Planning For Your Children's Education: RESPs

A Registered Education Savings Plan is a tax-assisted investment vehicle designed to help save for a student's post-secondary education. It was created as a way for Canadians to save for education without the growth being taxed under the regular attribution rules. Normally, when you give your minor child money, interest or dividends earned on this money is taxed as if you had received the income. With an RESP, income is not attributed back to the parent.

Rules of the game

Although contributions to an RESP are not tax deductible, all of the income in the plan accumulates on a tax-deferred basis. Furthermore, when the accumulated income is withdrawn from the plan to pay for education expenses, the student pays the taxes – not the contributor. In most cases, this income would attract little tax because the student's basic personal exemption, tuition and education credits will offset the tax liability.

Any individual can set up an RESP. This includes grandparents, aunts, uncles, godparents and friends (but it does not include trusts or corporations).

How it works

RESPs allow you to contribute up to $4,000 annually per beneficiary. The contributions may be made for up to 21 years, to a lifetime maximum of $42,000 per beneficiary. If these limits are exceeded, a 1% per month penalty tax is charged until the over-contributed amount is withdrawn from the plan.

If the child does not proceed with post secondary education, the contributions are returned to the contributor with no tax consequences and the CESG (explained below) is returned to the government. The accumulated income that has not been paid out to the beneficiary can be returned to the contributor by either:

- Transferring up to $50,000 to the contributor's RRSP or a spousal RRSP. The contributor must have sufficient RRSP contribution room available to do this.
- Having it taxed in the contributor's hands at their marginal tax rate plus an additional 20% tax. The additional 20 % tax is designed to make up for the deferral of taxes while the funds were tax-sheltered inside the RESP.

Canada Education Savings Grant (CESG)

The CESG grant was introduced in the 1998 federal budget. Under this program, the Government of Canada pays a grant of 20% of the first $2,000 of annual contributions directly into the beneficiary's RESP. Beginning in 1998, children under 18 will accumulate $2,000 of CESG contribution room each year. The maximum grant is $400 (20% of $2,000) per year to a maximum of $7,200. If no contribution is made in a given year, the CESG contribution room may be carried forward to future years.

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Individual Plans vs. Family Plans

An individual plan is set up for the benefit of one person. A family plan is set up to allow contributions to be made for more than one beneficiary. The one condition is that all the beneficiaries must be related to the contributor(s) by blood. This includes children and grandchildren, but not nieces or nephews. The main advantage of a family plan is that the RESP income does not have to be paid out proportionately between the beneficiaries. If one child does not pursue post-secondary education, the other beneficiaries may use the income for their education.

Conclusion

An RESP is one of several vehicles parents may choose to help fund their children's post-secondary education. With the combination of tax sheltering and the CESG, this savings strategy can play an important role in your child's future.

Note: The above article is for information purposes only and should not be construed as offering tax advice. Individuals should consult with their personal tax advisors before taking any action based upon the information in this article.