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## Tax Planning For Students

In late summer, as the school year approaches, thousands of students prepare for the challenges that lie ahead. While it's true that the majority of students think about their academic challenges, most do not consider the financial challenges that a post-secondary education entails. The cost to attend post-secondary education is accelerating quickly and many students (and parents alike) are feeling the financial burden. According to a survey done by the Bank of Montreal in 2001, by the year 2020 a four-year university or college education could cost \$96,000, or more if the child moves away from home to attend school. This trend, along with more and more people pursuing post-secondary education, has caused the government to address these issues. This is evidenced by an increased focus on students in the federal budgets over the past few years. This bulletin will review how students can use the tax rules to assist them during their pursuit of a higher education.

### Credits and Deductions

Let's take a look at the most common tax credits and deductions that students may be eligible to claim.

### Tuition and Education Amounts

Students may claim a non-refundable tax credit for any eligible tuition and education amounts incurred in the year. Eligible tuition amounts will normally include (if the total fees are greater than \$100) tuition

fees for courses at a post-secondary school level paid to a university, college or other educational institution in Canada, certified by the Minister of Human Resources Development (most university-level educational institutions outside of Canada will also qualify). The student must be at least 16 years old at the end of the taxation year and the courses must be taken to provide or improve upon occupational skills. Many students feel that the costs of such things as books, board or lodging should be deductible since it relates to pursuing their education. Unfortunately though, these costs are not directly deductible. However, the government does recognize the significance of these costs and offers the education amount as a tax credit to full- and part-time students who are enrolled in a qualifying educational program. The education amounts for full- and part-time students have increased significantly over the past few years and are as follows:

- \$400 for each month enrolled as a full-time student
- \$120 for each month enrolled as a part-time student

Let's take Mario for example. This September, he will be entering his first year of studies at the local university on a full-time basis. His tuition fees totalled \$1,500 for the courses taken in 2002 (September to December). When Mario prepares his 2002 tax return, he is eligible for a tuition credit based on \$1,500 and education credits based on \$1,600 (\$400 for each month between September and December). The total

*Cont'd on Next Page*

### TOPICS

### PAGE

Tax Planning for Students .....	1
Tax Planning Cont'd .....	2-3
Congratulations! .....	3
Financial Clutter: What to get rid of.....	4
Mortgage Rates .....	4

*Cont'd from First Page*

tax credit available to Mario on his 2002 tax return is based on a total of \$3,100 (\$1,500 plus \$1,600). What does this \$3,100 amount do for Mario? The \$3,100 amount will provide a federal tax credit of \$496, which is calculated as \$3,100 x 16 percent (most non-refundable tax credits are calculated as 16 percent of some base amount). Mario's province will also offer tuition and education amounts to add to this federal credit. There are some common misunderstandings that evolve from these tax rules. First, what if Mario did not pay for his own education and received some assistance from his parents? Many believe that his parents are then entitled to the tax credit since they are the ones who paid for the education. This is not the case. For tax purposes, Mario is entitled to the credits first, not his parents (who paid the fees). A second misunderstanding, which arises frequently, is that students may not stand to benefit from the tuition and education credits because, in many cases, they do not earn enough to be taxable and to be able to use the credits. The question then arises: What is the purpose of this credit?

### **Transfer or Carry Forward Unused Credits**

An important feature of the tuition and education amounts is that the student is able to transfer his or her unused portion of the amounts. Before a student can transfer any credits, he or she must use all or the portion of the credits necessary to reduce income taxes to zero. If there are credits left over after that, then they may be transferred to a parent, grandparent, spouse, or common-law partner. It would seem only fair that the unused credits should be transferred to the individual who paid for the education, although this is not a requirement.

