TAX STRUCTURE BRIEF

Rental Cash Damming

Pay off your personal property years sooner using rent you already collect, and turn borrowing you already carry into a deduction.

FOR CLIENT AND ACCOUNTANT REVIEW   ONTARIO, CANADA   VERSION 4.0

HOW TO READ THIS

What this document is

Part one explains the idea and what it is worth. Part two is the system you actually run each month, including who keeps the records. Part three is the technical detail your accountant needs.

Read part one. Read part two carefully, because that is where this succeeds or fails. Send part three to your accountant before anything is set up.

One thing to know before you start. This is not a product and it is not a refinance. It is a way of routing money you are already moving. It costs you no additional cash each month. It does require one account to stay clean for a decade, and it needs your accountant's sign off on the specifics of your file before the first dollar moves.

PART ONE

The idea

One rule, what changes on your balance sheet, and what it is worth over fifteen years.

SECTION 1 · THE IDEA

Two kinds of interest

Interest on money borrowed to earn income is deductible. Interest on money borrowed to live in a house is not. Same bank, same house, same signature. The only thing separating them is where the dollars went.

Deductibility follows the use of the borrowed money. It does not follow the property that secures it. That single point governs everything in this document, and it is the point most people get backwards.

Cash damming uses that rule. Rent stops paying the rental bills and goes against the personal property mortgage instead. A line of credit pays the rental bills. Every month, more of the household's borrowing sits on the deductible side of the line.

THE USUAL WAY

Rent pays the rental bills

RENT COLLECTED *Into the household account*	**$54,600**
↓	
PAYS THE RENTAL BILLS *Mortgage, tax, insurance, upkeep*	**$49,639**
↓	
REACHES THE PERSONAL PROPERTY *The leftover, and nothing more*	**$4,961**

WITH THE STRUCTURE

Rent attacks the personal mortgage

RENT COLLECTED *Into a dedicated rental account*	**$54,600**
↓	
ALL OF IT TO THE PERSONAL PROPERTY *Eleven times more, every year*	**$54,600**
↓	
HELOC PAYS THE RENTAL BILLS *And that interest is deductible*	**$49,639**

The same $54,600 of rent, routed two ways. On the left it is consumed by the rental bills and only the leftover reaches the home. On the right the full amount attacks the personal property mortgage and the bills are funded by borrowing that earns a deduction.

Because the personal property mortgage and the line of credit sit inside one readvanceable facility, every dollar of mortgage repaid frees a dollar of credit room. That is what makes this a loop rather than a one time move.

> **ROOM IS NOT A DEDUCTION**
>
> Prepaying the mortgage frees credit room, and that is all it does. Room is only capacity. The deduction is created by what you use the room for. Draw it to pay a rental expense and the interest is deductible. Draw the same room for a vacation and it is not, even though the room came from prepaying. Use governs, every time.

Four steps, repeating monthly. Rent never touches a rental bill, and the line of credit never pays anything personal. Those two rules are the whole discipline.

SECTION 2 · THE COMMON OBJECTION

Am I just taking on more debt

This is the first question almost everyone asks, and it deserves a straight answer. The line of credit balance climbing looks like pure accumulation until you put the mortgage balance next to it.

END OF YEAR ONE	WITHOUT THE STRUCTURE	WITH THE STRUCTURE
Personal property mortgage	*$523,222*	*$472,512*
Line of credit	*Nil*	*$51,129*
Total borrowing	**$523,222**	**$523,641**
Genuinely new debt		**$419**

Year one on the modelled file. Both approaches assume the same cash leaves the household.

Every dollar the line of credit borrows has a matching dollar removed from the mortgage. It is substitution, not addition. The $51,129 balance is made up of $49,639 of rental costs that rent would otherwise have paid, plus $1,490 of interest that was added to the balance rather than paid from cash.

That capitalized interest is the only genuinely new debt, and it is the price of admission. Over fifteen years it comes to roughly $43,000 of additional borrowing, against $106,216 of tax saved over the same period. Ahead by about $63,000 with the house owned outright far sooner, but it is not free money and nobody should present it that way.

THE HONEST FRAMING

This does not reduce your total debt faster. It reduces your **non-deductible** debt faster, and replaces it with debt that costs roughly half as much after tax. If you are looking for a smaller balance sheet, this is not the tool.

Does the line of credit payment cost me more each month

No new cash leaves your household. The line of credit funds its own minimum payment. You draw the exact interest amount from the line, it goes out as the payment, and the balance grows by that amount. Your personal mortgage payment does not change. Your rental mortgage payment does not change. Your living costs do not change.

What is happening is that two interest curves cross. As the mortgage balance falls, the non-deductible interest you pay falls with it. As the line of credit balance rises, deductible interest rises. You were always paying interest. The only question is which side of the tax line it sits on.

YEAR SEVEN	WITHOUT THE STRUCTURE	WITH THE STRUCTURE
Balance carrying interest	*$404,430 mortgage*	*$416,198 line of credit*
Interest that year	*Roughly $19,000*	*$21,196*
Deductible	*No*	*Yes, in full*
Real cost after tax relief	**Roughly $19,000**	**Roughly $10,960**

Year seven, comparing like for like. Similar debt, similar gross interest, close to half the after tax cost.

