

With the ever increasing cost of post secondary education, the Canada Education Savings Grant (CESG) and tax-deferred growth of a Registered Education Savings Plan (RESP) are attractive ways to plan for this major life event. An RESP is a government sponsored savings program specifically designed for education savings. The benefits of an RESP arise through:

- tax deferral (future income earnings remain tax sheltered until withdrawn)
- income splitting (amounts paid out of the plan are taxed in the hands of the beneficiary whose tax rate is typically lower)
- CESG incentive (20% grant paid annually by the government on contributions up to \$2,500) for beneficiaries under 18

INTRODUCTION

A subscriber is the person(s) who opens the plan and makes contributions. An RESP beneficiary must be a Canadian resident and must have a Canadian Social Insurance Number (SIN). The beneficiary is the person for whom the RESP is established.

INDIVIDUAL PLANS

An **individual plan** is created by a subscriber(s) for one beneficiary. A subscriber may designate anyone as the beneficiary of the plan, including themselves, a spouse or common-law partner. There is no age restriction on the beneficiaries of an individual RESP plan. However, to be eligible to receive a CESG payment a beneficiary must be under the age of 18.

FAMILY PLANS

A **family plan** is an RESP set-up by a subscriber(s) on behalf of one or more beneficiaries. The 2008 Federal Budget increased the age to 31 from 21 years as the contribution age limit for the beneficiaries for a family plan¹.

The beneficiaries must be related to the subscriber by blood or adoption. Children, grandchildren, brothers & sisters are considered blood relations while nieces and nephews are not. In other words, anyone can contribute to an individual plan but only a blood relative may contribute to a family plan. Subscribers **may not** designate themselves or a spouse or common-law partner as beneficiary under a family plan (in contrast to an individual plan where they can designate themselves, their spouse or common-law partner).

ANNUAL & LIFETIME CONTRIBUTION LIMITS

The 2007 Federal Budget eliminated the annual contribution limit and the lifetime limit has been increased to \$50,000. Contributions over \$50,000 are subject to a penalty of 1% per month on the excess amount. The interest paid on money borrowed to contribute to an RESP is also not tax deductible. The 2008 Federal Budget increased the number of years you can contribute to an RESP to 31 years. The maturity date of the plan has also been extended 35 years after it has been set-up.

CANADIAN EDUCATION SAVINGS GRANT (CESG)

The Canadian Education Savings Grant (CESG) is a Grant whereby the Federal Government matches contributions up to \$2,500 per year with a 20% grant (\$500). In addition if you missed a contribution in the previous year and make a \$5,000 contribution in one year you are eligible to receive \$1,000. Contributions must be made by December 31 and are not tax deductible. The maximum lifetime grant per child is \$7,200. The administrator of the RESP applies for the CESG on behalf of the subscriber until age 17. Note that the CESG is **excluded** from the lifetime contribution limit of \$50,000.

¹ For individual RESP beneficiaries that qualify for a disability tax credit, the contributory period and the lifespan of the RESP may be extended to 35 years and to 40 years, respectively. The terms and conditions of the RESP must include this optional provision.

In the case of children aged 16 & 17, the grant will be paid only if there have been contributions to a plan of at least \$100 a year for a minimum of 4 years **or** if total previous contributions had reached \$2,000 before that time. This means that you must start saving in the RESPs for your child before the end of the calendar year in which they turn 15 years old in order to be eligible for the grant.

CARRY FORWARD LIMITS

Any child who is a Canadian resident accumulates “grant room” from the later of the child’s date of birth or January 1, 1998 until age 17 (including the year the child turns 17). For contributions after 2006, the grant room is an annual maximum of \$500. Grant room accumulates whether or not a child is an RESP beneficiary. You can carry forward **unused CESG room**.

INVESTMENTS

Investments within an RESP are restricted to “qualified investments” and are the same as for an RRSP.

