The Navigator

RBC WEALTH MANAGEMENT SERVICES

Registered Education Savings Plans (RESPs)

Establishing an RESP

With the high cost of post-secondary education, many parents, grandparents and other family members and friends recognize the need to save for education well before the expenses become a reality. That's why the Registered Education Savings Plan (RESP) is such a popular saving vehicle. Not only is the tax on funds accumulating in the plan deferred until funds are paid out, but the government will also contribute to the plan through the Canada Education Savings Grant (CESG).

This article is the first of a two-part series and covers the basics of RESPs including:

- Setting up a plan, subscriber and beneficiary designations, contribution limits, types of plans, the Canada Education Savings Grant (CESG), and RESP saving strategies

The second article, Withdrawing from an RESP and Non-Resident Issues, includes the following:

- How you can withdraw and spend the accumulated RESP savings for educational purposes and special rules regarding non-resident

What is an RESP?

An RESP is a tax-deferred savings plan designed to allow you (the subscriber or contributor) to save for a beneficiary's post-secondary education. You can name one or more beneficiaries of the plan and make contributions for them.

Some important points about RESPs

- Contributions are not tax-deductible.
- There is a $50,000 lifetime contribution limit per RESP beneficiary but no annual maximum limit.
- In-kind contributions to an RESP trigger a deemed disposition. Capital gains are taxable but capital losses are denied. This is similar to in-kind transfers to a Registered Retirement Savings Plan (RRSP).
- Contributions cannot be made to a plan at any time after the end of the year that includes the 31st anniversary of the plan (35th year for a specified plan)
- An RESP has to be closed by December 31st of the year that includes the 35th anniversary of the plan (40th year for a specified plan).
- A specified plan is a single beneficiary RESP (non-family plan) where the beneficiary is entitled to receive the disability tax credit (DTC).
- All the capital appreciation (including interest, dividends, capital gains and the Canada Education Savings Grant (CESG)) grows on a tax deferred basis.

RBC Wealth Management

- RESP contributions are eligible to receive the Canada Education Savings Grant (CESG).The government will match 20% of the first $2,500 in contributions to a maximum grant of $500 ($2,500 x 20%) per beneficiary, per year.
- RESPs are registered with the Canada Revenue Agency (CRA).

The following highlights are explained in further detail in the second article of this series on withdrawing money from an RESP:

- Once enrolled in a designated educational institution, the beneficiary is eligible to receive Educational Assistance Payments (EAP) from the plan.
- A beneficiary is entitled to receive EAPs for up to six months after ceasing enrolment, provided the payments would have qualified as EAPs if the payment had been made before the student's enrolment ceased.

EAP payments consist of:

  - Accumulated income
  - CESG
  - Canada Learning Bond (CLB)
  - Provincial programs in Alberta and Quebec.

- EAPs are considered taxable income in the name of the beneficiary, who is likely to be in a very low tax bracket.
- Accumulated earnings that are not used by a beneficiary may be paid out as an Accumulated Income Payment (AIP). An AIP can be paid to the subscriber in cash or transferred to their RRSP or their spouse's RRSP within limits.
- Original contributions can be paid out to the subscriber tax-free at any time. Original contributions can also be paid out to the beneficiary tax-free.

Who can be a subscriber?

Parents and grandparents are the most common subscribers to RESPs. There are no restrictions on who can be the original subscriber of an individual RESP but family plans do have some restrictions. See the section on family plans.

A public primary caregiver of a beneficiary under an RESP may also be an original subscriber. This may include the department, agency or institution that cares for the beneficiary; or the public trustee or public curator of the province or territory in which the beneficiary lives.

There are no restrictions on who can be the original subscriber of an individual RESP but family plans do have some restrictions.

You and your spouse or common-law partner can be joint subscribers to an RESP. You can also add a spouse to an RESP that permits joint subscribers at any time before termination of the plan.

The CRA requires that the social insurance number(s) (SIN) of subscriber(s) are included when the plan is registered. **If you are not the original subscriber, you may become the subscriber in the following situations:**

- if, on the breakdown of a relationship, you receive subscriber's rights as a result of a court order or written agreement. There is no requirement to separate the assets upon marriage breakdown so former spouses or common-law partners can remain as joint subscribers of a plan after separation or divorce. However, the status of the relationship at the time the RESP was opened is important as individuals who are already divorced cannot enter into a joint contract.
- if you are appointed under a written agreement; or
- if, after the death of the subscriber, you acquire subscriber's rights under the plan by appointment under their Will; or if the deceased subscriber's legal representative designates you as a replacement subscriber. The legal representative may make contributions to the RESP on behalf of the estate until they designate a replacement subscriber.