One real cash flow change to expect. The rental currently produces a small monthly surplus, $413 on the modelled file. Under this structure all rent goes to the mortgage, so that surplus is absorbed. If you currently spend it, you will feel that. It has nothing to do with the line of credit payment, but it is the one place where your month to month actually tightens.

On timing. The interest is incurred monthly. The tax relief arrives once a year at filing. Your accountant can file form T1213 with CRA to reduce tax deducted at source, which turns the annual refund into higher monthly take home. Worth asking about, because it makes the benefit present rather than theoretical.

SECTION 3 · WORKED EXAMPLE

What it is worth

The figures below come from one hypothetical file, set out in full in Section 7. They are an illustration of how the structure behaves, not a projection of any particular household's result.

Year 7

PERSONAL PROPERTY MORTGAGE CLEARED, AGAINST YEAR 20 WITHOUT THE STRUCTURE

$36,834

TAX SAVED BY THE TIME THE HOUSE IS PAID OFF

$106,216

TAX SAVED OVER FIFTEEN YEARS

$416,198

DEDUCTIBLE BORROWING CREATED BY YEAR SEVEN

Year one, line by line

	WITHOUT THE STRUCTURE	WITH THE STRUCTURE
WHERE THE MONEY GOES		
Rent collected	*$54,600*	*$54,600*
The rent is used to	*Pay the rental bills*	*Pay down the personal property mortgage*
The rental bills are paid by	*The rent*	*The line of credit*
Reaching the personal property mortgage this year	*$4,961*	*$54,600*
WHAT GETS DEDUCTED		
Rental mortgage interest	*$23,727*	*$23,727*
Operating expenses	*$16,000*	*$16,000*
Line of credit interest	*Nil*	*$1,490*
Total deductions	**$39,727**	**$41,217**
THE TAX BILL		
Taxable rental income	*$14,873*	*$13,383*
Tax owing on it	*$7,178*	*$6,458*
Tax saved this year		**$720**

Year one is deliberately unimpressive. The line of credit starts at zero and builds through the year, so there is barely any interest to deduct yet. What matters is the last row of the first block. Eleven times more money reached the personal property mortgage, and that is what compounds.

> **NOTE WHAT DID NOT CHANGE**
>
> The rental mortgage interest is $23,727 in both columns. That interest was already fully deductible before any of this, because the borrowing bought an income producing property. This structure does not create it and does not improve it. The only new deduction created here is the line of credit interest.

Year seven, the same lines

	WITHOUT THE STRUCTURE	WITH THE STRUCTURE
WHERE THE MONEY GOES		
Rent collected	*$54,600*	*$54,600*
Personal property mortgage still owing	*$404,430*	*Nil, paid off*
WHAT GETS DEDUCTED		
Rental mortgage interest	*$20,276*	*$20,276*
Operating expenses	*$16,000*	*$16,000*
Line of credit interest	*Nil*	*$21,196*
Total deductions	**$36,276**	**$57,472**
THE TAX BILL		
Taxable rental income	*$18,324*	*Loss of $2,872*
Tax owing on it	*$8,843*	*Refund of $1,386*
Tax saved this year		**$10,229**

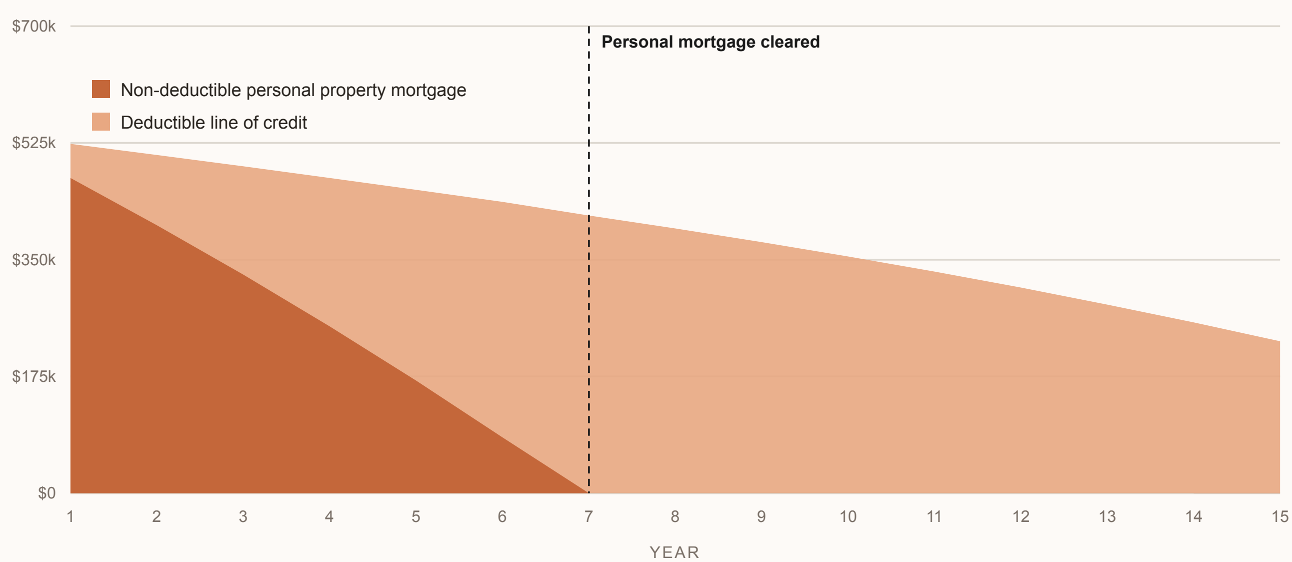
CONNECTING THE DOTS

Without the structure, the rental produces $18,324 of profit and an $8,843 tax bill, and the home still owes $404,430. With it, the same property produces a deductible loss that reduces tax on employment income, and the personal property is owned outright. Nothing about the property changed. Only the route the money took.

