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Registered Education Savings Plans (RESPs)

Part 3 — Withdrawing from the plan

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If your children are enrolling in post-secondary school, it's now time to use the registered education savings plan (RESP) for its intended purpose. This article explores the various ways of withdrawing funds from an RESP depending on your circumstances. This is the third article of a three-part series. The first article, "Establishing an RESP," covers the basics of RESPs and establishing an RESP. The second article, "Saving Strategies and Special Circumstances," discusses some of the best RESP saving strategies and deals with other special circumstances you might encounter.

RESP withdrawals

Since you have been contributing to your RESP for several years now, chances are the plan has accumulated a mix of original principal contributions, Canada Education Savings Grants (CESGs) and investment growth. If the plan beneficiary is enrolling or has enrolled in post-secondary school, now may be the time to start withdrawing funds from the RESP. These are the types of RESP withdrawals 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 contribution 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 that is enrolled full time in a qualifying educational program or part time in a specified educational program and is 16 years old or older.

To provide more flexibility, the February 26, 2008, federal budget proposes to allow an RESP beneficiary 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. Please note this is only a proposed change and is not yet law.

EAP payments comprise two components:

- Accumulated income
- CESG

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, yet the CESG and income portion remaining in an RESP after a beneficiary has completed school may have negative implications. 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).

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.

PROOF OF ENROLMENT

In order to receive an EAP, you must provide appropriate proof of enrolment such as a letter of confirmation from the registrar's office or a confirmation of enrolment on the institution's letterhead. The type of institution and its postal code, length of the program in weeks, number of weeks of study per year, year of current study and course start date must also be identified.

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 a beneficiary's full-time enrolment in a qualifying educational program. For part-time students, the maximum EAP is $2,500 in the fist 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 in reference to 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 prior 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, which for many students is their second term, the amount of the withdrawals must be “reasonable” to fund the educational needs of the beneficiary.

Once the EAP is paid out to the beneficiary, there is no restriction on the use of the funds.

A request is required in order to process an EAP or withdrawal of contributions. Once the form has been received, the request is reviewed along with the proof of enrolment. Human Resources and Social Development Canada (HRSDC) does a calculation to determine the portions of contributions, CESG (if applicable) and growth to be paid out.

WHAT IF THE EAP ISN’T ENOUGH?

For situations where your beneficiary’s cost of education is more than their $5,000/$2,500 limit for the first 13 weeks, there are several options available.

- You may wish to wait until the 13 weeks have passed, at which time the limit will be relaxed
- You may withdraw some of the original principal contributions and allocate them to your beneficiary. As long as the beneficiary is enrolled in a qualified post-secondary institution at the time the principal is withdrawn, you generally will not be required to repay any of the beneficiary’s CESG.
- Where the cost of post-secondary tuition for your beneficiary is substantially higher than average, as the subscriber, you may apply to the Minister of Human Resources Development 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 a T4A and RL2 for Quebec taxpayers. 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 exemption.

An NR4 is issued to non-resident beneficiaries to report the income and the non-resident withholding taxes that apply to this income.

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 is eligible for an EAP and the plan has been in effect for at least 10 years.
- The plan has reached December 31 of the 25th year following the year the plan was opened. The February 26, 2008, budget proposes to increase this to 35 years.
- All the beneficiaries under the RESP have died.

In order to receive the AIP, you must be the subscriber and a resident of Canada. In the event that you have passed away, the AIP can be made to the successor subscriber or your estate.

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

TRANSFERRING THE AIP TO YOUR RSP

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 where there is no subscriber, the spouse or common-law partner of a deceased original subscriber.

You cannot reduce the amount of AIP subject to tax if you become the subscriber in other situations upon the death of the original subscriber. For example, if your brother died and left instructions in his Will to name you as the new subscriber, you would not be able to reduce the amount of AIP that would be subject to tax.

The maximum amount of AIP that can be transferred tax-deferred to your RSP or your spouse’s or common-law partner’s RSP is $50,000. You must have the available unused RSP contribution room at the time of the transfer. If you and your spouses are joint subscribers, each of you is permitted to transfer a maximum of $50,000 to each of your RSPs, assuming you have adequate unused RSP contribution room. Note that only spouses and common-law partners can be joint subscribers of an RESP.

