

Tax memo

Canadian tax updates



RESPs: A user's guide

Helps you navigate the complexities and maximize the benefits of RESPs.

January 7, 2013

Contributing to a registered education savings plan (RESP) is an attractive way to save for a child's post-secondary education. Matching federal (and in some jurisdictions, provincial) grants make RESPs particularly appealing.

Although RESPs sound simple – your money earns investment income that is tax-free until it is withdrawn when the child attends college or university – they can be surprisingly complex.

This *Tax memo*¹ will help you navigate the complexities and maximize the benefits of RESPs. It covers the following topics:

What is an RESP?	1	Death of beneficiary.....	12
Why open an RESP?	2	RESPs and non-residents.....	12
The basics	2	U.S. citizens resident in Canada	13
Canada education savings grant (CESG) ..	4	Should you open an RESP?	13
Canada learning bond (CLB).....	6	Provincial incentives.....	13
Withdrawal of RESP funds.....	6	Other options	14
RESP overcontributions	11	Appendix – General information.....	16
Death of subscriber	12	We can help.....	17

What is an RESP?

An RESP is a tax-assisted saving vehicle used to save for an individual's post-secondary education. It involves:

- the subscriber – the person (usually the beneficiary's parent) who sets up an RESP and contributes to it;
- the beneficiary – the person for whom RESP contributions are made (usually the subscriber's child²); and
- the promoter – the administrator of the RESP.

1. This *Tax memo* replaces our *Tax memo* "Understanding RESPs" dated November 27, 2008.

2. This *Tax memo* generally assumes that the beneficiary is the subscriber's child.

Why open an RESP?

RESPs are attractive for several reasons:

- Government grants – The federal government pays:
 - Canada education savings grants (CESGs) – up to a lifetime maximum of \$7,200 per beneficiary – to RESPs that have minor beneficiaries, based on contributions to the RESP and the income of the beneficiary’s family; and
 - Canada learning bonds (CLBs) – up to a lifetime maximum of \$2,000 per beneficiary – to RESPs for children of low-income families.
- Tax deferral – Contributions, along with any CESGs and CLBs, earn investment income that accumulates tax-free until withdrawn. This tax deferral allows funds to grow faster than if invested outside an RESP.
- Income splitting – It is likely that little or no tax will be paid on the income withdrawn from an RESP to fund the beneficiary’s education. This depends on the amounts withdrawn and the beneficiary’s other income.
- Saving for education – RESP contributions, CESGs (and CLBs, if applicable) and the investment income earned by the plan are all available to fund the beneficiary’s post-secondary education.
- Provincial incentives – Alberta and Quebec (and commencing 2013, Saskatchewan) residents enjoy additional benefits from provincial programs that piggyback RESPs.

The basics Subscribers

Anyone (e.g., parents, grandparents and other relatives and friends) can open an RESP for a child. You can even open a plan for yourself or for another adult. However, you must have a social insurance number to open an RESP. There are no age limits for the plan subscriber. Therefore, if you plan to return to post-secondary school in the future, you should consider setting up an RESP and naming yourself as the beneficiary.

An individual can be a subscriber of more than one RESP. You and your spouse or common-law partner can be joint subscribers under an RESP. A former spouse or common-law partner of a subscriber will become a subscriber under an RESP if he or she acquires these rights on the breakdown of the marriage or common-law partnership. However, trusts are prohibited from being RESP subscribers (unless the trust is the estate of a deceased subscriber).

Beneficiaries

Generally, an individual must be resident in Canada when he or she is designated as a beneficiary, and contributions can be made only for beneficiaries that are resident in Canada. Beneficiaries must have a social insurance number (except for existing beneficiaries of RESPs entered into before 1999 and, in limited cases, for transfers from another RESP for the same non-resident beneficiary). (See **Non-resident beneficiary** on page 12 for more on the exceptions.) Also, only Canadian-resident beneficiaries can receive CESGs and CLBs.

Unlike individual and family plans, group plans often specify their own minimum and/or maximum age limits (see **Types of RESPs** in the **Appendix**). There is also no limit on the number of plans under which an individual can be a beneficiary. However, the per-beneficiary lifetime contribution limit (see **Contribution limits** on page 3) cannot be circumvented by having multiple plans for one beneficiary.

Tax implications

RESP contributions are not tax-deductible when made and are not taxable when withdrawn from the plan by the subscriber. Interest on borrowings used to contribute to an RESP is not deductible. Many RESPs permit you to withdraw your contributions at any time. However, as discussed under **CESG repayments** on page 10, adverse consequences arise if you withdraw contributions before your child starts post-secondary school.

The federal government pays CESGs to RESPs with a minor beneficiary, depending on various factors,

e.g., the contributions made to the RESP in the year (see **Canada education savings grant (CESG)** on page 4). Similarly, based only on the minor beneficiary's family income, the federal government may pay CLBs to RESPs (see **Canada learning bond (CLB)** on page 6).

CESGs and CLBs are not taxable until withdrawn from an RESP to fund the beneficiary's post-secondary education. Similarly, income earned in an RESP (whether on contributions, on CESGs or on CLBs) is tax-deferred until withdrawn for this purpose. At that time, the beneficiary will pay tax on these funds at his or her marginal tax rate.

If the beneficiary does not enroll in a qualifying educational program, the RESP contributions can be recovered by the subscriber. In addition, it may be possible to pay the accumulated investment income to the subscriber; these amounts would be subject to the subscriber's marginal income tax rate plus an additional penalty tax. The income tax can be deferred and the penalty tax can be avoided if the payment is transferred to a registered retirement savings plan (RRSP). See **Beneficiary doesn't pursue post-secondary education** on page 7.

Contribution limits

There is no annual contribution limit. The lifetime contribution limit is \$50,000 for a beneficiary. Therefore, \$50,000 can be contributed to an RESP over any number of years until the plan is terminated. It is also possible to contribute \$50,000 in one year. However, as discussed under **Contribution strategies** on page 4, even if you have sufficient cash to do this, it may not be desirable.