SECTION 4 · THE PICTURE

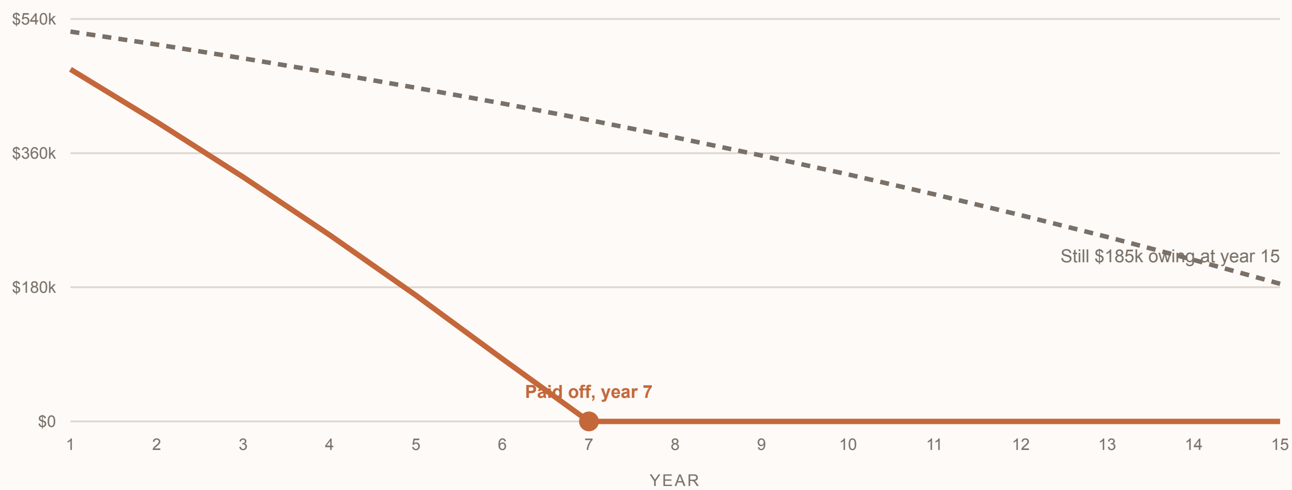
Fifteen years at a glance

Debt does not disappear. It changes sides.



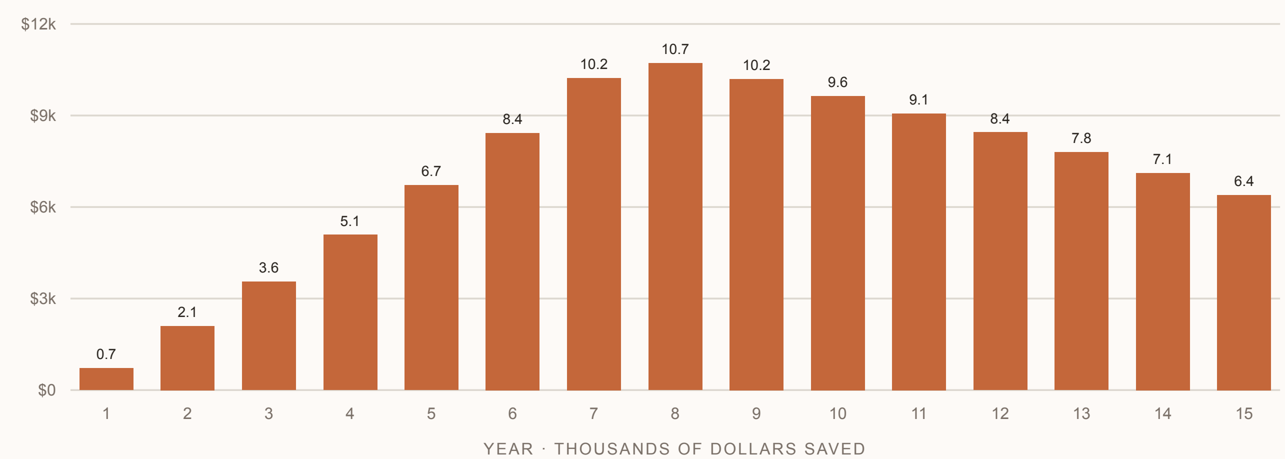
Total borrowing stays broadly level. The dark band is the personal property mortgage, where interest earns nothing back. The lighter band is the line of credit, where every dollar of interest comes off taxable income. By year seven the dark band is gone. Note also that the lighter band starts shrinking from year eight, which is phase two, explained in Section 5.

The personal property is owned outright thirteen years sooner.