It is important to note that the maximum amount that may be transferred to a parent, grandparent, spouse, or common-law partner is \$5,000 less whatever amount the student claimed to reduce income taxes to zero. You should be aware that the tuition and education amounts required to reduce income taxes to zero may differ federally and provincially. That is, the tuition and education amounts claimed by the student for federal tax purposes might be different than for provincial tax purposes. These calculations are done separately now that the provinces calculate taxes based on taxable income, and not simply as a percentage of federal tax as they used to. Any unused federal and provincial tuition and education amounts can be transferred to an eligible individual. Rather than transferring tuition and education amounts to an eligible person, the student has the option to carry forward his or her unused tuition and education amounts for up to five years, and to claim those amounts in a future year. Before the student decides to carry these amounts forward, he or she should remember that credits that are carried forward cannot be transferred to anyone in the future. In Mario's case, if he decides to carry his unused credits to next year, he will not be able to transfer those credits to his parents next year. If a student decides to transfer the amounts to someone else, he or she should not transfer more than the parent, grandparent, spouse, or common-law partner needs to reduce his or her federal and provincial income taxes to zero. The credits will go to waste in this case. The student would be better off carrying forward those excess credits for use in a future year.

*Note: In Quebec, tuition fees qualify for a 20 percent non-refundable credit for 2002 and while there is no education credit, the parents are entitled to a higher non-refundable credit for student dependants and other dependants. Also, Quebec does not allow the transfer of unused tuition fees to the parent. Unused tuition fees can only be carried forward and claimed in future years.*

### **Student Loans**

Students who have accumulated student loans may be entitled to a credit for interest paid on the loans if the loan is made under the Canada Student Loans Act or equivalent provincial programs. The credit is a 16 percent non-refundable tax credit available to students and former students and is calculated based on interest paid in the year or any of the five preceding years on an outstanding student loan. There is also a credit that can be claimed against provincial taxes. However, unlike the other credits discussed earlier, the credit for interest on student loans can only be carried forward (if not used in the current year) and cannot be transferred to any other individual. Students and former students will often consider consolidating their debts at their local bank in order to reduce their overall interest rate on all of their loans that they may have outstanding. The problem?

The consolidated debt may not qualify for the interest credit since the loan must fall under the Canada Student Loans Act or provincial program in order for the interest to qualify for the credit. So before you decide to consolidate your debt, you should compare the interest rate on your consolidated loan with the effective interest rate, after the interest credit, on your student loans. Finally, student debt should generally be paid off after other debt that may not provide a tax deduction or credit. The credit offered on qualifying student loans will effectively reduce the cost of that debt, making this type of debt more acceptable than many other loans.

*Note: In Quebec, the non-refundable tax credit for interest paid on a student loan is 20 percent for 2002. The interest paid in the year must be for a loan received under a federal or Quebec student loan program. Similar to the federal credit, any unused interest credits can be carried forward to a future year.*

### **Moving Expenses**

Students are able to claim a deduction for costs associated with moving to school or moving back home from school, provided the move is at least 40 kilometres and the student has income from the new location. For example, if you move more than 40 kilometres to go to school, any moving expenses can be claimed only against any income earned while at school, which can include scholarships, fellowships, bursaries or grants received in the year. Students moving from school to another location for employment (greater than 40 kilometres) may claim moving expenses against any income or self-employment income earned in the new location. Where moving expenses cannot be claimed in the year of the move due to a lack of sufficient income in the new location, those costs may be carried forward and claimed in the following year where sufficient income to claim the expenses is earned in that following year.

### **Ways to Pay for Education**

There are five general ways to pay for an education (taken from Tim Cestnick's book *Winning the Education Savings Game*): Begging, borrowing, stealing, sweating, and saving. *Begging* involves obtaining free money in the form of scholarships, bursaries, grants, and the like. *Borrowing* involves applying for student loans from the government, or from other sources. *Stealing* involves taking money from RRSPs, or liquidating other assets to pay for an education. *Sweating* involves the student working while attending school to help pay for that education. Finally, *saving* involves setting aside money today for an education in the future. Here are a few common ways to pay for an education:

### **Scholarships, Bursaries and Fellowships**

If you are fortunate enough to receive some educational assistance in the form of a scholarship, bursary or fellowship, there are tax implications. First, these types of income are taxable and must be reported on your tax

return. The good news, however, is that there is a \$3,000 (\$500 prior to 2000) exemption, which means that the first \$3,000 received from a scholarship, bursary or fellowship is tax-free. This is great news for students who hope to pay for an education partly with these awards. Visit [www.studentawards.com](http://www.studentawards.com) as a starting place to find these awards.

