



Registered Education Savings Plans

The Canada Education Savings Grant and tax-deferred growth make RESPs an attractive way to save for the rising cost of a child's education.

What is a Registered Education Savings Plan?

A Registered Education Savings Plan, or RESP as it is commonly known, is a tax-deferred education savings vehicle through which the federal government allows a subscriber to save money for a beneficiary's post-secondary education.

Who qualifies as a beneficiary?

This depends on the type of RESP. Qualifications for an RESP set up as an "individual" plan differ from those for a "family" plan. In an individual plan, the beneficiary can be anyone at all, whether related to the subscriber or not. In fact, the beneficiary can even be the subscriber. Since there are no age restrictions on this type of plan, a subscriber who thinks he or she may attend post-secondary school someday may want to set up an RESP naming himself or herself as the sole beneficiary.

In a family plan (i.e., an RESP that permits more than one beneficiary), each beneficiary must be connected to the subscriber by blood relationship or adoption. For this purpose, blood relationship includes children, brothers, sisters, grandchildren and great-grandchildren. It does not include the subscriber or the subscriber's spouse, nieces or nephews. In family plans, contributions can only be made for beneficiaries under age 21.

Under both the individual and family plans, a subscriber can change the beneficiary at any time, although certain restrictions may apply.

RESP contributions

The maximum amount that can be contributed for any beneficiary is \$4,000 per year, up to a lifetime limit of \$42,000 per beneficiary.

Remember, the maximum applies to each beneficiary and not to each subscriber. So, for example, if a parent and a grandparent each wanted to set up an RESP for their child or grandchild, the total amount that can be contributed by both subscribers each year is still \$4,000.

Contributions to an RESP are not tax-deductible, which is why contributions can be withdrawn tax-free from the plan at any time (See: Refund of contributions). The income or growth in the plan, however, remains tax-sheltered for the life of the plan until it is paid out in the form of educational assistance payments to qualifying beneficiaries, or as accumulated income payments to the subscriber.

Beneficiary(ies)

A beneficiary is the person who will be attending post-secondary education (or persons, in the case of a family plan) and to whom AIM Trimark Investments agrees to make educational assistance payments if the beneficiary qualifies to receive such payments.

Subscriber

A subscriber is an individual who enters into the RESP contract with AIM Trimark and names a beneficiary on whose behalf he or she will make contributions.

Spouses or common-law partners may be joint subscribers to an RESP. Trusts are prohibited from being subscribers to RESPs.

The RESP rules allow for a replacement subscriber to be named if the original subscriber dies. Where the RESP allows another person to make a contribution into the plan after the death of the original subscriber, that person is then considered the replacement subscriber under the plan. Therefore, if the estate of a deceased subscriber continues to make contributions into an RESP, the estate is considered to be a subscriber.

A former spouse or common-law partner of a subscriber may also become a subscriber under an RESP if he or she acquires these rights as a result of the breakdown of the marriage or common-law partnership.





Contributions can be made each year for 21 years. Contributions made on behalf of a beneficiary of a family plan must be made before the beneficiary's 21st birthday. The plan must be "collapsed" before the end of the 25th year following the year the plan was entered into. This allows the plan to continue to provide tax-deferred growth while the beneficiary is pursuing post-secondary education.

Penalty tax on overcontributions

If contributions are made in excess of the annual or lifetime limits, they are subject to a penalty tax of one per cent per month of the amount of the overcontribution at the end of that month. If the RESP has more than one subscriber, the penalty is based on the proportion of contributions per subscriber. The penalty is calculated on the T1E-OVP return "Individual Income Tax Return for RESP Overcontributions for 1996 and Future Years" and must be remitted to the Canada Customs and Revenue Agency (CCRA) within 90 days after the end of the year for which there was an overcontribution (generally, March 31).

Withdrawing an overcontribution will reduce the amount, if any, that is subject to the penalty tax. However, the overcontribution will still be included in the calculation of the \$42,000 lifetime limit for that beneficiary.

What is a Canada Education Savings Grant?

To promote saving for a child's education and to give a boost to RESPs, the government introduced the Canada Education Savings Grant, or CESG. The CESG, which is deposited directly into the RESP itself, is equal to 20 per cent of the annual contributions made to an RESP, to a maximum of \$400 per year per beneficiary. The CESG is not included in determining the annual \$4,000 or lifetime \$42,000 RESP contribution limits.