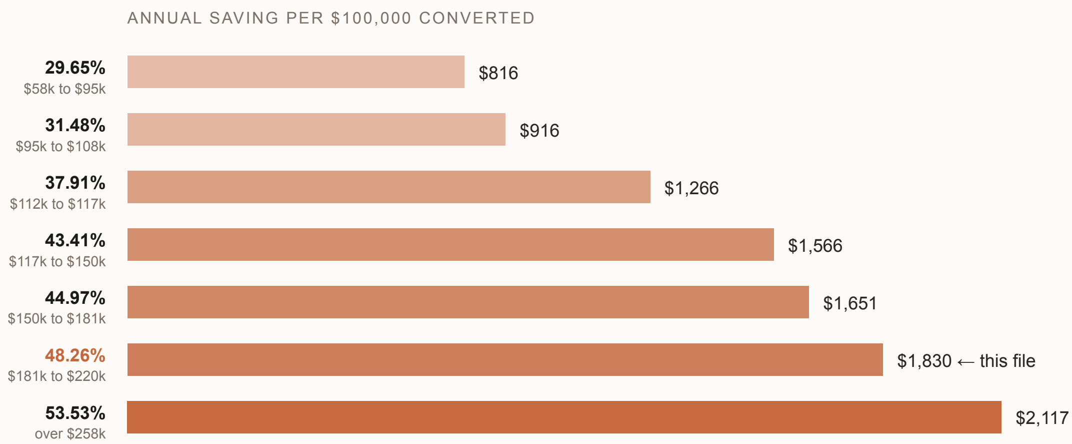
Solid line is the structured approach, dashed is conventional. Identical cash leaves the household in both. The difference is that the rent is aimed at the non-deductible balance instead of at the rental bills.

The saving compounds rather than arrives.



Year one returns $720. Year seven returns $10,229. This is judged over a decade, not over a filing season, and the discipline matters most in the early years when the visible reward is smallest.

The higher the tax bracket, the harder it works.



Annual saving per $100,000 converted, at each Ontario combined marginal rate for 2026, comparing a 4.65 percent non-deductible cost against a 5.45 percent deductible one after tax relief.

THE NUMBER THE WHOLE THING RESTS ON

At a 48.26 percent marginal rate, a 5.45 percent deductible line of credit costs 2.82 percent after tax. The personal property mortgage costs 4.65 percent with no relief at all. That 1.83 percent gap is the engine. It also means the line of credit rate could climb to 8.99 percent, which is prime at 7.99 percent against 4.45 percent today, before the structure stopped paying its way.

SECTION 5 · THE LONG GAME

This is a two phase plan

Most explanations of this structure stop at the moment the house is paid off. That is only halfway. If you do not understand phase two before you start, year eight is where the discipline quietly falls apart.

PHASE ONE · YEARS ONE TO SEVEN

Rent kills the mortgage. All rent goes to the personal property mortgage as prepayments. The line of credit funds the rental costs and its own interest. Non-deductible debt falls to zero, deductible debt builds to $416,198.

PHASE TWO · YEAR EIGHT ONWARD

The freed mortgage payment kills the line of credit. When the mortgage clears, the $3,048 monthly payment stops being required. That money, plus the rental surplus, now gets aimed at the line of credit. That is what retires the balance.

THE PART THAT MUST BE UNDERSTOOD BEFORE DAY ONE

In year seven your house is paid off and you still owe $416,198 on the line of credit. That balance does not disappear on its own.

If you do not redirect the freed mortgage payment, the line of credit simply keeps compounding. You will have traded a mortgage with a finish line for a line of credit without one. The plan only works if both phases run.

The good news is that phase two requires no new discipline and no new money. It is the same payment you were already making, pointed somewhere else. But it has to be set up deliberately, on the month the mortgage clears, not whenever someone remembers.

In the fifteen year projection, phase two brings the line of credit from $416,198 in year seven down to $227,702 by year fifteen, while the annual tax saving stays high because the balance is still substantial. That is the shape of a plan that finishes, rather than one that just relocates debt.

PART TWO

Running it

The accounts, the monthly order of operations, the records, and the one habit that breaks the whole thing.

SECTION 6 · THE SYSTEM

The system you run

Four accounts, one monthly rhythm, two rules that are never bent.

THE ACCOUNTS

ACCOUNT	WHAT GOES IN	WHAT GOES OUT
Personal property mortgage segment	*Regular payments plus all rent as prepayment*	*Nothing*
Rental line of credit segment	*Nothing but the lender's advances*	*Rental expenses only, ever*
Rental income account	*Rent received, nothing else*	*Transfers to the personal property mortgage only*
Personal chequing	*Employment income*	*Living costs and the regular mortgage payment*

WHY FOUR ACCOUNTS AND NOT ONE

A single account that everything flows through defeats the structure. Once borrowed money sits in the same place as rent, the money becomes impossible to follow, and you are reduced to arguing about how it should be allocated rather than proving where it went. Separation is not administrative tidiness. It is the entire basis of the deduction.

THE MONTHLY CYCLE, IN THIS ORDER

The order matters as much as the steps. It is what makes the trail obvious to someone reading your records cold, years later.

1. **RENT LANDS IN THE RENTAL INCOME ACCOUNT**

   Leave it there. Do not sweep it into personal chequing.

2. **SEND THE FULL RENT TO THE PERSONAL MORTGAGE AS A PREPAYMENT**

   Same day where possible, in one identifiable transfer rather than several. The rental account is now empty again, which matters for the next step.

