

Family Income Splitting Loans

March, 2009

Prescribed Rate Loans for Family Income Splitting

The Canada Revenue Agency ("CRA") recently announced that their prescribed rate of interest for the 2nd quarter of the year (i.e. from April 1, 2009 to June 30, 2009) will fall to 1%. This is the lowest interest rate on record and provides an excellent opportunity to save income taxes by splitting income with your spouse, children and grandchildren.

How it Works

If you are a high income earner, you should consider making formal loans to family members in lower income tax brackets. You charge interest on the loans at the CRA's prescribed rate of interest, being 1 % for the second quarter of 2009. This rate is locked in for the entire period the loan is outstanding. The family members will invest the proceeds of the loans at a rate of return higher than the interest levied on the loan (i.e. higher than 1 %). The net income earned will be taxed in the hands of your borrowing family member at their lower income tax rate.

The result is more after-tax income for the family and a larger total family asset base.

Important Factors to Consider

- In order to avoid the attribution rules (i.e. rules that attribute income earned on these loaned funds back to the individual who made the loan), you must ensure that it is bona fide loan and that the interest is paid on the loan within 30 days after the end of the year (i.e. by January 30). If you miss this deadline, attribution will apply in the year and all subsequent years, thereby permanently eliminating any benefits of income splitting from the loan.
- Once you formally establish a prescribed rate loan, the rate applies for the life of the loan even if prescribed rates subsequently rise or decline.
- While the loans must be bona fide loans, there is still plenty of flexibility over the loan terms, and there is no limit on the amount you can loan.

Please contact your Thomson Jaspar & Associates advisor if would like to discuss the possibility of taking advantage of this strategy.

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