New Canadian RESP Rules Make Saving for Tuition Easier, More Flexible

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(CEP News) Ottawa - With the average annual cost of post-secondary tuition expected to more than double over the next 15 years, it has become more important than ever to get a jump-start on saving for your child's education.

The most recent actuarial report on the Canada Student Loan Program published last month forecasts tuition to rise from $6,000 in 2008-2009 to $13,800 in 2025-2026.

In short, if you're a parent, it's time to get saving.

Fortunately, the last Canadian federal budget made a number of changes that make it easier to do just that through a Registered Education Savings Plan (RESP), in which savings and investments can grow free from taxation.

The Canada Education Savings Grant (CESG) has been boosted, contribution rules have been made more flexible and, depending on how much time is left before junior heads off to college or university, you may be able to take advantage of grant money you missed out on in previous years when you couldn't afford to make the maximum contribution to your child's RESP.

"I recommend to most of my clients that they try and set up monthly contributions so on a go-forward basis they are attracting all of the grant available," said David Phipps, Assante Wealth Management's senior financial adviser. Thanks to the latest federal budget, the maximum CESG is now $500. The CESG is 20% of annual RESP contributions, so Phipps said a contribution of $2,500 is needed to attract the maximum grant.

The maximums relate to individual children, so if you have two kids and contribute $2,500 to each one's RESP, then each plan will receive a $500 grant. Likewise, the $50,000 lifetime contribution cap relates to individual kids.

However, if you didn't contribute enough in prior years to attract the maximum grant, you can now regain that grant money by contributing more than $2,500 a year, Phipps said. The government has increased the lifetime RESP contribution limit to $50,000 from $42,000, and made it possible to make lump sum payments.

However, imagine for a moment that you have a spare $50,000 to contribute. Contributing $50,000 in one shot in the first year an RESP exists will still only get you the $500 CESG maximum, not the lifetime limit of $7,200, Phipps said.

The government will only pay more than the annual $500 maximum for old, unused CESGs and then only to a maximum of $1,000 a year. Unused CESG room can be carried forward until the RESP beneficiary is 17 years old.

Adding a further complication, 2007 is a watershed year in the RESP scheme because of the new rules. If you want to recover unused contribution room relating to years before 2007 - when the government only paid a maximum of $400 in CESG- the maximum catch up payment the government will pay is $800 and not $1,000.

Some experts say foregoing the bulk of the government grants might be worthwhile if your investments appreciate by an average of 6% a year while they are tax sheltered in the RESP.

But Phipps recommends against that course, arguing that you can do virtually the same thing and get the CESG at the same time. The way to do it, he said, is by setting up an "in trust" investment account in your child's name along with an RESP and transferring $2,500 a year from the trust to the education savings plan. If the trust account is invested in equities rather than interest bearing vehicles, the capital gains will be taxed in the hands of the child, he said.

"Since most children have zero taxable income, effectively it's tax-free growth," Phipps said.

A background note issued by Scotia McLeod, which Phipps cited, cautions that investors should check with

their accountant concerning the tax implications of using an in trust account to transfer funds into an RESP before trying such a transaction.

Families with more than one child are best to open a family RESP or convert a pre-existing RESP into a family one, said John Hogarth, associate director and portfolio manager at Scotia McLeod.

"RESPs are really well designed for this," Hogarth noted. "What you do is make a family RESP. That means you can register all of your children in one plan as long as each child has a Social Insurance Number (SIN)." That way, money can be allocated according to each child's level of need and if one child decides not to go to post secondary school, all of the money can be used on the remaining plan beneficiaries, he said.

When money is withdrawn from an RESP, the growth and grant money is taxable as income in the hands of the beneficiary, said Hogarth. The child must be attending an acceptable post secondary institution and parents must have documentation to prove it, such as a course timetable or correspondence from the institution indicating attendance, added Phipps. A letter of acceptance is not sufficient, he said, since a child can be accepted to multiple post secondary institutions.

"Parents who have younger kids should try to save as much as they can," said Phipps, but he added that people shouldn't lose sight of their other financial goals and demands. For some people who have seriously underfunded their retirement and have children who are close to post secondary school age, it might be better to concentrate on retirement saving, he said.

"There's a priority list one needs to go through. Preparing for retirement is probably more important than education savings in the long run," he said. But, Phipps added that he's had clients with pensions and well-funded retirement plans whom he advised to take a break from contributions to their Registered Retirement Savings Plans so they could top up their children's RESPs.

"Those clients had a fairly secure retirement plan in place already so it wasn't as problematic," he said. "It's a personal decision as to what degree they want to assist their children in paying for their education. Not every parent pays for their child's entire education."

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