Starting in 1998, every qualifying child under the age of 18 began to accumulate CESG eligibility. CESG eligibility is used to determine the maximum amount of CESG that a plan can receive from the government in a year. CESG payments are based on a maximum of 20 per cent of contributions actually made in the year or \$2,000 (\$2,000 is the maximum amount of contributions per year which can receive a grant), whichever is less. Unused CESG eligibility is automatically carried forward from year to year, however, since the maximum annual RESP contribution remains at \$4,000, the maximum CESG for any one year is \$800.

CESGs are available up to and including the year in which a beneficiary turns 17. In other words, the maximum amount of CESGs that can be received by a child born in 1998 or later is \$7,200 (18 x \$2,000 x 20 per cent).

To ensure that RESPs are used as systematic savings plans over the long term, contributions made for beneficiaries in the year they turn 16 or 17 will only receive a CESG if either:

- A minimum of \$2,000 of contributions had been made to an RESP before the year in which the beneficiary turns 16, or
- A minimum of \$100 in annual contributions were made in any four years before the year in which the beneficiary turns 16

Example One

In January 2003, Sally contributed \$4,000 to an RESP for her daughter, Anne. In October 2003, Anne's aunt, not knowing that Sally had already set up a plan, set up a separate RESP for Anne and contributed \$2,000. A total contribution of \$6,000 was made on Anne's behalf; two-thirds of it was made by Sally and one-third made by Anne's aunt. Since the annual contribution limit per beneficiary is \$4,000, a total of \$2,000 has been overcontributed. The penalty of one per cent per month will be charged for October, November and December 2003, resulting in a penalty of \$60 (\$2,000 x 1 per cent x 3 months). Sally will be responsible for \$40 (\$60 x 2/3) and Anne's aunt will be responsible for \$20 (\$60 x 1/3). This penalty will continue until \$2,000 is withdrawn from either plan.





For AIM Trimark to apply for a CESG on behalf of a beneficiary, the social insurance number (SIN) for the subscriber(s) and the beneficiary(ies) must be provided. A SIN can be applied for at local Human Resources Development Centres of Canada (HRDC). HRDC can be found in the federal government section of local telephone books.

How are RESPs taxed?

Unlike RRSP contributions, contributions made to an RESP are not tax-deductible. And if money is borrowed by the subscriber to make an RESP contribution, the interest paid on the loan would also not be tax-deductible.

The tax advantage of RESPs is this: All income, growth and CESGs, including any growth attributable to the CESG portion of an RESP, are tax-deferred until they are removed from the plan. If the income and CESGs are paid to the beneficiary, he or she will likely be in a low or no income tax bracket while attending school, and therefore he or she may pay little or no tax on the income and CESGs when withdrawn.

Note that when the income is withdrawn, it is considered to be “Other Income” – no breakdown of Canadian dividends, foreign income, interest income or capital gains is made. As a result, the income withdrawn is not eligible for the dividend tax credit or capital gains treatment. The income is reported to beneficiaries on a T4A slip.

How can contributions, income and CESGs be withdrawn from the plan?

Withdrawals from an RESP can be classified as one of the following: a refund of contributions, educational assistance payments or accumulated income payments.

Refund of contributions

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

As a result, when a contribution is removed from a plan that has received a CESG, an amount equal to 20 per cent of the contribution withdrawn for non-educational purposes must be repaid to the government up to the extent that CESGs were received. If more than \$200 of unassisted contributions in the same calendar year (contributions that did not attract CESGs) are withdrawn from the plan, the beneficiaries will not qualify for CESGs for the remainder of the year of withdrawal or the following two years. Additionally, they will not accumulate any new CESG contribution room for the following two years. Assisted contributions (contributions that did receive CESGs) are considered to be removed before unassisted contributions.

Example Two

Theresa gave birth to her first son, Noah, in February 2002. Noah will automatically accumulate \$2,000 of CESG room for 2002. Theresa decided to start saving early for her son's education and therefore opened up an RESP for Noah with a \$1,000 contribution right away. The government deposited a \$200 CESG into the child's RESP (\$1,000 x 20 per cent). In 2003, Noah had \$3,000 worth of CESG contribution room available (\$2,000 created in 2003 + \$1,000 carryforward from 2002). If Theresa contributes \$4,000 in 2003, the RESP will receive a CESG of \$600 (\$3,000 x 20 per cent) deposited directly into Noah's RESP account, which is limited to 20 per cent of the amount of unused CESG room. The extra \$1,000 contribution made by Theresa in 2003 cannot be carried forward to attract a CESG in a future year.