Table 1 – RESPs – the basics

		Per beneficiary
Contribution limits	Annual	None ¹
	Lifetime	\$50,000 ¹
Maximum annual	CESG	\$500 ²
	RESP contribution to get maximum CESG	\$2,500
Maximum lifetime CESG		\$7,200
RESP contribution deadline		December 31

1. The limits apply since 2007. Earlier limits are shown below.

	Contribution limits	
	Annual	Lifetime
1997-2006	\$4,000	\$42,000
1996	\$2,000	
1990-1995	\$1,500	\$31,500
Before 1990	No limits applied	

2. Higher amounts apply to low- and middle- income families. In addition, unused CESG entitlements can be carried forward to be received in future years when RESP contributions are made. See **Table 3**.

Time limits

The following time limits apply to RESPs:

Table 2 – RESP time limits

	Time limits ¹
Contribution years after plan started	31
Deadline for plan termination	35 th anniversary ²
Contribution age limit for family plan	No contributions for beneficiary ≥ 31 years old

1. Before 2008, RESP time limits were 10 years shorter.
2. For beneficiaries of individual plans who qualify for the disability tax credit, the 31-year limit is 35 years and the 35th anniversary is the 40th anniversary.

These time limits allow the use of RESP funds throughout a student's undergraduate studies, as well as for post-graduate studies. They also make family plans more appealing because a family RESP becomes less likely to be terminated before the youngest child in the family has started his or her post-secondary education.

Investments

The subscriber makes the investment decisions for the RESP. With the exception of certain annuity contracts, the investments that an RESP can make are identical to those that an RRSP can hold. They include (but are not limited to):

- money and deposits;
- guaranteed investment certificates (GICs);
- federal, provincial and municipal bonds and debts (those of a Crown corporation also qualify);
- shares listed on prescribed stock exchanges in Canada or in a foreign country;
- units or shares of mutual funds;
- segregated fund policies;
- certain mortgages; and
- shares of small business corporations.

RESPs have no foreign property limitations. However, dividends paid on shares listed on a prescribed stock exchange in a foreign country may be subject to foreign withholding tax; treaty relief for the withholding tax is generally not available.

Canada education savings grant (CESG)

The federal Canada education savings grant (CESG)³ program tops-up RESP contributions. Depending on the beneficiary's age, the beneficiary's family income, the contributions made to an RESP in a year and the cumulative contributions made, the government may pay a CESG to the beneficiary's RESP for that year. The calendar year is used to determine CESG eligibility. The government pays the CESG to the trustee of the RESP, who deposits this amount directly into the RESP. A beneficiary must be a resident of Canada to receive the CESG.

CESGs can be paid up to December 31 of the year the child turns 17 years old. (However, as discussed under **CESGs for children aged 16 or 17** on page 5, children over 15 receive the CESG only if certain conditions are met). Therefore, although contributions to an RESP can be made for up to 31 years after the plan is started (up to 35 years for beneficiaries of individual plans who qualify for the disability tax credit), CESG entitlement ends earlier.

CESG rules are shown in **Table 3**. The table shows that for high income families, the CESG is equal to 20% of RESP contributions (up to \$2,500) made in the year, resulting in the \$500 annual maximum CESG (i.e., \$2,500 x 20% = \$500).

Table 3 – CESG payments

		Incomes	
		High	Low and middle
Net income of beneficiary's family¹		> \$85,414	≤ \$85,414
Maximum annual	CESG	\$500	\$550 or \$600 ²
	RESP contribution for maximum CESG	\$2,500	
	CESG, if CESG was not received in previous years	\$1,000	\$1,100
% of RESP contribution yielding CESG (up to maximum CESG)		20%	Varies ³
Maximum lifetime CESG per beneficiary		\$7,200	

1. Income amounts are those used to determine eligibility for the Canada child tax benefit and are indexed each year. The amounts shown are compared to family net income in 2010 to determine CESGs paid in 2012.
2. The maximum annual CESG is \$550 if the net income of the beneficiary's family is in the middle-income range and \$600 if it is in the low-income range.
3. (30% or 40% on the first \$500, depending on the net income of the beneficiary's family) + 20% on the next \$2,000.

Contribution strategies

You should start contributing to an RESP for your child as early as possible. Maximizing your contributions in the early years optimizes the income that can accumulate tax-deferred in the RESP.

However, contributions exceeding \$2,500 in a year cannot attract the CESG in later years. For example, making a one-time RESP contribution of \$50,000 will result in a lifetime CESG of only \$500 (for a beneficiary in a high income family). Therefore, the benefit of doing so (i.e., the tax-free return on \$50,000 over the life of the RESP) should be weighed against the loss of \$6,700 in CESGs (i.e., the maximum lifetime CESG of \$7,200 less the \$500 CESG).

To receive CESGs of \$7,200, you will have to spread your contributions over a number of years. Ideally, you should contribute a minimum of \$2,500 in each of the first 14 years after a child's birth, plus a minimum of \$1,000 in the 15th year, i.e., 20% x $([\$2,500 \times 14] + \$1,000) = \$7,200$. You may want to:

- contribute \$16,500 in year 1 to maximize the income that will accumulate tax-deferred; and

3. CESGs were introduced for RESP contributions made after 1997, and were increased commencing 2007.

- contribute the RESP lifetime limit as early as possible without forgoing CESGs ($\$16,500 + [\$2,500 \times 13] + \$1,000 = \$50,000$).

Similarly, if your ability to contribute to RESPs will fluctuate from year to year, you should consider deferring contributions that exceed the CESG room in a year. For example, if you can contribute \$10,000 in year 1, but will have no available cash in years 2 to 4, you can maximize CESGs by making contributions of \$2,500 in each of the first four years, rather than making one contribution of \$10,000 in year 1.

Carryforward of CESGs

If the annual maximum CESG was not received in previous years, the unused CESG can be carried forward. The carryforward will automatically accumulate for every year from the child's birth, even if the RESP did not exist.

