Financing Your Child's Education

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It shouldn't come as news to anyone that the cost of post-secondary education has risen dramatically in recent years and is likely to continue to climb. The cost of university tuition has more than doubled in many provinces over the past decade, leaving many families wondering whether post-secondary education for their children is out of their financial reach.

Fortunately, there is help available in the form of registered plans which allow parents to save for their children's education on a tax-deferred basis, matching grants to boost those savings, tax credits for tuition and associated costs, and a deduction for interest costs incurred on student loans, as well as a tax exemption for scholarship income.

Getting started

As with saving for retirement, the operative phrase is "the sooner the better". Starting early has two benefits – more years in which to save, and a longer period over which those savings can grow through compounding. The most tax-beneficial way to save is through a registered education savings plan (RESP).

What is an RESP?

Most taxpayers are familiar with registered retirement savings plans (RRSPs). RESPs work in much the same way, but with a few differences. Simply put, RESPs offer a way for families to save for education on a tax-deferred basis. Unlike RRSP contributions, no deduction is allowed for contributions made to an RESP, but income earned by plan contributions is not taxed as it accumulates. Once the beneficiary of the plan enrolls in post-secondary education, withdrawals of income earned inside the plan and withdrawn to pay for that education are taxed in the hands of the student, and not those of the original contributor. Withdrawals of original contributions, though, are not taxable. Finally, the federal government will augment contributions made to an RESP through its Canada Education Savings Grant (CESG) program.

How much can I contribute?

Most RESPs are established for children by their parents or grandparents, but there is no actual requirement that the contributor and the beneficiary of an RESP be related. For each beneficiary, the lifetime limit on the amounts that can be contributed to RESPs is $50,000. There is no annual limit for contributions to RESPs—if your resources allow, it is possible to contribute $50,000 per beneficiary up front so as to take full advantage of the tax-free accumulation from the start. However, consult with your professional adviser in this regard because the advantage regarding tax-free accumulation on the full $50,000 from the start has to be weighed against the loss of government contributions (see below) that are based on annual contributions. Since income earned by plan contributions is not taxed as it accumulates, amounts contributed to the plan can benefit from tax-free compounding for many years.

RESP contribution limits

Maximum lifetime contribution per beneficiary of $50,000

What is a CESG?

Where contributions are made to an RESP, the federal government has agreed, through its Canada Education Savings Grant program, to augment those contributions with a grant equal to 20% of the first $2,500 in contributions made in a year. Therefore, the maximum annual grant which may be obtained is $500. Any CESG amounts received are non-taxable, and as with the original contributions, are allowed to compound within the plan tax-free.

CESG amounts

- *20% of first $2,500 in contributions made during the year*
- *Maximum annual grant per beneficiary of $500*
- *Maximum lifetime grant per beneficiary of $7,200*

Withdrawal of funds

Once the beneficiary of an RESP enrolls in qualifying post-secondary education, the second major benefit of the plan comes into play – any funds withdrawn from the plan in excess of original contributions (in effect, funds arising from plan

earnings) are taxed in the hands of the beneficiary, and not those of the original contributor. Contributions originally made to the plan can be withdrawn tax-free. Since students are generally in a low (usually the lowest) tax bracket, the taxes which must be paid on that income are almost always much less than they would be if the income was taxed in the hands of the parents or grandparents, who made the original contribution. A student who has no other income could receive up to about $10,000 in RESP plan earnings in a year (or more, depending on the kinds of tax deductions and credits for which the student is eligible), before any federal or provincial tax would become payable.

What if my child decides not to go to university?

Parents who are contemplating setting up an RESP are often concerned about what will happen to their investment should their child choose not to pursue post-secondary education. Recognizing these concerns, the federal government made certain changes to the RESP rules. Those changes make it possible for funds in the RESP to be refunded to a contributor where the intended beneficiary is not enrolled in post-secondary education by the age of 21, and the plan has been in existence for at least ten years. However, any plan earnings will be taxed as income of the contributor, and not as income of the child for whom the RESP was set up. In addition, amounts earned in the plan and withdrawn will attract a surtax of 20%. Any amounts originally contributed to the plan are not taxed.

Contributing RESP withdrawals to your RRSP

In some circumstances, it is possible for amounts earned within an RESP and withdrawn by the contributor, to be transferred to the contributor's RRSP. Where the contributor has contribution room (generally, where he or she has not made a current year contribution or has not made the maximum allowable contribution in previous years), plan earnings refunded from the RESP may be contributed to his or her RRSP to the extent of available contribution room (and to a lifetime limit of $50,000). A deduction from income may also be claimed on the year's tax return.

Deferred compensation arrangements

For children born in or after 2005 to a parent resident in Alberta, the province will offer what is in effect a $500 supplement to the federal CLB grant. The Alberta grant will also be available where a child is adopted by an Alberta resident. As with the federal program, someone must open an RESP for the child. The steps to obtain the Alberta grant are: (1) register the birth or adoption of the child; (2) apply for a birth certificate; (3) apply for a SIN for the child; (4) open an RESP account with a financial institution or RESP provider; and (5) apply to Alberta for the Alberta Centennial Education Savings Plan grant. The grant is intended for newborn children, natural or adopted. Applications must be received by the time the child turns two years old (although the Minister of Learning has discretion to extend this period). There is no requirement for the RESP contributor to match the initial grant of $500 but there may be a minimum contribution required to open an RESP account. Unlike the federal program, there appears to be no rule restricting the grant to lower income families.

