WOOD GUNDY

PLANNING FOR A CHILD’S EDUCATION

Recognizing the dramatically increasing costs of post-secondary education, many people would like to start setting funds aside for children or grandchildren as soon as possible. And, of course, they prefer to use the most tax-effective savings strategies available. Often, the strategy chosen largely depends upon their financial means, the age of the children, and the length of time left to save.

In some cases, parents, grandparents, or guardians have excess capital to kick-start an education savings program for older children. However, parents with young children also need to focus on paying down their mortgage, daycare costs and saving for retirement. As a result, many of them choose to take a long-term approach to education funding.

Regardless of your family circumstances or stage in life, there are education funding strategies available to suit every need. You may even choose to implement a combination of strategies. Your CIBC Wood Gundy Investment Advisor can help you review all of the strategies and determine which option(s) is best-suited for your personal circumstances.

Education Savings Plans

The most popular way to save for a child’s education, while retaining ownership of assets, is to become a subscriber and make contributions to an Education Savings Plan (ESP). An ESP offers some tax advantages, and government grants (federal and provincial, where applicable) that make this an attractive savings vehicle. Although an ESP is subject to contribution limits and various other restrictions, it can be very effective under the right circumstances. An ESP can also be used in combination with other savings options.

ESP rules

1. The lifetime contribution limit is $50,000 per beneficiary. Annual contribution maximums do not apply.
2. Contributions may attract a Canada Education Savings Grant (CESG) from the federal government and will be paid directly into the RESP. CESG accumulates for a child until the end of the year in which the beneficiary turns 17.
3. As of 2007, up to $500 in annual grants are available for each eligible beneficiary (20% of the first $2,500 of annual contributions).
4. Up to $1,000 in annual grant may be received if there is unused grant room available from previous years (20% of the first $5,000).
5. The maximum lifetime CESG amount each beneficiary is eligible to receive is $7,200.
6. To receive CESG, a separate government grant application must be completed per beneficiary.
7. Contributions for children ages 16 and 17 are eligible for grants only if:
   - At least $100 was contributed per year in any four years before the end of the year the child reaches age 15; or
   - A minimum of $2,000 has been contributed before the end of the year the child reaches age 15. Unused basic CESG amounts may be carried forward until the end of the year in which a child turns 17. Even if an ESP has not been opened for the child, grant room is still accumulated.
8. Taxes on income earned are deferred, but contributions are not tax-deductible.
9. Contributions can be withdrawn tax-free but may trigger a repayment of government grant(s) unless the beneficiary is attending a post-secondary school and has received an Education Assistance Payment (EAP).
10. EAPs can be made if educational requirements are met and are taxed in the child’s hands.

11. An Accumulated Income Payment (AIP) is a payment of accumulated earnings in the RESP to a subscriber, or upon death of the subscriber to their estate. Generally, AIPs are used when none of the beneficiaries of an RESP is or will be pursuing post-secondary education.
12. AIP payments are subject to 2 taxes, the subscriber's regular income tax and an additional 20% tax, however, there may be tax-free rollover options available to the subscriber. The subscriber may roll up to $50,000 of AIPs to his/her own Registered Retirement Savings Plan (RRSP) or a spousal RRSP, to the extent RRSP contribution room is available.
13. Generally, if all beneficiaries are 21 years of age or older, are not pursuing post-secondary education, and the RESP is at least 10 years old or the plan has been open for 35 years: [1]
    - The subscriber may roll up to $50,000 of accumulated income to his or her own RRSP or a spousal RRSP, provided sufficient RRSP contribution room is available.
    - In some circumstances, accumulated income can be paid to the subscriber subject to tax at the subscriber's tax rate plus a 20% penalty surtax.
14. The 2017 Federal budget proposes to extend advantage rules, as per the Income Tax Act (Canada), to RESPs. This would subject RESP investments to strict anti-avoidance rules which levy penalties to the subscriber(s) when they acquire an investment that is considered to be non-qualified or prohibited.

For more information on the types of withdrawals available within an RESP and the payment conditions and tax treatment by CRA, please request to see a copy of the CIBC Wood Gundy special report: Making RESP withdrawals.