Basically, the amount of CESG to be paid in a carryforward year for high-income families equals the least of:

- 20% of the contributions for that year;
- the CESG carryforward for previous years plus the CESG entitlement in respect of the current year; and
- \$1,000.

Therefore, if two years of contributions are missed, the CESG in the third year cannot exceed \$1,000, even if one large catch-up contribution is made in the third year. The additional CESG for low- and middle-income families cannot be carried forward. Consequently, the maximum carryforward is \$500, even for low- and middle-income families.

Example – Carryforward of CESGs

Robert set up an RESP for his daughter. His RESP contributions and the CESG payments are as follows:

	RESP Contributions	CESG	
		Received	Carryforward
2011	\$500	\$100	\$400
2012	\$1,000	\$200	\$300
Total			\$700

In 2013, Robert will contribute \$10,000 to the RESP.

Result

The amount of CESG to be paid in 2013 will equal the least of:

- $20\% \times \$10,000 = \$2,000$
- $\$700 + \$500 = \$1,200$
- \$1,000

Therefore, \$1,000 of CESGs will be paid to the RESP in 2013. The remaining \$200 of CESG entitlement ($\$1,200 - \$1,000$) will be carried forward.

CESGs for children aged 16 or 17

To encourage RESPs to be used as long-term saving vehicles, there are restrictions on the CESG that will be paid for children aged 16 or 17. Specifically, RESP contributions will be eligible for CESGs only if either:

1. a minimum of \$2,000 of contributions was made to (and not withdrawn from) RESPs for the beneficiary before the year the beneficiary turned 16; or
2. a minimum of \$100 in annual contributions has been made to (and not withdrawn from) RESPs for the beneficiary in any four years before the year the beneficiary turned 16.

You should ensure that at least one of these conditions is satisfied to preserve CESG eligibility for the child's 16th and 17th years. For example, if your child turns 15 this year and is not a beneficiary of an RESP, you should set up an RESP before the end of the year and make a contribution of at least \$2,000.

If you contribute at least \$5,000 per year in each of the three years before your child turns 18, the maximum CESG carryforward can be received. This will provide up to \$3,000 more in CESGs for your child's post-secondary education (i.e., \$1,000 of CESGs x 3 years) plus the income that would be earned on these amounts. The \$3,000 assumes you are a high-income earner.

Even if neither of the above conditions is met and CESG eligibility is lost, an RESP for your child may still be worthwhile if:

- he or she is expected to attend post-secondary school;
- you have funds available to set aside for his or her education; and
- your child is not expected to have much other income in the years he or she will receive the RESP income.

Although you won't be able to benefit from the CESG, you may still achieve a moderate level of income splitting and your contributions will earn tax-deferred investment income.

Canada learning bond (CLB)

The Canada learning bond (CLB) program provides a further federal government incentive for low-income families to set up RESPs for their children born after December 31, 2003. It benefits children under 16 in each year for which the child's family qualifies for the national child benefit supplement. Families with net incomes that did not exceed \$42,707 in 2010 will be entitled to the CLB in 2012. For purposes of the CLB, a benefit year is from July 1 to June 30.

The CLB is an initial deposit of \$500 in a qualifying child's RESP, followed by annual deposits of \$100, for a maximum lifetime CLB of \$2,000 per child. You do not actually have to deposit any money in the RESP to get the CLB. All that is required is that you open an RESP for your child with an RESP provider that offers the CLB. CESGs are not paid on CLBs.

Accumulated CLB entitlements can be requested up to the child's 21st birthday. After that, they will be forfeited.

Withdrawal of RESP funds

The subscriber makes the decisions about the amount and timing of withdrawals from the RESP. Funds from an RESP can be received by a beneficiary when he or she is enrolled in a qualifying post-secondary education program. These include

apprenticeships and programs offered by a trade school, CEGEP (a post-secondary education institution exclusive to Quebec), college or university. Distance education courses, such as correspondence courses, can qualify. Enrolment in an educational institution in Canada that is certified by the Minister of Human Resources and Skills Development will also qualify.

For qualifying full-time programs:

- the course of study must:
 - require at least 10 hours of instruction and/or work each week; and
 - last at least three consecutive weeks; and
- the program must be at a post-secondary institution, which generally includes:
 - a university, college or other educational institution in Canada; or
 - a university outside Canada.⁴

Qualifying part-time programs (and full-time programs at an educational institution outside Canada that is not a university) must require at least 12 hours per month spent on courses and last at least three consecutive weeks (13 consecutive weeks if the educational institution is outside Canada). The student must be at least 16 years old for a part-time program to qualify.

Tax consequences on withdrawal

The tax consequences on withdrawing funds from an RESP depend on whether your child is enrolled in a qualifying educational program at the time of the withdrawal. The possibilities follow:

4. Before 2011, for students enrolled at a university outside Canada, the course of study had to last 13 (not three) consecutive weeks.

Table 4 – Tax consequences on withdrawal

		Is child enrolled in a qualifying post-secondary educational program?	
		Yes	No
Source of funds	RESP contributions	Tax-free to subscriber ¹	
	Investment income	Constitute educational assistance payments (EAPs). Taxable to child at his or her marginal tax rate.	Called accumulated income payments (AIPs). Taxable at subscriber's marginal tax rate, plus an additional 20% tax (12% ² for Quebec residents).
	CESGs		If not used for a sibling's education, ³ must be returned to the government.
	CLBs		Must be returned to the government.

1. No tax consequences arise even if the subscriber gives the withdrawn contributions to the beneficiary or someone else.
2. The rate is 12% instead of 20% in Quebec, because Quebec imposes its own 8% tax.
3. However, no beneficiary can receive EAPs that include more than \$7,200 in CESGs. Any excess must be returned to the government.

If your child is enrolled in a qualifying post-secondary educational program, you must decide the source of the funds that will be withdrawn from the RESP (for non-group plans). If your child is not so enrolled, certain conditions must be met to withdraw accumulated income payments (see **Accumulated income payments** on page 8).

