The Navigator

RBC WEALTH MANAGEMENT SERVICES

Registered Education Savings Plans (RESPs)

Withdrawing from the plan and non-resident issues

If your registered education savings plan (RESP) beneficiary has enrolled or is enrolling in post-secondary education, now is the time to use the RESP for its intended purpose. This article explores the various ways of withdrawing funds from an RESP depending on your circumstances. It also explains issues that may exist for non-resident subscribers and/or beneficiaries of an RESP.

This is the second article in a two-part series. The first article, "Establishing an RESP," covers the basics of RESPs including:

- Setting up a plan, subscriber and beneficiary designations, contribution limits, types of plans, Canada Education Savings Grants (CESGs), and RESP saving strategies...

RESP withdrawals

If you have been contributing to your RESP for several years now, the plan has probably accumulated a mix of original principal contributions along with Canada Education Savings Grants (CESGs) and investment growth. If the plan beneficiary is enrolling or has enrolled in post-secondary education, now may be the time to start withdrawing funds. Several types of RESP withdrawals are available:

- Refund of contributions (principal) to you, the subscriber, or to your beneficiary
- Educational assistance payments (EAPs)
- Accumulated income payments (AIPs)
- Payment to a designated educational institution in Canada

Refund of contributions

As the subscriber, the original RESP contributions you made to the plan can be returned to you at any time. You can receive them yourself, or you can redirect them to the plan beneficiary. This type of withdrawal may not exceed the total RESP plan value net of the CESG. When principal is removed from a plan, it is removed in the following order:

1. Assisted contributions that have attracted CESG
2. Unassisted contributions made after 1997 that did not receive the grant (although the CESG program began in 1998)
3. Unassisted contributions made prior to 1998 (when the CESG program did not exist)

If you ever need to withdraw some of your original contributions for non-educational purposes and your beneficiary is not eligible to receive an EAP, any

CESG that you received for the original contributions will need to be repaid to the federal government. The RESP trustee will make the CESG repayment, equal to 20% of the non-educational withdrawal, from the plan assets.

Tax impact of receiving a refund of contributions

Since your original contributions were made with your after-tax dollars, withdrawals of these funds are non-taxable. You will not receive any tax slips and you should not report these payments as income on your or your beneficiary's tax return. CESG repayments are not taxable.

Educational assistance payments (EAPs)

An EAP is the amount paid to a beneficiary from an RESP, including CESG and income, but not principal, to help finance the cost of post-secondary education. EAPs can be paid from the RESP to a beneficiary who is enrolled full time in a qualifying educational program or part time in a specified educational program and is 16 years old or older.

An RESP beneficiary is entitled to receive EAPs for up to six months after ceasing to be enrolled in a qualifying educational program or specified educational program as long as the payment would have qualified under the rules for EAPs if it had been made immediately before the student's enrolment ceased.

EAP payments consist of:

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

Details of payments made under the final two categories are beyond the scope of this article.

In order to receive any CESG as part of an educational assistance payment (EAP), the beneficiary must be a resident of Canada at the time that the EAP is received.

It is generally advisable for a beneficiary to receive an EAP, rather than a refund of contributions, while they are enrolled in a qualifying or specified educational program. This is because contributions can be removed at any time, but the CESG and income portions that remain in an RESP after a beneficiary has completed school may be treated negatively. The unused CESG may have to be returned to the government and the unused income may be heavily taxed (to be discussed further in the section on AIPs).

Since your original contributions were made with your after-tax dollars, withdrawals of these funds are non-taxable.

Qualifying educational program and specified educational program

A qualifying educational program is an educational program at the post-secondary school level that lasts at least three consecutive weeks and requires a student to spend no fewer than 10 hours per week on courses or work in the program.

A specified educational program is a program at the post-secondary level that lasts at least three consecutive weeks and requires a student to spend no fewer than 12 hours per month on courses in the program.

