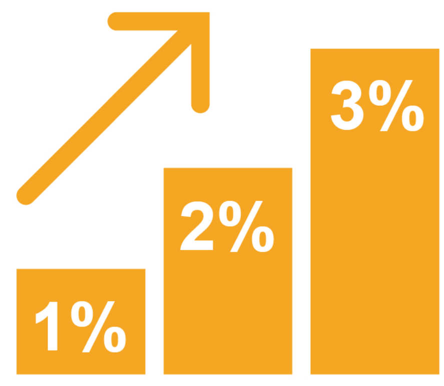
HOW TO PREPARE FOR THE CRA PRESCRIBED RATE INCREASE IN Q4 2022

The CRA prescribed rate of interest increased from 1% to 2% starting in Q3 2022. And now, based on increases in Bank of Canada treasury bill yields, the CRA announced another prescribed rate increase to 3% starting in Q4 2022.

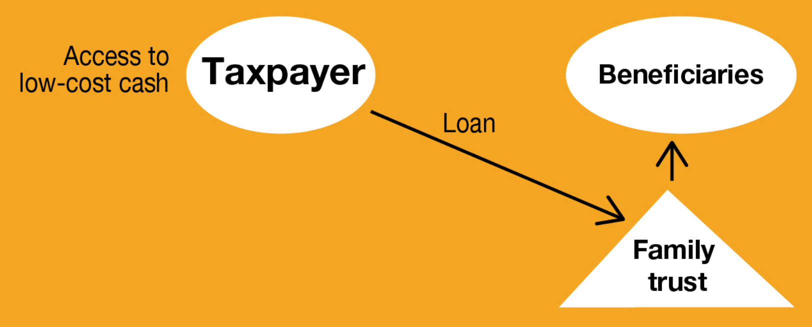
Quarters	Interest on overpaid taxes, etc.	Interest on PLOI
Q1 2022	1%	4.15%
Q2 2022	1%	4.38%
Q3 2022	2%	5.20%
Q4 2022	3%	6.45%



This increase has various implications from a tax planning perspective. To curb the impact this will have on your finances, we have a few recommendations you may consider:

Consideration 1:

Prescribed rate loan planning



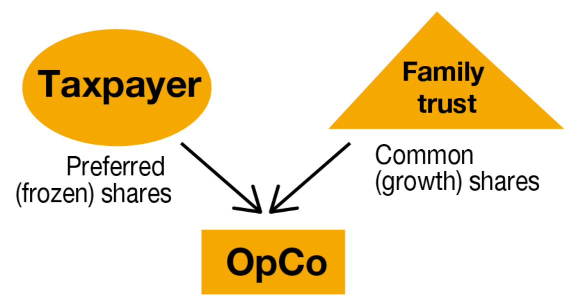
You may consider splitting your family's income to save on your taxes. One common way to split your income is to make a loan to a family trust carrying the CRA prescribed rate of interest. Your family trust would then use the loan proceeds to acquire an income-earning investment portfolio and allocate that trust income (net of any interest expense) to lower tax bracket family members.

While the cost of this planning will go up after the prescribed rate increase, you may still see some tax savings—assuming the family trust can generate a rate of return higher than the prescribed rate.

Bear in mind that all existing prescribed rate loan structures are not affected by an increase in prescribed rates. As such, you should finalize any plan to enter into a new prescribed rate loan structure at 2% should the end of Q3 2022.

Consideration 2:

Corporate “freezes” and intergenerational transfers



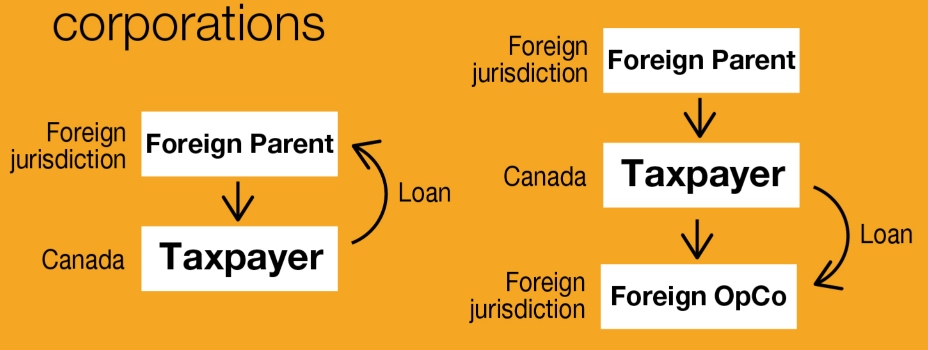
You may consider a "freeze" of your share ownership as a technique to transfer future wealth to the next generation. Then, introduce family members as the future growth owners of the business. However, this runs the risk of potentially triggering adverse tax consequences under the Income Tax Act known as “corporate attribution”.

You can structure a corporate freeze in a certain way to limit the application of corporate attribution. Some structures require the corporation to maintain “small business corporation” status or ensure there is a “designated persons” clause in the trust indenture.

Other structures can avoid corporate attribution by having the company pay an annual dividend to the original shareholder based on the prescribed rate of interest. An increase in the prescribed rate means that corporations will now have to pay a larger dividend than they historically needed to.

Consideration 3:

Corporate debt with non-resident corporations



You can consider making a Pertinent Loan Or Indebtedness (“PLOI”) election in either of these two situations:

- There is a long-term, unpaid debt owing to a foreign shareholder.
- When a loan to a foreign subsidiary is at risk of triggering adverse tax consequences under the “foreign affiliate dumping” rules.

This election allows you to include a notional amount of interest income in your tax return based on the CRA prescribed rate of interest. You must include this amount of notional interest income annually in the creditor’s tax return as long as the loan amount remains outstanding.

Given the two back-to-back quarterly increases in prescribed rates, a higher deemed interest inclusion may result when the Canadian corporation receives insufficient interest income from the debtor.

While this infographic contains general information, Crowe Soberman recommends that you speak with your tax advisor before taking specific planning steps.