CRA drops prescribed interest rate for employee loans

January 2025 (A previous version of this report appeared in the National Post on November 5, 2013)

Jamie Golombek
Managing Director, Tax and Estate Planning, CIBC Private Wealth

On January 1, 2025, the Canada Revenue Agency decreased its prescribed interest rate to 4% from the previous rate of 5%. The prescribed rate is important for business owners who make loans to their employees. The prescribed rates are set quarterly by the CRA and are tied directly to the yield on Government of Canada 90-day Treasury Bills, albeit with a lag. The calculation is based on a formula in the tax rules that takes the average of three-month Treasury bills for the first month of the preceding quarter rounded up to the next highest whole percentage point.

Under the tax rules, if you loan an employee money, that employee is deemed to have received an employment benefit with respect to the interest-free or reduced interest loan. The amount of this benefit is calculated as the difference between the interest actually paid by the employee and the interest computed at the prescribed rate on the outstanding loan balance. This benefit must be reported in Box 14 of the T4 slip and in the "Other information" area, using code 36 for the interest benefit.

There is, however, a special rule that applies if you give an employee a loan to assist them in buying a home, formally called a "home purchase loan." Under this rule, the employment benefit for the first 5 years is calculated using the lesser of the prescribed rate in effect for the quarter in question and the prescribed rate that was in effect at the time the loan was granted, reduced by any interest that the employee actually paid.

This rule is favourable in that it guarantees that the employment benefit calculated in respect of the interest won't increase if the prescribed rate for a subsequent quarter increases. At the same time, it also allows the employee to benefit if the prescribed rate drops.

If you grant an employee a home purchase loan for more than 5 years, the tax rules state a new home purchase loan is deemed to have been received on the fifth anniversary and the employment benefit to be reported in respect of this new loan must be based on the prescribed rate of interest in effect at the time the new loan is deemed to be received.

For example, let's say you loaned an employee money to buy a home in January 2022 when the prescribed rate was 1%. Even though the prescribed rate has now gone up to 4%, the employment benefit related to the interest-free loan is still calculated at the original prescribed rate of 4%.

Note that should the prescribed rate drop down to a lower rate in the future, an employee who was granted a home purchase loan when the prescribed rate was higher would only have to include the interest benefit using the lower rate for that quarter.

Jamie Golombek, FCPA, FCA, CPA (IL), CFP, CLU, TEP is the Managing Director, Tax and Estate Planning with CIBC Private Wealth, Toronto.

jamie.golombek@cibc.com