RBC Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Withdrawing from a Registered Education Savings Plan (RESP)

Withdrawing from the plan and non-resident issues

If the beneficiary of the registered education savings plan (RESP) you set up 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.

Please contact us for more information about the topics discussed in this article.

RESP withdrawals

If you have been contributing to your RESP for several years now, the plan may have accumulated a combination of original principal contributions along with Canada Education Savings Grants (CESGs), Canada Learning Bonds (CLBs), designated provincial program incentives 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 including:

- 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 (DEI) 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, CLB and designated provincial program incentives that have been paid into the RESP.

Losses in the RESP must also be taken into account. If the RESP realizes losses, the losses may reduce the amount of contributions that you are available to withdraw. Losses will first be applied against the amount of investment income available, then against the principal contributed. If both of these sources are exhausted, the remaining losses may then be applied against the government incentives. For example, consider an account that has received $10,000 in

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contributions and $2,000 in CESG over 5 years. If in year six, the value is $15,000, then $3,000 is considered to be income and the full $10,000 in contributions can be withdrawn. If in year seven the value of the plan dropped to $9,000 through market changes, then the RESP would be considered to hold $2000 in CESG, $0 in income and $7,000 in contributions. Only $7,000 would be available as a principal withdrawal at that point in time.

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
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 there is no beneficiary of the plan who is currently 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. Payments received under some of the designated provincial plans may have to be repaid to the provincial government when there is a refund of contributions.

Tax impact of receiving a refund of contributions

Since you made your original contributions with after-tax dollars, you will not pay tax if you withdraw these funds. You will not receive any tax slips and you should not report these payments as income on your or your beneficiary's tax return. There are no tax consequences when you make a repayment of CESG or other incentives to the government.

Educational assistance payments (EAPs)

An EAP is the amount paid to a beneficiary from an RESP 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)
- Other provincial incentives

In order to receive any CESG or CLB as part of an EAP, the beneficiary must be a resident of Canada at the time they receive the EAP. Residency requirements for receiving other provincial program incentives vary by province. The details of these requirements are beyond the scope of this article.

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 due to the fact that, while contributions can be removed at any time, if government incentives and income portions remain in an RESP after the beneficiary(ies) has completed school, there may be negative consequences when these funds are withdrawn from the plan.

In order to receive an EAP, a beneficiary of an RESP must provide appropriate proof of enrolment.

The unused government incentives may have to be returned to the government and the unused income may be taxed heavily. This will be discussed in more detail later in this article 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.

Students who are enrolled full-time at a foreign university in a course that is at least three consecutive weeks in duration will have access to educational assistance payments (EAPs). Note that this only applies to universities. It does not apply to foreign colleges or other foreign post-secondary educational institutions, which will require enrolment in a course that is at least 13 weeks in duration.

Proof of enrolment

In order to receive an EAP, a beneficiary of an RESP must provide appropriate proof of enrolment. You may be required to provide a letter of confirmation from the registrar's office or confirmation of enrolment on the institution's letterhead or a verification of enrolment form provided by Canadian universities and colleges. Please check what your financial institution will accept as proof of enrolment. 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 the lesser of $5,000 and total allowable expenses in the first 13 weeks of full-time enrolment in a qualifying educational program. If the beneficiary is enrolled in part-time studies the maximum amount of EAP that they can receive during the first 13 weeks of enrolment is the lesser of $2,500 and the total of all allowable expenses. There are no limits on plans that were established prior to 1989 and not modified after 1998.

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 $5,000 or $2,500 withdrawal limit will apply again upon their return to school.

This limit applies across all plans held with the same RESP provider. However, the limit does not apply to plans held by different providers.

After the first 13 weeks of post-secondary school, which for many students is their first term, the $5000 restriction on EAP withdrawals is removed. 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 that permit an

The EAP is taxable income to your beneficiary and is reported on their tax return. It is fully taxable and reported on a T4A slip.

EAP are met. The CRA will not expect providers to assess the reasonableness of each expense item, as long as the conditions permitting an EAP are met and the request is below $23,113 (in 2017 and indexed annually).

When the financial institution that holds the RESP receives a request for an EAP or a withdrawal of contributions, they review the request along with the proof of enrolment. The RESP provider will use a prescribed formula to determine the portions of CESG, other government incentives and income that form the EAP. You and the RESP provider will not be able to specify which amounts are taken out first.

What if the EAP isn't enough?

In situations where your beneficiary's educational costs exceed the limit for the first 13 weeks of enrolment, there are several options available, they include:

- The beneficiary can wait until the 13 weeks have passed;
- 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 or other government incentives; or
- Where the beneficiary's post-secondary tuition costs are substantially higher than average, you may be able to have the EAP limit increased. Higher EAP limits are granted on a case-by-case basis.

Taxation of EAPs

The EAP is taxable income to your beneficiary and is reported on their tax return. The income portion of the EAP does not retain its character (e.g. dividends, interest, and capital gains). It is fully taxable and reported on a T4A slip. Keep in mind that many students pay very little, if any, income tax since they are entitled to tuition tax credits in addition to their basic personal exemption and they may earn little to no taxable income.

Non-resident beneficiaries will receive an NR4 outlining the taxable income that is withdrawn and the non-resident withholding taxes that apply to this income.

Accumulated income payments (AIPs)

An AIP is an amount that may be paid to you, the subscriber, if there is income earned within the RESP that has not been 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 open for at least 10 years.
- The plan has reached December 31st 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 31st of the 40th year.
- All the beneficiaries named in the RESP have died.

As the subscriber, you 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 has occurred, the AIP can be paid to the successor subscriber, if there is one, who is resident in Canada.

