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Registered Education Savings Plans (RESPs)

Part 1 — Establishing an RESP

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With the high cost of post-secondary education, many parents, grandparents and other family and friends are recognizing the need to save for education well before the expenses become a reality. That's why the Registered Education Savings Plan (RESP) is becoming such a popular saving vehicle. Not only is the taxation on this type of savings deferred until it is payed out, but the government will also contribute to the plan with a Canada Education Savings Grant (CESG).

This article, which covers the basics of RESPs, is the first of a three-part series. The second article, "Savings Strategies and Special Circumstances," talks about some of the best RESP saving strategies and other special circumstances you might encounter. Finally, the third article, "Withdrawing and Spending Savings," explains how you can withdraw and spend the accumulated RESP savings for educational purposes.

So, if you're thinking about setting up an RESP today, this is a great place to start.

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.
- Contributions can be made to a plan for 21 years; although the February 26, 2008, Federal budget proposes to increase this to 31 years.
- The maximum life of an RESP before it has to be closed is by December 31st in the year that includes the 25th anniversary of the plan. The February 26, 2008 Federal budget proposed to increase this to 35 years.
- All of the capital appreciation (including interest, dividends, capital gains and the grant pool) is allowed to grow on a tax-deferred basis.
- 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 third 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.
- Each EAP has two components:
  - Accumulated income
  - CESG
- EAPs are considered taxable income in the name of the beneficiary, who will likely 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 you (the subscriber) in cash or transferred to your retirement savings plan (RSP) or spousal RSP within limits.
- Original contributions can be paid out to the contributor tax-free at any time. Original contributions can also be paid out to the beneficiary tax-free.

Who can be a subscriber?

The most common subscribers of RESPs are parents and grandparents. However, there are no restrictions on who can be the original subscriber of an RESP. Family plans, however, do have some restrictions (see the section on family plans).

You and your spouse (including common-law partners) can be joint subscribers to an RESP. The CRA requires that the social insurance number(s) (SIN) of subscriber(s) be included when registering the plan. If you are not the original subscriber, you may become the subscriber in the following situations:

- Upon the breakdown of a relationship, you receive subscriber's rights as a result of a court order or written agreement;
- When you are appointed under a written agreement; or
- When, after the death of the subscriber, you acquire subscriber's rights under the plan by appointment under their Will; or when the legal representative designates you as a replacement subscriber. (Until the legal representative designates a replacement subscriber, they may also make contributions to the RESP on behalf of the estate.)

Who can be a beneficiary?

Any resident of Canada, with a Social Insurance Number, can be named as a beneficiary. The only time the Canadian residency requirement is waived, is if funds are being transferred from an existing RESP to a newly created plan that benefits the new non-resident beneficiary.

Types of plans

The designation of a family plan or individual plan is not necessarily based on the number of beneficiaries in the plan, but rather the plan text approved by the government. For example, a family plan can be set up with only one beneficiary named. However, additional beneficiaries can be added to a family plan as long as certain requirements are met.

FAMILY PLANS

Family plans are the only plans that allow the subscriber to name more than one beneficiary. In order for a family plan to have multiple beneficiaries, these beneficiaries must be connected to the subscriber by a blood relationship or adoption. This means that your children, grandchildren, siblings and adopted children and grandchildren can be included in a single family RESP. Nieces and nephews are specifically excluded as beneficiaries of family plans; they can only be named 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 beneficiary.

INDIVIDUAL PLANS

An individual plan is for one beneficiary only and has fewer limitations than a family plan. The beneficiary can be the subscriber, be related to the subscriber or not be related to the subscriber. There is no age limit for the beneficiary of an individual plan.

WHICH PLAN IS RIGHT FOR YOU AND YOUR FAMILY?

If you have several children, having a family plan simplifies the administration for you.

A further advantage of a family RESP is that the funds in the plan do not have to be shared equally between each of the beneficiaries. This is useful if the different beneficiaries have different educational costs. For example, if one child stays at home while attending school and another child lives out of town to attend school, the one out of town may have significantly higher costs. Or perhaps one named beneficiary doesn’t go to school at all.

With an individual plan, the accumulated income can be paid only 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.

Families that 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 25th anniversary of the plan. For example, a plan that was established 10 years ago will have to be wound down in 15 years from now. If a newborn child is added to this plan, the child will only be 15 when the plan winds down, well before post-secondary school age.

The February 26, 2008, budget proposes to increase the maximum life of an RESP to 35 years, which would benefit families in this situation.

Grandparents may have an advantage when establishing multiple beneficiary plans in certain circumstances. A grandparent can include all their grandchildren from each of their children in a family RESP, while a parent can not include that same list of beneficiaries in a similar plan since they can not include nephews and nieces as beneficiaries of a family plan. One possible drawback for grandparents establishing an RESP is the inability to transfer RESP income to their RSP if they are or will be over 71 years of age and the grandchild does not go to post-secondary school. This is explained in more detail in part three of this series.

If you want to establish a plan for someone who is not blood related to you or adopted by you, or if the beneficiary at the time you want to establish a plan is 21 years old or older, you must establish an individual plan.

Canada Education Savings Grant (CESG)

For many subscribers, the CESG is the most attractive feature of an RESP and its strongest selling point. The basic annual CESG maximum for 2007, and any year thereafter, is 20% of the first $2,500 in contributions (or $500 per year). The maximum grant for years 1998 to 2006 is $400 per beneficiary, per year. And the lifetime maximum grant per beneficiary is $7,200.

Grants can be carried forward to future years if you can't contribute the full $2,500 in a year. Any CESG you carry forward goes into a "grant pool" that you can draw from in future years. If in later years you contribute more than $2,500, you can draw up to $500 per year from the grant pool. The carryforward maximum is $400 per year for years 1998 to 2006 and $500 per year for 2007 or later.

For example, if your child was born in 2003 and you made no RESP contributions from 2003 to 2006, you would have a total grant pool of $1,600 ($400 for each of 2003, 2004, 2005 and 2006). If then you contributed $5,000 in 2007, the CESG would be $1,000, $500 for the 2007 contribution and $500 carried forward from the grant pool. The grant pool would then be reduced to $1,100.

Now, if instead your child was born in 2006, the grant pool would be only $400. A $5,000 contribution in 2007 would then trigger $900 in grant payments, $500 for the first $2,500 and the $400 from the grant pool.

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).

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. Also, the CESG relating to a particular beneficiary may have to be returned to the government if the beneficiary doesn't pursue post-secondary education or is not able to share it with another beneficiary.

For example, if a couple has a family plan with two 12-year-old twin beneficiaries and contributes a combined total of $5,000 per year for six years, as long as they contributed the amount evenly 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 school of the other child, all or a majority of the CESG in the plan can be paid out to the child who needs it. There is not a 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.

Non-residents

CONTRIBUTIONS BY NON-RESIDENTS

Contributions to an RESP can be made only if the subscriber's SIN is provided and the beneficiary is a resident of Canada. If you are a resident or citizen of another country, there may be tax implications in that country; you should check with your tax advisor before making contributions to an RESP.

WHEN THE BENEFICIARY IS A NON-RESIDENT

At the time contributions to an RESP are made, the beneficiary must be a resident of Canada.

There are implications if they later become a non-resident. For example, a non-resident beneficiary attending post-secondary school may use some, but not all, of the funds accumulated in an RESP.

The third article in this series gets into more detail about non-resident beneficiaries withdrawing money from an RESP. There are several negative implications for non-residents, including their inability to receive CESG payments.

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

“KEYWORDS / CODING”

RESP
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Canada Education Savings Plan
CESG