The June 2011 federal budget proposed that access to an educational assistance payment (EAP) will be available for students enrolled full time at a foreign university in a course that is at least three consecutive weeks, instead of 13. Note that this applies to universities, not foreign colleges or other foreign institutions, which will still require 13 weeks enrolment.

In order to receive any CESG as part of an educational assistance payment (EAP), the beneficiary must be a resident of Canada at the time that the EAP is received.

Proof of enrolment

In order to receive an EAP, a beneficiary of an RESP must provide appropriate proof of enrolment. This requirement could be satisfied by a letter of confirmation from the registrar's office or confirmation of enrolment on the institution's letterhead. The beneficiary must also provide details of the type of institution, its postal code, the length of the program in weeks, the number of weeks of study per year, the current year of study and the course start date.

Payment amounts

For RESPs established or modified after 1998, the beneficiary can withdraw an EAP of up to $5,000 in the first 13 weeks of full-time enrolment in a qualifying educational program. For part-time students, the maximum EAP is $2,500 in the first 13-week period of enrolment in a specified educational program. There are no limits on plans that were established prior to 1989 and not modified after 1998.

The first 13 weeks of enrolment are defined as the first 13 weeks in a 12 month period. The EAP is limited to $5,000 (or $2,500 for part-time students) in the first 13 weeks of a beneficiary's enrolment if the beneficiary was not enrolled in a qualifying educational program for at least 13 weeks in the preceding 12-month period.

For example, if your beneficiary is currently in the second term of their first year of a post-secondary education program, your beneficiary will not be subject to the EAP withdrawal limit for the second term. However, if there is a 12-month period in which your beneficiary is not enrolled in a qualifying educational program for 13 consecutive weeks, the withdrawal limit will apply again upon their return to school.

After the first 13 weeks of post-secondary school, which for many students is their first term, the restrictions on EAP withdrawals are relaxed. After that point, the amount withdrawn must be "reasonable" to fund the educational needs of the beneficiary.

There is no requirement to show what the funds are going to be used for as long as the conditions permitting an EAP are met. From an administrative standpoint, EAP requests under $20,000 are considered acceptable to financial institutions.

When a financial institution holding the RESP receives the form requesting an EAP or a withdrawal of contributions, they review the request along with the proof of enrolment. Human Resources and Skills Development Canada (HRSDC) provides the formula to determine the portions of contributions, CESG (if applicable) and growth to be paid out.

For RESPs established or modified after 1998, the beneficiary can withdraw an EAP of up to $5,000 in the first 13 weeks of full-time enrolment in a qualifying educational program. There are no limits on plans that were established prior to 1989 and not modified after 1998.

What if the EAP isn't enough?

In situations where your beneficiary's educational costs exceed the $5,000/$2,500 limit for the first 13 weeks of enrolment, there are several options available.

- The beneficiary can wait until the 13 weeks have passed, at which time the limit will be relaxed
- You can withdraw some of the original principal contributions and allocate them to the beneficiary. As long as the beneficiary is enrolled in a qualified post-secondary institution at the time you withdraw the principal, you generally will not be required to repay any of the beneficiary's CESG.
- Where the beneficiary's post-secondary tuition costs are substantially higher than average, as the subscriber, you can apply to HRSDC to receive a higher EAP limit. Higher EAP limits are granted on a case-by-case basis and only in exceptional cases.

Taxation of EAps

The EAP is taxable income to your beneficiary and is reported on their tax return. Keep in mind that many students pay very little, if any, income tax since they are entitled to tuition and education credits in addition to their basic personal exemption.

Non-resident beneficiaries will receive an NR4 to report the income and the non-resident withholding taxes that apply to this income.

The EAP is taxable income to your beneficiary and is reported on their tax return.

Accumulated income payments (AIPs)

An AIP is a payment that may be paid to you, the subscriber, if there is income earned within the RESP that is not used by a qualifying beneficiary and any one of the following three conditions apply:

- The current beneficiary and all past beneficiaries have reached age 21, none of them are eligible for an EAP and the plan has been in effect for at least 10 years.
- The plan has reached December 31 of the 35th year following the year the plan was opened. In the case of a specified plan – where the beneficiary is entitled to the disability tax credit (DTC) the relevant date is December 31 of the 40th year.
- All the beneficiaries named in the RESP have died.

