Education Planning

RESPs and the Canada Education Savings Grant

An investment in your child's post secondary education is a gift that will benefit your child for the rest of his or her life. With the introduction of the Canada Education Savings Grant (CESG) in 1998, Registered Education Savings Plans (RESPs) have become one of the best ways to save for your child's education. This article reviews the basic RESP rules and outlines the main features of the CESG.

Registered Education Savings Plans (RESPs)

An RESP is a tax-deferral plan designed to help parents, grandparents and anyone interested in saving for a child's education. While RESP contributions are not tax deductible, the income earned on contributions held inside the plan compounds on a tax-deferred basis. The lifetime contribution limit per beneficiary is $50,000. The CESG will only be paid on the first $2,500 of contributions per beneficiary per calendar year. The lifetime CESG limit per beneficiary is $7,200. While a child may be the beneficiary of more than one RESP, all contributions made to the respective plans cannot exceed the stated maximums. When the income and CESGs are eventually withdrawn from the RESP to pay for education-related costs such as tuition, books, travel and accommodation, they are taxed in the hands of the beneficiary (the student), not the subscriber (contributor) and should attract little or no tax if withdrawn over a number of years.

Types of RESPs

Single Beneficiary Plans

Single beneficiary plans are set up for only one person. This person does not need to be related to the subscriber, so with this type of plan, you may name your niece, nephew, godchild or even yourself or your spouse as the beneficiary of the plan. There are no restrictions on the age of the beneficiary but contributions cannot be made after the 21st year from which the plan was first established.

Family Plans

Family plans are set up for one or more beneficiaries. However, each beneficiary must be related by blood or adoption to each living subscriber or have been related to a deceased original subscriber. A beneficiary can be added or changed provided the new beneficiary is similarly related to the subscriber and is under 21 years of age. In a family plan, the subscriber cannot be a beneficiary. RESP contributions can be made until the beneficiary reaches age 21.

Canada Education Savings Grant (CESG)

Since 1998, grant room accumulates for a Canadian resident child until the end of the year in which he/she turns 17, even if the child is not currently a beneficiary of an RESP. From 1998 to 2006, $400 was added annually to the grant room for each eligible child (or since birth if the child was born after 1998). In 2007 or later, $500 is added annually to the grant room for each eligible child (or since birth if the child was born after 2007). The lifetime CESG limit per beneficiary is $7,200, while the annual CESG limit is $500 (20 percent of $2,500).

When an RESP contribution is made, the government pays a grant into the plan based on the child's available CESG contribution room. The grant is calculated as the lesser of:

- 20 percent of the RESP contribution amount;
- 20 percent of available CESG contribution room; or
- $1,000 (20 percent of $5,000 if there is unused grant room from a previous year).

If no RESP contribution is made, the CESG contribution room is carried forward and can be used in future years.

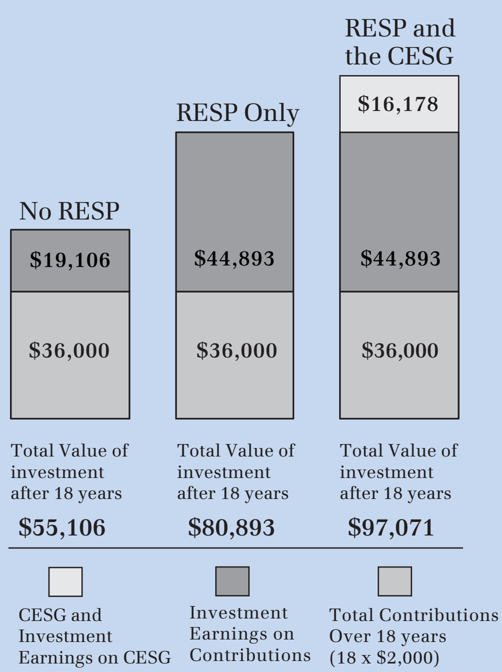
For example, a father has a daughter who was born in 2001 and he does not open an RESP for her until the year 2007 when she is six. The child will have $2,900 ($400 for each year from 2001-2006 and $500 for 2007) of CESG contribution room available. If the father contributes $5,000 to an RESP for his daughter in 2007, a CESG of $1,000 (20 per cent of $5,000) will be paid into the plan. The child will still have $1,900 ($2,900 minus $1,000) of CESG contribution room available that can be carried forward for use in a future year. If the father then contributes $5,000 to the RESP in 2008, 2009, 2010 and 2011, additional CESGs of $1,000 will be paid into the plan each year until 2011 when only $900 will be paid. Since there would be no more CESG contribution room carried forward into 2012, even if the father contributes $5,000 in 2012, the CESG payment would be only $500.

