Interest payable on corporate tax overpayments

Like anyone else who has the use of borrowed funds, the federal government pays interest. However, the federal government is unlike most borrowers, in that the rate of interest which it pays is set by law. For some “borrowings”, that law is about to change.

Current rules provide that for each calendar quarter, the rate of interest paid by the federal government on overpayments of most taxes, for all taxpayers, is calculated as the average yield of three-month Government of Canada T-bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point, *plus 2 percentage points.*

In the low interest rate environment of the past few years, some corporations have made large advance deposits of corporate income tax and, as a result, have received interest on those funds at the statutory interest rate which the Canada Revenue Agency is required to pay. This practice was noted by the federal Auditor-General in a report made in 2009, which concluded that the federal government was, as a result, effectively borrowing funds at a higher than necessary interest rate.

To address those concerns, there will be change, effective July 1, 2010, in how the rate of interest payable on corporate tax overpayments is calculated. The rate will continue to be based on the average T-bill yield for the first month of the preceding quarter, rounded up to the nearest percentage point, but the two percentage point “bump” is to be eliminated.

Although the practice of making substantial overpayments was more common for large corporations than for small businesses (which seldom, in any event, have the cash flow required to deliberately overpay their taxes by a significant amount), the change will affect *all* corporations, large and small. There is no change to the rate of interest payable on tax overpayments by individuals or trusts.