A subscriber must be a resident of Canada to be eligible to receive an AIP. If you are the original subscriber and you pass away before one of the above events occurs, the AIP can be made to the successor subscriber or to your estate.

AIPs may also be transferred to your registered retirement savings plan (RRSP) within certain limits or paid out to you as taxable income.

Transferring the AIP to your RRSP

An AIP is considered taxable income. However, you may be able to reduce the amount of AIP subject to tax if you are the original subscriber, or the spouse or common-law partner of a deceased original subscriber.

You will not be able to reduce the amount of AIP subject to tax if you are not the original subscriber. For example, if your brother died and named you as the new subscriber in his Will, you would not be able to reduce the amount of AIP subject to tax.

You can transfer a maximum amount of $50,000 AIP on a tax-deferred basis to your RRSP or to a spousal RRSP (including common-law partner). However, you will need adequate unused RRSP contribution room to make this transfer. If you and your spouse are joint subscribers, each of you can transfer a maximum of $50,000 to your respective RRSPs, assuming you have the required contribution room. Note that only spouses and common-law partners can be joint subscribers to an RESP.

If you make a tax-deferred transfer to your RRSP, you must do so in the year you receive the AIP or within 60 days of the calendar year-end. You are required to convert your RRSP into a registered retirement income fund (RRIF) by December 31 of the year in which you reach age 71. So, if you wish to transfer some or all of your AIP to your RRSP, you must do so before you convert your RRSP to a RRIF.

Once you receive an AIP, you must close the RESP by the end of February of the year following your first AIP withdrawal. If there are any funds remaining in the RESP after this time, the funds will be transferred to the designated educational institution you identified in your RESP application form.

Taxation of AIPs

Whether or not you transfer an AIP to an RRSP, your AIP must be included in your personal tax return in the year it is received. If you receive an AIP that is not transferred to your RRSP, the AIP will be taxable to you.

You will pay tax on your AIP at your marginal tax rate plus an additional 20% tax (12% for residents of Quebec). The additional tax owing is calculated using a T1172 form, which is included with your tax return for the year in which you receive the AIP.

The total tax bill is not quite as onerous as it may sound. This is because the funds in the RESP have been benefiting from tax-deferred growth throughout the lifetime of the plan. Consequently they have probably grown more than they would if they had not been growing in a tax-sheltered environment.

Tax is generally withheld on AIPs. However, if you have contribution room available and are able to transfer directly or contribute to your RRSP or a spousal RRSP, your AIP will not be subject to withholding tax.

Designated educational institution

In the event that your RESP has to be collapsed while investment income remains in the plan and the plan does not qualify for an AIP, the remaining income will be paid to the designated educational institution (DEI) you identified in your RESP application form.

A DEI must be located in Canada and be a university, college or other educational institution designated by the Lieutenant Governor in Council of a province as a specified educational institution under the Canada Student Loans Act; or designated by an appropriate authority under the Canada Student Financial Assistance Act; or designated by Quebec’s Minister of Education as per Quebec’s Act Respecting Financial Assistance for educational purposes.

Taxation of payments made to a designated educational institution

If a payment is made from your RESP to your DEI, it will be taxable income to the DEI — not to you. This type of payment is not eligible for a charitable donation tax credit.

Other Considerations

Closing an RESP

35-year limit
An RESP must be closed by December 31 of the year that includes the 35th anniversary of the opening of the plan (40th year for a specified plan), even if a beneficiary of the plan is still attending post-secondary school.

Plan closed at your request
You may choose to close your RESP plan if your beneficiary is not attending post-secondary school or if the beneficiary you named has passed away. In either case, if your RESP is a family plan, you may choose to add another beneficiary to benefit from the plan and keep the plan open.