Under an individual or family plan, all or any portion of your RESP contributions can be returned to you at any time, tax-free. However, as discussed under **CESG repayments** on page 10, adverse consequences can arise if the beneficiary is not attending post-secondary school at the time the contributions are withdrawn.

Group plans may be automatically revoked if contributions are withdrawn before the beneficiary:

- reaches a certain age; or
- attends post-secondary school.

See **Types of Plans** in the **Appendix**.

Investment income – whether paid as an EAP or an AIP – is taxable as ordinary income to the recipient. No breakdown of Canadian dividends, foreign

income, interest or capital gains is made. As a result, the income is not eligible for the dividend tax credit or capital gains treatment.

Tracking withdrawals

When withdrawing funds from an individual or family RESP to fund the beneficiary's post-secondary education, the subscriber is required to specify what portion of the withdrawal will be from contributions or will be EAPs. The RESP promoter will track this information and therefore can advise the subscriber of the source of funds remaining in an RESP. In the case of group plans, the portion of contributions and EAPs withdrawn is usually determined by the promoter, with limited discretion available to the subscriber.

Termination of RESP

An RESP terminates on the earlier of:

- the withdrawal of all funds in the plan; and
- the end of the year that is the 35th year after the plan opened (40th year for a beneficiary of an individual plan who qualifies for the disability tax credit).

Beneficiary doesn't pursue post-secondary education

Before opening an RESP, you should ask your RESP provider about your options if the beneficiary does not continue education right after high school. For example, you may be able to:

- withdraw the funds;
- retain the funds in the RESP in case your child decides to continue studying later (RESPs can remain open 35 years; 40 years for a beneficiary of an individual plan who qualifies for the disability tax credit);
- transfer the funds to an RESP for another individual, such as a sibling, or change the beneficiary to a sibling (these strategies may enable the CESGs to be retained and are discussed under **Changing the beneficiary and Transfers between RESPs** on page 11);
- transfer the funds to your RRSP (see **Transfers to RRSPs** on page 9); or
- transfer the AIPs after 2013, to a registered disability savings plan (RDSP) with the same beneficiary (see **Transfers to RDSPs** on page 9).

Educational assistance payments

An educational assistance payment (EAP) is a distribution of investment income earned in an RESP, CESGs, CLBs and amounts paid under designated provincial programs (see **Provincial incentives** on page 13) to fund a beneficiary's post-secondary educational costs (e.g., tuition, room, board, books, supplies, computers, travel and other incidentals relating to the student's education). EAPs are reported on the T4A slip (box 42). The student must include the EAPs in income in the year of receipt.

EAPs can be paid for up to six months after a student ceases to be enrolled in a qualifying program, if that payment would have qualified as an EAP had it been made immediately before the student's enrolment ceased. Therefore, if a graduate of a post-secondary institution has EAPs remaining in his or her RESP, these funds will not be forgone.

Documentation to support EAPs

Before remitting the EAP, the promoter is required to obtain proof that the beneficiary is enrolled in a qualifying educational program at a post-secondary level at a designated educational institution. The post-secondary institution will normally provide a "proof of enrolment" for this purpose.

Although promoters are not required to obtain receipts from a beneficiary as proof of expenses, they are responsible for determining the "reasonableness" of a specific expense before making an EAP. As a result, promoters may request documentation related to a beneficiary's expenses. However, the Canada Revenue Agency does not expect promoters to assess the reasonableness of each expense for annual EAP requests that do not exceed \$20,000⁵.

EAP limits

Limits apply to the EAPs that can be made:

Table 5 – EAP Limits

	Full-time	Part-time
First 13 consecutive weeks in program	\$5,000	\$2,500 ²
Subsequently	No limit ¹	

1. Except for group plans, the amount of the EAP is at the subscriber's discretion. However, for full-time students, if there is a 12-month period in which the student is not enrolled in a qualifying educational program for 13 consecutive weeks, the \$5,000 maximum applies again.
2. The \$2,500 limit applies to the 13 weeks preceding the EAP request. Therefore, a request for an EAP will be refused if the EAPs to the beneficiary in the 13 weeks preceding the request exceeded \$2,500.

Therefore, if your child pursues post-secondary education that is of a short duration (i.e., less than 13 weeks), the EAPs that can be withdrawn from the RESP will be restricted. If more than this amount has accumulated in the RESP, and you do not transfer the funds to another beneficiary (see **Changing the beneficiary and Transfers between RESPs** on page 11) the remaining income can be withdrawn as an AIP as long as certain conditions are met (see **Accumulated income payments** below). However, this is generally not an option under a group RESP.

The \$5,000 and \$2,500 limits continue to apply, despite the introduction of the \$20,000 threshold (discussed above under **Documentation to support EAPs**). However, Human Resources and Skills Development Canada may approve an EAP above the \$5,000 or \$2,500 limit if the cost of tuition plus related expenses for a particular program is substantially higher than average. Also, subject to the terms of the RESP, the child can receive funding above these limits by receiving contributions made to the RESP.

Accumulated income payments

As noted in **Table 4**, accumulated income payments (AIPs) refer to the investment income withdrawn from an RESP by the subscriber if the beneficiary is not enrolled in a qualifying education program.

An RESP must be terminated by February 28 (February 29 for leap years) of the year after the year in which an AIP is first paid. An RESP that has made an AIP cannot make a transfer to another RESP.

5. The \$20,000 threshold was announced on August 12, 2008. It is indexed, but the CRA has not published the updated thresholds.

Requirements to receive AIPs

A subscriber can receive AIPs only if he or she is a Canadian resident and any of the following conditions are met:

- the RESP has existed at least ten years and all (past and present) plan beneficiaries (other than deceased individuals) are at least 21 years old and are not eligible to receive EAPs;
- the RESP has been terminated; i.e., it has existed 35 years (40 years for beneficiaries of individual plans who qualify for the disability tax credit);
- all (past and present) beneficiaries are deceased; or
- the Minister has agreed that it is reasonable to expect that a beneficiary will not be able to pursue post-secondary education because he or she suffers from a severe and prolonged mental impairment.