3. **DRAW FROM THE LINE OF CREDIT TO PAY EACH RENTAL COST**

   Pay the payee directly from the line where your lender allows it. Where it does not, draw the exact amount and pay the same day. Exact to the cent. Never rounded, never in advance, never bundled with anything else.

4. **DRAW THE LINE OF CREDIT INTEREST SEPARATELY**

   The line funds its own minimum payment. Draw it as its own transaction, not combined with the rental mortgage payment, because the two are treated differently for tax and your accountant needs them separated at the source.

5. **LOG EACH DRAW AGAINST ITS RECEIPT**

   One draw, one expense, one document, same day. This is the step people skip and it is the one that matters most.

THE TWO RULES

RULE ONE

The line of credit pays rental expenses. Nothing else. Not once. Not a vacation, not a vehicle, not a renovation on your home, not a tax bill, not something that will be repaid next week. A single mixed transaction turns a clean tracing exercise into a permanent proportional claim you have to defend every year afterward, because CRA traces the actual historical use of the funds. Personal needs come from a different facility.

RULE TWO

Rent never pays a rental bill. The moment rent covers an expense, that expense was not funded by borrowing, and there is nothing to deduct. Rent has exactly one destination, and that is the personal property mortgage.

SECTION 7 · THE HABIT THAT BREAKS IT

Never pay first and reimburse yourself

Most landlords pay rental costs out of their chequing account and reimburse themselves from rent later. It is a normal, sensible habit. It also breaks this structure completely, and it is the single most likely way a well set up file goes wrong.

	WHAT THE BORROWED MONEY PAID FOR	DEDUCTIBLE
Draw from the line, then pay the payee	*A rental expense*	**Yes**
Pay the payee, then draw from the line to reimburse yourself	*Your chequing account*	**No**

Same dollars, same bill, same month. Completely different tax outcome, because the test is what the borrowed money was used for, and in the second case the borrowed money was used to top up a personal account.

The order is not a technicality that gets sorted out at year end. It is the thing being tested. Draw first, then pay. Every time, without exception.

Practical version. Set the rental payees up on the line of credit directly if your lender allows it, so the order is enforced by the plumbing rather than by memory. Where the lender does not allow direct payment, the draw and the payment happen the same day, in that sequence, and both appear on the same line of your ledger.

SECTION 8 · THE RECORDS

The ledger, and who keeps it

The value of this structure lives entirely in the records. Not in the argument, not in the strategy, not in how well it was explained. In the ledger.

When it starts

Day one, before the first draw. Opening balances written down and dated: personal property mortgage, rental mortgage, line of credit at zero. Every later reconciliation refers back to that starting point.

This is not a year end exercise. Records created as events happen carry real weight in a review. Records assembled after CRA has asked for them carry noticeably less.

What it looks like

One row per draw. Five columns. That is the whole format.

DATE	AMOUNT DRAWN	PAYEE	EXPENSE CATEGORY	SOURCE DOCUMENT
Draw date	*Exact to the cent*	*Who was paid*	*T776 line it maps to*	*Invoice or statement reference*

Amounts must match the underlying bill exactly. Rounded draws, advance draws and consolidated monthly draws all weaken the link between the borrowing and the expense.

How much work it actually is

Every rental cost is its own draw and its own row, not just the large ones. On a duplex that realistically means:

WHAT GETS LOGGED	ROWS PER YEAR
Rental mortgage payments	*12*
Line of credit interest draws	*12*
Property tax installments	*2 to 4*
Insurance	*1 to 12*
Water and utilities	*4 to 12*
Repairs and maintenance	*Variable*
Realistic total	**40 to 60**

Call it thirty to forty five minutes a month. Not heavy. It also never stops, which is a different kind of demand than a one time setup.

Who keeps it

There are three workable models and one that is not workable.

MODEL	HOW IT WORKS	BEST FOR
You keep it, accountant reviews quarterly	*You log each draw as it happens. Accountant checks the ledger every three months.*	*Organized owners who want the lowest cost. Main risk is losing the habit around month eight.*
Bookkeeper keeps it, accountant reviews	*Statements and receipts go to a bookkeeper monthly. They reconcile draws to expenses.*	*Most people. The most durable option, and the one that survives a busy year.*
Accountant does everything	*Full outsource of entry and review.*	*Owners who want a single point of accountability. Usually more than the task requires.*
Nobody, reconstructed at year end	*Receipts in a drawer, sorted out in April.*	*Nobody. This is how the deduction gets lost.*

A bookkeeper handling a file like this in Ontario typically falls in the range of one hundred to two hundred dollars a month, though quotes vary with volume and provider. Weigh that against the benefit, which is modest in the early years and substantial later.

THE SPLIT THAT MATTERS

Data entry and classification are two different jobs. You or a bookkeeper can do the entry. Your **accountant** decides whether each cost is a current expense or a capital improvement, because misclassifying a capital improvement as a current expense is the most common way these files fail. Do not guess that call.

Where responsibility sits. Hiring someone moves the work, not the responsibility. In a review, the onus is on the taxpayer to prove the deduction, not on CRA to disprove it. That means the records are yours regardless of who maintains them, which is a good reason to look at the ledger quarterly even if someone else keeps it.

