TAX MATTERS

Take maximum advantage of an RESP for your children – and grandchildren

TIM CESTNICK
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A number of years ago, education officials in the London borough of Islington decided it would be a good idea to pay some students with failing grades to attend extra classes on Saturdays. They were paid the equivalent of more than $5 per hour, about 75 cents more than the minimum wage for students, in an attempt to motivate them to succeed in school. Interesting concept.

I wish Canadian universities would take the same approach. I could tell my children that all they need to do to help pay for their education is to start failing their courses. Paying for a postsecondary education isn't easy. The average cost per year for a student living away from home is just under $20,000 – or about $80,000 for an undergraduate degree. Making use of a registered education savings plan (RESP) is a good start to help cover these costs. Today, I want to focus on some tips for using RESPs to your maximum advantage.

RESP BASICS

An RESP is an investment plan to which you – the "subscriber" – can contribute to save money for a child's postsecondary education. There's a lifetime contribution limit of $50,000 for each student. You can contribute these funds all at once or over time – unlike RRSPs, there's no annual limit for contributions.

A key reason to contribute to an RESP is that Ottawa will kick in an additional 20 per cent of your contribution, to a maximum of $500 a year or $7,200 over the lifetime of each child. That's free money – called the Canada Education Savings Grant (CESG). Lower- and middle-income families might be entitled to additional grants, bringing the total to as much as 40 per cent in some cases on the first $500 contributed each year.

Although you won't be entitled to a tax deduction for contributions to an RESP, the funds inside the plan can grow tax-free over the years. And when you make withdrawals (called educational assistance payments) from the RESP to pay for school, your beneficiary – the student – will face tax on the income that was earned in the plan, not you. Of course, with a student's income level, it's expected to be a negligible hit.

RESP TIPS

Contribute what you can. To take advantage of all the CESG money available, you should contribute $2,500 to an RESP each year if possible (this will result in the maximum $500 grant being paid into the plan for that year). If you can't contribute that much to an RESP, don't fret, just contribute what you can. Any unused grant room for a particular year can be carried forward and claimed in a later year. There's only one catch here: The maximum CESG you can collect in a given year is $1,000 (a $5,000 contribution will net you that $1,000 grant). So try your best to contribute regularly. Set up a monthly automatic withdrawal plan from your bank account so the RESP contributions are made like clockwork – they'll add up over time.

Maximize the grants available. Although you could contribute the full $50,000 to an RESP in one year if you had the means, this wouldn't be ideal when it comes to collecting CESGs. Why not? Since the maximum CESG that will be paid out in a particular calendar year is $1,000, and a $5,000 contribution achieves this, any contribution over $5,000 in a particular year won't give rise to a grant from the government. In a perfect world, you'd contribute $2,500 a year, for 15 years, giving rise to a $500 grant annually and a total of $7,200 in CESGs. As an aside, $2,500 contributed per year, plus the CESGs paid into the plan, should allow the RESP to be worth $87,800 by the time the child reaches the age of 18 at a return of 6 per cent annually. This could be enough to pay for four years of postsecondary education. You will have received the $7,200 maximum in CESGs and will have contributed $37,500 over that time (well within the $50,000 contribution limit).

Get involved if you're a grandparent. It's possible to set up a family plan with a number of beneficiaries named, provided those beneficiaries are related to the subscriber by blood or adoption. When a grandparent sets up a plan for grandchildren, there can be a greater number of beneficiaries because cousins can be beneficiaries under the same plan. The advantage? If one or more beneficiaries chooses not to pursue postsecondary studies, the assets in the plan can be used by the other beneficiaries. This provides more flexibility and assurance that the assets will actually be used for education.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca.