Registered Education Savings Plan

While a post-secondary education is an invaluable personal asset, it is expensive to acquire. The good news is that, over the years, Canada Revenue Agency (CRA) has significantly enhanced the Registered Education Savings Plan (RESP) rules. In addition to the tax advantages, there are increased savings limits and the Canada Education Savings Grant (CESG) – a program that deposits up to $500 per year directly into your child's RESP. To obtain the maximum benefit from an RESP and the CESG, it makes sense to start your savings program early. We can help you determine the best way to finance your child's education and work with you to develop a savings program that will help meet your education savings goals.

Your RESP contributions are not tax deductible nor are they considered taxable when withdrawn. The main reason for contributing to an RESP is that all of the investment income generated compounds on a tax-deferred basis. Since RESPs may be in existence for up to 35 years, the tax-deferred compounding of income can result in substantial growth in the plan. When the income and CESG are paid out for education expenses, called Education Assistance Payments (EAPs), the funds are taxed in the student's hands and not the subscriber's (i.e. the individual who made the contribution).

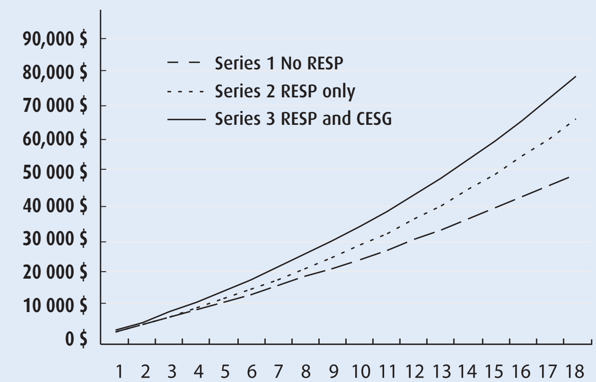
Contributions

You may contribute a lifetime maximum of $50,000 per beneficiary. The number of years that contributions can be made is 31 years. There is no minimum annual contribution limit that you must make.

Canada Education Savings Grant

The CESG was introduced to help ensure that students will have enough money to fund a higher education. Under the program, the Government of Canada pays a grant of 20 per cent of annual contributions to a maximum of $500 per beneficiary ($1,000 in CESGs if there is unused grant room from a previous year) into the RESP.

Comparison of Growth Using an RESP, Personal Investment Account and Formal Trust



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

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

Children born after 1997 are eligible for CESGs totalling $7,200. The following chart shows the benefit of using an RESP to save for your child's education and the additional benefit provided by the CESG.

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If you are in a 48 per cent tax bracket and invested $2,000 per year at six per cent for 18 years inside an RESP, you would accumulate $65,520 versus only $49,407 if the $2,000 was invested outside an RESP. If the RESP received the CESG each year, the RESP would be worth a total of $78,624 after 18 years. By combining the benefits of an RESP and the CESG you could accumulate over 60 per cent more money than saving for your child's education outside an RESP.

Multiple Beneficiaries

Assume a total of $8,000 of CESG was paid into a family plan with two beneficiaries ($4,000 of CESG received for each beneficiary). If only one beneficiary pursues post-secondary education, $7,200 of grant money can be paid to that beneficiary even if the beneficiary only earned $4,000 in grants. The remaining $800 would have to be repaid to the government. However, only the CESGs would have to be repaid, not the income earned on the CESG.

Contributions and the CESG

While unused CESG contribution room may be carried forward for use in future years, RESP contributions made in one year that exceed the available CESG contribution room cannot be carried forward and applied to a future year. For example, if the subscriber makes a $3,000 RESP contribution this year and the child has $2,000 of available CESG contribution room, a $500 ($2,500 x 20 percent) CESG payment will be paid into the plan. Next year, if a $1,500 RESP contribution is made, a CESG of $300 ($1,500 x 20 per cent) will be paid into the plan. The extra $1,000 contributed to the RESP in the prior year cannot be carried forward to help qualify for the full CESG payment in a future year.