Your broker's role. Thom's involvement ends with the structure: sourcing a readvanceable product that behaves correctly, confirming prepayment privileges, and confirming there is room under the 65 percent readvanceable cap. He does not maintain the ledger and does not give the tax opinion. Those belong to you and your accountant.

PART THREE

The detail

The rule underneath it, the file we modelled, the accountant's blueprint, and an honest account of what can go wrong.

SECTION 9 · LEGAL FOUNDATION

The rule this rests on

Paragraph 20(1)(c) of the Income Tax Act allows a deduction for interest on borrowed money used for the purpose of earning income from a business or property. The Canada Revenue Agency sets out its position in Income Tax Folio S3-F6-C1, Interest Deductibility.

That folio does not merely tolerate this structure. It names it. Paragraph 1.34 states that taxpayers may segregate funds received from borrowed money from funds received from other sources, and that this segregation, commonly referred to as cash damming, makes it easier to trace borrowed money to specific uses.

Paragraph 1.42 explains the consequence of not doing so. Where borrowed money is commingled with other cash in one account, tracing becomes problematic because cash is fungible, and the taxpayer is reduced to arguing an allocation rather than proving a link.

The case law. Singleton confirmed that a taxpayer may deliberately arrange borrowing and asset ownership to satisfy the direct use test. Ludco confirmed that an ancillary purpose of earning income is enough. Bronfman Trust is the cautionary one and the most relevant here: courts look at the direct use of the borrowed funds, not at the overall shape of the balance sheet. Lipson applied the general anti-avoidance rule to a related arrangement, but the majority was explicit that the deciding factor was the spousal attribution element in that particular structure, not interest deductibility planning as such.

The structure is well established. It succeeds or fails on records, not on arguments.

SECTION 10 · ASSUMPTIONS

The file we modelled

Every figure in this document comes from these assumptions. They describe a household that moved up and kept a legal duplex as a rental, which is the profile this structure suits best.

ITEM	PRINCIPAL RESIDENCE	RENTAL, LEGAL DUPLEX
Value	*$900,000*	*$800,000*
Mortgage balance	*$540,000*	*$480,000*
Loan to value	*60 percent*	*60 percent*
Rate	*4.65 percent fixed*	*4.99 percent fixed*
Payment	*$3,048 monthly*	*$2,803 monthly*

Rates current as of July 2026, when prime stood at 4.45 percent.

RENTAL OPERATION	AMOUNT	TAX POSITION	AMOUNT
Upper unit, three bedroom	*$2,600 monthly*	*Owner employment income*	*$185,000*
Lower unit, two bedroom	*$1,950 monthly*	*Marginal rate*	*48.26 percent*
Gross annual rent	*$54,600*	*Ownership of the rental*	*100 percent, one owner*
Property tax, insurance, upkeep, water	*$16,000 yearly*	*Line of credit rate*	*5.45 percent, prime plus 1*
Net rental cash flow	**Positive $413 monthly**	**Readvanceable limit, 65 percent**	**$585,000**

On the rent assumption. The combined $4,550 reflects typical market rates for a three bedroom and a two bedroom unit in a mid-sized Ontario market. Local rents should be substituted before this is applied to a real file. A duplex is used deliberately, because a single family rental at this price point does not generally produce the expense volume or the positive cash flow this structure runs on.

One structural detail governs everything else. Under OSFI's rules for combined loan plans, the readvanceable portion of a mortgage is capped at 65 percent of the property value, and lending above that line must be amortizing and non-readvanceable. At 60 percent, this household sits below the ceiling, so the credit limit grows automatically as the mortgage is repaid. The lowest headroom at any point in the projection is roughly $60,000, so the ceiling never binds. A household starting at 75 or 80 percent loan to value would have no working room at all until the balance came down.

Two things to confirm with the lender at setup

1. **How the line of credit minimum payment is handled.** Some lenders capitalize the interest automatically, which is simplest. Some allow a draw to service the line. Some require the minimum by pre-authorized debit from a chequing account at that institution, in which case the draw must land in the rental account first and be debited from there. This needs to be established on day one, not discovered in month three.
2. **Whether payees can be paid directly from the line.** Direct payment removes the risk of the reimbursement error described in Section 7 by making the correct order automatic.

TWO LIMITS TO CONFIRM BEFORE STARTING

1. **Prepayment privileges.** This file directs $54,600 a year at the personal property mortgage on top of regular payments, which is 10.1 percent of the original principal. Most lenders allow 15 or 20 percent, but the privilege on the specific mortgage must be confirmed before the structure is relied on.
2. **The 65 percent ceiling.** The credit limit only grows while combined borrowing stays under 65 percent of the home's value. If the line reaches the ceiling, capitalizing stops and the interest has to be funded from cash.

