TAX ADVISOR

Tuition Perk

Company scholarships non-taxable

COURT REPORT

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With the start of the winter semester, Canadian students returning to universities and colleges can breathe a (chilly) sigh of relief: last month, the Federal Court of Appeal upheld a lower court decision dealing with the non-taxability of scholarships awarded to students from their parents' employer.

To better understand the case (*The Queen v Bartley et al*, 2008 FCA 390), let's first review the rule governing the taxation of scholarships generally. In 2006, the government fully exempted all post-secondary scholarships from tax. In 2007, the government extended this exemption to elementary and secondary school scholarships as well. Prior to 2006, however, only the first $3,000 received by a student annually was tax-exempt.

While you would think this would settle the issue, this recent case had the Canada Revenue Agency challenging what otherwise would seem to be a tax-free scholarship. The case involved two taxpayers, Brian Bartley and John DiMaria, whose situations were very similar.

Let's take a closer look at DiMaria's situation. In 2004, Andrew DiMaria, a third-year engineering student at the University of Waterloo, received a $3,000 award from Dow's Higher Education Award Program (HEAP) to help him pay for his tuition. Andrew is the 21-year-old son of John, a senior tax specialist with Dow Chemical Canada Inc., which sponsors the HEAP.

HEAP was established for the purpose of "recognizing the scholastic achievement of children of eligible employees," and offering them financial assistance to undertake post-secondary education."

The HEAP covers an employee's children's tuition up to a maximum of $3,000 for post-secondary education each year and is available to a maximum of 100 students per year.

To qualify, the student must be a dependent child of a Dow employee, must attend an approved university, college or institute and must have at least a 70% average when graduating from high school.

The Canada Revenue Agency (CRA) included the $3,000 in John's income on the basis that the award was a taxable benefit from his employment at Dow.

John disagreed and appealed to the Tax Court, submitting that the HEAP award ought to be properly classified as scholarship income to his son, Andrew, and thus should be tax-free under the *Income Tax Act*. The case was first heard by the lower court in November 2007 before Justice Eugene P. Rossiter, who was subsequently named the Court's Associate Chief Justice.

Justice Rossiter, after undertaking a thorough legal analysis, concluded that the HEAP award was not an employment benefit received or enjoyed by John DiMaria for several reasons.

First of all, John was not "enriched by $3,000" since the payment was made directly to his son Andrew and John had no legal obligation to either support his 21-year-old son nor to pay for his post-secondary education. He also had no right to recover the $3,000 from Andrew.

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Judge Rossiter concluded, therefore, that the only person who was economically enriched was Andrew. He was attending the school and he was benefiting from the reduced cost of education.

The judge found that the $3,000 was scholarship income and therefore neither taxable to John as an employment benefit nor taxable to Andrew since it fell within the $3,000 scholarship exemption limit, in force since 2004.

The CRA appealed Judge Rossiter's decision to the Federal Court of Appeal, which heard the case on December 9, 2008.

In an oral decision delivered from the bench, the Appeal Court stated that in order to overturn Judge Rossiter's decision, it would be necessary to find that the lower court judge "made a palpable and overriding error." Turning down the CRA's appeal, the court said: "We are unable to conclude that he did make such an error." AER

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