TAXADVISOR

No Credit

Statutes, not purpose, determine student loan eligibility

COURT REPORT

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As tax season begins, the issue of interest deductibility comes once again to the top of mind of both tax advisors and their clients.

Just over a decade ago, the tax law changed so that the interest expense on student loans, while not actually tax-deductible, became eligible for federal and provincial non-refundable tax credits, which combined, can be worth approximately 25% (the amount varies by province/territory).

But as a recent tax case shows, the rules on what interest qualifies for the credit are somewhat confusing for some students.

Under the *Income Tax Act*, to be eligible for the credit, the interest must be paid, either by the student or by someone related to the student, 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 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.

A case (*Wilkins v. the Queen, 2009 TCC 61*) decided in late January, 2009, involved Darren Wilkins and whether he was entitled to the tax credit in relation to interest paid on a bank line of credit that was arranged to provide him with assistance while he was attending Confederation College.

In addition, Wilkins received a separate student loan that was made under the *Canada Student Loans Act* for which he was allowed a tax credit for the interest paid on that loan.

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Wilkins argued even though the bank line of credit was not a loan made under one of the statutes listed above, nonetheless "the purpose of the loan was the same as the loan that... [he] had... [obtained]... under the *Canada Student Loans Act*."

The judge disagreed, stating that the Tax Act was quite specific in its wording and did not simply specify a "purpose test" but rather that the credit is only available in circumstances where it was obtained "under one of the statutes listed or described in that section [of the Tax Act"].

This case mirrors a 2003 case (*Vilenski v. the Queen, 2003 TCC 418*) in which MBA student Tal Vilenski received various student loans, including a loan under the *Canada Student Loans Act* [the "qualifying loan"]. Vilenski later 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 nearly $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 eligible for the tax credit. The CRA denied the tax credit because the interest paid on the line of credit was not technically paid on a qualifying loan.

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 denied the interest expense credit, explaining that the Tax Act says interest is deductible when it is paid on a loan which is made "under" the *Canada Student Loans Act.*

So, the lesson is clear: Students should take the time to do the math before immediately refinancing a student loan. Whether it makes financial sense to do so will depend on the interest rate differential between the qualifying and non-qualifying loans versus the loss of the approximately 25% non-refundable federal and provincial tax credits. AER

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