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Cash damming

Cash damming is a technique that lets you deduct the interest on a mortgage loan from your taxable income.

This technique is for self-employed workers, unincorporated professionals, rental building owners and members of a partnership. When these individuals borrow for business purposes and the money they borrow generates either business income or rental income, the interest on the loan is tax deductible.

Simply structuring your loans appropriately will make the interest tax deductible, including interest on a personal residential mortgage.

Cash damming

Cash damming is a technique where taxpayers use their cash (generated by gross business or rental income) to pay their personal expenses or loans (since the interest on personal loans is not deductible), and fund their business expenses through a loan (since interest on business loans is deductible).

Steps

You will need to open two separate bank accounts: one to deposit your rental or business income (income account) and one to cover business expenses such as taxes, insurance, maintenance, and mortgage payments (expense account).

Then open a line of credit for the expense account to pay your business expenses. Careful: do not deposit any income to this account or use it to pay any personal expenses. Personal expenses, such as your mortgage on your personal home, will be paid from the income account.

In this way you can gradually convert all of your loans with non-tax-deductible interest to loans with entirely tax-deductible interest. The higher your business expenses, the quicker the conversion.

Other uses

Cash damming can be used to catch up to unused RRSP or TFSA contributions or pay life insurance premiums, for example. Just keep the funds generated by your gross business income to pay expenses that would otherwise be covered by a loan with non-tax-deductible interest, and use your line of credit for your business expenses (deductible interest). The bank will not grant you a loan to contribute to

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your RRSP or TFSA, but it will give you a line of credit for your business expenses that increases at the same rate as your RRSP or TFSA contributions. All you need to do is use your gross business income to contribute to your RRSP or TFSA.

Investments and debt

Unfortunately, salaried workers and retirees cannot use the strategy explained above. However, if you have investments and debt, it is possible to make the interest on your debt deductible (even for residential mortgages). You can accomplish this by cashing in your investments to pay off existing loans and borrowing again to invest. This technique will gradually make the interest on your loans tax deductible.

Contamination

Interest on a loan is not deductible if the money borrowed is used to earn employment income or capital gains, or if it is used for personal purposes.

If you use the cash damming technique, make sure you do not contaminate the loan by using the money for an ineligible purpose!

Remember, it's not the collateral that determines whether the interest is deductible or not, but the use of the money borrowed.