Tax on AIPs

AIPs are subject to regular income tax plus an additional 20% tax (12% for Quebec residents because Quebec imposes its own 8% tax), which is intended to ensure that RESPs are not set up merely for tax deferral purposes. The total of both taxes can be extremely high. For subscribers in the top income tax bracket, the total tax rate can range from 59% to 70%, depending on the province or territory of residence.

Transfers to RRSPs

The regular tax can be deferred and the additional tax can be avoided if the AIP is transferred to an RRSP of the subscriber or a spousal RRSP. To make the transfer you must have sufficient RRSP contribution room. In addition, you must meet all of the following conditions:

- you are:
 - the subscriber of the RESP (and you did not become a subscriber because of the death of the original subscriber); or
 - the spouse or common-law partner of a deceased original subscriber under an RESP for which there is no subscriber;
- you transfer the AIP to your RRSP (or a spousal RRSP) in the year of receipt or in the first 60 days of the following year; and
- you deduct the RRSP contribution in the year the AIPs were received (and you have sufficient RRSP room to allow the deduction).

The maximum of all AIPs that you can roll over to an RRSP is \$50,000 (\$100,000 if you and your spouse are joint subscribers to the RESP) for purposes of avoiding the penalty tax. Also, you cannot avoid the penalty tax if you make the transfer in the first 60 days of the year following the year of receipt, and claim an RRSP deduction in that following year. This is because the RRSP deduction must be claimed in the same year the AIP was received (see the last condition above).

If you are expecting to receive AIPs in the next year or two, you may wish to avoid making RRSP contributions in those years. This will help you build up RRSP contribution room to shelter the AIP. Also, you may want to receive the AIPs over two calendar years to use your RRSP contribution room for both years.

Transfers to RDSPs

Starting 2014, AIPs can be transferred on a tax-deferred basis to an RDSP (i.e., regular tax can be deferred and the additional tax can be avoided) if the RESP beneficiary is also the beneficiary under the RDSP and one of the following conditions is met:

- the beneficiary is, or will be, unable to pursue post-secondary education because he or she has a severe and prolonged mental impairment; or
- the RESP has been in existence for:
 - at least 10 years and each beneficiary is at least 21 years old and is not pursuing post-secondary education; or
 - more than 35 years (40 years for certain plans).

A transfer can be made only in respect of individuals who:

- qualify for the disability tax credit;
- are under 60 years old; and
- are resident in Canada at the time of the transfer.

Furthermore, to make a transfer, the RESP subscriber and RDSP holder must jointly elect in prescribed form. No form has been prescribed yet.

When a rollover from an RESP to an RDSP occurs, RESP contributions will be returned to the RESP

subscriber tax-free. As well, CESGs and CLBs in the RESP must be repaid and the RESP must be terminated by the end of February following the year in which the rollover was made.

The overall RDSP lifetime contribution limit of \$200,000 continues to apply. The AIP transferred cannot exceed, and will reduce, the beneficiary's available RDSP contribution room. Therefore, if an AIP might be transferred from an RESP to an RDSP, this should be taken into account when planning RDSP contributions.

Administrative requirements and AIPs

AIPs are reported on the T4A slip (box 40). The recipient must include the AIP in income in the year of receipt and must file Form T1172, "Additional Tax on Accumulated Income Payments from RESPs." Any additional tax owing must be paid by the taxpayer's filing-due date for regular income tax. In most cases, the filing-due date for individuals is April 30 of the year following the year in which the AIP is received.

To avoid withholdings of regular income tax and the additional tax on AIPs transferred directly to your RRSP (or a spousal RRSP), you have to complete Form T1171, "Tax Withholding Waiver on Accumulated Income Payments From RESPs." Otherwise, both income tax and the penalty tax will be withheld. Presumably, a similar filing requirement will apply to avoid tax on transfers to RDSPs.

CESG repayments

It is best to retain your contributions in an RESP until your child starts post-secondary school. If the beneficiary is not enrolled in a qualifying educational program at the time the contributions are withdrawn, the withdrawal will necessitate a repayment of CESGs, as shown in **Table 6**.

Table 6 – CESG Repayments

The CESG repayment is the lesser of the CESGs in the RESP¹ and the result of the following calculation:

$$\frac{\text{CESGs in the RESP}^1}{\text{Contributions withdrawn that attracted CESGs}} \times \text{Contributions in the RESP that attracted CESGs}^1$$

1. Refers to the balance immediately before the withdrawal.

A possible strategy is to deplete the RESP of EAPs before withdrawing contributions. If your child does not complete post-secondary school, but all of the EAPs have been withdrawn, there will be no CESGs to repay. On the other hand, because EAPs are taxable, while contributions can be returned tax-free, tax will be deferred by withdrawing contributions first. (These alternatives would apply to individual and family plans, which allow subscribers discretion over withdrawals.)

Contributions that attracted CESGs are considered to be withdrawn before those that did not.

CESG repayments will also be required if property is transferred to another RESP. However, this may not be the case if a beneficiary of the transferring RESP is:

- a beneficiary of the receiving RESP immediately before the transfer; or
- a sibling of a beneficiary of the receiving RESP and that sibling is under 21 years old.

CESG overcontributions

If more than the maximum lifetime CESG of \$7,200 was paid to an individual's RESPs (e.g., because he or she is the beneficiary of more than one RESP), the excess must be repaid to the government.

CESGs and withdrawals of pre-1998 funds

The CESG was introduced in 1998. Because of concerns that individuals might use the withdrawal privileges to tap into CESGs (by contributing, withdrawing, and then re-contributing the same RESP contribution), the early RESP withdrawal (i.e., withdrawal before the child attends post-secondary school) of pre-1998 RESP funds is penalized. The CESG entitlement for the year of the early withdrawal (but only starting from the day of the

early withdrawal) and the two subsequent years is lost for any individual who was a beneficiary of the RESP at any time from February 24, 1998, to the day of the withdrawal.