The transfer needs to be done within the same year the AIP is received or within 60 days of the calendar year-end of the year in which the AIP is received.

By December 31 of the year in which you reach 71 years of age, you will need to convert your RSPs into registered retirement income funds (RRIFs). Should you wish to transfer part of your AIP to your RSP, you will need to do so before your RSPs are converted to RIFs.

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

TAXATION OF AIPS

Regardless of going to an RSP or not, your AIP income will be reported in box 40 of a T4A. Report the income on your personal tax return in the year it's received. If you receive an AIP payment and it is not placed in an RSP, the AIP is taxable to you.

Your AIPs will be taxable to you at your marginal tax rate and are also subject to an additional 20% tax. The 20% additional tax owing is calculated using a T1172 form, which is included with your tax return for the year in which you received the AIP.

This total tax is not quite as onerous as it sounds since the amount in the RESP has been benefiting from tax-deferred compounding growth, and thus, the funds available are likely larger than they would have been had they not been able to grow tax-sheltered.

Usually, regular and additional taxes are withheld on AIPs. However, if you have contribution room available and the AIP is transferred directly or contributed to you or your spouse's or common-law partner's RSP, there will not be any withholding taxes.

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 need to 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 credit.

Other Considerations

CHANGING A BENEFICIARY

If you should decide to replace one of your RESP beneficiaries with a new one, the contributions you made for the former beneficiary will be treated as if they were made for the new beneficiary on the date they were originally made.

Keep in mind that if your new beneficiary is already a beneficiary of another RESP, you will need to ensure your new beneficiary is not in an over-contribution position.

This will not be a concern if the new beneficiary is the sibling of the former beneficiary or if both beneficiaries are connected by a blood relationship or adoption, since in these cases there are exceptions — contributions made for the former beneficiary will not impact the new beneficiary's lifetime contribution limit.

CLOSING AN RESP

25-YEAR LIMIT

An RESP has to be closed by December 31 of the 25th year following the year in which the plan was established, even if a beneficiary of the plan is still attending post-secondary school. The February 26, 2008, federal budget proposes to change this to the 35th year; although this is not yet law.

PLAN CLOSED AT YOUR REQUEST

You may choose to close your RESP plan if your beneficiary is not attending post-secondary school or your beneficiary has passed away. In either of these cases, 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 such that your beneficiaries do not deplete the account, you may be able to request receipt of the remaining balance. RESP funds are composed of original contributed capital, CESG and investment income — the type of funds will determine how they will be paid out once you close out 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 RSP. Please see the previous section on AIPs for more details on AIP withdrawals.

Non-residents

NON-RESIDENT BENEFICIARY

Some of the funds accumulated in an RESP may be used by a non-resident beneficiary to attend post-secondary school in their country of residence.

Original contributions may be received by the subscriber or the beneficiary as a tax-free return of capital at any time.

Withdrawals of investment income and growth will be subject to a non-resident withholding tax of 25%, unless reduced by a tax treaty, and may only be paid once the beneficiary begins attending post-secondary school.

Non-resident beneficiaries are not able to receive CESG payments. If the beneficiary is still a non-resident when attending post-secondary education, the CESG will need to be returned to HRSDC.

If the non-resident beneficiary does not attend a qualifying post-secondary educational program, then the funds will be forfeited to a designated educational institution.

Keep in mind that there may also be foreign income tax implications with regard to the RESP plan for the beneficiary in their country of residence.

NON-RESIDENT SUBSCRIBER

The subscriber of a plan may be non-resident, but the plan can still stay open. However, if the subscriber decides to close the plan, there may be implications.

The capital contributed will be received by you as the subscriber or the beneficiary tax-free as a return of capital at any time.

By closing the account, the subscriber will not be eligible for EAPs or AIPs and all growth will have to be paid out to a designated Canadian educational institution. Normally, non-residents are not entitled to the grant.

Sometimes, after a resident sets up an RESP and subsequently becomes a non-resident, the RESP has some CESG in it. The CESG must be returned to HRSDC if the plan is being closed by someone that is a non-resident at the time of the RESP's closure.