



CESTNICK

TAX MATTERS

Education's pricey. But paying your kids can help ease the burden

School season is upon us again. My kids are very excited – which is good. Among the possible reasons for their enthusiasm, their school is offering sport-specific training from high-level coaches (which my son loves) as part of its athletics program, a new gym floor was installed last year, the music and theatre program is expanding, and the list goes on.

This all costs money, of course.

At a parent meeting the other night, the principal spoke about all that was going on. “I have good news and bad news,” he began. “The good news is that we have enough money to pay for our new programs. The bad news? It's still out there in your pockets.”

He was joking – really. But let's face it, education can be expensive – whether it's private elementary school or postsecondary education.

Today, I want to share a couple of ideas that make it easier to pay those costs. These ideas speak to the value of self-employment in tax planning.

PAY WAGES

Whether you're self-employed full time, or create a part-time, home-based business, you can pay wages to your children to help in the business.

They might be cleaning, stuffing envelopes, helping at trade shows, or performing other duties. You'll be entitled to a tax deduction against your business income for reasonable wages paid to your children.

As long as your child's income is under \$10,320 in 2009, he won't pay any tax, thanks to the basic personal tax credit. That money can be used to help pay for your child's education costs. You'll effectively be deducting all or part of the cost of that education.

MAKE LOANS

If you're a business owner and you own a corporation, chances are that you've got some cash in your company that could help to pay for your child's education. If so, consider lending your child some of that money to cover education costs.

The problem? Canadian tax law is designed to limit your ability as a shareholder to take money out of your company on a tax-free basis. And subsection 15(2) of our tax law deals specifically with loans to shareholders – including loans to a child of a shareholder.

Here's what the tax law generally says: If you borrow money from your company, the amount is taxed as income, unless you meet one of the very few exceptions spelled out in our tax law. Now, a loan from your company to a child of yours to pay for an education is not one of those exceptions.

The bottom line? A loan to your child to pay for an education will be taxable in the hands of your child in the year of the loan.

My response to this: So what?

You see, an adult child (age 18 or older) who receives a loan and has little or no other income in the year will pay little or no tax on the loan amount included in income, thanks to the basic personal tax credit, tuition and education tax credits, and any other credits he may have available. So, the tax rules have little or no bite in this case.

But there's more: After your child graduates and is working full time, he can repay that loan to your company, and will receive a tax deduction for those repayments at that time. That's right, subsection 20(1)(j) of Canadian tax law will allow a deduction when the loan is paid back. And let's face it, that deduction will come at a time when your child will be earning an income and looking for tax relief.

Keep a couple things in mind if you're going to implement this strategy.

First, your child must be an adult for the idea to work. If he has not yet reached age 18, special rules in subsection 120.4(2) of our tax law will cause your child to pay tax

at the highest rate on that loan, with no offsetting tax credits.

Second, this is a loan from your company, so the amount will not be deductible by the company, unlike salary or wages paid to your child.

Finally, your child may face a taxable-interest benefit on the outstanding loan each year at the prescribed rate (currently just 1 per cent).

Still, a potentially tax-free payment made to help with your child's education, plus a deduction for your child when (and if) the loan is repaid – I'll take those tax savings any day.

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