



Wealth
Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES



Aaron Fennell, MBA, CFA
Portfolio Manager & Investment
Advisor
Tel: 416-313-6397
aaron.fennell@rbc.com

RBC Dominion Securities
181 Bay Street, Suite 2350
Toronto, ON M5J 2T3
www.aaronwfennell.com

Employee compensation – employee loans

As an employee, you may be compensated in a number of ways. Your remuneration could include salary, shares of the company you work for, or your employer may lend you money to help you purchase a home. This article discusses the taxation and implications of receiving a loan from your employer.

The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.

What is it?

Your employer may provide a loan to you to assist you in making certain purchases. The purpose of the loan could be to assist you in purchasing shares of the company or to allow you to purchase your principal residence. Employee loans could also be used for other personal purposes such as consumer purchases, home improvements or the purchase of a recreational property. The loans could be interest free loans, low-interest loans or loans at current market interest rates and have various repayment terms.

Why is it used?

Companies may use employee loans to help you purchase shares of the corporation to give you partial ownership of the company. At the executive level, many companies require a certain amount of shares to be held by their executives. An employee loan helps the executives meet that ownership requirement. The rationale behind such a requirement is that by making an employee a shareholder of the corporation, the employee will likely make decisions that will be in the best interests of the company so that the employee doesn't lose value in their shares.

Interest-free or low-interest loans can also be used as part of the employee's compensation package or a reward to employees for loyal service. If you are required to relocate to a different location, your employer may provide you with a loan to help with the costs of relocating.

How is it taxed?

There are a number of rules detailed in the Income Tax Act regarding employee loans to prevent employers from providing employees tax-free or tax-deferred compensation. How a loan from your employer will be taxed depends on your relationship with the company as well as the purpose of the loan.

To a shareholder

If you are a shareholder of the corporation, or if you are related to a shareholder of the corporation and you have obtained a loan, the loan will generally be treated as income received by you in the year of the borrowing. Repayment of the loan in a subsequent year will qualify as a deduction from your income that you can claim in the year the loan is repaid. An exception to this rule is that if you repay the loan within one year after the end of the corporation's fiscal year following the year in which the loan was made, you will not have to report the loan as income provided that the repayment was not part of a series of loans and repayments.

To an employee

If you are an employee of the corporation, and the loan meets certain criteria, you could be exempt from including the loan in your income in the year it is made to you. If you are both an employee and a shareholder, you may still qualify for the employee exemption if you obtained the loan in your capacity as an employee and not as a shareholder. Generally, you will be considered to have received the benefit in your capacity as shareholder if you have significant influence over the corporation's business policies. However, this presumption may not apply where loans on the same terms and conditions are offered to other employees of the corporation who are not shareholders. If all the employees are either shareholders or related to the shareholder, the presumption may not apply if loans on the same terms and conditions are typically offered to employees that are not shareholders of similar-sized business who perform similar services.

In order for an exception to apply, at the time the loan is made, bona fide arrangements must be made to repay

How a loan from your employer will be taxed depends on your relationship with the company as well as the purpose of the loan.

the loan within a reasonable time. In addition, the loan is made to:

- 1) An employee owning less than 10% of any class of shares of the corporation or a related corporation, or who deals at arm's length with the corporation;
- 2) An employee or the employee's spouse to acquire a dwelling;
- 3) An employee to acquire treasury shares of the corporation; or
- 4) An employee to acquire a car for use in carrying out the employee's duties of employment.

Low-interest or interest-free loan

If you are an employee or a shareholder and you receive an interest-free or low-interest loan, you may be deemed to have received a taxable interest benefit. The benefit is calculated as the difference between the Canada Revenue Agency's prescribed interest rate and the actual interest rate you are being charged multiplied by the outstanding loan balance of the loan (calculated daily). Although you have to pay tax on this amount, even at the highest tax bracket, the amount of tax you will pay is significantly less than the interest you have to pay on a regular commercial loan.

If you are a shareholder of the corporation and included the loan amount in your income, you will not need to include the interest benefit in your income.

Loan forgiveness

If an employer forgives a loan made to you, the outstanding balance for the loan at the time of forgiveness will be included in your income as employment income. However, if you have already included the loan in your income because you received the loan in your capacity as a shareholder, you do not have to include the forgiven loan in your income again.

To the company

Interest received from an employee is considered investment income to the company unless the company is in the business of lending money. The investment income is taxable to the company.

Funds lent to an employee or a shareholder is not deductible to the corporation. Also, if a loan to a shareholder is forgiven, the corporation will not be able to deduct the forgiven amount. This can result in double taxation as the forgiven amount is taxable to the borrower but the corporation cannot claim a deduction. If a loan to an employee is forgiven, the corporation may deduct the forgiven amount in some circumstances. Speak with a qualified tax advisor to determine the tax implications of a particular loan arrangement with your employee.

Funds lent to an employee or a shareholder is not deductible to the corporation.



Wealth
Management

This document has been prepared for use by the RBC Wealth Management member companies, RBC Dominion Securities Inc. (RBC DS)*, RBC Phillips, Hager & North Investment Counsel Inc. (RBC PH&N IC), RBC Global Asset Management Inc. (RBC GAM), Royal Trust Corporation of Canada and The Royal Trust Company (collectively, the "Companies") and their affiliates, RBC Direct Investing Inc. (RBC DI) *, RBC Wealth Management Financial Services Inc. (RBC WMFS) and Royal Mutual Funds Inc. (RMFI). *Member-Canadian Investor Protection Fund. Each of the Companies, their affiliates and the Royal Bank of Canada are separate corporate entities which are affiliated. "RBC advisor" refers to Private Bankers who are employees of Royal Bank of Canada and mutual fund representatives of RMFI, Investment Counsellors who are employees of RBC PH&N IC, Senior Trust Advisors and Trust Officers who are employees of The Royal Trust Company or Royal Trust Corporation of Canada, or Investment Advisors who are employees of RBC DS. In Quebec, financial planning services are provided by RMFI or RBC WMFS and each is licensed as a financial services firm in that province. In the rest of Canada, financial planning services are available through RMFI, Royal Trust Corporation of Canada, The Royal Trust Company, or RBC DS. Estate and trust services are provided by Royal Trust Corporation of Canada and The Royal Trust Company. If specific products or services are not offered by one of the Companies or RMFI, clients may request a referral to another RBC partner. Insurance products are offered through RBC Wealth Management Financial Services Inc., a subsidiary of RBC Dominion Securities Inc. When providing life insurance products in all provinces except Quebec, Investment Advisors are acting as Insurance Representatives of RBC Wealth Management Financial Services Inc. In Quebec, Investment Advisors are acting as Financial Security Advisors of RBC Wealth Management Financial Services Inc. RBC Wealth Management Financial Services Inc. is licensed as a financial services firm in the province of Quebec. The strategies, advice and technical content in this publication are provided for the general guidance and benefit of our clients, based on information believed to be accurate and complete, but we cannot guarantee its accuracy or completeness. This publication is not intended as nor does it constitute tax or legal advice. Readers should consult a qualified legal, tax or other professional advisor when planning to implement a strategy. This will ensure that their individual circumstances have been considered properly and that action is taken on the latest available information. Interest rates, market conditions, tax rules, and other investment factors are subject to change. This information is not investment advice and should only be used in conjunction with a discussion with your RBC advisor. None of the Companies, RMFI, RBC WMFS, RBC DI, Royal Bank of Canada or any of its affiliates or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. ®/™ Registered trademarks of Royal Bank of Canada. Used under licence. © 2021 Royal Bank of Canada. All rights reserved. NAV0205 (05/17)