Withdrawing the remaining funds
If your RESP has sufficient funds that your beneficiaries do not entirely deplete the account, you may be able to request the remaining balance. RESP funds are composed of original contributed capital, CESG and investment income. The nature of the funds will determine how they will be paid out when you close your RESP.

- **Contributions** — You may always withdraw the original contributions you made to your RESP. There are no income tax consequences to this type of withdrawal since this is a return of your contributions, which were originally made with after-tax dollars.
- **CESG** — Any amounts originating from the CESG remaining in the plan must be repaid to the government. Only the actual CESG itself needs to be returned; the income generated on the CESG is treated the same way as the income earned on the contributed capital, which is discussed next.
- **Investment income** — The remaining investment income can be withdrawn from the RESP in the form of a taxable AIP or as a tax-deferred AIP transferred to your RRSP or a spousal RRSP. See the previous section on AIPs for more details on AIP withdrawals.

Non-residents

Non-resident beneficiary

The Canada Revenue Agency (CRA) determines an individual's residency status for tax purposes. A beneficiary of an RESP must be a resident of Canada at the time contributions are made to the plan, however, a beneficiary of an RESP can study outside Canada and still be considered a Canadian resident.

If a beneficiary becomes a non-resident at a later date, it is important to understand the potential implications. For example, if a non-resident beneficiary attends post-secondary school in the country where they live, he or she may use some, but not all, the funds that have accumulated in an RESP.

Note that the subscriber, or the beneficiary, can receive the original contributions as a tax-free return of capital at any time.

If a non-resident beneficiary who is enrolled in a qualifying program requests an EAP, investment income that has been earned in the RESP may still be included in the EAP, even though the beneficiary is not a resident of Canada when the payment is made. Withdrawals of investment income and growth will be subject to non-resident withholding tax at a rate of 25%, unless reduced by a tax treaty. The payment can only be paid when the beneficiary starts attending post-secondary school.

Non-resident beneficiaries cannot receive payments of CESG. If the beneficiary is still a non-resident at the time they attend a post-secondary educational institution, the CESG will be returned to HRSDC.

Keep in mind that tax legislation in the beneficiary's country of residence may also apply.

For example, if the beneficiary is a U.S. person, the income that has accumulated in the plan will be taxable to the beneficiary when it is withdrawn. However, a special prescribed tax and interest charge is calculated based on the accumulated income distributed from the plan. This results in the income being taxed as if it had been earned over the lifetime of the RESP.

Non-resident subscriber

You can only make contributions to an RESP if the subscriber provides their SIN and if the beneficiary is a resident of Canada.

The plan can remain open even if the subscriber is a non-resident, but there can be implications if the subscriber decides to close the plan.

If you are the subscriber, you can withdraw the capital you contributed to the plan as a tax-free return of capital at any time or you can direct that it is paid to the beneficiary.

However, if you close the plan, you will not be eligible for EAPs or AIPs. The investment income and growth that has accumulated in the plan will have to be paid out to a designated Canadian educational institution. Non-residents are generally not entitled to receive the CESG.

If you set up an RESP while you are a Canadian resident, and you subsequently become a non-resident, the RESP will generally contain some CESG. This portion of the plan must be returned to HRSDC if you close the plan while you are a non-resident.

If you are a resident or citizen of another country, there may be tax implications in the country where you live. Obtain the advice of your professional tax advisor before making contributions to an RESP.

For example, if you are a U.S. person and the subscriber to an RESP, the income in the plan (including CESG) is taxable for U.S. purposes on an annual basis. There are no U.S. tax implications when you withdraw your contributions but you should be aware that when the beneficiary withdraws the income in the plan, it will be taxed, for Canadian tax purposes, in that beneficiary's hands and that can potentially mean double taxation.

There may also be U.S. reporting requirements for U.S. beneficiaries and/or subscribers of an RESP. For example, forms 3520- Annual Return to Report Transactions with Foreign Trusts and Receipt of Foreign Gifts and 3520A- Annual Information Return of Foreign Trust with a U.S. Owner may be required in the U.S.

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