

Getting a Head Start on Post-Secondary Education Costs

The start of the new school year, and the inevitable outlays for school-related costs, often remind parents of the even greater expenditures that will be necessary when their children head off for post-secondary education. Everyone knows that getting a college or university education costs a lot of money, and most parents know that the most tax-effective way to save for that education is through a Registered Education Savings Plan (RESP). The rules governing how one can save through an RESP have undergone a lot of changes over the past few years, and most of those changes were welcome ones. Generally, the federal government has sought to increase the flexibility of what was, at one time, a fairly rigid and complex set of rules, in order to make it easier for families to put money aside for post-secondary education. What follows is an outline of the current “state of play” for saving for post-secondary education through an RESP.

First, the basics. The benefits of saving through an RESP are twofold. First, while contributions made to a plan are not tax deductible in the way that RRSP contributions are, investment returns earned by funds held inside an RESP are not taxed as they are earned – in effect, they can grow and accumulate on a tax-free basis. Second, when the child who is the beneficiary of the plan attends post-secondary education, funds withdrawn from the plan receive preferential tax treatment. Where either the student or the original contributor withdraws original contributions (known as a refund of contributions), no tax is payable on the withdrawn funds. Where the amounts withdrawn by the student from the plan represent investment returns in any form (known as Educational Assistance payments), those amounts are taxed in the hands of the student, rather than those of the person who originally made the contribution. Under Canadian tax law, an individual can earn up to about \$10,000 of taxable income in any tax year on a tax-free basis, because of the operation of the basic personal exemption which is claimable by all Canadian resident taxpayers. As the income of most students is relatively low, it is frequently the case that amounts received from an RESP don't attract any tax at all.

At one time, the rules placed fairly rigid restrictions on the amount of annual contributions that could be made to an RESP, as well as imposing a lifetime limit. While that approach worked well for families that could make regular, consistent contributions over the years, others found it difficult to save on that basis. As of 2007, however, there is no annual limit for contributions to an RESP. Instead, a lifetime limit of \$50,000 is imposed on the amounts that can be contributed to all RESPs for each beneficiary. As the lifetime contribution limit rule suggests, it's possible for a single individual to have more than one RESP. And while most RESPs are set up by parents, there is in fact no real restriction on who can set up an RESP for a qualifying beneficiary, as long as the total lifetime contributions for that beneficiary don't exceed the \$50,000 lifetime limit.

In 2008, the federal government made changes to the RESP rules that extended many of the existing time frame deadlines. Prior to that time, contributions could be made to an RESP for up to 21 years after the plan had been established, but that limit was extended, effective for 2008 and subsequent tax years, to 31 years. In addition, where the RESP was originally set up as a “family plan”, the rules were changed to provide that contributions could be made as long as the beneficiary was under 31 years of age (the former limit was 21 years of age). While most parents are understandably hoping to be finished financing post-secondary education by the time their child reaches his or her mid to late 20s, the extension does enable parents to continue to contributing to an RESP for a child still working toward a first or second university degree. Parents who set up an RESP when a child was born can now continue to make contributions (up to the lifetime limit of \$50,000) through the undergraduate years and even through graduate

school or professional education, while continuing to enjoy the benefits of tax-sheltered growth of those funds inside the RESP.

At one time, parents and grandparents who might otherwise have considered setting up an RESP for a child or grandchild were reluctant to do so where there was any doubt about whether that intended beneficiary would in fact pursue post-secondary education. Their reluctance stemmed from the fact that, while it was always possible for contributors to get back contributions made (on a tax-free basis, since tax had already been paid on the income that gave rise to those contributions), a different fate awaited investment returns earned on contributions made over the years. In effect, those amounts were frequently forfeited, a result that benefited neither the contributor nor the intended beneficiary. However, beginning in 1998, payments of RESP earnings can be made to the original contributor or contributors. While the payment of investment returns would normally represent taxable income to the recipient (and would in addition be subject to a special 20 per cent federal tax), such earnings may be contributed to the RRSP of the contributor or his or her spouse, to the extent that he or she has RRSP contribution room. As with all RRSP contributions, the amount contributed can then be deducted from income in the year that the contribution is made.

While the basic rules governing registered education savings plans are fairly straightforward, the application of those rules, particularly when funds are being paid out of the plan, can be somewhat detailed and complicated. There is, however, an abundance of information available on the subject from the Canada Revenue Agency. The Agency's guide to Registered Education Savings Plans, which incorporates the rules as they stood at the end of 2008, can be found on the Agency's Web site at <http://www.cra-arc.gc.ca/E/pub/tg/rc4092/rc4092-08e.pdf>. In addition, general information on RESPs is available on the Web site at <http://www.cra-arc.gc.ca/tx/ndvdl/tpcs/resp-reee/menu-eng.html>.