SECTION 11 · YEAR BY YEAR

The full projection

YEAR	PERSONAL PROPERTY MORTGAGE, CONVENTIONAL	PERSONAL PROPERTY MORTGAGE, STRUCTURED	LINE OF CREDIT	INTEREST	TAX SAVED	CUMULATIVE
1	*$523,222*	*$472,512*	*$51,129*	*$1,490*	*$720*	**$720**
2	*$505,648*	*$401,818*	*$105,115*	*$4,347*	*$2,098*	**$2,818**
3	*$487,238*	*$327,765*	*$162,118*	*$7,364*	*$3,553*	**$6,371**
4	*$467,954*	*$250,195*	*$222,306*	*$10,550*	*$5,091*	**$11,462**
5	*$447,754*	*$168,940*	*$285,858*	*$13,913*	*$6,715*	**$18,177**
6	*$426,595*	*$83,825*	*$352,961*	*$17,464*	*$8,428*	**$26,605**
7	*$404,430*	*Paid off*	*$416,198*	*$21,196*	*$10,229*	**$36,834**
8	*$381,212*	*Paid off*	*$396,870*	*$22,205*	*$10,716*	**$47,550**
9	*$356,891*	*Paid off*	*$376,461*	*$21,125*	*$10,194*	**$57,744**
10	*$331,415*	*Paid off*	*$354,913*	*$19,984*	*$9,644*	**$67,388**
11	*$304,729*	*Paid off*	*$332,160*	*$18,780*	*$9,064*	**$76,452**
12	*$276,775*	*Paid off*	*$308,135*	*$17,508*	*$8,449*	**$84,901**
13	*$247,493*	*Paid off*	*$282,768*	*$16,166*	*$7,802*	**$92,703**
14	*$216,821*	*Paid off*	*$255,983*	*$14,748*	*$7,118*	**$99,821**
15	*$184,691*	*Paid off*	*$227,702*	*$13,252*	*$6,395*	**$106,216**

Both columns assume identical household cash. In the conventional case the $413 monthly rental surplus is applied to the personal property mortgage, so the comparison is not flattered by assuming the money is spent.

From year eight the personal property mortgage payment and the rental surplus are both free, and in this projection they are turned on the line of credit. That is phase two, and it is why the deductible balance starts falling while the annual saving stays high.

SECTION 12 · FOR THE ACCOUNTANT

The blueprint

What follows is written so the file can be picked up cold, in year six, by someone who was not there at the start.

At setup

1. **Confirm which expenses qualify.** Every cost routed through the line of credit must be a deductible rental expense. Capital improvements are not current expenses and belong in the capital cost allowance pool. Misclassification here is the most common failure point in the entire structure.
2. **Record opening balances in writing.** Personal property mortgage, rental mortgage, line of credit at zero, all dated. Every later reconciliation refers back to this.
3. **Confirm the line of credit has never been drawn.** A line with prior personal use carries that history. If a balance exists from a personal purpose, open a fresh segment rather than repurpose the existing one.
4. **Document the commercial purpose.** Copies of both leases, evidence the rents are at market, and confirmation the tenants are at arm's length. This is what answers the loss question in year seven.
5. **Take a position on the rental mortgage principal.** Where the full rental mortgage payment is funded by the line, the interest portion is straightforward. The principal portion is borrowed money used to repay borrowed money, which retains its character because the original borrowing acquired an income producing property. The position is defensible but it should be documented at setup rather than assumed at filing.

Through the year

The client or their bookkeeper maintains the ledger described in Section 8. Review it at least quarterly rather than discovering it in April.

Note that the ledger will contain two categorically different kinds of draw. Draws funding rental expenses and the rental mortgage are ordinary interest under paragraph 20(1)(c). Draws funding the line of credit's own interest are compound interest under paragraph 20(1)(d). They should be separated at the source, which is why the monthly cycle in Section 6 calls for them as distinct transactions.

At year end

1. **Reconcile total draws to total rental expenses.** These should agree to the dollar. Any gap is a tracing break and needs to be identified and explained in the working papers before filing, not after.

2. **Claim the line of credit interest on Form T776.** It is a rental expense because the borrowed money was used to earn rental income. Where interest is claimed as a rental expense on the T776, the Canada Revenue Agency directs that it not also be included as a carrying charge on the Federal Worksheet.
3. **Treat capitalized interest correctly.** Interest added to the balance rather than paid in cash is compound interest, and paragraph 20(1)(d) requires it to be deducted on a cash basis. The timing differs from ordinary interest and should be tracked separately.
4. **Confirm the interest is fully deductible.** On a clean file it is. Any personal use during the year converts this into a proportional claim which then has to be carried forward and defended every subsequent year.
5. **Address the rental loss.** On this file the rental turns from taxable profit into a deductible loss in year seven and the loss persists. That loss is available against employment income and is a large part of the benefit. It also invites questions when it repeats, so the market rent evidence and arm's length confirmation belong in the working papers from year one.
6. **Consider a source deduction reduction.** Where the projected deductions are reliable, form T1213 converts an annual refund into improved monthly cash flow, which materially helps client adherence in the early years.
7. **Retain everything for six years.** Line of credit statements, mortgage statements, the ledger, and every underlying receipt.

On framing. The purpose of the borrowing is to earn income from a rental property. That is what the folio tests and what the documentation should say. Describing the arrangement internally as a way of converting mortgage interest is both inaccurate and unhelpful, because it characterises the borrowing by its tax effect rather than by its use. The use is what governs.

If the file is reviewed

A tracing review asks three questions in order. Where did the money come from, where did it go, and what documents that. A file kept as described answers all three from the ledger without reconstruction. Records assembled after a request carry noticeably less weight than records kept as events occurred.

