MoneySense

The benefits and flexibility of family RESPs

Grants and growth can be allocated amongst any beneficiaries of the plan

by Jason Heath
April 25th, 2018

Q: Can you write an article on how family RESPs work once the oldest children start to take money out of the plan while for the youngest we are still putting money into the plan?

What are the rules? Can you find one child with more money from the plan than another child? If one child does not go to post-secondary can their funds be used to fund one of the children in the plan?

—*John*

A: Good question, John. It's surprising how few people know the withdrawal dynamics of an individual Registered Education Savings Plan (RESP), let alone how a family plan works.

Just to bring everyone up to speed, a family RESP is a tax-deferred education savings investment account with annual government grants that has multiple beneficiaries. A beneficiary can qualify for grants of 20% or more of a contribution, subject to both annual and lifetime limits, historical contributions, age, income and province or territory of residence.

A family RESP is generally opened by parents or grandparents, though technically can be opened by a sibling, however unlikely. In addition to children or grandchildren related by blood, a child or grandchild who is adopted qualifies as a beneficiary for a family RESP.

Of note is that stepchildren or stepgrandchildren cannot be beneficiaries of a family RESP, nor can nieces or nephews. A parent, grandparent, aunt or uncle who wants to open an account for one of these classes of beneficiaries must do so with an individual plan for that child.

A beneficiary must also be under 21 if they are added to an existing, qualifying family plan.

The ability to contribute to an RESP or receive a government grant for a beneficiary depends on all contributions made to all RESPs for that beneficiary and all government grants received during that beneficiary's lifetime. Those contributions and grants are tracked based on their social insurance number, so that if there are multiple accounts – say, parents, grandparents, etc. – a running tally is kept by the government.

That said, when it comes time to taking withdrawals from a family RESP, there is more flexibility than an individual RESP, John.

When a qualifying withdrawal is taken from an individual RESP to help fund post-secondary costs, the account balance, at any time, is broken down into three pools of money. There's principal, which represents your contributions; there's grants, which represents government matching contributions; and there's growth, which represents investment growth over and above the principal and grants.

Grants and growth are taxable to the RESP beneficiary upon withdrawal, but most students have little to no income tax to pay on the taxable portion. Every taxpayer has a basic personal amount representing income they can earn tax-free. It varies based on province or territory of residence and is impacted by other income sources they have for the year. Qualifying post-secondary tuition gives rise to a tax credit as well, which usually wipes out any potential tax implications of an RESP withdrawal for most RESP beneficiaries.

It may be wise to try to front-end load the taxable withdrawals an RESP beneficiary takes. This is because there may be additional growth on the RESP balance before the account is exhausted. It may also make sense on the assumption that an RESP beneficiary may have lower income from other sources (summer or part-time jobs, for example) in the early years of their post-secondary education as compared to their later years.

Unused grants must be paid back to the government, with growth taxed at the subscriber's tax rate plus a 20% penalty tax – another reason to save principal for later withdrawals. Growth can be transferred into a subscriber's Registered Retirement Savings Plan account to the extent they have RRSP room.

The benefit of family RESPs, John, is that both grants and growth can be allocated amongst any beneficiaries of the plan. So, if one child does less or cheaper post-secondary education than another, you can use more of the RESP funds for one child and less for another.

So, you can contribute to a family RESP and get government grants just like you can with an individual RESP. And you can simultaneously take withdrawals for another beneficiary. And withdrawals can be taken for any of the beneficiaries of the plan.

For these reasons, and because managing one account is easier than managing multiple accounts, I would generally opt for family RESPs. Even if you have a single child, you can open a family RESP and add subsequent children to it. The main exception to the preference for a family RESP would be if an RESP is for a stepchild, niece, nephew or other beneficiary who is not related by blood (children or grandchildren).

Jason Heath is a fee-only, advice-only Certified Financial Planner (CFP) at Objective Financial Partners Inc. in Toronto, Ontario. He does not sell any financial products whatsoever.