### Research Grants

A research grant is money received during the year to help pay for expenses to carry on research or similar work. Unfortunately, the grant does not qualify for the \$3,000 exemption. However, expenses associated with the research can be claimed against any research grant received and only the amount received in excess of the expenses incurred to carry out the research is taxable. Normally, deductible expenses include those necessary to carry out the research such as equipment and supplies, provided the expense was incurred in the year the grant was received, the year prior to receiving the grant, or the year after.

### Salary or Wages from a Business

If a family member owns a business, it may make sense for them to pay a reasonable salary or wage to the student to help pay for his or her education. This makes most sense when the salary or wage paid remains below the child's personal tax credits. The federal basic personal amount for 2002 is \$7,634. The student can earn this amount, plus any tuition or education amounts being claimed for the year, without paying any taxes. Back to our first example, Mario has tuition and education amounts totaling \$3,100. Therefore, if Mario were to earn a salary or wage from a family business, he could earn up to \$10,734 (\$7,634 plus \$3,100) in 2002 without paying any taxes on those earnings.

### Loans from a Corporation

A parent who owns a corporation can use that corporation to help pay for a child's education. Here's how: The corporation can make a loan to the student. Since the student does not act at arm's-length with the corporation, the full amount of the loan will be included in the student's income. If the student's total income, including the amount of the loan, is less than the combined basic personal amount and tuition and education amounts, then the student will not have to pay tax. Further, once the student begins earning an income and repays the loan back to the corporation, the student will be entitled to a deduction to reduce taxes owing. Therefore, the student may pay little or no tax when the loan is granted, and can claim a deduction when the loan is repaid and the student is earning an income and could use the deduction – a double benefit!

### Loans from the Government

The federal and your provincial government offer loans to students who need assistance to pay for a post-secondary education. Certain criteria must be met to qualify for loans, but this option may make sense where paying for that education will otherwise be difficult. The student should visit the educational institution to apply for loans from the government. You may also want to contact your provincial student loans office.

### Lifelong Learning Plan

The Lifelong Learning Plan (LLP) is a program that allows you to withdraw up to \$10,000 per year to finance full-time training or education for yourself, your spouse or common-law partner. You can withdraw from your RRSP for up to four consecutive calendar years, as long as the student continues to meet the LLP conditions every year and the total withdrawals do not exceed the LLP limit of \$20,000. Normally, withdrawals from your RRSP are taxable in the year received; however under the LLP program, money

is received tax-free. Of course, in order to avoid having this income taxed to you in the future, you will be required to repay the money withdrawn from your RRSP over a 10-year period, with your first payment due no later than the first 60 days of the 6th year after your first withdrawal. While this option may not be practical for most 18-year-old students beginning school since most do not likely have RRSPs, it may be worthwhile for those who are pursuing an education at an older age than a traditional student.

### Registered Education Savings Plans

Registered Education Savings Plans (RESPs) are a great way to systematically save for an education. One of the main reasons for their popularity is that contributions for an eligible child to an RESP will give rise to the Canada Education Savings Grant (CESG). The available CESG is 20 percent of any contribution, up to a maximum of \$400 for each calendar year. The maximum contribution to an RESP on a calendar year basis is \$4,000 for each beneficiary, with a lifetime contribution limit of \$42,000 per beneficiary. Therefore, the first \$2,000 of contributions for each year will attract the maximum grant ( $\$2,000 \times 20\% = \$400$ ). Over time, the contributions, CESGs, and accumulated income inside the plan (which grow tax-deferred) could generate the funds required to pay for a student's education. When the student (beneficiary) is enrolled as a student in a qualifying educational program at a post-secondary educational institution, payments can begin out of an RESP. These payments are referred to as Educational Assistance Payments (EAPs). Each EAP from the plan will include a portion of the grant that was paid into the RESP. Once the student begins taking EAPs from the plan, they will be required to report income on his or her tax return. Only the income earned in the RESP over the years is taxable. The contributions, including the CESGs, are not taxed when withdrawn by the student. The good news? There may be very little or no tax to pay on the EAPs if the student has little or no other income.