SECTION 13 · STRUCTURE DECISIONS

What we deliberately did not do

There is an obvious looking move available on this file that would have cost the household money, and it is the most common misunderstanding in this area. It is usually the first thing an owner asks about.

The duplex has room. At 60 percent loan to value it could be refinanced to 80 percent, releasing roughly $160,000. The intuition is to put that against the personal property mortgage, on the reasoning that debt secured by a rental is deductible debt.

It is not. Deductibility follows the use of the borrowed money, not the property pledged against it. Money borrowed against a rental and used to pay down a personal residence mortgage has been used for a personal purpose, and the interest is not deductible. This is the precise point Bronfman Trust settled.

EFFECT	CONSEQUENCE
Rate on the relocated debt	*Moves $160,000 of non-deductible borrowing from 4.65 to 4.99 percent, roughly $544 a year of pure waste*
Rental mortgage tax status	*A clean, fully deductible mortgage becomes a 75 and 25 split requiring proportional interest claims every year thereafter*
Rental cash flow	*Payment rises by roughly $934 a month, taking the property from positive $413 to negative $521*
Audit profile	*Introduces mixed use into the one account that most needs to stay single purpose*

The instinct is sound. Debt is better held on the deductible side. The refinance is simply the wrong route there, because it fails the use test at the moment the money moves. Cash damming reaches the same destination legitimately, one traceable expense at a time.

Also worth noting on the mortgage side

This structure does not require money to be taken out of anything. What it requires is that the personal property mortgage be a readvanceable combined plan, so that the credit limit grows as principal is repaid. A standalone line of credit sitting behind an existing first mortgage will not work, because its limit never grows and the loop stops after the first cycle.

Moving into a readvanceable product mid term means a discharge penalty, an appraisal and legal costs. Where renewal is close, waiting is often the better economics. Both should be priced before anything is committed.

SECTION 14 · HONEST LIMITS

What can go wrong

1. **Total debt is not reduced faster.** Over fifteen years this structure carries roughly $43,000 more total borrowing than the conventional route, because the interest is capitalized. It returns $106,216 in tax over the same period, leaving the household ahead by about $63,000 with the house paid off thirteen years sooner. But anyone expecting a smaller balance sheet should look at the first chart again.
2. **Phase two has to actually happen.** If the freed mortgage payment is not redirected at the line of credit from year eight, the balance compounds indefinitely and the plan has simply relocated debt rather than retired it.
3. **The monthly surplus is absorbed.** The $413 of rental cash flow currently available each month goes to the mortgage instead. Households used to spending it will feel that.
4. **The rate on the line moves.** It is tied to prime. The cushion is wide at higher marginal rates and narrow at lower ones. A household in the 29.65 percent bracket has roughly 1.16 percentage points of room on prime before the structure stops paying.
5. **The personal property secures the borrowing.** The line is registered against the principal residence. This is leverage, and the household is exposed if income falls or values decline.
6. **A single mixed transaction is expensive.** The discipline is permanent, not seasonal, and errors are difficult to correct afterwards because historical use is what is traced.
7. **Reimbursing yourself breaks it.** The most likely operational failure is not fraud or carelessness, it is a normal landlord habit carried into a structure that cannot tolerate it. See Section 7.
8. **Persistent rental losses attract questions.** They are allowed and they are part of the benefit. They still need market rent and arm's length evidence sitting in the file.
9. **Vacancy hurts more here.** The structure runs on rent arriving every month. An empty unit means the line keeps growing while nothing reaches the mortgage.
10. **Bookkeeping is a real cost.** The professional time this adds has to be weighed against a benefit that is modest in the early years.

WHO THIS SUITS

A household with a meaningful non-deductible mortgage, a rental with regular deductible cash costs and reliable cash flow, at least 35 percent equity in the personal property so the readvanceable structure works from day one, a marginal tax rate comfortably above 40 percent, and the temperament to keep one account clean for a decade. Remove any one of those and the case weakens quickly.

The simpler alternative. If the discipline is not realistic, there is a version of this with no structure and no audit exposure: direct the rental surplus at the personal property mortgage as prepayments and leave everything else alone. The result is much smaller, and it is still better than doing nothing. Choosing this deliberately is a far better outcome than starting the full structure and abandoning it in month eight.

SECTION 15 · BEFORE ACTING

Next steps

1. Review this document with your accountant and agree the expense list that will run through the line of credit.
2. Confirm prepayment privileges and readvanceable terms on the existing mortgage, and price the cost of moving into a readvanceable product against waiting for renewal.
3. Confirm with the lender how the line's minimum payment is handled and whether payees can be paid directly.
4. Decide who keeps the ledger and agree the format and the quarterly review point in advance.
5. Open the dedicated accounts and record opening balances before the first transaction, not after.
6. Set a calendar reminder for the month the mortgage is projected to clear, so phase two starts on time.

This document is educational and is provided for discussion between the client and their accountant. It is not tax advice. The figures are illustrative projections based on the stated assumptions and on rates current as of July 2026, and actual results will differ with rates, property values, income, expenses, tenancy and future changes to tax and lending rules. Interest deductibility depends on the specific facts of each file and must be confirmed by a qualified tax professional before this structure is implemented. Mortgage products, readvanceable terms and prepayment privileges vary by lender and are subject to approval. No outcome is guaranteed.