However, this penalty will not apply in certain instances (e.g., if the total withdrawals for the year do not exceed \$200 or, in the case of a family plan, if at the time of the withdrawal at least one beneficiary under the RESP is eligible to receive an EAP).

RESP overcontributions

If more than \$50,000 has been contributed to an RESP (or to RESPs) for a beneficiary, each subscriber for that beneficiary must pay a 1% per-month tax on his or her *pro rata* share of the overcontribution that is not withdrawn before the end of the month. This could be a concern if a child is the beneficiary of more than one RESP and each RESP was opened by a different subscriber (e.g., if a father and grandmother each open an RESP for the same child). Subscribers in this situation should coordinate to prevent overcontributions.

You can reduce the amount subject to the tax by withdrawing the overcontribution. However, in determining whether the \$50,000 lifetime limit has been exceeded, the withdrawn amounts continue to be included for the beneficiary.

Alternatively, the Minister can waive the tax when it is “just and equitable to do so having regard to all of the circumstances.” For example, the Minister would exercise this discretion if the tax “arose as a consequence of reasonable error.”

Form T1E-OVP, “Individual Tax Return for RESP Excess Contributions for _____ (year),” should be used to compute the overcontribution tax. The tax is payable by March 30 (March 29 for leap years) following the year in which there is an overcontribution.

Changing the beneficiary

If the RESP’s terms permit, you can change the name of the RESP beneficiary. The contributions for the former beneficiary are treated as if they had been made for the new beneficiary on the date they were originally made unless:

- the new beneficiary is a sibling of the former beneficiary and is under 21 years old; or
- both beneficiaries are related to the original subscriber and both are under 21 years old.

For purposes of the RESP rules, you are related to the beneficiary if you are connected by blood or adoption. Specifically, you:

- are related to your children (including adopted children), grandchildren, great-grandchildren, brothers and sisters, but:
- are not related to your spouse, common-law partner, niece, nephew, aunt or uncle.

If the new beneficiary already has an RESP and the contributions for the former beneficiary are treated as if they had been made for the new beneficiary, this can cause an overcontribution for the new beneficiary.

Transfers between RESPs

Similarly, a transfer from one RESP to another can result in an overcontribution. However, contributions from the transferring RESP will not be treated as contributions to the receiving RESP (and an overcontribution will not be created) if a beneficiary of the receiving RESP is:

- a beneficiary of the transferring RESP immediately before the transfer; or
- a sibling of a beneficiary of the transferring RESP immediately before the transfer: and
 - the receiving RESP allows more than one beneficiary at any time⁶; or
 - the beneficiary of the receiving RESP was under 21 years old at the time that the RESP was established.⁷

For purposes of determining the contribution years remaining for the transferee RESP and the deadline

6. For transfers before 2011, this condition was not available.

7. For transfers before 2011, the beneficiary of the receiving RESP had to be under 21 years old at the time of the transfer.

for its termination (see **Table 2**), the transferee plan is deemed to have started on the earlier of the day on which:

- the transferee plan; and
- the transferor plan, was started.

This deeming rule also applies for purposes of determining whether the RESP has existed at least ten years for purposes of assessing its eligibility to make AIPs.

Death of subscriber

The RESP rules allow a replacement subscriber to be named if the original subscriber dies. If the estate of a deceased subscriber continues to make contributions into an RESP, the estate is considered to be the replacement subscriber.

If spouses are joint subscribers, the surviving spouse would continue to manage the RESP. Otherwise, the executors of the subscriber's estate assume this responsibility.

Death of beneficiary

On the death of a beneficiary of a family RESP, the RESP would continue with the remaining beneficiaries. However, if the RESP is an individual plan, the subscriber may be able to name a new beneficiary, or the subscriber can withdraw his or her contributions, in which case the CESGs must be repaid. The subscriber can use the AIPs only if all plan beneficiaries are deceased (or any of the other conditions discussed under **Requirements to receive AIPs** on page 9 have been met).

RESPs and non-residents

If an RESP subscriber or beneficiary is (or will become) a non-resident, there may be tax consequences in the foreign jurisdiction (in addition to the Canadian tax consequences, discussed below).

RESPs may not be desirable if the subscriber and/or the beneficiary is not a Canadian resident. The main concern is that the taxation of income earned in an RESP may not be deferred in the foreign

jurisdiction, resulting in a mismatch of income recognition in the two jurisdictions and of any consequential foreign tax credits. Therefore, the potential for double taxation exists.

Tax advice should be obtained in the foreign jurisdiction.

Non-resident subscriber

Subscribers need not be Canadian residents. However, as mentioned, a subscriber must have a social insurance number when opening an RESP. Therefore, a non-resident can set up and contribute to an RESP only if he or she has a social insurance number. No Canadian tax is payable if there is a return of contributions to a non-resident subscriber, but AIPs cannot be made if the subscriber is non-resident.

Non-resident beneficiary

A beneficiary must be resident in Canada when⁸:

- he or she is designated as a beneficiary; and
- contributions are made on his or her behalf.

An exception applies, in certain cases, if the designation is made in connection with (or the contribution is made by way of) a transfer from another RESP under which the individual was a beneficiary. In this situation, the non-resident beneficiary need not have a social insurance number. This exception accommodates transfers from existing RESPs entered into before 1999, which is when the requirement for a beneficiary to have a social insurance number was introduced.

Furthermore, non-residents do not accumulate CESG room.

Beneficiaries who are non-resident when they start their post-secondary education are eligible to receive EAPs, but cannot receive CESGs as part of the EAPs. EAPs paid to non-residents are subject to 25% Canadian withholding tax (may be reduced by a tax treaty), unless the payments are otherwise subject to regular Canadian income tax.

8. These conditions apply since 2004.

U.S. citizens resident in Canada

RESPs may not be desirable if the subscriber and/or beneficiary is a Canadian resident who is:

- a U.S. citizen; or
- a U.S. green card holder who files U.S. resident tax returns.

