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Your Guide to Tax-Saving Strategies

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TAXSTRATEGY

The Prescribed Loan

The 1% is back

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So far, 2020 has been quite a downer - and not just emotionally, but also economically. So it was only a matter of time before the CRA announced a drop in the prescribed rate. For the last couple of years, the prescribed rate has been at 2 per cent (it has previously been at 1 per cent for many years before that). But with the drop in interest rates at the bank and federal levels, the prescribed rate had to follow suite. How does the CRA come to this conclusion? The prescribed rate as set by the government is determined by using the simple average of the three-month treasury bills for the first month of the preceding quarter, rounded to the next highest percentage point. Since the average yield on 90-day treasury bills dur-

ing April of this year was only 0.27%, the prescribed rate was set for 1 per cent as of July 1, 2020.

So, in line with my theme over the last few articles since Covid started, I wanted to try to focus on the silver lining during this downturn in the economy: saving tax. The prescribed rate loan strategy is a simple one: it allows you to income split with low tax-rate family members without tripping over the attribution rules (where income will still be taxed in your high-rate hands). So can you, during these low times, put more money back into your pocket?

The Strategy

You, as the lender, can loan after-tax money to a spouse, minor child, or a family trust for the benefit of your spouse and minor children at the prescribed rate in place at the time of the loan. Such funds would then be invested, and any income arising from such investment can be taxed in the

hands of those family members (and assuming they are in lower tax-brackets, tax savings would thereby result). Alternatively, you can transfer property-in-kind instead of cash, and take back a promissory note bearing the prescribed rate of interest. However, any transfer of assets could potentially trigger capital gains in your hands if the assets have an inherent, unrealized gain. So think wisely before you transfer assets (Happily, cash, by its nature, does not trigger any gains).

In order to qualify for this tax break, the interest on the loan for each year must be paid no later than January 30th after the year end. Otherwise, the attribution rules will apply and the profits will be taxable in your hands. Furthermore, if you miss even one January 30th deadline, the attribution rules will apply on the particular investment forevermore. Tip: Of course, if the borrowed funds are invested in something that will trigger a loss, you might want to purposely trigger the attribution rules by missing an interest payment. That way, for tax purposes, the loss will probably be treated as yours. So you can actually take advantage of the attribution rules, and turn them in your favour.

Note: once you make the loan, the parties are locked in to the 1 per cent rate; so if the prescribed rate were to increase after implementing this strategy, the original loan is still able to benefit from the low 1 percent.

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