ELIGIBLE INSTITUTIONS AND PROGRAMS

Eligible post-secondary educational institutions include a Canadian university, community college, technical college and certain universities outside Canada. A qualifying educational program is an educational program which lasts at least three consecutive weeks, and requires a student to spend no less than 10 hours per week on courses or work in a program at a post-secondary level. A program at a foreign educational institution must last at least 13 weeks.

EDUCATIONAL ASSISTANCE PAYMENTS

RESP withdrawals by the beneficiary are called **Education Assistance Payments (EAP)** and are taxable to the student. An EAP consists of the RESP income and CESG. The amount of EAPs is limited to a maximum of \$5,000 (for plans entered into after 1998) until the student has completed 13 consecutive weeks in a qualifying educational program. Once the 13 week period is over, the beneficiary can get any amount of EAPs. Students requiring more than \$5,000 in EAPs during the first 13 weeks of enrolment may apply to Human Resources & Skills Development Canada (HRSDC) for permission to receive a larger amount. Normally payments must be in support of qualifying full time post-secondary education, but payments in support of part-time education are permitted for students who cannot enrol full-time due to physical or mental impairment.

To provide more flexibility, Budget 2008 proposes to allow a six-month grace period for receiving EAPs after ceasing to be enrolled in a qualifying program, provided it had been made immediately before the student’s enrolment ceased. This will apply to RESP beneficiaries who are no longer enrolled in a qualifying program after 2007.

Generally funds used for an eligible program have few restrictions and generally include tuition fees, books, equipment, lab fees, accommodation, transportation and other incidentals relating to a student’s education.

CAPITAL CONTRIBUTIONS

Beneficiary

The financial institution/promoter can payout the contributions made by the subscriber to the beneficiary without any tax consequences. It’s important to remember that all contributions made over the years can be withdrawn tax-free.

Planning Tip: Consideration should be given to the combination of capital withdrawn and EAPs received to ensure the beneficiary makes the best use of their personal credits and low tax bracket.

Subscriber

The subscriber may also withdraw contributions (refund of contributions) at any time without any income tax implications. However, the government has put in place several anti-avoidance rules to ensure that the CESG program is not abused as a result of premature refund of contributions.

Contributions must be redeemed in the following order:

- **Assisted contributions – contributions that received CESG**
- **Unassisted contributions from January 1, 1998 – contributions that did not receive CESG**
- **Unassisted contributions prior to January 1, 1998 – contributions that did not receive CESG**

As a result, when a contribution is removed when none of the beneficiaries are eligible for an EAP from a plan that has received a CESG, an amount between 20% and 40% of the contribution withdrawn must be repaid to the government up to the extent that CESGs were received.

If more than \$200 of pre-1998 unassisted contributions in the same calendar year are withdrawn from the plan, all the beneficiaries of the RESP will not qualify for CESG for the remainder of the year of withdrawal or the following two years. Additionally, the beneficiaries will not accumulate any new CESG contribution room for the following two years.

If any amount of assisted contributions are redeemed after March 22, 2007, all the beneficiaries of the RESP will not be eligible for the additional CESG for the remainder of the year of the withdrawal and the following two calendar years.

Contributions that are withdrawn when one of the RESP beneficiaries (in a family RESP) is eligible for an EAP do not require grant repayments. Subscribers must take care that enough contributions remain in the RESP for younger beneficiaries to qualify for the CESG when he/she turns 16 and 17 in the calendar year.

CHANGING BENEFICIARIES ON AN RESP

If the named beneficiary does not go on to post-secondary studies and the subscriber wishes to change beneficiaries, this can be accomplished provided the following requirements are adhered to:

1. **Individual Plan** - the new beneficiary can be anyone, even the subscriber. However, to be eligible to use the CESG money, the replacement beneficiary must be:

- under age 21 and
- either the brother or sister of the former beneficiary.

OR

- both the former and replacement beneficiaries are under 21 and
- connected to the subscriber by blood or adoption.

If either of these 2 options cannot be fulfilled, the CESG must be repaid to the government.