Death of the Subscriber

The maximum life span of an RESP is 35 years (40 years for a specified plan). You may therefore wish to appoint a successor subscriber who would act in the event that you pass away before the RESP funds have been fully utilized by the beneficiaries. Consider the following scenarios:

- If you and your spouse are acting as joint subscribers of the RESP and one of you passes away, the surviving spouse will become the sole subscriber.
- You may designate a replacement subscriber in your Will.
- If you do not designate a replacement subscriber in your Will, your executor or liquidator may designate someone as a replacement subscriber.
- If your executor or liquidator does not name a successor subscriber, a person who makes contributions to the plan after the death of the subscriber for the beneficiary can become a subscriber.

A successor subscriber will assume responsibility for the management of the RESP and may also continue making contributions to the plan. The new subscriber can be an individual, an estate or a company.

Your successor subscriber will have the same rights that you have as the original subscriber. However, unless your spouse or common-law partner becomes the successor subscriber, your successor will not be able to reduce accumulated income payments (AIPs) subject to tax by transferring up to $50,000 of income from the RESP to their RRSP. AIPs and educational assistance payments (EAPs) are discussed in the RESP article, "Withdrawing from the Plan and Non-Resident Issues."

If you pass away and do not have a spouse as a joint subscriber or a Will that names a successor subscriber, or if your plan (if permitted) does not name the successor subscriber and your beneficiaries are not able to agree on a successor subscriber, there are circumstances in which your executor may be compelled to wind up the RESP.

Depending on the situation, an RESP may require probate on the death of a subscriber. The executor or successor subscriber may be asked to provide the death certificate of the original subscriber and inform the financial institution holding the plan of the identity of the new subscriber. The value of the assets in the plan will likely be included for the purpose of calculating probate taxes.

Your successor subscriber will have the same rights that you have as the original subscriber.

Who can be a beneficiary?

You can name any resident of Canada, who has a Social Insurance Number, as a beneficiary of an RESP. The Canadian residency requirement is waived only in the event that funds are transferred from an existing RESP to a newly created plan that benefits the new non-resident beneficiary.

Generally, when you replace one RESP beneficiary with a new beneficiary, CRA treats the contributions for the former beneficiary as if they had been made for the new beneficiary on the date they were originally made. If the new beneficiary already has an RESP, this may create an excess contribution. This rule does not apply in the following situations:

- the new beneficiary is a brother or sister of the former beneficiary and is under 21 years of age;
- both beneficiaries are connected by a blood relationship or adoption to an original subscriber of the RESP and both are under 21 years of age.

In these situations, CRA does not include the contributions made for the former beneficiary when they determine whether the new beneficiary's lifetime contribution limit has been exceeded.

Death of a beneficiary

In the unfortunate event that the beneficiary of the RESP account you established should pass away before depleting all the funds in the account, you may designate a replacement beneficiary. If you name a replacement beneficiary who is already a beneficiary of another RESP, be cautious of the contribution and CESG limits and determine how much room is still available to the new beneficiary. .

In a family plan with multiple beneficiaries, the RESP assets, including CESG can be shared between the beneficiaries. So if one of the beneficiaries dies during the lifetime of the plan, their share of the RESP assets may be utilized by other beneficiaries. However, each beneficiary can only receive a lifetime maximum CESG of $7,200. Any CESG remaining in the RESP after the plan has been wound up must be returned to the government.

Family plans are the only plans that allow you to name more than one beneficiary. These multiple beneficiaries must be connected by a blood relationship or adoption to each living subscriber or to a deceased original subscriber.

Types of plans

An RESP is not designated a family plan or an individual plan based on the number of beneficiaries in the plan, but rather according to the plan text approved by the government. For example, you can set up a family plan that only names one beneficiary. You can then add additional beneficiaries to the plan as long as certain requirements are met.

Family plans

Family plans are the only plans that allow you to name more than one beneficiary. These multiple beneficiaries must be connected by a blood relationship or adoption to each living subscriber or to a deceased original subscriber. This means that you can include your children, grandchildren, siblings and adopted children in a single family RESP. Nieces and nephews are specifically excluded as beneficiaries of family plans but you can name them as beneficiaries of individual plans.

For family plans established after 1998, each beneficiary must be less than 21 years of age at the time they are named as a beneficiary. However, when one family plan is transferred to another, a beneficiary who is 21 years of age or older can still be named as a beneficiary of the new RESP.