The main concern is that the taxation of income earned in an RESP is not deferred for U.S. tax purposes. Consult your PwC tax adviser for more information.

Should you open an RESP?

If your child is expected to have other income when he or she attends school (e.g., from summer jobs, co-op work terms, taxable scholarships), you should carefully consider whether to establish an RESP. Because your child pays tax on the EAPs in addition to any other income, your child may have to claim more than the basic personal credit on his or her tax return to eliminate the tax liability.

Some of these credits, such as the tuition and education credits, might have been transferable to you had your child not been required to report this additional income. You need to be reasonably assured that the additional income earned in the RESP (compared to what you could accumulate after tax outside an RESP) exceeds any tax savings that could have resulted if your child had been able to transfer tuition and education credits to you.

In addition, higher income can eliminate or reduce other credits students can typically take advantage of (such as the GST credit, and other provincial tax credits for rent and sales tax).

If for some unforeseen reason your child does not enroll at a qualifying post-secondary institution, you will be entitled to the accumulated income in the RESP only once the plan has been in existence for ten years. There are no restrictions on the return of your RESP contributions.

To make an informed decision today, you need to make several assumptions about the future. In spite of any potential disadvantages, an RESP can be a

good way to ensure that funds are set aside for your child's post-secondary education.

Provincial incentives

Residents of Alberta or Quebec (or Saskatchewan, starting 2013) can benefit from programs related to RESPs.

Alberta

Under the Alberta centennial education savings plan (ACESP), the province pays both:

- \$500 to the RESP of every child born to (or adopted by) Alberta residents. The payment becomes part of the EAPs. An application must be submitted within six years of birth.
- \$100 to children who attend school and turn 8, 11 and 14 (for a total of \$300 by the time the child turns 14). An application must be submitted within six years of the child's turning 8, 11 or 14. A minimum of \$100 must be contributed to the RESP within one year before each application. A child need not have received previous grants to qualify for subsequent grants.

The ACESP funds must be returned to Alberta if the beneficiary does not attend post-secondary school.

To receive ACESP payments:

- the child's parent must be a resident of Alberta at the time of the request; or
 - in respect of the \$500 grant, when the child was born or adopted; and
 - in respect of the \$100 grant, when the child turns 8, 11 or 14, as the case may be;
- the child must have a social insurance number; and
- the child must be the beneficiary of an RESP.

The RESP subscriber does not have to be the parent or a resident of Alberta (e.g., it could be a grandparent who is a resident of another province).

Quebec

The Quebec education savings incentive (QESI) tops-up contributions made to an RESP and is paid directly to the RESP.

To qualify:

- the RESP beneficiary must be under 18; and
- both the beneficiary and the RESP must reside in Quebec at the end of the year (for this purpose the RESP can be deemed to reside in Quebec).

Table 7 – Quebec education savings incentive

	Incomes		
	High	Low- and middle-	
Net income of beneficiary's family¹	> \$80,200	≤ \$80,200	
Maximum annual	QESI	\$250	\$275 or \$300 ²
	RESP contribution for maximum QESI	\$2,500	
	QESI, if QESI was not received in previous years ³	\$500	\$550
% of RESP contribution yielding QESI (up to maximum QESI)	10%	Varies ⁴	
Maximum lifetime QESI per beneficiary	\$3,600		

1. Income amounts are indexed annually. The amounts shown are compared to family net income in 2011 to determine QESIs paid in 2012.
2. The maximum annual QESI is \$275 if the net income of the beneficiary's family is in the middle-income range and \$300 if it is in the low-income range.
3. Any QESI accrued during previous years can be added to the current year's entitlement (up to \$250).
4. (15% or 20% on the first \$500, depending on the net income of the beneficiary's family) + 10% on the next \$2,000

To claim the QESI, the trustee of an RESP must apply to Revenu Quebec, using a prescribed form before April 1 (March 31 for leap years) of the following year. If the beneficiary does not pursue post-secondary education, the QESI must be repaid to the government.

Saskatchewan

Commencing 2013, the Saskatchewan advantage grant for education savings will provide a 10% matching grant for RESP contributions, to a maximum of \$250 per child per year. Therefore, a \$2,500 contribution will result in the maximum grant. Further details are forthcoming.

Other options

In addition to the RESP initiatives, other education-related incentives may be worth considering when planning for your child's education.

Lifelong learning plan

The lifelong learning plan (LLP) allows you to make tax-free withdrawals from your RRSP to finance full-time training or education (part-time for students who meet one of the disability conditions) for yourself, your spouse or your common-law partner. If certain conditions are met, you can withdraw up to \$10,000 in a calendar year and up to \$20,000 in total. You have up to ten years to repay the withdrawals. Any amount you do not repay will be included in your income for the year it is due.

Your child can use the LLP to fund his or her education, while getting a start on saving for retirement. You should consider having a child that has qualifying RRSP income (e.g., from summer jobs) set up an RRSP. If your child is 18 years or older, you may want to gift or lend funds to the child to make an RRSP contribution.

Tax-free savings account

Canadian residents 18 years or older can make annual contributions of \$5,500⁹ into a tax-free savings account (TFSA). The contributions are not deductible for tax purposes, but income earned in the TFSA and withdrawals from the TFSA are not taxable. Any unused contribution room for a year can be carried forward indefinitely. Furthermore, amounts withdrawn from a TFSA will be added to the individual's unused contribution room for the following year.

Interest on money borrowed to contribute to a TFSA will not be deductible. The investments that a TFSA can make are similar to those that can be made by an RESP.

You can make withdrawals from your TFSA to fund your child's education. In addition, a TFSA is an option for children 18 years of age or older, particularly if they are uncertain about pursuing post-secondary education, and therefore do not want to use an LLP (i.e., they do not want to lock funds into an RRSP). These individuals no longer qualify for CESGs, so an RESP will be less appealing.

9. A \$5,000 threshold applied from 2009 to 2012. The threshold is indexed and increased to \$5,500 starting 2013.

You may want to gift or lend funds to the child to make a TFSA contribution; the income earned in the TFSA will not be taxable to you.

