

# THE ABACUS

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## Students and Income Tax – Making the Most of Your Education Dollar

With Labour Day less than a month away, summer jobs will be winding up and university students will begin to prepare for the return to school. Frequently, for them (and their parents), September means an onslaught of bills for tuition fees, residence or rent deposits, moving costs and new textbooks. Each new school year means incurring thousands of dollars in education and education-related costs. Fortunately, many of those costs can be offset by tax credits or deductions, and changes introduced in this year's federal budget have increased somewhat the level of tax assistance available.

Probably the most significant tax break available to students comes from the federal tuition and education tax credits. The federal tuition tax credit provides post-secondary students with credit against federal income tax equal to 15.25% (for 2006) of tuition amounts paid during the year. The credit can be claimed by the student in the year in which the tuition is paid, can be transferred to one of a number of other taxpayers, including the student's spouse, parents or grandparents, or can be carried forward to be claimed by the student in a future year. Assuming an average annual undergraduate tuition bill of \$5,000, the federal credit would result in a tax reduction for 2006 of \$763. A concurrent credit against provincial/territorial tax payable is also available, with the percentage amount of the credit depending on the student's province or territory of residence.



The other major credit available to post-secondary students is the education tax credit, which provides both full and part-time students with a non-refundable credit based on the number of months of the year during which they are attending school. For full-time students, the monthly "education amount" on which the credit is calculated is \$400, and for part-time students the monthly amount is \$120. In all cases, the total education amount is multiplied by 15.25% (for 2006) to arrive at the actual non-refundable tax credit. Therefore, a student who attended university or college for 8 months during 2006 on a full-time basis would be able to reduce federal taxes payable by \$488. ( $8 \times \$400 \times 15.25\%$ ). As with the tuition tax credit, the education credit may be claimed for the year by the student, or transferred to a spouse, parent or grandparent, or the credit may be carried forward to be claimed by the student in a future

taxation year. Once again, a concurrent provincial/territorial credit is available, at varying rates.

While tuition is usually the major expense faced by post-secondary students (and their parents), it's far from the only one. Textbook costs have risen dramatically in recent years, and the federal government has responded by introducing, in this year's federal budget, the "textbook tax credit". The name is, in truth, something of a misnomer, as the amount of the credit is not tied in any way to the cost of textbooks, nor does it seem to be necessary that any textbook purchase actually be made. The explanatory notes issued by the Department of Finance with the budget simply indicate that students who are eligible for the full-time education tax credit amount may also claim a "textbook tax credit amount" of \$65 for each month of full-time study, while students who qualify for the part-time education amount may claim a "textbook tax credit amount" of \$20 per month for each month of part-time study. As with the tuition and education tax credits, the textbook tax credit amount is multiplied by 15.25% (for 2006) to arrive at the actual tax credit. A full-time student who attends a qualifying program for 8 months during 2006 would therefore be able to reduce federal taxes payable by \$79. ( $\$65 \times 8 \times 15.25\%$ ). Textbook tax credits earned may also be carried forward to be claimed in a future year by the student, or may be transferred in accordance with the general rules governing the transfer of tuition and education tax credits earned.



Most post-secondary students move at least twice a year, and co-op students move even more often. Where a student moves to be at least 40 kilometres closer to a job (including a summer job), the costs of that move are deductible from income earned at that job, and should be claimed on the student's tax return for the year.

Finally, scholarship or bursary income received by post-secondary students has always received favourable tax treatment, in that the first \$3,000 of such income was not taxable. That rule still applies for scholarship or bursary income received prior to 2006. However, this year's federal budget changed the tax treatment of scholarship and bursary income by providing that all such income received after 2005 would be exempt from federal tax. In order to qualify for the tax exemption, such scholarship or bursary income must be received in connection with a post-secondary program which qualifies for the education tax credit. Virtually all post-secondary university and community college programs in Canada would qualify.

The Canada Revenue Agency publishes a very useful pamphlet entitled Students and Income Tax (P105), and that pamphlet is available on the Agency's website at <http://www.cra-arc.gc.ca/E/pub/tg/p105/README.html>

Unfortunately, the publication has not yet been updated to incorporate the changes brought about by this year's budget announcements: notwithstanding, it provides a good outline of those aspects of our income tax system of particular relevance to students.