2. **Family plan** - the replacement beneficiary must be connected to the subscriber by blood or adoption and under the age of 21. The CESG paid into the family plan can be used by the replacement beneficiary or any other of the beneficiaries up to a maximum of \$7,200 per beneficiary. Any excess must be repaid.

RETURN OF CONTRIBUTIONS & ACCUMULATED EARNINGS TO THE SUBSCRIBER

If the beneficiary does not go on to post-secondary studies (and there is no one else who can be substituted as a beneficiary) you must collapse the RESP. An RESP may allow the subscriber to gain access to **Accumulated Income Payments (AIP)** when **all** of the following rules are met

- All of the plan's beneficiaries are over 21 but none is pursuing a post-secondary education
- The plan has been in existence for at least 10 years
- The subscriber is a Canadian resident
- The recipient of the AIP is a subscriber of the RESP

If these four requirements are met, a withdrawal of AIP (which consists **only** of the earnings of the plan) can be made by the contributor(s). If the contributor has RRSP contribution room available, the AIP can be transferred to an RRSP in the contributor's name (to a lifetime maximum of \$50,000). Otherwise the earnings are taxable and subject to a 20% penalty (12% for Quebec residents).

The original capital can be withdrawn with no tax consequences because it was paid with after-tax dollars.

The CESG payments must be returned to the government.

Planning Tip: *When setting up an RESP, naming joint spousal subscribers on the plan should be considered. This will allow for the option of transferring an AIP to either spouse's RRSP if a future transfer is necessary. In the event of the death of one of the joint subscribers, the surviving subscriber will have the right of survivorship to continue managing the RESP.*

Planning Tip: *One way to reduce the risk of a future taxable AIP to the subscriber is to set-up a family plan if there is more than one child in the family. This will cover all children in the family, so if one decides not to go on to post-secondary studies, the others can benefit from the extra money.*

Planning Tip: *If a subscriber has invested in an RESP (whether it is a family or individual plan) and it appears that no beneficiary will use the plan before its mandatory 35 year expiration, the subscriber should consider foregoing RRSP contributions, if necessary, to ensure adequate contribution is available to allow a transfer of plan earnings (AIP) into the RRSP. Remember that only earnings give rise to income; contributions can be returned without tax consequences.*

IN TRUST FOR ACCOUNTS

An In-Trust Account (ITF) is an investment account opened by an adult for the benefit of a child. The adult will contribute assets (usually cash) to the account. The name of an adult (not necessarily the contributor) will appear on the account with the child's name. The adult whose name appears on the account is the trustee of the account. One of the purposes of an in-trust account is to have the child pay any tax on capital gains generated in the account. Interest, dividends, or other income earned in the account will be taxed in the hands of the contributor. To ensure capital gains will be taxed in the child's hands, the contributor to the account should not be the trustee, and the assets in the account must be used exclusively for the child's benefit.

CONCLUSION

An RESP is a great way to save for your child's education. With the introduction of the CESG program in 1998, RESPs have become a very popular investment. For more information on your specific situation, please consult your Richardson GMP Investment Advisor.

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TRANSFERRING "ITF" ASSETS TO AN RESP

Clients may want to transfer "ITF" (in-trust for) assets to an RESP. While it is possible to transfer these assets, there are a number of potential legal and tax issues which need to be considered. It is therefore recommended you consult with your lawyer prior to transferring assets from an ITF to an RESP. Some of the issues to consider are:

- Contributions to an RESP belong to the subscriber who can withdraw them at any time
- The transfer of property from an ITF to an RESP will be a deemed disposition of the property
- All income earned on the deemed disposition will become fully taxable to the individual who contributed the funds
- If ITF assets are transferred to an RESP and subsequently withdrawn for the subscriber/trustee's personal use, this may taint the original intention of the trust
- A transfer from an ITF account to an RESP may indicate that there was never a trust arrangement in place and any income splitting that might have occurred may be denied
- ITF funds can be used for any purpose as long as it is for the beneficiary whereas the beneficiary of an RESP must be attending a qualified educational institution in order to be receiving funds