Student loans

Federal or provincial student loans are another option. The interest portion of student loan payments made in a year can be claimed as a tax credit. If your child cannot use the credit in a given year, the amount can be carried forward for five years.

Trusts

Finally, if you are worried about setting up an RESP and losing the income accumulation if your child doesn't pursue post-secondary education (relevant for plans that will have less than a ten-year life), then consider setting up a trust. In this case, if your child does not pursue post-secondary education, the funds could be used for other purposes, e.g., to start a business or purchase a home.

Appendix – General information

Opening an RESP

As mentioned, to open an RESP both you and the beneficiary will need a social insurance number.

Also, the CESG will not be paid until the beneficiary's social insurance number is provided.

Types of RESPs

There are three types of RESPs:

Table 8 – Types of RESPs

	Individual Plan	Family Plan	Group Plan ¹
Beneficiaries	One	One or more	Subscriber names one beneficiary, but plan is for children of many different families (contributions are pooled)
Must beneficiary and subscriber be related²?	No	Yes ³	No
Age of beneficiary at time of designation contribution	No maximum	Must be under 21 ⁴ Must be under 31 ⁴	May be specified by plan
Specific monthly contributions required?	No (unless specified by promoter)		Generally, yes
Payouts based on amount of money in plan and:	Subscriber determines amount and timing		Contributions: Usually repaid when beneficiary reaches a certain age EAPs: Generally, based on the total number of students of the same age who are in school that year, but CESGs are paid to specific beneficiaries
RESP providers	Financial institutions (e.g., bank, credit union), life insurance companies and mutual fund companies, non-profit trusts		Group plan dealer (i.e., non-profit trusts)
Rule of thumb – The plan is a good choice if you:	Want to save for a child that is not related to you	Want all, or any, of the children named in the plan to use the money ⁵	Are fairly sure the child you are saving for will continue education after high school
	Want to decide how to invest the money and the amount and timing of EAPs		Want someone else to decide how to invest your money (usually, low-risk investments are made) and the amount and timing of EAPs
	Don't want to make regular payments		Want to make regular payments

- Group plans are offered by group plan dealers. Each group plan has its own rules, so it is important to know the details. For example, ask what happens to your money if the child does not continue with education right after high school. In a group plan, if one beneficiary does not attend a post-secondary educational institution, the CESGs and CLBs for that beneficiary must be returned to the government.
- The meaning of "related" for purposes of the RESP rules is discussed under **Changing the beneficiary** on page 11.
- In a family plan, the subscriber and beneficiary cannot be the same person.
- Transfers can be made from another family plan regardless of the age of the beneficiaries.
- In a family plan, if one beneficiary does not attend a post-secondary educational institution, the other beneficiaries can share in the plan's:
 - income – the income does not have to be paid proportionately to the beneficiaries; and
 - CESGs – but no beneficiary can receive more than \$7,200 of CESGs (any excess CESG must be repaid) and the other beneficiaries cannot share in the CLBs.

Selecting an RESP

If you are considering an RESP, you will have to decide which plan best suits your family's needs and which RESP provider to use. In making your decision, you should consider several factors.

Degree of control

If you want to be able to control the investments the RESP makes, and the amount and timing of the educational assistance payments your child will receive, then the group RESP is not advisable. However, if you prefer to leave the investing to someone else and are happy with the calculation of potential payouts to beneficiaries, then the group RESP may be ideal.

If you are a knowledgeable investor and want to invest directly in stocks, a self-directed individual or family RESP might be the best alternative.

Fee minimization and restrictions

The type of fees and their magnitude vary by institution. Set-up fees, trustee fees, and/or annual administration fees may be payable. In some cases, there are no fees or the fees are waived if conditions are met. Higher initial fees may be payable with group RESPs, but the annual costs thereafter may be nominal. Penalties may also apply.

If you have more than one child and want to put aside funds for each, then establishing one plan with multiple beneficiaries is likely the most cost-effective. This means you should have to pay only one set of fees. As well, if you already have brokerage accounts, bank accounts, RPPs, group RRSPs, self-directed RRSPs, and spousal RRSPs, the convenience of having one RESP for your children may outweigh other considerations.

The ages of your children

The fact that an RESP has a 35-year life (40 years for an individual plan if the beneficiary qualifies for the disability tax credit) can be relevant to parents with only one child now, but who are planning to have more. If you set up an RESP now, but plan to have three more children (over the next ten years), then the RESP might have to be wound up before

the fourth child finishes school. An individual plan for each child might be the better alternative. If one child does not pursue post-secondary education, you may still be able to change the beneficiary under the RESP or transfer the RESP funds to a plan with a different beneficiary. (See **Changing the beneficiary** and **Transfers between RESPs** on page 11.)

Leverage

If having your accounts with one institution gives you more leverage with respect to interest rates, loans and other dealings, then your choice might be obvious. In this case, however, you should make sure you are aware of the plan's limitations before you set up the RESP. Some institutions may waive the administration fee for their self-directed RESP if you have a self-directed RRSP account with them.

Plan restrictions and requirements

Some plans may have more restrictive provisions than those imposed by the government. You should find out whether beneficiaries can be changed, what the requirements under the plan are for EAPs, and what the conditions are concerning transfers between different plans offered by the same RESP provider.

A group plan may be a good choice if you can make regular payments into the RESP and you are fairly certain the beneficiary will attend post-secondary school. However, you should ask your group plan provider what happens to your money if the child does not continue with education right after high school or if the child decides to go to school part-time.

We can help

Your PwC adviser or any of the individuals listed on the next page can help you determine how to navigate the RESP rules and make the most of these plans. Please contact us.

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1. Member of PwC's Canadian National Tax Services (see www.pwc.com/ca/ents).

2. A law firm affiliated with PwC Canada (see www.wilsonandpartners.ca).

How much tax do you owe?

Use our **Income Tax Calculator for Individuals** to estimate your 2012 tax bill and marginal tax rates: www.pwc.com/ca/calculator.