Transferring Tuition

Two tax credits help students knock their income tax to zero. One may be more beneficial to their parents.

By Jamie Golombek

“Students” and “income tax” are words that are seldom used in the same sentence, since most students have so little income that they don’t have to pay any tax. But there are still some significant tax planning opportunities advisors can discuss with students (or their parents).

Tuition and Education Credits

Non-refundable tax credits are available for tuition fees paid for post-secondary level education. Education credits are also available for each month of either full- or part-time post-secondary studies.

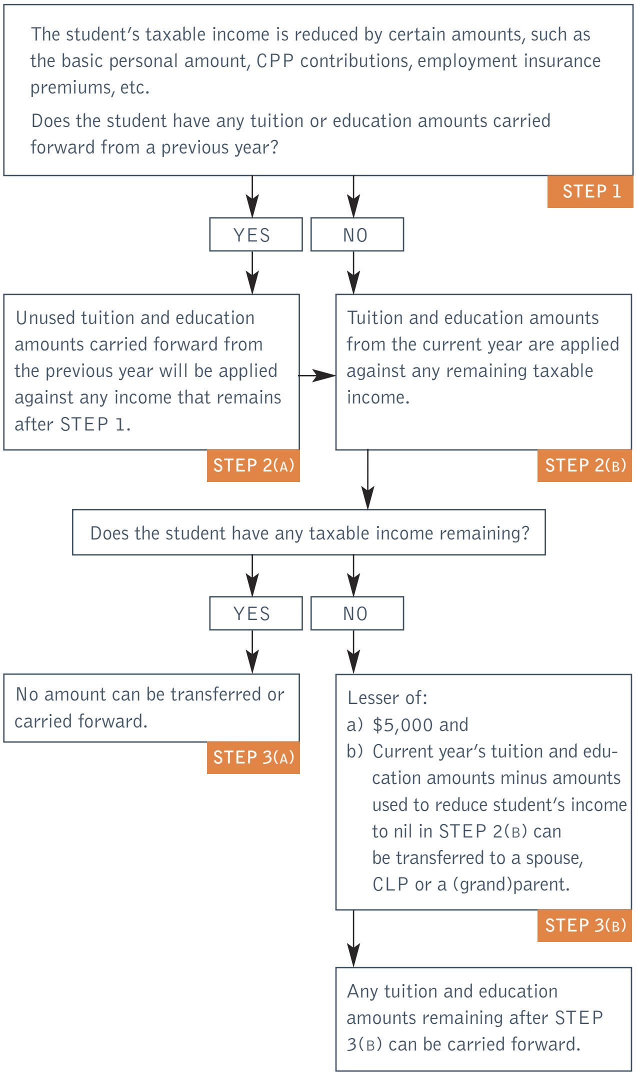
Illustration by Alanna Cavanagh

Some students may find they don’t need to claim all of their tuition and/or education credits to reduce their income tax to zero. As a result, students can transfer the unused amounts to a spouse or common-law partner (CLP), parent, grandparent or carry forward unclaimed amounts indefinitely. The parent (which includes a natural parent, a step-parent, an adoptive parent or even a spouse’s or CLP’s parent) need not be the one who paid the tuition to entitle the credits to be transferred to him.

Limitations on Transfers

The student must first use the tuition and education credits to reduce his or her tax payable to zero before carrying forward and/or choosing to transfer any unused amounts. The maximum amount that can be transferred to a spouse, CLP, parent or grandparent is $5,000 less the amount claimed on the student’s return. In addition, amounts carried forward from previous years must be used before the current year’s amounts, and any carried-forward amounts that are not completely used by the student in the current year can only be carried forward by the student and cannot be transferred in a subsequent year.

The student needs to complete Schedule 11, Federal Tuition and Education Amounts to determine the amounts that must be used in the current year and the amounts that can be carried forward by the student and/or transferred



to a spouse, CLP, parent or grandparent.

To transfer the unused part of tuition and education amounts to a spouse or CLP, the student needs to complete the applicable areas on the back of Form T2202, Education Amount Certificate, or Form T2202A, Tuition and Education Amounts Certificate. The spouse or CLP needs to complete his or her own Schedule 2, Amounts Transferred From Your Spouse or Common-Law Partner, to calculate the transfer amount.

The chart above illustrates these complex rules and how they work.

As a financial advisor, sit down with your student clients (and their families) to determine who should be claiming these credits. That being said, many parents who help fund their children's education often do so on the condition that the student transfers the tax credits back to the parent.

Interest on Student Loans

The other non-refundable tax credit that applies to students is for interest paid on student loans. A student, or someone related to the student, can claim the interest paid on loans made for post-secondary education under the Canada Student Loans Act, the Canada Student Financial Assistance Act, or similar provincial or territorial laws. If the student or relative doesn't need to claim all of the interest in the year it is paid, it can be carried forward and claimed in any of the next five years.

But a recent tax case, Vilenski v. the Queen, illustrates a problem. During Vilenski's university studies, he received various student loans, including a loan under the Canada Student Loans Act (the "qualifying loan"). Vilenski learned of a bank's "Professional Student Plan," under which he could obtain a line of credit at a rate of interest that was 2% lower than the rate of interest payable on the qualifying loan. He opened up a line of credit and issued a cheque of almost $25,000 to repay the balance outstanding on the loan.

On his tax return, Vilenski claimed approximately $4,300 of interest paid on the line of credit over three years as qualifying for the tax credit. CCRA denied the tax credit because the interest paid on the line of credit was not technically paid on a qualifying loan.

The judge agreed with CCRA and found the interest was not deductible. Vilenski argued that the line of credit is "essentially the same money" as the qualifying loan. Since the qualifying loan was subject to the Act, "therefore (the line of credit) should qualify in the same manner as if it were interest on the qualifying loan." The judge went on to explain that the Act says interest is deductible when it is paid on a loan, which is made "under" the Canada Student Loans Act. Since the line of credit was not subject to the provisions of the Act, the interest is not deductible.

All students should do the math before immediately paying off a student loan. Whether it makes sense will depend on the interest rate differential between the qualifying and non-qualifying loans. Assuming that the tax credit is worth approximately 22% (combined value of the federal and provincial tax credits), as long as the interest rate on the new loan is at least 22% lower than the rate on the qualifying loan, it makes sense to refinance.

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