Education Planning – For the Children in Your Life

Most parents hope their children will pursue higher education – and for good reason. A post-secondary education can prepare your child for a fulfilling career, lead to enhanced earnings potential and, ultimately, steer them on the path to a successful and rewarding life. However, if adequate savings are not in place for post-secondary education, your children could graduate with the added stress of carrying significant student debt before they've even secured their first job.

In the early 1990s, average undergraduate tuition fees in Canada were $1,464.[1] Today, these fees have risen dramatically to an average of $5,959[2] – far outpacing inflation. And, in today's competitive job market many young people are choosing to remain in school to earn a second degree, making post-secondary education expenses even higher. According to the Canadian Federation of Students, Canadian post-secondary students graduate with an average student debt of $30,000.[3]

With these costs in mind, education planning should be an important component of your overall family wealth management plan. Beginning a dedicated education savings plan while your children are still young helps ensure you have the funds necessary when they begin their post-secondary studies.

Education savings options

There are many ways to fund your children's higher education. What's right for your situation depends on many factors, including: your disposable income; whether financial assistance will be provided by other family members, such as grandparents; the ages and number of children involved; the options for your savings if your child doesn't pursue a formal post-secondary education program; and whether you want your children to have control over the assets when they reach the age of majority.[4]

Registered Education Savings Plans

Many parents begin saving for their children's post-secondary education by establishing a Registered Education Savings Plan (RESP).

While your RESP contributions are not tax deductible, the funds grow tax-deferred inside the plan and are eligible for additional contributions from the federal government through the Canada Education Savings Grant (CESG). Over the life of the RESP, parents can contribute up to $50,000 per child, and each child qualifies for up to $7,200 in CESGs. As well, RESPs may be eligible for additional educational grants through other federal and provincial programs, where applicable.[5]

When RESP funds are used to pay for education expenses, the accumulated income (including CESGs) is taxed in your child's hands, resulting in little or no tax if withdrawn over a few years, because of the basic personal exemption and the tuition and education tax credits.

Your RESP contributions can be returned to you (or your child) tax-free at any time. However, a withdrawal of the RESP contributions will require repayment of the CESG if your child is not attending a qualifying post-secondary educational program.

While an RESP is a great starting point, you may want to consider additional funding options to supplement your children's education expenses.

Non-registered account

One of the simplest ways to supplement RESP savings is by opening a non-registered account specifically earmarked for your children's post-secondary education savings. The account will not be subject to any special rules or restrictions concerning

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contribution amounts or their frequency, and you maintain control over the timing of contributions and use of the funds, even when your children reach the age of majority. You can withdraw money to fund your children's post-secondary education, or both.

The downside of saving for your children's education with a non-registered account is that all income and capital gains are taxed in your hands, causing tax inefficiencies.

Tax-Free Savings Account

Another option to consider is the Tax-Free Savings Account (TFSA). Canadians can contribute $5,500 annually to a TFSA and unused TFSA contribution room is carried forward for use in future years. While your contributions to a TFSA are not tax deductible for income tax purposes, your savings grow tax-free, and you can withdraw the money when it comes time to finance your children's post-secondary education without attracting any taxes.

Additionally, once they reach the age of majority, you can give money to your children, who can then use these funds to make a contribution to their own TFSA. While you can't contribute directly to someone else's TFSA, this strategy allows you to help your adult children build assets, without having to worry about any income being attributed back to you. However, they will have full control over how their TFSA funds are used and whether they are withdrawn.

Trusts

A formal trust may be appropriate if you want to contribute a large amount of money in a tax effective manner, or where it is important that a trustee has flexibility and discretion over the management of the trust assets.

A formal trust requires that there be a settlor, contributed property, a trustee and one or more beneficiaries. The person, usually a parent (or grandparent), who creates the trust and initially contributes the assets is the settlor. The trustee is responsible for choosing the investments and for the overall administration of the trust, including distributing funds as governed by the terms of the trust. For an educational trust, the beneficiary – a child or children – is the individual(s) who will benefit from the trust by receiving payments when they begin their post-secondary studies. The trust deed specifies how the trustee is to manage the trust assets, names the beneficiaries and details when the trust's income and capital can be paid to the beneficiaries or the educational institution.

While there are costs associated with establishing and administering a trust, parents (or grandparents) have peace of mind knowing that the money in the trust will be used for the purpose for which it was intended.

Corporate dividends

If you are an incorporated professional or have an incorporated family business, consider accumulating funds in your corporate account, and later paying out company dividends to fund your child's education, starting in the calendar year that your child reaches the age of 18 (in light of the 'kiddie tax' rules). With this strategy, your child is required to own shares of your company, either directly or indirectly, which is easiest to implement when initially establishing your corporate structure (if possible).

Since the dividends are paid out directly to your child – who will presumably be in a lower tax bracket than you – this may be a viable and tax-effective income-splitting strategy to explore with your professional tax advisor; particularly if there will be significant retained earnings in your company.

Life insurance

If you've maximized your RESP contributions and have a need for permanent life insurance protection, this may be another way to help save for your child's post-secondary education. Using life insurance gives you the ability to tap into the excess cash value in certain types of policies.

With this strategy, an application is made for a life insurance policy naming yourself as the owner and your child as the individual whose life is being insured. The beneficiary – the individual who will receive the death benefit – can be the owner of the policy or someone else. For example, grandparents wanting to help fund their grandchild's education could purchase an insurance policy insuring their grandchild, and then name their child – the grandchild's parent – as the policy beneficiary.

To build the cash value within the life insurance policy, a supplement to the required monthly premium is made by depositing additional payments (within set limits) which grow

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tax deferred inside the policy during the accumulation period. When your child reaches the age of majority, ownership of the policcan be transferred tax-free to your child. As the new owner, your child can withdraw the excess cash value that has accumulated to pay for post-secondary education costs or other expenses. Any resulting gains will be taxed in the hands of your child, who will presumably be in a lower tax bracket than you.

It is important to note that this strategy is not suitable for everyone as you may lose control over the money and other policy rights, such as beneficiary designations, after you transfer title to your children, as well as issues caused by excess withdrawals impacting the coverage offered by the contract.

Choosing the best option

The actual cost of a higher education varies with the school chosen, the degree(s) sought and the discipline selected. While these costs continue to rise, a comprehensive education savings strategy, and an early start, will help ensure your children get the education they want and deserve.

Your BMO financial professional can prepare an in-depth education analysis that details the anticipated costs of educating your children and your ability to fund these costs. This information will assist you in developing a personalized education savings strategy that complements your overall wealth management plan, and may include one or more of the savings options discussed in this article.

For more information, speak with your BMO financial professional.

[1] Statistics Canada, 'The Daily,' September 1, 2005.

[2] Statistics Canada, 'University Tuition Fees,' 2014.

[3] The Canadian Federation of Students, 'Public Education for the Public Good,' 2014.

[4] Age 18 or 19, depending on your province of residence.

[5] Additional educational grant programs include the Canada Learning Bond, Quebec Education Savings Incentive, Saskatchewan Advantage Grant for Education Savings (SAGES) and British Columbia Training and Education Savings Grant (BCTES). Please note: The SAGES and BCTES are not available for BMO Nesbitt Burns RESP accounts.

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