Table

Year	RESP contribution	Actual CESG paid to the RESP	CESG room available at year end
2007	$5,000	$1,000	$1,900
2008	5,000	1,000	1,400
2009	5,000	1,000	900
2010	5,000	1,000	400
2011	5,000	900	0
2012	5,000	500	0

The following chart shows the advantage of using an RESP to save for your child's education and the additional benefit provided by the CESG.

Growth in Savings



Assume annual contributions of $2,000 for 18 years at an 8% annual rate of return and 46% tax rate.

If you invested $2,000 a year for 18 years inside an RESP, you would accumulate $80,893 versus only $55,106 if the funds were invested outside an RESP. And if the RESP received the CESG each year, the RESP would be worth $97,071 after 18 years. By combining the benefits of the RESP and the CESG, you could accumulate over 76 percent more money for your child's education.

Special Rules Apply if the Child is Age 16 or 17

In the year a child turns age 16 or 17, RESP contributions will only receive a CESG if a minimum of $2,000 in RESP contributions was made before the year the child turns 16, or if a minimum of $100 in annual RESP contributions was made in any four years before the year the child turns 16.

RESP withdrawals

Educational Assistance Payments

When the beneficiary begins his or her full-time (or part-time, if the student is disabled) postsecondary education or training program, the CESG and all of the investment income earned in the RESP may be used to pay for education-related expenses. Expense reimbursement is limited to $5,000 for the first 13 weeks unless special permission is obtained from the Minister designated for the purposes of the Canada Education Savings Act. The withdrawals, called Educational Assistance Payments (EAP), are taxed in the hands of the beneficiary.

Return of the Subscriber's Capital

A subscriber may withdraw his or her original RESP contributions at any time, with no tax consequences. However, if you withdraw contributions before the beneficiary begins his or her post-secondary education, you may have to make a CESG repayment equal to 20 percent of the amount withdrawn if the plan has received a CESG payment.

For example, if Clare established an RESP in 2001 for her six-year-old daughter Tanya and contributes $1,500 a year for six years, a total of $1,800 in CESGs would have been paid into the plan ($1,500 X 20 percent X 6 years). In 2007, if Clare withdraws $3,000 of her original contributions from the RESP, she will not have to pay income tax on the capital withdrawal. However, the RESP must make a CESG repayment of $600 (20 percent of $3,000) to the government. Once Tanya begins her post-secondary studies, Clare may withdraw her RESP contributions without having to repay the CESG.

What if the Beneficiary Does Not Pursue Post-Secondary Studies?

If the beneficiary does not pursue post-secondary studies and another beneficiary is not named, the contributions are returned to the subscriber with no tax consequences and the CESG payments are returned to the government. The accumulated income in the plan may be withdrawn by the subscriber if the following conditions are met:

a) the subscriber is a Canadian resident; b) the RESP is at least 10 years old; and, c) all beneficiaries under the plan are age 21 or older and not pursuing post-secondary education.

The accumulated income may be withdrawn by the subscriber without meeting (b) or (c) if all of the plan's beneficiaries are deceased and were related to the subscriber by blood or adoption or were the niece, nephew, great-niece or great-nephew of the subscriber. Canada Revenue Agency may also allow an accumulated income payment to be withdrawn without meeting (b) or (c) if the beneficiary will be unable to pursue post-secondary studies due to a severe and prolonged mental impairment.

When the accumulated income is returned to the subscriber it is taxed in the subscriber's hands at regular tax rates plus a further 20 percent tax is levied. The regular tax can be deferred and the 20 percent tax avoided if the subscriber has sufficient RRSP contribution room available. Up to $50,000 of the income may be used to make a regular or spousal RRSP contribution. Any income in excess of $50,000 would be taxed as income and assessed the 20 percent penalty.