In addition to the $500 birth grant, grants of $100 will be available to children enrolled in school in Alberta at age 8, 11, and 14, beginning with children born in 2005. The first $100 grants will be issued in 2013. A child will not have to receive previous grants in order to qualify for subsequent grants. However, the $100 grants will require a minimum matching deposit by the contributor to the RESP of $100.

The funds will be returned to the provincial government if the beneficiary has not begun post-secondary studies within 26 years of the RESP being opened. The funds will be returned to the government if they were received by a subscriber/beneficiary on the basis of false information.

Alberta contemplates that it will work with the federal government, so that once the federal government receives notification that an individual has opened an RESP account and made a valid application for the Alberta Centennial Education Savings Plan, the grant funds should be deposited into the RESP account.

Quebec CESG supplements

Where subscribers to an RESP have made contributions (after February 7, 2007) to the RESP for 2007 or a later year for beneficiaries resident in Quebec at the end of that year, and the contribution

has attracted a Canada Education Savings Grant, Quebec will provide an additional grant of 50% of the federal grant. Note that the RESP subscriber need not be resident in Quebec, since the subscriber is receiving no tax benefit. The benefit is paid to the RESP for the benefit of the designated beneficiary.

Quebec will establish its own rules on the taxation of amounts when received by beneficiaries, and its own recapture taxes to deal with situations in which funds are withdrawn otherwise than for the intended use by the beneficiary. It is expected that these will parallel federal rules, although one cannot be certain.

In any event, the burden of compliance with the detailed rules for the application of grants will, as with federal rules, fall primarily on the plan provider. In the circumstances, where a subscriber is dealing with a non-Quebec plan provider for a beneficiary resident it Quebec, it would be wise to ensure that the provider is conversant with the Quebec rules, and will indeed obtain the available grants.

Once they get there—tax breaks for students

Students enrolled in post-secondary education can benefit from a number of deductions and credits, for both the direct costs of their education (e.g., tuition and similar expenses), and for "incidental" costs incurred along the way (e.g., costs incurred in moving to take a summer job).

What fees qualify as tuition fees?

University and college students pay a variety of fees for the services provided to them, but not all of those fees qualify as tuition for purposes of the tuition tax credit. The division between qualifying and non-qualifying fees looks like this.

Qualifying Fees

- Fees paid for admission
- Fees paid for use of the library or laboratory
- Examination fees
- Computer service fees
- Diploma fees
- Mandatory athletic or health services fees

Non-qualifying fees

- Student association fees
- Cost of books
- Medical care
- Meals and lodging
- Transportation and parking

Tuition fee credit

Students enrolled in qualifying programs are entitled to claim a tuition fee credit which reduces tax otherwise payable, on both their federal and provincial tax returns. The federal credit is equal to 15% of tuition paid. The provincial credit percentage will vary, depending on the student's province of residence, but generally ranges from 6% to 11%. In order to be eligible for the credit, courses must be taken in the year, and tuition paid must be greater than $100.

- Education and textbook tax credit
- Federal and provincial credits available
- Credits available to both full and part-time students

Education and textbook tax credit

To receive the education tax credit, a student, whether full-time or part-time, must be enrolled in a qualifying educational program (for full-time students) or a specified education program (for part-time students) at a designated educational institution. As is always the case in tax matters, all of those terms have specific definitions. The definition of a designated educational institution for purpose of the education tax credit is the same as that used for purposes of the tuition tax credit.

Both full-time and part-time students may claim the education amount. Full-time students, in order to claim an amount of $400 for each month of qualifying full-time attendance, must be enrolled in a qualifying educational program – one that lasts at least three consecutive weeks and requires a minimum of 10 hours of instruction or work each week. Where a student is enrolled part-time, he or she must be enrolled in a specified educational program – one that lasts a least three consecutive weeks and requires at least 12 hours of instruction per month. A part-time student who fulfills those requirements can claim an education amount of $120 for each month of qualifying attendance.

Students who are eligible for the education amount can also claim what is termed a "textbook" amount. The name is misleading, as the amount has nothing to do with the cost of textbooks, and in fact, there is no requirement that any textbooks be acquired. The amount is simply an enhancement to the education amount, under which full-time students are permitted to claim an additional $65 and part-time students an additional $20 for each month of qualifying attendance.

As is the case with nearly all non-refundable federal individual credits, the amounts claimed are converted to a credit by multiplying by 15%.

As announced in the 2016 federal Budget, the Education and Textbooks Tax Credits will be eliminated in 2017.

Just what is "post-secondary" education?

