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The federal government provides significant financial support for families that are saving for a child's post-secondary education. In this edition of the Canadian Tax Planners Newsletter we shall review a number of these tax incentives including:

- Registered Educational Savings Plans. In addition to a review of the rules, we shall focus on the available options if a child does not pursue a post-secondary education
- possible disadvantages of RESPs
- an alternative saving strategy to fund an education
- provincial incentives

Registered Educational Savings Plans

Terminology – The three key players involved with Registered Educational Savings Plans are the promoter, subscriber and beneficiary.

Promoter – Also known as a trustee, this is the organization that administers the RESP. They are responsible for registering the plan with CRA, accepting payments from subscribers and eventually distributes the educational assistance payments to the beneficiary.

Subscriber – Normally this is a parent or grandparent who enters into a RESP contract with the promoter and names one or more beneficiaries.

Beneficiary – This is the student that will receive funding from the RESP. There are no restrictions on who can become a beneficiary unless it is a family plan. We shall review these restrictions later in the article.

The Basics of RESPs – Effective in 2007, the annual contribution limit of \$4,000 was eliminated and replaced with a lifetime limit of \$50,000. Contributions are not deductible for income tax purposes. Investment income generated within the RESP is not taxable until it is eventually withdrawn and it is taxable to the student and not the parent. Since contributions to a RESP are not deductible, they can be withdrawn tax free

at any time, unless the plan does not permit such withdrawals. This may be the case for pooled plans. Contributions can be made to a RESP for up to 31 years, but the RESP must be terminated after 35 years.

Canada Education Savings Grants – The federal government will make a grant to the RESP equal to 20% of the first \$2,500 of contributions. Thus the maximum annual grant is \$500. There is a lifetime limit of \$7,200 and the Canada Education Savings Grants (CESG) does not count against the \$50,000 lifetime contribution limit. The grants are paid directly to the trustee and the beneficiary must have a social insurance number to qualify for the grant. Grants are not paid to children who are over the age of seventeen in the year.

An additional grant is available to low income families on the first \$500 contributed to a RESP. In addition to the regular 20% grant, the rate is increased to 40% if the family income is less than approximately \$39,000. If the family income is between \$39,000 and approximately \$78,000, the grant is increased to 30% on the first \$500 of contributions. These thresholds are indexed annually.

Maximizing the Grant – Since the Canada Education Savings Grant is equal to 20% of the first \$2,500 of contributions, a \$2,500 contribution would generate the same grant as a \$50,000 contribution, i.e., \$500. Parents should develop a contribution strategy that takes the CESG into consideration. One contribution strategy that maximizes the grants and allows an extended period of tax free compounding would be:

| | Contribution | Total |
|----------------------|--------------|-----------------|
| Year one | \$15,000 | \$15,000 |
| Years two to fifteen | \$ 2,500 | <u>\$35,000</u> |
| | | \$50,000 |

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