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All About RESP Accounts

BY KURT ROSENTRERER  SEPTEMBER 23, 2024

By Kurt Rosentreter, CPA, CA, CFP, CLU, TEP, CIMA, FCSI, CIM

What is an RESP?

RESPs or registered educational savings plans are the “go to” savings account products for parents of kids in Canada who have goals of their child pursuing post-secondary education after high school.

An RESP is a registered investment account that you open at a bank, a brokerage or an insurance company to save tax sheltered money for your child or children from birth. Parents should open a family RESP plan if they have more than one child and strive to contribute \$2,500/ per child for at least 16 years. Money inside the RESP account is tracked by child and can be invested to buy GICs, stocks, bonds and other investment products. By the time the child is age 18 and ready for post secondary education, parents who have fully funded the RESP plan usually have around \$60,000 to \$100,000 per child for the educational costs ahead.¹

Time For Withdrawals!

So your child is age 18 and starting some kind of post secondary program. Universities, trade schools, colleges, co-op programs, school outside of Canada, so many options for kids qualify for RESP cost coverage.

What Kind of Costs Qualify?

Besides tuition costs, consider seeking withdrawals from the RESP for the following additional costs you incur:

- Costs of living on campus in residence or rent for living off-campus.
- Food costs while going to school
- Travel costs to and from school and while at school
- All technology related costs to help you learn – internet connections as well as buying a laptop or Ipad all count.
- Specialty equipment needed for certain professionals (eg. Musical instrument for a music student, steel toe shoes for a welder's course).
- Any other costs you incur (student or parent) in furtherance of education over the years the child is in post secondary school.

Keep all your receipts to support your request for reimbursement through an RESP withdrawal. We recommend you (the parent) pay the expenses yourself for a few months, add all the receipts together and ask for one or two withdrawals from the RESP a year to keep administration simple.

RESP Sharing

It is important to know that money contributed into the RESP is tracked for each child (contributions, grant, earnings) but money withdrawn from the RESP can be commingled to some extent so that you can use a larger proportion towards one child if needed. We recommend that you use the RESP as needed in the initial years even if it means you run out for the last child. We know you will be fair to all kids (you will cover all shortages) but we feel that using the money fast is important in case any of the kids do not use their portion – you do not want to have money left over in the plan at the end and face potential penalties!

Important Tax Planning

When you make a withdrawal from the RESP each year, it is important to know that the grant and the earnings inside the RESP plan are taxable to the child upon withdrawal while your contributions are not. That means every withdrawal should be carefully planned so not to create huge amounts of taxable income for the child – especially when considered against money they make from summer jobs or investment income. To avoid triggering income tax on the child's tax return, it is advisable to keep the taxable withdrawal portion of the RESP money well below \$20,000 per year, depending on the child's other sources of income and applicable tax credits.

Further, note that the child's tuition costs may qualify for a tuition tax credit that can be claimed by the child and some of which can be transferred to a parent. The transfer of the tax credit can be as much as \$5,000/year and should also be carefully thought out as you are taking future tax benefits away from your child or you may also create taxable income this year for the child.

Generally speaking, if a child ends up paying income tax in any calendar year while they were in university, and it is a result of large taxable RESP withdrawals, this may be a strong sign of poor planning.

For personalized advice, please consult with a tax professional.

Prioritizing RESP Withdrawal Design

Remember, your RESP consists of capital you contributed (this is after-tax money), earnings on the money invested over 18 years and free grant you received from the government after you contributed. We have already talked about how the grant and earnings are taxable so that withdrawals of this part need to be controlled and planned each year. But also know that the free grant money needs to be repaid back to the government if your child doesn't use it up. So what does that mean? It means you start your withdrawals trying to use up the grant money first and as fast as possible.

And if the likelihood is that your child will have better paying summer jobs by third or fourth year of post secondary school, then get the taxable portion (grant, earnings) out of the RESP and taxed in the child's hands in year one and two.

Investing inside an RESP from Years 17+

From ages 0-12, consider placing a significant portion of the RESP funds in the stock market to maximize growth, while keeping in mind your risk tolerance and the importance of diversification.

From ages 13 to 16, consider scaling back on risk by gradually reallocating some of the RESP funds into bonds and GICs. This strategy can help reduce volatility and preserve capital as you approach the time when your child will need the funds, typically around age 18.

From ages 17 until the end of the plan, it is advisable to shift the majority of the funds into GICs and cash holdings as you may have reached the point of making major annual withdrawals and this conservative approach helps to preserve the capital, ensuring that the funds are available for tuition and other education-related expenses without the risk of significant losses from the stock market. At this age, the time for stock market investing is behind you.

Paperwork To Process RESP Withdrawals

Every semester that you want to process an RESP withdrawal, as the brokerage holding your RESP investment account, we need official school documentation showing the enrollment of the child and the full time or part time list of courses they are taking. We need this every semester.

We do not need invoices for all the types of costs you are claiming reimbursement for. You need to keep those receipts in case CRA (Canada Revenue Agency) ever audits you.

The child will get a tax receipt each year showing the portion of the RESP withdrawals that are taxable. This income needs to be included on their personal tax returns.

The payment of money out of the RESP can either be paid to the student or to the parent who paid the expenses.

RESP Deadlines

Do not defer making RESP withdrawals until the end of the student's program as you can see from above it may compromise grant money (if they quit) or lead to adverse excess

taxation of income and grant because you are claiming it all in one year.

You can claim expenses from an RESP up to six months after after graduating from a qualifying education program.

You can keep an RESP open until the child is age 35.