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 DEI you identified in your RESP application form.

You will pay tax on the AIP you receive at your marginal tax rate plus an additional 20% tax (12% for residents of Quebec).

CESG, CLB or other provincial incentives remaining in the RESP may have to be repaid to the government when an AIP is made.

Taxation of AIPs

You will pay tax on the AIP you receive 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. You may also be able to avoid the penalty and defer the taxes on the AIP by transferring the AIP to your RRSP. It may also be possible to transfer the income earned in the RESP to an RDSP for the benefit of the RESP beneficiary to avoid the penalty.

Tax is generally withheld on AIPs. However, if you are able to transfer directly or contribute to your RRSP or a spousal RRSP, your AIP will not be subject to withholding tax. There is also no withholding tax on the amounts transferred to an RDSP.

Transferring the AIP to your RRSP

An AIP is 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 can transfer a maximum amount of $50,000 of AIPs 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 each 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 can no longer hold an RRSP and are required to choose a maturity option for your RRSP by December 31st 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 this time.

You will not be able to reduce the amount of AIP subject to tax if you are not the original subscriber or the spouse or common-law partner of a deceased 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 by making a tax-deferred transfer to your RRSP.

When you transfer an AIP to an RRSP, you will receive a T4A. You must include the income from the AIP on your personal tax return in the year you receive it. You will also receive an RRSP contribution receipt and be able to claim a deduction to offset the income inclusion.

Transfer of an RESP to an RDSP

Income that has accumulated in an RESP can be transferred to an RDSP if the RESP beneficiary is the same as the RDSP beneficiary and the beneficiary meets the existing age and residency requirements for RDSP contributions. Also, one of the three following requirements must be met:

- The beneficiary is, or will be unable to pursue post-secondary education because of a severe and prolonged mental impairment; or

An RESP must be closed by December 31st 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 pursuing post-secondary education.

- The RESP has been in existence for at least 35 years; or
- The RESP has been in existence for at least 10 years and the beneficiary(s) of the plan has attained 21 years of age and is not eligible to receive EAPs.

If you rollover the AIP payment to an RDSP, it will not be subject to regular income tax or the additional 20% tax. No tax slips will be issued.

The amount transferred from the RESP to an RDSP will reduce the beneficiary's RDSP lifetime contribution limit. A beneficiary has a lifetime RDSP contribution limit of $200,000. Amounts transferred from an RESP to an RDSP will not attract RDSP grant.

Payment to designated educational institution (DEI)

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 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 is not taxable income to you or your beneficiary. This type of payment is not eligible for a charitable donation tax credit.

Closing an RESP

35-year limit

An RESP must be closed by December 31st 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 pursuing post-secondary education.

Plan closed at your request

You may choose to close your RESP if your beneficiary is not attending a 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, who would be able to benefit from the plan and keep the plan open under certain circumstances. Alternatively, you can name a replacement beneficiary on an existing individual plan

Withdrawing the remaining funds

If the beneficiary of the RESP does not need all of the funds accumulated in the RESP, you may be able to request that the remaining balance be paid to you. RESP funds are composed of the capital you originally contributed, CESG, CLB, designated provincial program incentives and investment income. The nature of the funds in the plan will determine the manner in which they will be paid out when you close your RESP.

- **Contributions** — You can withdraw the contributions you made to an RESP or you can pay them to a beneficiary. There are no income tax consequences to this type of withdrawal since this represents a return of your contributions, which you originally made with after-tax dollars.
- **Government incentives** — Any amounts originating from government incentives (e.g. CESG, CLB, provincial incentives) that remain in the plan must be repaid to the government.

Non-resident beneficiaries cannot receive payments of CESG, CLB or some provincial program incentives.

- **Investment income** — You can withdraw the remaining investment income from the RESP in the form of a taxable AIP or as a tax-deferred AIP transferred to your RRSP/spousal RRSP or an RDSP. See the previous section on AIPs for more details on AIP withdrawals.

Non-residents

Non-resident beneficiary

It is important to determine the beneficiary'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 for tax purposes.

If a beneficiary becomes a non-resident at a later date, it is important to understand the potential implications. In some cases, the beneficiary may not be able to use all of the funds that have accumulated in an RESP.

Note that you (the subscriber), or the beneficiary(ies) of the plan, 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, they can receive the investment income earned in the RESP. 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 made when the beneficiary starts attending post-secondary school.

Non-resident beneficiaries cannot receive payments of CESG, CLB or some provincial program incentives. If the beneficiary is a non-resident at the time they attend a post-secondary educational institution, these amounts will need to be returned to the government.

The tax rules in the beneficiary's country of residence may also apply to the RESP. The beneficiary should obtain professional advice in the country where they live to ensure they understand any potential tax consequences.

Non-resident subscriber

You (the subscriber) can only make contributions to an RESP if you provide your SIN and if the beneficiary is a resident of Canada.

The plan can remain open even if you are a non-resident of Canada but there can be Canadian tax implications if you decide to close the plan.

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 DEI.

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, CLB and designated provincial program incentives. This portion of the plan must be returned to ESDC and the applicable provincial government if you close the plan while you are a non-resident of Canada.

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 a professional tax advisor in your country of residence to understand any tax implications of holding an RESP in Canada.

Conclusion

There are many things to consider when withdrawing funds from an RESP. The needs of the beneficiaries along with the tax implications that may apply to both the subscriber(s)

Please contact us for more information about the topics discussed in this article.

and beneficiary(s) must be considered. Speak with a qualified tax advisor to ensure that you have taken into account your circumstances before making a withdrawal from the RESP.

This article outlines several strategies, not all of which will apply to your particular financial circumstances.

The information is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.