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Tax Tip

"Taking Advantage of Low Interest Rates"

The Canada Revenue Agency ("CRA") has announced that the prescribed rate for the first quarter of 2013 will be 1%. A tax opportunity exists provided it is in place prior to March 31, 2013.

If a higher income spouse lends to the lower-income spouse and charges the prescribed rate throughout the period in which the loan is outstanding, all income and capital gains, net of the interest paid, is taxed in the hands of the lower income spouse. The lending spouse would only include interest based on the prescribed rate at the time of granting the loan.

In order for the income and capital gains earned by the lower-income spouse not to attribute back to the higher-income spouse, a loan agreement should be entered into between the spouses which provides that the borrowing spouse will pay the prescribed rate of interest on the loan no later than January 30th of each year following every year in which the loan is outstanding.

In addition, you should consider repaying loans that may have been entered into previously at a higher rate and enter into a new loan at the lower rate. This will further decrease the interest income that will be included on the tax return of the higher income spouse.

Individuals with this type of loan arrangement in place during 2012 should be reminded to make the required interest payment related to 2012 no later than January 29, 2013.

The current prescribed rate (1%) is locked in, as long as the loan is in place. As a result, if interest rates begin to rise later this year as speculated, further significant tax savings will accumulate.

Keep in mind that the borrowing spouse may only deduct the interest paid, if the loan was used for the purpose of earning income from property (e.g., stocks, bonds, other investments, but does not include RRSP investments).

The prescribed interest rate also applies to interest-free or low-interest loans to employees and, in some cases, shareholders. In order to reduce the taxable benefit associated with a low-interest loan to an employee, the employee can reimburse his or her employer. Employees that want to reduce the 2012 taxable benefit must make the payment to their employer no later than January 29, 2013.

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