



**Historically Low Interest Rates Create Income Splitting Opportunities**

[Kevin Fritz](#)  
[Andrea Shreeram](#)

As a result of the economic downturn interest rates have fallen to historic lows as governments try to spur economic recovery. From a personal tax planning perspective, these low interest rates provide a high income earner with an enhanced opportunity to split income with a low-taxed spouse and/or children and reduce a family's overall tax burden on investment income.

A high income earner may lend money to a lower income earning spouse or child, who can then use the money for investment purposes. The tax liability on any investment income from the borrowed money is taxed at a lower rate in the hands of the lower income person, provided that interest is properly paid to the high-income lender. The Canada Revenue Agency sets quarterly "prescribed interest rates" which apply to such loans. The interest must be paid by January 30<sup>th</sup> of each year following the making of the loan. If this is not done then the investment income will be "attributed" to the high income lender and the attempt at income splitting will be defeated. It is important to note that the prescribed interest rate on the date that the loan is made will apply for the entire term of the loan, even though the prescribed rate may increase in future periods.

The prescribed interest rate is currently 1%. It is difficult to imagine that it will ever reach a lower point.

As an example of the possible tax savings by making a loan at 1% to a lower income spouse, assume that John and Jane are residents of Ontario and that John is in the highest tax bracket, while Jane is in the lowest. John's investment of \$500,000 earns an 8% annual return. Currently, John has the following after-tax return on investment:

	John
Interest income	\$40,000
Tax (46.41%)	( \$18,564)
Net return after tax	\$21,436

If John were to loan the \$500,000 to Jane at a 1% interest rate then the result would be as follows:

	John	Jane	Total
Interest income	\$5,000	\$40,000	
Less interest expense		(\$5,000)	
Net income	\$5,000	\$35,000	\$40,000
Tax (46.41%) (21.05%)	(\$2,320)	(\$7,367)	(\$9,687)
Net return after tax	\$2,680	\$27,633	\$30,313
Net return without loan			(\$21,436)
Annual tax savings			\$8,877

The spousal loan arrangement in this example has resulted in a tax savings of close to \$9,000. Additional savings could potentially be achieved by making the loan to a discretionary family trust with a spouse and children as the beneficiaries.

It can be seen that properly implementing such a loan strategy while the prescribed interest rate is so low provides a rare opportunity to reduce a family's overall tax burden.

*This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.*

*If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.*

**Wildeboer Dellelce LLP**

Wildeboer Dellelce Place  
365 Bay Street, Suite 800  
Toronto, ON M5H 2V1  
Phone: (416) 361-3121  
Fax: (416) 361-1790

72 Victoria Street South, Suite 401  
Kitchener, Ontario N2G 4Y9  
Phone: (519) 741-8708  
Fax: (519) 741-9576