RESP Special Considerations

If a child has two parents, having both parents as joint subscribers of the plan involves them both in the child's educational planning, provides more options for plan wind up if the child doesn't use all the money and simplifies estate planning if one spouse dies.

If parents of a child are divorced, make sure that both parents get regular RESP investment statements, both parents jointly approve all withdrawals, all expensed costs are approved by both parents and match the withdrawals, decisions about taxation of income annual are discussed together and the sharing of the tuition tax credit transfer to a parent are planned and shared as often outlined in a separation agreement. Note that RESP's are an area where one ex-spouse can abuse the financials of the family by making unauthorized withdrawals if not monitored by the second ex-spouse.

People that plan to move out of Canada after having children may not want to open an RESP as complications arise on the use of RESP if you are a non-resident. With that said, if you are a Canadian resident and citizen and your child chooses to attend post-secondary education in another country, often these costs do qualify for RESP withdrawals for reimbursement.

Grandparents

Often grandparents or aunts and uncles give wonderful gifts to children by opening an RESP in their name. Generally this should be avoided. The family members and friends should instead encourage the parents to open an RESP for the child and they merely put money into the plan. Administration can be greatly complicated by having multiple RESP plans for one child and this is made worse if that grandparent or aunt dies as the subscriber.

Still Wondering What to Do?

Our team is here to help you plan your RESP withdrawals. For 30 years we have helped families in Canada plan their educational costs for children and grandchildren. Contact us in the office with all your questions and definitely a few weeks in advance of all your RESP withdrawals.

Best regards,



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1. Calculation based on total projected value of RESP at year 18 with assumed annual contributions of \$2,500 per child and receiving maximum CESG. Range based on an assumed annualized return of 2% (low-end) to 7% (high-end) ↩



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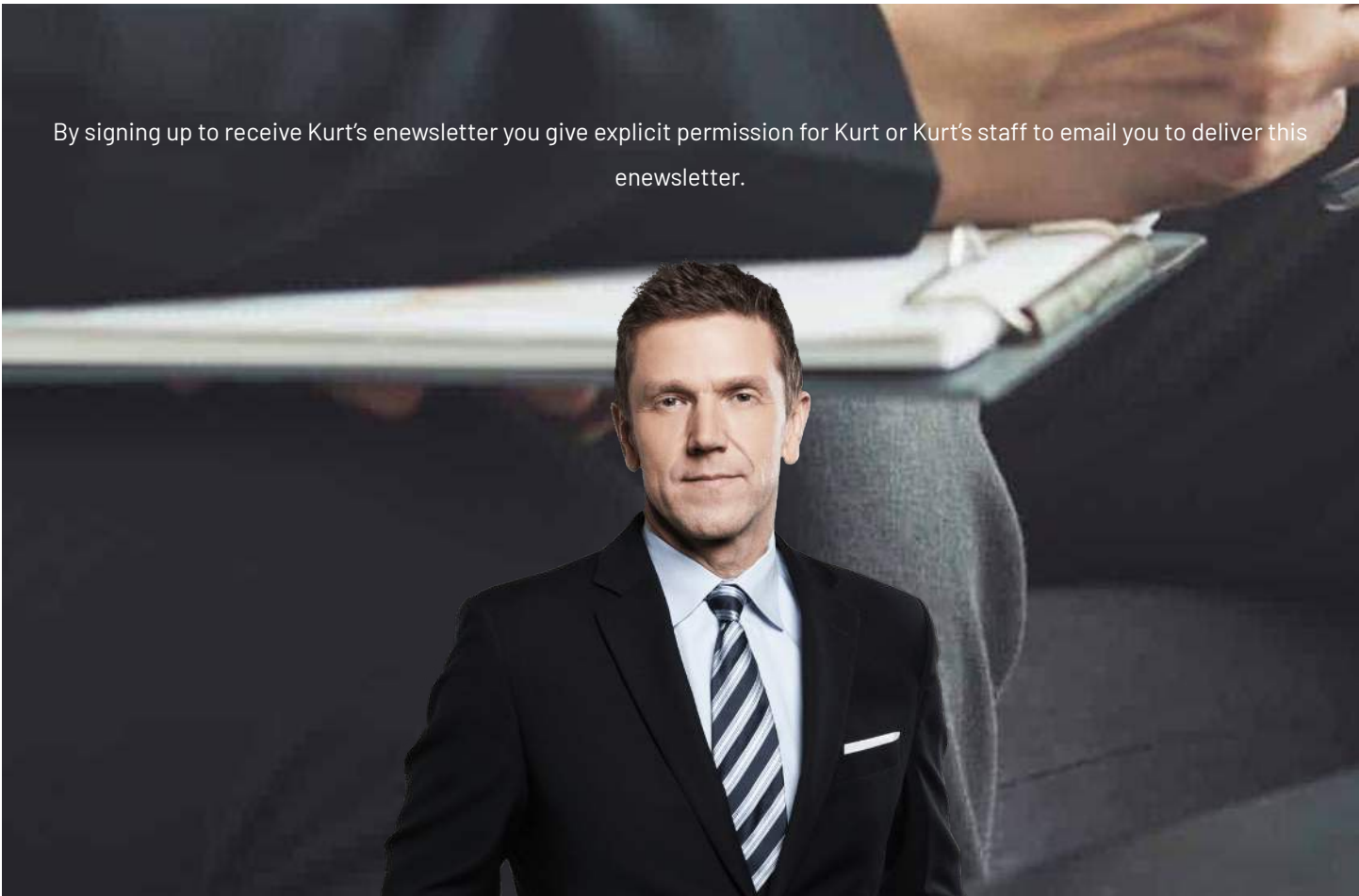
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