Contribution requirements for beneficiaries who are 16 or 17 years old

Since the CESG has been designed to encourage long term savings for post-secondary education, there are specific contribution requirements for beneficiaries who attain 16 or 17 years of age. RESPs for beneficiaries 16 and 17 years of age can only receive CESG if at least one of the following two conditions is met:

- a minimum of $2,000 of contributions has been made to, and not withdrawn from, RESPs in respect of the beneficiary before the year in which the beneficiary attains 16 years of age; or
- a minimum annual contributions of at least $100 has been made to, and not withdrawn from, RESPs in respect of the beneficiary in any four years before the year in which the beneficiary attains 16 years of age.

This means that you must start to save in RESPs for your child before the end of the calendar year in which the beneficiary attains 15 years of age in order to be eligible for the CESG.

Enhanced Benefits for RESPs

Canada Learning Bond

Government of Canada has introduced a Canada Learning Bond (CLB) for children born after December 31, 2003 in families entitled to the National Child Benefit (NCB) supplement for their child. 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 15 years for each year the family is entitled to the NCB supplement for the child.

Enhanced CESG

The 20 percent CESG may be increased to 30 percent on the first $500 contribution for families with less than approximately $85,000 of annual income and to 40 percent for families with less than approximately $42,000 of annual income (the annual income amounts are adjusted yearly based on the rate of inflation).

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 $100 grants available to those children at ages eight, eleven, and fourteen.

Quebec Education Savings Incentive

Each year, an RESP account can receive an amount equal to 10% of the net contributions paid into it over the course of a year, up to a maximum of $250. To help low-income families, an increase of up to $50 per year, calculated on the basis of family income, may be added to the basic amount.

Under the Quebec Education Savings Incentive, a single beneficiary cannot be granted more than $3,600 for all of the RESPs of which the child is beneficiary.

RESP and your Will

An RESP can be held by a single subscriber or joint subscribers (generally a parent or parents). Since the RESP is the property of the subscriber(s), it is an asset that belongs to the subscriber(s). If there is only one subscriber, then upon death, the RESP becomes the property of the subscriber's estate. If there are two subscribers (joint subscribers), upon the first death, the RESP becomes the property of the surviving subscriber.

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The RESP assets would be subject to the terms of the deceased subscriber's Will. Ideally, where there is only one subscriber, the subscriber's Will would appoint a successor subscriber to continue the RESP. If the maximum RESP contribution limit has not been reached, the succeeding subscriber can continue the RESP contributions.

Joint subscribers are encouraged to have mirror RESP clauses in their Wills, directing how the RESP is to be dealt with, upon the surviving subscriber's death. Of course without a contract between the joint subscribers, the surviving subscriber is free to change the RESP clause in his or her Will.

US Citizens and RESPs

If you are a US person (US citizen or green card holder) living in Canada, you are required to file annual US income tax returns in addition to your Canadian income tax return. It is important to consider the US income tax consequences of your investment and savings strategies – including setting up an RESP for your child.

A US citizen parent contributing to an RESP should be including the income earned within the RESP as taxable income for US tax purposes. However, for Canadian income tax purposes, the RESP income is generally only taxable to the child when withdrawn from the RESP for education purposes and is therefore not included as taxable income to the contributor. This mismatch in the timing of the taxation (and taxpayer) between Canada and the US may result in double taxation.

Depending on the specific terms of the RESP, if the contributing parent is not a US person, but the beneficiary is, the accumulated income may be included in the child's income for US tax purposes upon withdrawal from the RESP. The ultimate distributions from the RESP that include accumulated income may also be subject to significant interest charges in addition to the US income tax that results from any RESP withdrawal.

In addition to US income tax considerations, annual US information reporting requirements should be considered as RESPs may be considered foreign trusts for US income tax purposes.

If you or your child is a US person, the US tax filing and reporting obligations associated with a Canadian RESP should be discussed with a cross-border tax advisor to determine the feasibility of establishing (or maintaining) an RESP.

Please contact your BMO Financial Professional for more information and strategies to effectively develop a child's education savings plan.

BMO Wealth Management

We're here to help.™

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