If the subscriber dies, the executor of his or her estate will be responsible for managing the RESP. The capital belongs to the subscriber's heirs who may elect to leave it in the RESP or withdraw it with no income tax consequences. If the spouses are joint subscribers the surviving spouse would continue to manage the plan.

When Does an RESP Mature?

An RESP matures when all the funds have been withdrawn or by the end of the year that includes the 25th anniversary of the plan, whichever comes first. Since the maximum life of an RESP is 26 years, parents should be careful when setting up a family plan with multiple beneficiaries. For example, if a plan is established when the first child is born, and a sibling is born ten years later and added as a beneficiary to the existing RESP, he or she will only be 15 when the plan would have to be wound up. Setting up a separate plan for the second child would avoid this problem.

The CESG must be repaid to the government if a plan is terminated before all the CESGs have been paid out for post-secondary education or when a beneficiary under the plan is replaced, except if the new beneficiary is under age 21 and is either a brother or sister of the former beneficiary, or both beneficiaries are related to the contributor by blood or adoption.

The lifetime CESG limit may affect family plans where CESGs have been received for more than one beneficiary. For example, assume $8,000 of CESGs were paid into a family plan for David and Janet ($4,000 of CESGs per beneficiary). If only David pursues post-secondary education, $7,200 of the CESG can be paid to him even though part of the CESG was paid into the plan on behalf of Janet. The remaining $800 would be repaid to the government. It is only the CESG that would have to be repaid, not the income earned on the CESG.

Enhanced Benefits for RESPs

Enhancements have been recently introduced that make using RESPs for education planning even more appealing by providing for additional government assistance in the following ways:

Canada Learning Bond

The government of Canada has introduced a Canada Learning Bond (CLB) for children born after December 31, 2003. Only families with less than approximately $37,178 of annual income in 2007 (income brackets as defined by Human Resources & Social Development Canada - HRSDC) are eligible to receive the CLB. The CLB is a grant that is paid into the child's RESP. It consists of an initial sum of $500 and for subsequent years, annual payments of $100 for up to fifteen years or as long as the family remains in the low income category.

Enhanced CESG

The 20 percent CESG may be increased to 30 percent for families with an annual income between $37,178 and $74,357 in 2007 (income bracket as determined by HRSDC). The CESG may be increased to 40% for families with an annual income of under $37,178 in 2008 (income bracket as determined by HRSDC).

Alberta Centennial Education Savings Plan

The province of Alberta has introduced the Alberta Centennial Education Savings Plan that provides for a grant to all children born in Alberta on or after January 1, 2005, to be used to open an RESP. The grant provides for $500 in the year of birth with additional grants of $100 available to all children at ages 8, 11 and 14.

Start planning today

To get the maximum benefit from an RESP and the CESG, it makes sense to start your savings program early. For example, let's assume you have a new born child and chose to set up an RESP right away. You could invest a lump sum of $16,500 into the RESP today and set aside $33,500 in a non-registered account. In each of the next 14 years, funds will be withdrawn from the investment account and contributed into the RESP to receive the yearly maximum allowable grant. A total of $2,500 will be contributed for the 13 years and $1,000 contributed in the 14th year. This strategy will allow for tax deferred growth sooner on the initial contribution and also provide the beneficiary with the maximum CESG available. Your BMO Nesbitt Burns Investment Advisor can help by preparing an Education Analysis that identifies how much you will need to save for your children's education and the most effective way to meet that goal. Prepared for you using our proprietary planning software BMO Nesbitt Burns Pathfinder, an Education Analysis will help you estimate future post-secondary education costs by analysing a number of factors including the number of beneficiaries, the number of years of postsecondary education you anticipate for each child, your existing savings and ability to save going forward, and a possible rate of return for the level of risk you can comfortably accept. The Pathfinder program also allows you to compare the various types of arrangements that can be used to save for education, including RESPs, personal investment accounts and formal trusts. Through the program's database, you are able to incorporate the costs for more than 50 Canadian and American Universities into your projection.

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For more information on RESPs and the CESG, please contact your BMO Nesbitt Burns Investment Advisor.

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