PERSONAL Newsletter

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Tax Planning for Post-Secondary Education

Registered Education Savings Plans ("RESPs")

An RESP is a tax-deferred plan that incentivizes individuals to accumulate savings to provide for the post-secondary education of named "beneficiaries" — typically, the individual's children or grandchildren. There are, however, no relationship requirements imposed as between the contributor and beneficiary, so that you may set up an RESP for any relative or deserving beneficiary, including yourself. An RESP beneficiary must be a Canadian resident who has a Canadian Social Insurance Number.

The benefits of an RESP include:

- tax deferral, in that income earned on the (non-deductible) contributions you make to the plan is not subject to tax as it is earned; accordingly, income accumulates more rapidly in the plan than it would if you earned normally outside the plan;
- income splitting, in that when amounts are paid out of the plan for the post-secondary education of a beneficiary, they will be taxed to the beneficiary, whose tax bracket is typically lower at that time than the contributor's tax bracket; and
- incentive grants, in that the government will match contributions with 20% grants paid to the plan on contributions of up to $2,500 per year.

As a contributor (subscriber) to an RESP, you are not entitled to a deduction in respect of your contribution; however, the interest income (or other investment income) earned in the plan on your contribution is not taxed in your hands. Rather, the investment income earned in the plan is accumulated free of tax and will be taxed in the student's (child's) hands only when the child receives funds from the plan. There is no limit to the amount of annual contributions that can be made on behalf of a particular beneficiary. However, penalty provisions impose an overall "lifetime" per-beneficiary limit of $50,000.

Types of RESPs

RESPs are of two types: group plans and individual plans. In either case, the plan is offered under the auspices of a "promoter" who is responsible for the terms, administration, and registration of the plan, and for ensuring that the assets are maintained in a trust company. Group plans are typically more rigid, specifying a schedule of payments by the contributor and, generally speaking, controlling the investments made for the plan. Individual plans provide the contributor with greater control over investments made and the timing and amount of educational assistance payments made to beneficiaries. Group plans typically have the virtue of simplicity and more or less compulsory savings.

Also, you can open an individual plan for each child, or a single plan for the whole family. Family plans may provide more flexibility to tailor benefits to each child, although individual plans permit transfers of assets to the plans of siblings.

Use of RESP Funds

Funds accumulated in an RESP and used as intended for full-time education are subject to few restrictions. Generally speaking, an RESP is permitted to make an educational assistance payment (EAP) to an individual only if, at the time of the payment, the individual is enrolled as a student in either a qualifying educational program (which is generally a full-time program) or a specified educational program (which is a part-time program) at a post-secondary educational institution. Individuals enrolled in a qualifying educational program may receive up to $5,000 of EAPs during their first 13-week period of study. Thereafter, there is no dollar limit on the amount of EAPs. Students enrolled in a specified educational program may receive up to $2,500 of EAPs during each 13-week period of study.

What If the Beneficiary Does Not Attend School?

The benefits of RESPs must be weighed carefully, not simply in tax terms, but with an understanding of plan provisions in the event that beneficiaries do not ultimately attend designated schools within the anticipated time frame.

It is possible under these plans for the original capital contributions to be returned to the contributor, typically in the event that no related beneficiary qualifies by taking post-secondary education within the required time frame. Refunds of RESP earnings may be made to a contributor where none of the intended beneficiaries is pursuing post-secondary education by age 21 and the plan has been in place for at least 10 years. Returned earnings will be taxable income.

If contributions are withdrawn for non-educational purposes from an RESP which has received a CESG, the RESP trustee will be required to make a CESG repayment equal to 20% of the withdrawal. Grant repayment will also be required where a payment of RESP income is made for non-educational purposes, where a beneficiary is replaced (except by a sibling or a beneficiary related to the subscriber by blood or adoption), and where a plan is terminated or revoked.

RESP Grants

Canada Education Savings Grants ("CESGs")

This program is intended to create a further incentive for taxpayers to save through RESPs by providing a direct federal grant to any valid RESP equal to 20% of the first $2,500 per year contributed for each child under 18 years of age. Grants are limited to a specified annual amount. There is also an overall lifetime maximum of $7,200 of grants for each beneficiary of an RESP. The grant itself is not included in calculating the lifetime RESP contribution limit, nor in calculating annual contribution limits. Thus, where a $4,000 contribution was made in a year, the grant would provide an additional 20% of $2,500 ($500), so that the total added to the plan would be $4,500 (plus income earned in the plan).

The basic annual CESG limitation (as opposed to contribution limitations) is $500 per year, which would require a $2,500 annual contribution to the plan. Low-income families can be eligible for additional CESG amounts and the Canada Learning Bond ("CLB"). All of this being said, the RESP provider should provide you with details about the grants available to you, and make the necessary applications on your behalf.