Educational Assistance Payments

Educational assistance payments (EAPs) are any amounts paid out under an RESP, other than a refund of contributions but including CESGs, to a beneficiary to help the beneficiary attend a post-secondary educational institution.

The subscriber of the RESP decides when and how much should be paid out of the plan to the beneficiary. The subscriber can also choose whether to pay out income or capital. There is a \$5,000 limit in EAPs per beneficiary during the first 13 weeks of a qualifying educational program. There is no EAP limit beyond the first 13 weeks provided the beneficiary continues to be enrolled in a qualifying program. A part of each income payment will be attributed to the CESGs deposited to the plan, based on the ratio of CESGs to total investment earnings. A maximum of \$7,200 of CESGs per beneficiary can be paid out. This is especially important when dealing with family plans.

In a family plan, if one beneficiary does not attend a post-secondary educational institution, the other beneficiaries in the plan can share in any growth or income in the plan, as well as any CESGs, up to a maximum of \$7,200 of CESGs per beneficiary.

RESPs have recently been modified to permit individuals who are certified as having a mental or physical disability to receive EAPs to fund part-time studies.

Accumulated Income Payments

If all intended beneficiaries under an RESP are not pursuing a higher education by age 21 and the RESP has been in existence for at least 10 years, a Canadian resident subscriber will be permitted to withdraw accumulated income from the plan. This allows subscribers to gain access to this income if the beneficiary doesn't attend a post-secondary school.

Accumulated income payments (AIPs) may be taken without meeting the 10-year and age-21 criteria under certain circumstances. Where a beneficiary with a severe and prolonged mental impairment does not pursue or complete a qualifying post-secondary program or if all of the beneficiaries die, the subscriber may be permitted to take an earlier AIP.

AIPs, when withdrawn, are fully taxable to the subscriber at his or her marginal tax rate. However, the subscriber has the option of transferring this accumulated income to his or her RRSP or to a spousal RRSP if contribution room is available. If the subscriber does not have enough contribution room to shelter this income, the excess will be subject to an additional penalty tax of 20 per cent – this is above the normal tax he or she would pay on the RESP income inclusion. This tax is calculated and reported to the CCRA on Form T1172 “Additional Tax on Accumulated Income Payments from RESPs” and is due with the subscriber's income tax return for the year in which the payment was received.

The maximum amount of income eligible for transfer to avoid the penalty tax is \$50,000 per subscriber. Additionally, the RESP must be terminated by March 1 of the year following the year in which the first accumulated income payment is made.

Example Three

Alan is the subscriber of an RESP for his daughter, Sandy, which has \$8,000 of pre-1998 (i.e., unassisted) contributions. In October 2000, Alan contributed a further \$2,000 to the RESP, which attracted a CESG of \$400. In March 2001, Alan withdrew \$3,000 from the plan, requiring a \$400 CESG repayment, being the lesser of 20 per cent of the withdrawal and the CESG actually received. Alan went on to contribute another \$1,000 in October 2001; however, this did not qualify for a CESG as a result of his withdrawal of unassisted contributions, and neither will any contributions made by anyone on Sandy's behalf in 2002 and 2003. Sandy will not earn any CESG room in either 2002 or 2003 so the amount of unused CESG contribution room carried forward to 2004 is \$6,000 representing unused CESG contribution room of \$2,000 from 1998, \$2,000 from 1999 and \$2,000 from 2001.





The CCRA's Form T1171 "Tax Withholding Waiver on Accumulated Income Payments from RESPs" can be used by the subscriber to request that AIM Trimark not withhold any tax on the direct transfer to an RRSP. Otherwise, the withholding rates are 30 per cent for payments of \$5,000 or less, 40 per cent for payments between \$5,001 and \$15,000, and 50 per cent for payments greater than \$15,000 (for Quebec residents the rates are slightly higher). Note that these are simply withholding rates used by the CCRA to estimate the amount of tax that may be due from the subscriber. The actual amount of tax owing, if any, will be calculated by the subscriber when completing his or her tax return. The subscriber will then get credit for the taxes already withheld by AIM Trimark when calculating the amount due to, or from, the CCRA.

