FINANCIAL POST

How to strategically withdraw money from an RESP

JAMIE GOLOMBEK | September 2, 2016 9:45 AM ET
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Illustration by Chloe Cushman/National Post You may have a small fortune accumulated in your RESPs by the time the kids start school. Here's the best way to access those funds.

With kids heading back to school this week, no doubt much ink will be spilled in the financial press this Labour Day weekend rehashing the benefits of contributing to a Registered Education Savings Plan to save for the cost of postsecondary education. In my experience, however, much less time is spent discussing an equally important topic: how to best access funds in an RESP, once the children start school. And what if there's money left in the RESP after paying for tuition?

Before addressing these questions, here's a quick RESP refresher. An RESP is a tax-deferred savings plan that allows parents to contribute up to $50,000 per child toward saving for post-secondary education. The addition of government money in the form of Canada Education Savings Grants can add $7,200 per child to the plan. Combine that with income earned and gains realized in an RESP but untaxed over the course of your kid's childhood and you may have a small fortune accumulated by the time the kids start school.

When considering RESP withdrawals, the first thing to remember is that your contributions to RESPs, which were not tax-deductible, can generally be withdrawn at any time, tax-free. Any other funds coming out of the plan for post-secondary education are referred to as "educational assistance payments." EAPs include the income, gains and CESGs in the RESP. When these are paid out, they are taxable to the student receiving the funds who, in many cases will either pay minimal or no tax at all on the EAPs withdrawn, owing to the various personal tax credits available to students. For example, the 2016 basic personal amount ($11,474) combined with a tuition credit ($6,500 for estimated average 2016/2017 Canadian undergraduate tuition fees) means about $18,000 of EAPs could be withdrawn annually, free of tax, by the student. And this ignores the education and textbook credits, which were eliminated in this year's federal budget effective 2017, but can be claimed one last time in 2016.

My general advice, therefore, is to first withdraw sufficient EAPs annually to use the child's basic personal amount, which if unused, is permanently "wasted." The tuition credit, however, can always be carried forward, indefinitely, for use in a future year against the student's future earnings. Alternatively, with the child's consent, up to $5,000 of the tuition credit may be transferred annually to a (grand)parent's tax return.

Of course, in employing this strategy, any other income the student earns from part-time work during the school year or from a summer job must also be taken into account to determine the optimal amount to withdraw. Any additional funds needed for education can then come from tax-free RESP contribution withdrawals.

As for the funds withdrawn, there is no requirement that the money taken out of the RESP be used towards tuition, books, etc. As long as the child is enrolled in a qualifying post-secondary program, EAPs can be paid to the child. The child can then choose to do whatever they want with the funds, including paying for rent, food or even reinvesting any excess funds not currently needed for school in a TFSA.

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References

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