Given the range of education options available following high school, it's not surprising that there is often confusion about what types of programs will or will not qualify for specific tax credits. Generally, tuition fees paid to a university or college in Canada will qualify for the tuition fee credit. To qualify for the education and textbook credits, a student must be attending a "designated educational institution". Although the institutional criteria for the tuition and education and textbook credits are therefore not identical, it is generally true that most programs or institutions that qualify for one will also qualify for the others.

Transferring the credits to someone else

Tax credits work by reducing the amount of tax which would otherwise be payable by the taxpayer claiming the credits. Since students are often in the lowest tax bracket, it is entirely possible that the tuition and education tax credits claimable by them, when combined with other available tax credits, will exceed the amount of tax which they actually have to pay. In that event, there are two options.

The first is for the student to transfer the credit to another taxpayer, either a spouse, parent or grandparent. The second is for the student to retain the credit for carryover to a future year in which income (and tax payable) will presumably be higher and the tax credit can therefore be utilized. The education, tuition, and textbook tax credits are all transferable.

The mechanics of transferring tuition and education credits

Detailed rules apply to determine any credit amounts which may be transferred and the order in which the transfers can take place. Initially, the student must claim any available credits to the extent necessary to reduce his or her tax to zero. Credit amounts remaining once the student's tax payable is zero are then available for transfer. The maximum amount which may be transferred is $5,000 of combined tuition, education and textbook tax credit amounts.

In situations where a student is married, and the student's spouse (legal or common-law) claims the spouse or common-law partner amount, or any other of the student's transferable tax credits are transferred to the spouse, then no transfer of education or tax credits to a parent or grandparent is possible. If the student is not married, or is married but the student's spouse does not claim any of these amounts, excess tuition, education and textbook tax credits may be transferred to a parent or grandparent. There is no requirement that the student be a dependant of the person to whom the amounts are transferred.

Amounts left after the student has reduced his or her tax to zero, and any other available transfers have taken place, may be carried forward by the student to be claimed in any future year against tax payable in that year. Such carryforward amounts may be claimed only by the student, as the transfer of carryforward amounts is not permitted.

Tax treatment of scholarship income

Over the past few years, the federal government has, to an increasing degree, exempted scholarship income from tax. As a result, scholarship income received after 2005 for qualifying post-secondary education programs (generally, all programs that would qualify for the education tax credit) is tax exempt.

The exemption from income tax for shcolarships was expanded to cover scholarships received in respect of elementary or secondary education, effective for the 2007 and subsequent taxation years.

Funds withdrawn from RESPs, at any time, are not considered scholarship income and, consequently, do not qualify for the exemption.

2010 Budget restrictions re: Scholarship Exemption and Education Tax Credit

Please note that, effective for the 2010 and subsequent taxation years, the scholarship exemption for post-secondary scholarships, fellowships, and bursaries will be narrowed for post-secondary programs that consist primarily of research. For these programs, the education tax credit and the scholarship exemption will be available only if it leads to a college diploma, bachelor, masters, doctoral, or equivalent degree. Therefore, post-doctoral fellowships wil be taxable.

Moving expense deduction

In the course of their post-secondary education, students typically do a lot of moving – moving to attend school, moving to take a summer job, and back to school in September. In some cases, the costs incurred in doing all that moving are deductible. Where a student moves to take a summer job (even if they are moving back to their parent's home), the cost of that move is deductible from income earned at that job, as long as the move brings the student at least 40 kilometers closer to the job.

Before 2006, students who moved to attend school could deduct the cost of such a move (assuming that the 40 kilometre criterion was satisfied) from any taxable scholarship income received in respect of that school program. However, as scholarship income is no longer taxable, that deduction is no longer available.

Once they're finished—paying it off

Few students manage to complete their post-secondary education without incurring at least some debt. Students may claim a tax credit (15% federal credit and a varying provincial credit) for interest paid on qualifying student loans. To be eligible for the credit, the interest must have been paid on a loan made under, generally, government student loan programs such as the *Canada Student Loans Act*. There is no limit on the amount of interest paid for which a credit can be claimed, and any credits generated but not used in a year may be carried forward and claimed in any of the subsequent five years.

A note of caution – only interest paid on government student loans is eligible for the credit. Interest paid on a loan or line of credit from a financial institution, even if used to finance post-secondary education, will not be eligible for the credit. In addition, where government student loans are consolidated with such commercial loans (perhaps to obtain a favourable interest rate), the interest credit which would have been available in respect of interest paid on the government student loan will be lost. In effect, the mixing of the government and non-government loans will "taint" the government student loan, such that eligibility for the interest credit is lost. Students contemplating such a consolidation loan should consider whether any expected benefits will be sufficient to compensate for the loss of the tax credit for interest paid on the government student loan portion of their debt.

Conclusion

The total cost of a post-secondary education, when looked at as a lump-sum figure, can seem overwhelming, and no one would claim that getting such an education is not one of life's major expenditures. However, by making use of available tax-assisted education savings plans, maximizing available government grants, and ensuring that every possible tax deduction, credit and benefit is claimed by the student and his or her family, it is possible to make post-secondary education plans a realizable goal.

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