

Interest on Overpaid Taxes

Under the *Income Tax Act* and the *Excise Tax Act* the prescribed interest rate payable by the Canada Revenue Agency (CRA) on a refund of net tax will be the basic rate, plus 2%. The prescribed interest rate charged on amounts owing is the basic rate plus 4%. "Basic rate" is based on the rate charged on three-month Treasury Bills (T-bills), adjusted quarterly, and rounded up to the nearest whole percentage point (expressed as a percentage per year).

Budget 2010 proposes effective July 1, 2010 to reduce the interest rate paid on refunds to corporations from the T-bill rate plus 2% to the T-bill rate, while leaving the interest rate charged on tax owing at the T-bill rate plus 4%. This change will not apply to interest rate calculations for non-corporate taxpayers. The stated reason for this reduction is that the Auditor General indicated in her Spring 2009 report that if the government (i.e. CRA) "unnecessarily holds large amounts of deposit, with an obligation to pay interest when making a refund," it "effectively is borrowing those funds at a higher interest rate" than it can borrow directly. The unstated impetus for the proposal may be to prevent taxpayers from intentionally overpaying their taxes in order to receive a higher rate of interest from the CRA than they would receive from other deposits.

Taxpayers have legitimate concerns regarding the gap between the taxable lower rate of interest paid by the CRA on refunds and the higher non-deductible rate of interest charged by the CRA on taxes owing. Additionally, large corporations are generally forced to immediately pay one-half of any tax that has been reassessed, even though they are disputing the reassessment. Reassessments are often issued without the taxpayer receiving a full hearing on either the facts or the law. Forcing large corporations to pay one-half of the tax in dispute, only to receive low rate taxable interest if they are successful, is regarded by businesses and their non-resident parent corporations as being penal in nature and an unfair impediment to conducting business in Canada.

Recommendation

That the federal government exclude any refund issued as a consequence of an amount paid pursuant to a notice of reassessment from the new reduced interest rate rule.