No contributions can be made for a beneficiary who is 31 years of age or older. However, transfers can be made from another family plan, even if one or more of the beneficiaries are 31 years of age or older at the time of transfer.

Individual plans

An individual plan is established for one beneficiary only and has fewer limitations than a family plan. The beneficiary can be the subscriber and may, or may not be related to the subscriber. There is no age limit for beneficiaries of individual plans. If you want to establish a plan for yourself, or someone who is not related to you by blood or adoption, or if the beneficiary is 21 years old or older when you establish the plan, you must set up an individual plan.

Which plan is right for you and your family?

If you have several children, a family plan may be easier to administer.

Another advantage of a family RESP is that the funds in the plan do not have to be shared equally between the beneficiaries. This can be useful if one of the named beneficiaries doesn't go on to post-secondary education or if the beneficiaries have different educational costs. For example, if one child stays at home while attending school and another child goes to school out of town, the child living away from home may have significantly higher costs.

One drawback with an individual plan is that the accumulated income can only be paid to the named beneficiary of the plan. This could be an issue if the named beneficiary decides not to go to post-secondary school, or does not use all of the funds within the plan. However, families who have children with a significant age difference may be better off using individual plans since an RESP has to be wound down by December 31st in the year that includes the 35th (40th for a specified plan) anniversary of the plan. For example, a plan that was established 15 years ago will have to be wound down in 20 years from now. If a newborn child is added to this plan, the child will only be 20 when the plan winds down, at which time they may not have completed post-secondary school.

Most transfers from one RESP to another will have no tax implications.

Transfers

Most transfers from one RESP to another will have no tax implications. This is the case when the transferring RESP and the receiving RESP have the same beneficiary. There are also no tax implications when a beneficiary under the transferring RESP has a brother or sister (under 21 years of age before the transfer is made) who is a beneficiary under the receiving RESP.

In any other case, transfers can result in an excess contribution. This is because the RESP contribution history for each beneficiary under the transferring RESP is assumed by each beneficiary under the receiving RESP. CRA treats each contribution as if it had been made into the receiving RESP on the date of the original contribution to the transferring plan. In addition, CRA treats each subscriber under the transferring RESP as a subscriber under the receiving RESP. This means that he or she is liable for any tax on excess contributions.

When a transfer is made to a plan with a different beneficiary or if the beneficiaries of the original and new plan are not siblings, the CESG is not transferred and must be repaid to the government.

Overcontributions

An overcontribution occurs when the total contributions made for a single beneficiary exceeds that beneficiary's limit. Excess contributions to an RESP are subject to a 1% per month penalty to the subscriber for the excess amount contributed. The 1% is charged until the overcontribution is removed. The penalty is not charged for the month in which the overcontribution is withdrawn.

Since 2007, $500 of CESG has been available each year for a qualifying beneficiary who is 15 years old or under. (Specific rules exist for children who are 16 and 17 years old.

Canada Education Savings Grant (CESG)

For many subscribers, the CESG is the most attractive feature of an RESP and its strongest selling point. No matter what your family income, Human Resources and Skills Development Canada (HRSDC) pays a basic CESG of 20% of annual contributions to a maximum CESG of $500 for each beneficiary ($1,000 in CESG if there is unused grant room from a previous year), to a lifetime limit of $7,200 per beneficiary. Additional government funding may also be available to lower income families, however further details are beyond the scope of this article.

Accumulating CESG carry forward room

Since 2007, $500 of CESG has been available each year for a qualifying beneficiary who is 15 years old or under. (Specific rules exist for children who are 16 and 17 years old, as described below.) Since the annual CESG is 20% of the RESP contribution made during the year, an RESP contribution of $2,500 for the year attracts the full $500 CESG annual limit.

Prior to 2007, the maximum CESG that was available for each qualifying beneficiary was $400 per year; thus annual RESP contributions of $2,000 attracted the full CESG.

If your RESP contribution for a particular beneficiary for the year is less than $2,500 ($2,000 for years prior to 2007) and does not attract the full CESG, the remaining CESG amount, also referred to as unused grant room, may be carried forward. This unused CESG creates a “pool” of carry forward room for the beneficiary, which is available for future years. Each beneficiary has their own pool, even if the contributions made on their behalf are combined with those of other beneficiaries in a family RESP.

Using up the CESG carry forward room

When you make a contribution to an RESP of more than $2,500 per year, ($2,000 for years prior to 2007), you may be able to use the carry forward pool. The maximum grant available in a year is limited to 20% of the first $5,000 of RESP contributions made ($2,500 for the maximum CESG of $500 and another $2,500 for the maximum CESG carry forward of $500).