## Tax Instalments - Who Pays And When?

Over the next few weeks, millions of Canadian taxpayers will receive "Instalment Reminders" from the Canada Revenue Agency (CRA), suggesting that they can make instalment payments of tax on September 15 and December 15 of this year, and setting out amounts to be paid on each date. Such notices can create a great deal of confusion and concern for taxpayers (especially when they are received for the first time) and much uncertainty as to the right course of action to follow. While it's true that the rules governing tax instalments can be complex, the basic rules governing who pays instalments and the calculation of payment amounts are relatively straightforward.



The majority of Canadian taxpayers may never receive an instalment reminder. That's because taxpayers who work as employees have tax deducted from their paycheques by their employers and remitted to the CRA on their behalf. At the end of the tax year a T4 is issued to the employee indicating the amount of tax which the employee has paid over the course of the year, and the employee reports that amount on his or her tax return for the year.

The issue of instalments comes up where a taxpayer receives income from which no income tax has been deducted - usually this would be income from self-employment, investment income, rental income or some types of pension income. Any taxes owed on such income will, of course, be due and payable by the taxpayer on April 30 of the following year, but the CRA is disinclined to wait until then for its entitlement. Instead, such taxpayers may be subject to instalment requirements.

The CRA determines who must make instalment payments by comparing each taxpayer's total tax owed for the year to the amount which must

be remitted when the return is filed. In other words, the Agency looks at how much tax remains to be paid at tax filing time. If that amount is more than \$2,000 for the current year and *either* of the two previous years, then an instalment reminder will be sent to the taxpayer.

Taxpayers who receive an instalment reminder have two basic options open to them. The simpler (and safer) option is to pay the amount outlined on the instalment reminder - the so-called "no calculation option". If a taxpayer pays the amount suggested by the CRA by the due dates, there will be no penalties or interest assessed in respect of those payments, even if the amounts turn out to be insufficient and a balance is owed on filing.

If the taxpayer thinks that the amounts identified on the instalment reminder are out of line with what his or her actual tax liability for the current year will be, he or she can calculate a different amount of instalment payment to make. That calculation can be based on the previous year's tax liability - a useful approach where income and deductions for the current year will be very similar to those of the immediately prior year. Or, where the current year's income will change significantly from that of the previous year, and the amount of that income is known, the taxpayer can calculate the income taxes which will be payable on the current year's income and base instalment payments on that figure. The risk with these approaches is that, should the amount of instalment payments made turn out to be insufficient, and a balance is owed on filing as a result, the CRA will charge interest (at a rate in excess of current commercial rates, and with interest charges compounded daily) on any shortfall and may impose a penalty. A penalty is imposed only where instalment interest charges for the year exceed \$1,000.



Where the CRA sends an instalment reminder to a taxpayer, the package includes copies of Form INNS3 Instalment Remittance Form. Using that personalized form, the taxpayer can pay income tax instalments at any chartered bank branch in Canada, or can send the funds (via cheque or money order, never cash) to the CRA at an address provided on the instalment reminder. It

is also possible to make such payments through the Internet or telephone banking facilities of many financial institutions. Finally, taxpayers who make regular instalment payments in the amount suggested by the CRA may choose to have those payments automatically debited from their bank account. The CRA provides a form, T1162A (available on the Agency's website at <http://www.cra-arc.gc.ca/E/pbg/tf/t1162a-1/README.html>) which may be used to set up such an arrangement.

Regardless of the method of payment, the due dates for such payments are the same. Instalment payments of tax are due on the 15<sup>th</sup> day of March, June, September and December, and the CRA will levy interest on any late or insufficient required payments. Taxpayers who, through error or omission, underpay an instalment or are late with a payment may reduce or eliminate such interest charges by overpaying the next instalment or making the next instalment payment early.

The CRA publishes a detailed guide to income tax instalments - P110, Paying Your Income Tax by Instalments - which answers many of the questions taxpayers frequently have about tax instalments. That guide can be found on the Agency's website at <http://www.cra-arc.gc.ca/E/pub/tg/p110/README.html>



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