Clearly, it is beneficial for the subscriber to attempt to shelter any accumulated income payments from being subject to tax at rates that could be as high as 69 per cent (including the 20 per cent penalty tax). If he or she expects to receive accumulated income payments in the next year or two, the subscriber may wish to avoid making RRSP contributions in those years. This may make it possible to build up the room necessary to be able to shelter the accumulated income payment and thus avoid the additional penalty tax.

An RESP must be terminated before March 1 of the year following the year in which the first accumulated income payment is made out of the plan. Therefore, when a subscriber is in a position to receive accumulated income payments, there may be advantages to spreading the payments over two calendar years. If the subscriber is transferring the amount to his or her RRSP or to a spousal RRSP, a transfer over two years may allow the subscriber to accumulate additional RRSP contribution room so that the penalty tax may be avoided on the amount transferred. Alternatively, if the subscriber has no contribution room (perhaps due to a pension adjustment), he or she can spread the accumulated income payment over two years to take advantage of graduated marginal tax rates each year.

Note that to avoid the penalty tax on the amount transferred to an RRSP or spousal RRSP, it must be deducted on the subscriber's tax return for the same taxation year in which the accumulated income payment is received. So, if a subscriber received the first accumulated income payment in April 2003, the subscriber must transfer that amount to his or her RRSP or to a spousal RRSP before March 1, 2004 and claim the RRSP deduction on the 2003 tax return. If the final accumulated income payment is received in February 2004, then this amount must be transferred to his or her RRSP or to a spousal RRSP by March 1, 2005 and deducted on the 2004 tax return to avoid the penalty tax. Note, however, as discussed above, withholding taxes of up to 50 per cent may apply on accumulated income payments that are not transferred directly to an RRSP.

Which educational institutions qualify?

For the educational assistance to be paid to a beneficiary, the beneficiary must be in full-time attendance at a post-secondary educational institution (part-time if the student has a disability).

Full-time attendance means the program must not be less than three consecutive weeks with at least 10 course hours per week. Correspondence courses also qualify.

Example Four

Jonathan set up a family plan for his three children: Sarah, Ted and Adam. For the years 2001 through 2007, he contributes \$2,000 per beneficiary, resulting in \$2,800 of CESGs for each child ($\$2,000 \times 20$ per cent $\times 7$ years), for a total of \$8,400 of CESGs in the plan. In 2011 his youngest child, Adam, goes to university. The two older children did not pursue post-secondary studies. Adam may receive all of the income or growth accumulated in the plan; however, he may only receive up to \$7,200 of CESGs. The remaining \$1,200 of CESGs must be repaid to the government.

Example Five

In 1988, Michael established an RESP for his daughter, Carole. The total income in the plan to date is \$10,000. Carole turned 21 on July 25, 2003 and decided not to pursue a post-secondary education. Michael has \$6,000 of unused RRSP contribution room for 2003. If he takes the full \$10,000 as an accumulated income payment in 2003, he will have an inclusion of \$10,000, an offsetting deduction of \$6,000 and will have to pay tax at his marginal rate on \$4,000 plus a penalty tax of \$800 (20 per cent \times \$4,000). However, had Michael taken only \$6,000 of accumulated income payments in 2003 and the additional \$4,000 in 2004, and additional RRSP contribution room of \$4,000 was generated for 2004, he could have deferred all the tax on the full \$10,000 payment.





What if the beneficiary does not attend a post-secondary educational institution?

If a beneficiary does not attend a post-secondary educational institution, the subscriber of an individual plan can name anyone as a replacement beneficiary – though not every replacement can take advantage of the CESG. In a family plan, the subscriber can name an individual connected to the subscriber by blood or adoption under 21 years old as a replacement beneficiary of the plan.

In an individual plan, any CESGs paid into the plan must be repaid unless the replacement beneficiary is under 21 years of age and one of the following conditions is met:

- The replacement beneficiary is the brother or sister of the former beneficiary
- Both the former and replacement beneficiaries are connected to the subscriber by blood or adoption

In a family plan, if one beneficiary doesn't attend a post-secondary institution, any CESGs paid into the plan can be used by the other beneficiaries up to a maximum of \$7,200 per beneficiary (See: Example Four on page five); any excess must be repaid.

Conclusion

RESPs can be a tax-effective way to save for a child's post-secondary education. The introduction of the CESG program makes these plans even more attractive as savings and investment vehicles.

The information provided is general in nature and is provided with the understanding that it may not be relied upon as, nor considered to be, the rendering of tax, legal, accounting or professional advice. Readers should consult with their own accountants and/or lawyers for advice on the specific circumstances before taking any action.

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