



CESTNICK

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TAX MATTERS

# Prescribed-rate loans are affordable again and can save the family taxes

SPECIAL TO THE GLOBE AND MAIL  
PUBLISHED JULY 30, 2025

This weekend is our wedding anniversary. I've learned how to always remember this special day: by forgetting it once. Yes, I've made many mistakes over the years. I still remember the time I accidentally handed Carolyn a glue stick when she asked for a ChapStick. She's still not talking to me. When we got married, we did agree to share everything – except the last piece of chocolate cake, which is non-negotiable.

When it comes to sharing, we try to share income – often called income splitting. We're doing this today using a loan that I made to Carolyn many years ago. This idea has been out of vogue for a while, given how high interest rates have been in recent years. The good news? There are opportunities to save tax again given that the prescribed rate has been reduced to just 3 per cent effective July 1, 2025. Let me explain.

## The rate

The prescribed rate is used for a few things under our tax law. The rate is set quarterly and is based on the average of

three-month treasury bills for the first month of the preceding quarter, rounded to the next highest percentage point. So, for the third quarter of 2025, the rate is now just 3 per cent.

The rate was as low as 1 per cent back in the second quarter of 2022 and hasn't been as low as 3 per cent since the fourth quarter of 2022.

## The opportunities

When the prescribed rate is charged on certain loans, it allows the lender or borrower – depending on the type of loan – to take advantage of specific planning and avoid certain negative tax consequences along the way. Here are the top five ideas to consider today:

**Make a spousal loan:** You can lend money to your lower-income spouse for him or her to invest. If you charge the 3-per-cent prescribed rate, and your spouse pays this interest by Jan. 30 each year for the prior year interest charge, then you'll avoid the attribution rules. This will allow your spouse to pay the

tax on the investment earnings – not you. You'll have to pay tax on the interest received, and your spouse can deduct this interest. You'll save tax as a couple to the extent your spouse earns more than the 3-per-cent prescribed rate on the investments.

**Lend to a family trust:** Similar to lending your spouse money, you can accomplish the same income splitting with your minor children or grandchildren if you lend the funds to a family trust and charge the prescribed rate. The income of the trust can be taxed in the hands of the minor children – the beneficiaries – who will likely pay little or no taxes. The income can be used for their benefit to pay for things such as school, computers, summer camp and more.

**Refinance existing loans:** When you make a prescribed-rate loan to your spouse or a family trust, the rate at the time of the loan is locked in forever. If the prescribed rate drops, you could repay the loan and then make a new loan at the lower rate. But the Bank of Canada would have to lower its policy rate by another 75 basis points for the prescribed rate to drop to 2 per cent, so the current rate is likely to be with us for a while. If you have a prior loan at a rate higher than 3 per cent, consider repaying it today and taking out a new loan at the current rate.

**Avoid tax on shareholder loans:** If you borrow money from a corporation you own, the general rule is that the loan must be paid back by the end of the tax year following the year in which the loan is made – otherwise the loan will be included in your income. There are some exceptions for shareholder-employees who borrow for certain purposes. And you can avoid a taxable interest benefit on shareholder loans by charging the

prescribed rate on the loan – a cost which is lower now given the reduction in the rate effective July 1.

**Borrow from your employer:** If you borrow from your employer, you'll avoid any taxable benefit if you pay the 3-per-cent prescribed rate on the loan. This is a cheaper loan than you'll find at a bank. There's also a special rule that applies to loans to assist you in buying a home: For the first five years of the loan, you'll benefit from any drop in the quarterly prescribed rate without having to repay the loan and take out a new loan at the lower rate.

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