Best choice for most people – the RESP

Years ago, in an effort to promote higher education for a greater number of Canadians, the government introduced the Registered Education Savings Plan (RESP).

An RESP is a flexible investment plan designed to provide parents, grandparents, and relatives and friends a tax effective way of saving for a child's post-secondary education. Its flexibility allows you to hold a wide variety of investments so you can try to achieve the best growth and income.

Like an RRSP, all the income earned in an RESP can accumulate tax-free until it's withdrawn. And when it is withdrawn for educational purposes, only the growth is taxed in the child's hands, so there should be little or no tax payable. Also, the money withdrawn can be used for any reasonable education related expense, such as tuition, books, travel and living costs.

Although similar to an RRSP, there are several key differences with an RESP:
-Your contribution is limited to $4,000 per calendar year per beneficiary
-There is a lifetime maximum contribution of $42,000 per beneficiary
-You must make your RESP contribution by the end of the calendar year
-You can't carry forward unused contribution room
-Your RESP contribution is not tax deductible
-Most plans allow all of the capital you contributed to be returned to you at any time without taxation
-Most plans allow accumulated growth to be transferred to an RRSP or a spousal RRSP, subject to several conditions

If there are two or more children, a Family RESP offers huge advantages
Instead of setting up an individual RESP for each child, it can be far more effective to set up a Family RESP – a single plan with multiple beneficiaries.

The main advantage of a Family RESP is that if one child decides not to pursue higher education, you can either name an alternate beneficiary or simply divide the assets in the plan among any remaining children.

Another advantage is that the funds in the plan do not have to be shared equally by the beneficiaries. This means that if any child has educational expenses higher than another child, they could receive more income from the plan. This decision would be up to the plan's subscriber – the one who created and contributed to the plan.

This is a much easier solution than when a child with their own plan makes the decision to not go on. When that happens, you can wind up paying as much as 70% or more tax on the income that has been generated by the plan. Plus any CESG money would likely have to be repaid. (Please note: the issue of a child with an RESP not going on to further education can be very complex and there are many possible outcomes. You should speak to an advisor in this area)

To qualify as a member of the "family" for a family RESP all of the beneficiaries must be connected to the subscriber by blood – only children, grandchildren, brothers, sisters and adopted children and grandchildren may be included in a family RESP. Plus eligibility for inclusion in a Family RESP ends in the year a beneficiary turns 21.

How to get up to $500 a year from the government
It's called the Canada Education Savings Grant (CESG) and it will add a 20% match of the first $2,500 that you contribute for each beneficiary. Over the life of the plan, this could add up to an extra $7,200 – absolutely free from the government. This is an opportunity that should not be missed. Eligibility for the CESG ends in the year that the beneficiary turns 17.

It was stated above that unused RESP contributions cannot be carried forward. However, eligibility for the CESG can be carried forward for use in future years. Also, the CESG does not count towards the annual limit or the lifetime contribution limits mentioned above.

Self-directed RESP vs a pooled RESP
Each has its advantages and disadvantages, but on the whole, for most people, you will be better off with a self-directed RESP. When you see below some of the disadvantages of the pooled RESP, you'll see why.
With a pooled RESP, which are offered by several "scholarship trust" companies, investments are required by law to be in safe, government guaranteed vehicles, such as T-Bills and Government bonds. This means the returns are dependent on interest rates, and can often be very low.
There may be up front fees.
If you stop paying into the fund, there may be penalties.
Not all schools are recognized by all plans.
For some plans, students must finish schooling uninterrupted to continue receiving funds.
Some plans don't permit transfer of funds to another child if the original child doesn't go on.

The major advantage of a pooled RESP is that the funds are required by law to be safe. Plus most plans allow for very small monthly payments, making it easy for just about anyone to participate.

In general, a pooled RESP is good for those who can't afford other plans or who do not have the desire or the discipline to save / invest on a regular basis.

With a self-directed RESP, you have much more flexibility. You can decide what kind of investments you want to hold and none of the disadvantages listed above for the pooled RESP would apply.

If you have children, grandchildren or others for whom you would like to assist with educational expenses, click here to find the CPA financial planning professional closest to you.

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