For example, a child who is born in 2006 for whom no RESP contributions have ever been made will have a total pool of $2,400 in 2011 in unused grant room ($400 for 2006 and $500 for each of 2007-2010). A contribution of $5,000 in 2011 will trigger a grant of $1,000: $500 for the 2011 contribution and $500 from the CESG carry forward pool being used. The grant pool will then be reduced to $1,900. To find out what past contributions have been made to an RESP and what the grant carry forward pool is, you can contact Human Resources and Skills Development Canada (HRSDC).

The following table illustrates the possible amounts in the carry forward pool for beneficiaries born in given years. This example assumes that a $5,000 contribution is made in 2011 and that RESP contributions have not been made previously for these beneficiaries in any RESP plan.

Year in which child was born	CESG carry forward pool	Contribution made in 2011	Grant paid in 2011	Remaining carry forward pool
2006	$2,400	$5,000	$1,000	$1,900
2007	$2,000	$5,000	$1,000	$1,500
2008	$1,500	$5,000	$1,000	$1,000
2009	$1,000	$5,000	$1,000	$500
2010	$500	$5,000	$1,000	$0
2011	$0	$5,000	$500	$0

Eligibility for CESG

In most cases, to be eligible for the CESG, the beneficiary must be no more than 15 years old during the calendar year and the contribution must be a “net new contribution”. This means that if a previous contribution was withdrawn from the RESP in a particular year and then re-contributed in the same year, this contribution would not be eligible for the CESG. The CESG is also available to 16 and 17 year olds under specific circumstances (see section on 16 and 17 year olds).

A beneficiary must be a resident of Canada to accumulate grant room for any given year at a rate of $500 per year ($400 from 1998-2006) until the age of 17. Grant room accumulates whether or not an RESP account has even been opened, however grant room does not accumulate for years when the beneficiary is not a resident of Canada and it cannot be recovered, even if the beneficiary subsequently becomes a Canadian resident again.

A beneficiary must be a resident of Canada to accumulate grant room for any given year.

Sharing CESG among beneficiaries of a family plan

One of the benefits of a family plan is that accumulated CESG contributions do not have to be paid out equally among beneficiaries. However, the maximum CESG that each beneficiary can receive is $7,200. If a beneficiary doesn't pursue post-secondary education or is not able to share the accumulated CESG with another beneficiary, that beneficiary's CESG may have to be returned to the government.

For example, a couple has a family plan for two 12-year-old twin beneficiaries and contributes a combined total of $5,000 per year for six years. As long as they contributed equal amounts to each child, the grant allocated to each child will be $500 per year for a total of $3,000. Assuming a 7% average annual rate of return, the plan will have a total balance of $42,920 at the end of six years including the CESG. If one child goes to a school that is much more expensive than the other child's school, all or the majority of the CESG in the plan can be paid out to the child who needs it. There is no requirement to pay out $3,000 of CESG to each child.

16 and 17 year old beneficiaries

A beneficiary may receive the CESG as long as they are 15 years of age or less in the current calendar year.

A beneficiary who is turning 16 or 17 during the current calendar year can qualify for the CESG if one of the following two conditions is met:

- Contributions to all RESPs for the beneficiary are at least $2,000 and were made before the calendar year in which the beneficiary turned 16; or
- Contributions for the beneficiary of at least $100 per calendar year were made in any four years before the calendar year in which the beneficiary turned 16.

If no previous RESP existed, the beneficiary turning 16 or 17 in the current calendar year will not be eligible to receive the CESG. As well, any beneficiary who was already 17 years of age at the start of the calendar year will not be eligible for the CESG.

Making a large lump sum contribution and the impact on the CESG

Two of the most recent and substantial changes to RESPs have been the elimination of the annual $4,000 RESP contribution limit per beneficiary and an increase in the lifetime maximum RESP contribution from $42,000 per beneficiary to $50,000. As a result of the elimination of the annual limit, you may wonder if you should contribute $50,000 up front to your RESP in order to take full and immediate advantage of the tax-deferral opportunity.

The issue is that if you contribute $50,000 up front, you will benefit from the tax deferral on the investment income; however, you will likely forfeit a substantial part of the CESG, which may otherwise be available if you make regular annual contributions. The CESG is paid based on 20% of the annual RESP contribution to a maximum of $500, or if there is a CESG carry forward pool, up to a maximum of $1,000. Thus if you make a one-time lump-sum contribution of $50,000 to the plan, the maximum CESG the plan could receive is $1,000. A lump-sum contribution in excess of $5,000 in any given year will attract CESG on only the first $2,500 ($5,000 if there is enough CESG in the carry forward pool). Grants are not paid to the plan in future years for past years' contributions.

