelines which may be helpful. Please consult with your independent tax advisor on your particular situation.

Do I potentially qualify for an interest deduction on an RBC Credit Access Line?

The extent to which you may potentially deduct interest on any loan depends upon tracing the purpose for which the loan is used. For example, interest paid on a

loan for business expenses may be deductible, while interest paid on a loan for personal expenditures cannot. **The purpose of the debt has a critical impact on the deductibility of the associated interest payments.** Tracing the use of proceeds allocates the debt and interest, depending upon the type of expenditure to which the proceeds are used. The underlying property used to secure the loan (i.e., an investment account in the case of RBC Credit Access Line) is generally irrelevant¹; only the loan's use is significant (subject to a limited exception for personal residences to be discussed below).

In certain circumstances, such as when using an RBC Credit Access Line for residential rental property, investments such as private equity capital calls or business expenditures, the interest deductibility guidelines may be of interest to you.

Does using my RBC Credit Access Line to purchase or improve investment property qualify for an interest deduction?

Loan interest may be the single biggest deductible expense attributed to your rental property. Common examples of interest that you can deduct include interest payments on loans used to acquire or improve rental property, and interest on credit cards for goods or services

used in a rental activity. Whether you decide to make repairs or improvements that cannot be expensed immediately, such as new appliances or a new in-ground pool where the cost must be depreciated over time, any loan interest to finance the cost of these repairs or improvements may still be deductible.

Consider the example of someone who uses an RBC Credit Access Line to acquire a home or other investment real estate solely for the purpose of receiving rental income. Interest payments (not principal) on loans used to: (i) acquire rental property; (ii) improve rental property; (iii) refinance credit card debt for goods or services used in a rental activity; or (iv) other expenses related to rental activities (i.e., insurance, maintenance, cleaning, etc.) may be deductible from rental income depending upon your circumstances.

Unlike the home mortgage interest deduction that has certain limitations (i.e., only mortgages up to \$750,000 qualify and the loan must be collateralized by the residence itself), there may be no limitations on the amount of interest one can write off against an RBC Credit Access Line used for a rental property, when applicable. Rental property owners with a loan, therefore, will find that loan interest is likely their largest deductible expense.

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¹ There are certain disallowances for margin loans collateralized by tax-exempt securities.



To determine your potential tax savings for deductible interest payments, simply multiply your annual interest payment by your tax rate. For example, if you paid \$5,000 in loan interest for repairs and/or improvements to your residential property and your tax rate is 37%, your tax savings would be \$1,850 (\$5,000 x .37).

More important, even if you have no rental income, but you made repairs, paid loan interest and covered all applicable rental expenses, it is considered a loss for tax purposes. Taking losses never sounds like a good thing, particularly when it comes to investments. For rental property owners, however, a tax-loss carry forward (a loss today that can be used in the future) might be something to get excited about for years to come because you can **carry forward** these losses to future years, indefinitely to when rental income returns.

Does using my RBC Credit Access Line for business expenses and capital expenditures qualify for an interest deduction?

You can generally deduct, as an expense, all interest paid during the tax year on an RBC Credit Access Line related to your trade or business if certain criteria² are met. These may include expenses incurred during the course of regular business, such as employee compensation, rent or business-related insurance. It's important to remember that the deduction begins only when the borrowed RBC Credit Access Line funds are spent for business purposes.

In contrast to business expenses, a capital expenditure is incurred when a business spends money on either buying a new asset or adding to the value of an existing asset with the expectation of receiving benefits for longer than a single tax year. Essentially, a capital expenditure represents an investment in the business rather than an expense. Examples of capital expenditures include the purchase of fixed assets, such as new buildings, trucks or business equipment, or upgrades to existing facilities. For example, you borrow \$1 million from your RBC Credit Access Line to buy new office equipment and pay 3% interest on the loan, your annual interest expense of \$30,000 may be deductible because the loan is

a business loan, even though the purchase is a capital expenditure and the collateral consists of assets in your brokerage account. In other words, as in the previous example for rental property, it is tracing the use of proceeds that is relevant, rather than the collateral used for the loan.

In contrast, if you borrow from your RBC Credit Access Line for personal purposes, as well as business purposes (so-called "mixed purposes"), you may only deduct the interest on the part properly allocated for business purposes. Often, accountants recommend that clients maintain separate accounts for investment, personal and business borrowing. In this case, it may be prudent to have one RBC Credit Access Line for personal use and another for business, or segregate the loans for more efficient tax reporting.

The tax rules around specific transactions can be complicated. As always, you should consult your own tax advisor about the application of these rules to your own particular circumstances as RBC Wealth Management does not provide tax advice.

If you have any questions or want to learn more about RBC Credit Access Line, contact your financial advisor.

What does tax deductible interest really mean in dollars? (DIP X TR) = \$ saved.

The savings from tax deductible interest can be significant. When in doubt, remember this simple equation:

(DIP) Deductible Interest paid X (TR) your tax rate = dollars saved

For example, if you paid \$5,000 in deductible interest on a \$100,000 loan (5% rate), and you are in the highest tax bracket (37% for married couples earning > \$693,750 in 2023), you saved \$1,850. Or, expressed differently, your after-tax interest rate is 3.15% (1- [interest rate x your tax rate]) rather than 5%. That's good news, if your use of RBC Credit Access Line loan proceeds is for a deductible purpose.

² For further information, see your independent tax advisor or IRS Publication 535, Business Expenses – Interest.



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RBC Credit Access Line is a securities-based, demand line of credit offered by Royal Bank of Canada and RBC Bank (Georgia), N.A., Equal Opportunity Lenders and bank affiliates of RBC Capital Markets, LLC. Subject to Credit Approval. Securities-based loans involve special risks and are not suitable for everyone. You should review the provisions of the RBC Credit Access Line agreement and related disclosures, and consult with your own independent tax and legal advisors about any questions you have prior to using RBC Credit Access Line. Considerations should be given to loan requirements, portfolio composition and diversification, time horizon, risk tolerance, portfolio performance expectations, and individual tax situations. **There are important risks associated with securities-based loans that you should consider:**

- You will be required to deposit additional cash or securities, or pay down the line of credit, should the value of your securities decline below the percentage equity you must maintain or the percentage equity you must maintain increase. During a market downturn in which the securities in your portfolio decline in value, the percentage equity you must maintain will cause your losses to be greater than if there were no loan against your portfolio. Your losses can exceed your original collateral amount.
- You are not entitled to an extension of time to satisfy equity percentage requirements.
- Should you be unable to maintain the required percentage equity, some or all of your securities may be sold without prior notice to you. In the event of such a sale, you will not be entitled to choose which securities are sold, your long-term investment strategy may be interrupted and you will be responsible for all resulting fees and tax consequences.
- The equity percentage requirements may increase at any time without prior notice to you and may require you to pay down your line of credit, in part or in full, at any time and for any or no reason.
- The rates, terms and conditions of your RBC Credit Access Line are subject to change in accordance with the terms of the RBC Credit Access Line agreement.
- Should the rate of your RBC Credit Access Line be set to float against an index, you will be subject to greater interest costs in a rising interest rate environment.

RBC Credit Access Line is a non-purpose facility. The proceeds of an RBC Credit Access Line may not be used to purchase, trade, or carry margin stock or repay a margin debt that was used to purchase, trade, or carry margin stock. Repayment of all proceeds of RBC Credit Access Line advances may be demanded if there is reason to believe they were used to purchase or carry margin stock.

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