*Canadian provinces and territories impose their own tax rates in addition to the federal tax rates. Therefore, depending on where an investor lives, that individual's tax rate may differ from any examples shown. The content of this article is for informational purposes only and in no way should be construed as tax advice. Please consult a professional tax advisor for tax advice related to your specific situation.*

## Client News

Congratulations to Charlie Young and his **Nothin' Dragon**

Dragonboat team on their recent win at the International

competition they attended in Kent, Washington.

Charlie's team, consisting of 20 paddlers, a

steer person, and a drummer took home

the gold medal.



*Congratulations Charlie!*

## FINANCIAL CLUTTER: WHAT TO KEEP AND WHAT TO GET RID OF

### KEEP TILL WARRANTY EXPIRES OR CAN NO LONGER RETURN OR EXCHANGE

- SALES RECEIPTS (Unless needed for tax purposes and then keep for 7 years)

### WHAT TO KEEP FOR ONE MONTH

- ATM PRINTOUTS (When you balance your cheque book each month throw out the ATM receipts)

### WHAT TO KEEP FOR ONE YEAR

- PAYCHEQUE STUBS (You can get rid of them once you have compared to your T4)
- UTILITY BILLS (You can throw out after one year, unless you are using these as a deduction like a home office – then you need to keep them for 7 years after you've filed that tax return)
- CANCELLED CHEQUES (Unless needed for tax purposes and then you need to keep them for 7 years)
- CREDIT CARD RECEIPTS (Unless needed for tax purposes and then you need to keep them for 7 years)
- BANK STATEMENTS (Unless needed for tax purposes and then you need to keep them for 7 years)
- QUARTERLY INVESTMENT STATEMENTS (Hold on to until you get your annual statement)

### WHAT TO KEEP FOR 7 YEARS

- INCOME TAX RETURNS (Please keep in mind that you can be audited by the CCRA for no reason up to 7 years after you filed a tax return. If you omit 25% of your gross income that goes up to 6 years and if you don't file a tax return at all, there is no statute of limitations.)
- MEDICAL BILLS AND CANCELED INSURANCE POLICES
- RECORDS OF SELLING A HOUSE (Documentation for Capital Gains Tax)
- RECORDS OF SELLING A STOCK (Documentation for Capital Gains Tax)
- RECEIPTS, CANCELED CHEQUES AND OTHER DOCUMENTS THAT SUPPORT INCOME OR A DEDUCTION ON YOUR TAX RETURN (Keep 7 years from the date the return was filed)
- ANNUAL INVESTMENT STATEMENT (Hold onto 7 years after you sell your investment)
- RECORDS OF SATISFIED LOANS

### WHAT TO HOLD WHILE ACTIVE

- CONTRACTS
- INSURANCE DOCUMENTS
- STOCK CERTIFICATES
- PROPERTY RECORDS
- STOCK RECORDS
- RECORDS OF PENSIONS AND RETIREMENT PLANS

- PROPERTY TAX RECORDS DISPUTED BILLS (Keep the bill until the dispute is resolved)
- HOME IMPROVEMENT RECORDS (Hold for at least 7 years after the due date for the tax return that includes the income or loss on the asset when it's sold)

### KEEP FOREVER\*

- MARRIAGE LICENSES
- BIRTH CERTIFICATES
- WILLS
- ADOPTION PAPERS
- DEATH CERTIFICATES
- RECORDS OF PAID MORTGAGES

\*These documents should be kept in a very safe place, like a safety deposit box.

## Mortgage Rate Update (as of September 1, 2003)



*Lender/Broker fee may apply to non-traditional applications*

*Mortgage rates quoted for first mortgage as of  
September 1, 2003*

Term	Posted Bank Rates	Our Best Rates
<b>6 MONTHS</b>	5.30%	4.30%
<b>1 YEAR</b>	4.55%	3.55%
<b>2 YEARS</b>	5.00%	4.00%
<b>3 YEARS</b>	5.65%	4.35%
<b>4 YEARS</b>	6.10%	4.85%
<b>5 YEARS</b>	6.55%	5.10%
<b>7 YEARS</b>	7.25%	5.55%
<b>10 YEARS</b>	8.00%	5.99%

Mortgage rates provided by  
Karen Hall, Invis Financial Group