The CESG is paid based on 20% of the annual RESP contribution to a maximum of $500, or if there is a CESG carry forward pool, up to a maximum of $1,000.

Variables to consider

Is there an advantage to making a lump-sum contribution up front or several annual contributions to maximize the amount of CESG? The answer may depend on a number of variable factors such as:

- Your ability to make a larger up front contribution
- The age of the beneficiary, which is used to determine the balance in the CESG carry forward pool and the approximate timing of future withdrawals
- Your marginal tax rate on your non-registered investment income
- Your expected rate of return on the investment income (both inside and outside the RESP)
- Your beneficiary's expected marginal tax rate when the funds are withdrawn (often 0% given the basic personal exemption and other tax credits available to students)

Analyzing the numbers

Your advisor can use the RESP funding strategy calculator to illustrate the potential outcome of making a $50,000 lump-sum contribution to an RESP compared to an annual contribution that maximizes the CESG payment. It is assumed that the $50,000 is in a non-registered account and is available to fund the RESP.

Though the CESG is a boost to many families' education savings plans, generally, if you have the ability to make an up front $50,000 lump sum contribution, it will be more advantageous to do so and permanently forgo the full potential value of the CESG in order to have a larger amount growing tax-deferred for a long period of time.

Opportunities and constraints for grandparents

Grandparents may have the desire and the financial means to contribute to an RESP for their grandchildren. It can be a wonderful way to give a meaningful gift.

If you are a grandparent, you can establish an RESP yourself (i.e., be the "subscriber") and also contribute to the RESP for your grandchildren; however, you may want to consider an alternative approach. You could decide to gift the funds to your son or daughter who in turn establishes the RESP for your grandchildren. In both cases you provide the financial gift and your grandchildren are the beneficiaries of the RESP, but in the latter case, your child will be the subscriber of the plan.

The advantage of the second approach is that if one of the beneficiaries doesn't attend post-secondary education, the subscriber can transfer the earnings from the RESP to their own RRSP, within certain limits (as discussed further in the RESP article, "Withdrawing from the Plan and Non-Resident Issues.")

The subscriber must be 71 years of age or younger to do this. As RESP plans have a potential life span of 35 years (40 for a specified plan), this opportunity may not exist for you by the time you realize that one of your grandchildren will not attend school, but your son or daughter may still be able to benefit.

The disadvantage of this approach is that you have little or no legal control over the funds. Your son or daughter will have control over the funds and there is no guarantee that they will follow your wishes. Even if the funds are contributed to an RESP, as the subscribers, they will have the ability to withdraw the contributions.

Grandparents may have certain advantages when establishing multiple beneficiary plans. For example, a grandparent can include all their grandchildren from each of their children in one family RESP. A parent, by comparison, cannot include the same list of beneficiaries since they cannot include nephews and nieces as beneficiaries of a family plan.

Investment options

As with any other investment, you must consider your own risk tolerance, your investment objectives, the time horizon for the use of the funds and any investment bias you may have when you determine the appropriate investment asset allocation for the RESP funds.

Also, by having a larger plan balance from the time the plan is opened, you may have access to a wider array of investment solutions than you would if you made smaller annual contributions.

You may also decide to combine a lump-sum amount of less than $50,000 with future contributions to maximize the CESG.

Eligible investments and allocation of assets

Investments that are eligible for an RRSP are also eligible for an RESP.

Since RESPs enjoy tax-deferred growth, many contributors would rather hold investments that generate capital gains in their non-registered accounts and hold assets that predominantly produce dividends and interest in their RESPs. However, as RESPs generally have a long investment time horizon (depending on the age of the beneficiaries), other contributors may choose to invest in equity-based securities that produce capital gains rather than dividends or interest income.

Keep in mind that income from U.S. investments held in an RESP does not qualify for the Treaty exemption for U.S. non-resident withholding tax. The exemption relates to trusts set up for the purpose of providing retirement income and since the primary purpose of an RESP is to provide benefits for education, income earned in the RESP will be subject to US non-resident withholding tax. You may wish to consider investing in U.S. investments that produce income which is not subject to U.S. withholding tax, such as U.S. preferred shares.

Both strategies have their merits. Speak to your Advisor about determining the best approach for you based on your circumstances and your risk tolerance.

› Please contact us for more information.