Any child who is a Canadian resident accumulates "grant room" at a rate of $500 per year up to and including the year in which they turn 17. Grant room accumulates whether or not a child is an RESP beneficiary. You can make "catch-up" contributions to an RESP for years in which you did not maximize the CESG amounts with respect to a beneficiary. The RESP can receive up to $1,000 in CESG (by contributing $5,000) provided that the beneficiary has sufficient grant room for that year. Contributions for children aged 16 and 17 will receive a grant only if there have been contributions of at least $100 per year in any four years before the year in which the beneficiary turned 16, or if total previous contributions for the children reached $2,000 before the year the beneficiary turned 16.

If your ability to contribute to RESPs will fluctuate from year to year, you should consider deferring contributions in excess of available grant contribution room in any particular year. Excess contributions do not generate the 20% government contribution, and you might want to put aside an excess contribution in one year and contribute it in a year in which matching is assured.

If, on the other hand, you can afford to fund an RESP to the full extent of the permitted $50,000 per beneficiary, you face a similar but rather different set of considerations. Essentially, you must weigh the fact that the full $50,000 will generate a substantial tax-free return over the years of the plan against the fact that the government contribution will be largely lost. Thus, to take the extreme case, a top bracket "subscriber" who contributes for a particular beneficiary, say in the year of birth, the full $50,000 permitted (in total by all subscribers in respect of a particular beneficiary) will generate a grant of $500, but will be able to generate no grants in later years for that beneficiary. Essentially, the parent is wagering that the tax-free compound return on the $50,000 over 18 years (assuming the RESP is created at birth) will exceed the $7,200 available under the grant program.

Canada Learning Bonds

The CLB is another benefit (in addition to the CESG program discussed above) for low-income families to set up an RESP for their children. Essentially, the program provides a $500 CLB at birth for children in families that qualify based on their household income and number of children. In subsequent years, these children will qualify for $100 CLB instalments, provided that the family continues to be eligible. When you open your RESP, the provider should provide you with the option to apply for the CLB on the application form.

Provincial RESP Incentives

Many of the provinces offer additional grants for families who contribute to their children's RESP, so do ask your RESP provider what provincial incentives are available.

Other Tax Incentives

RRSP Lifelong Learning Plan

RESPs are essentially designed to assist savings on behalf of children. Recognizing that adult retraining will also be increasingly required, the government permits RRSP withdrawals for the purpose of financing full-time training or education for the plan annuitant or its spouse or common-law partner. Withdrawals may be made over a period of four years, but the total withdrawn may not exceed $20,000 over the four years and may not exceed $10,000 in any particular year.

RRSP funds may be withdrawn under the plan where the recipient (or his or her spouse or common-law partner) is enrolled as a full-time student in a qualifying educational program of at least three months' duration at an eligible educational institution. The full-time requirement will not apply to disabled students. Where funds are withdrawn prior to enrolment, enrolment must occur no later than January of the year following the withdrawal.

Withdrawals from the RRSP must be repaid commencing no later than 60 days after the fifth year following the first withdrawal. Repayments will normally be required in equal annual instalments over a 10-year period. If the student does not complete the educational program, withdrawals may be added back to income unless certain conditions are met.

Student Loans

Canada and most provinces have programs to underwrite student loans. Under Canada's program, the government pays interest on the loan while a student is in school and all payments are deferred until the completion of studies (at the earliest). Individuals repaying student loans are allowed to claim a non-refundable tax credit (calculated at the lowest marginal tax rate) on the interest portion of repayments made in the year or the five preceding years on account of student loans under the Canada Student Loans Program and provincial post-secondary student loan programs.

Tuition Tax Credit

A qualifying student who is enrolled full-time or part-time at an educational institution may deduct a tax credit equal to the lowest marginal tax rate multiplied by the eligible tuition fees paid.

Eligible tuition fees are those paid to a post-secondary educational institution in Canada or an institution certified by the Minister of Employment and Social Development as being an institution that develops or improves skills in an occupation. Also eligible for the credit are tuition fees paid to: (i) a university outside Canada if the student is in full-time attendance for courses of at least three consecutive weeks' duration and leading to a degree; and (ii) an educational institution in the U.S. for post-secondary level courses if the student lived in Canada near the border throughout the year and commuted to the school.

A student may transfer the unused portion of the tuition credit to a spouse or common-law partner, parent, or grandparent, or carry it forward for their own future use. A student may also transfer part of the unused portion of the credit and carry forward the remainder. Eligible tuition fees also include fees paid to an institution, association, or ministry for an examination required to obtain a professional status or to be licensed or certified to practice a trade or profession in Canada.