Tax-Free Savings Account

A Tax-Free Savings Account (TFSA) provides an alternate option to assist in saving for a child's education. Canadian residents 18 years of age[2] and older can now contribute up to $6,500 each year to a TFSA[3], and amounts saved can be used at any time for any purpose.. Contributions to a TFSA are made with after-tax dollars and cannot be deducted from your income for the year. Your annual TFSA contribution room is not determined by earned income and will accumulate even if you do not have any earned income in a year.

While contributions to a TFSA are not eligible for government grants, there are no restrictions on withdrawals and you will not be taxed on income or capital gains earned within the account. In contrast, a withdrawal of earnings from an RESP, where the withdrawal is taxed in the hands of the beneficiary, is generally permitted only when the RESP beneficiary is attending a post-secondary institution and the withdrawal qualifies as an EAP.

You can contribute to both an RESP and a TFSA to take advantage of the benefits offered by both plans. One option to consider is contributing the maximum amount that will attract government grants to an RESP and directing the remainder of your education savings to a TFSA.

Features and benefits of a TFSA

- The annual TFSA dollar limit is $6,500[2]
- Tax-free growth on investments
- Funds can be withdrawn at any time, for any reason
- Withdrawals are not taxable
- Amounts withdrawn can be re-contributed in future years (other than withdrawals to correct over-contributions)
- Unused contribution room can be carried forward

Invest in your own name

You may prefer to save for a child's future education needs while retaining ownership and complete discretion over all of the funds. One way to do this is to invest in a non-registered account held in your own name. With this option, any interest, dividends, or capital gains earned on the investments will generally be taxable to you at your marginal tax rate. The advantage of investing in your own name is that you will always be in the driver's seat as far as if, why, when and to whom your assets are distributed to.

Transfer ownership of assets using a trust

A trust is an arrangement whereby a settlor transfers ownership of property to a trustee with instructions as to how the property should be handled for the benefit of a beneficiary. For more information on trusts and the attribution rules that may apply, refer to our special report entitled Trusts: an introduction.

Estate planning

Death of the last RESP subscriber

The RESP forms part of the deceased subscriber's estate. Standard estate processing procedures may apply regarding requirements for probate/proof of authority of the estate representative. Any bequest of the RESP or attempt to appoint a successor subscriber by the deceased subscriber is subject to the proper administration of the deceased's estate. If the RESP is to continue, the estate representative will be required to assist in the setup and provide detail in how the RESP is to be administered after the subscriber's death. If there is no direction regarding the RESP in the Will or there is no Will, generally the RESP must be collapsed and managed as part of the residue of the estate. This would mean any applicable repayment of government assistance and proper treatment of any accumulated income, with contributions paid to the estate representative to form part of the estate assets. In the event that there is a specific bequest of the RESP in the Will that names a successor subscriber, the estate representative must consent to the named successor taking over the RESP. If the Will directs the estate representative(s) to continue to operate the RESP, then the estate representative(s) must sign the appropriate documentation to take over as the subscriber(s).

We're here to help

There are several choices available if you are planning to save for your child's education. Depending on your financial means and time horizon, an ESP, TFSA, non-registered account, trust or a combination thereof may be suitable. Your CIBC Wood Gundy Investment Advisor has the knowledge and expertise to assist you in determining which strategy may best help you achieve your child's education savings objectives.

[1] Subscribers may roll over investment income earned on or after January 1, 2013 from the RESP to a Registered Disability Savings Plan (RDSP) for the beneficiary, up to the RDSP lifetime contribution limit, provided the beneficiary meets the required conditions. The rollover will not attract Canada Disability Savings Grants (CDSG) and any CESG and Canada Learning Bonds (CLB) in the RESP will need to be repaid to the government. The RESP must also be terminated by the end of February in the year after the rollover to the RDSP is made.

[2] Due to security industry regulation, CIBC Wood Gundy is not able to open brokerage accounts for minors. Age of majority is based on the province the client resides in at the time of account open. Please note contribution room is accumulated from age 18 onwards regardless of when the account was opened.

[3] The annual dollar limit between 2009 and 2012 was $5,000. In 2013 and 2014 the annual dollar limit was $5,500. In 2015, the annual dollar limit increased to $10,000, and was reduced back to $5,500 beginning January 1, 2016 to December 31, 2018. The annual dollar limit between 2019 and 2022 was $6,000. As of January 1, 2023, the annual contribution limit increased to $6500.

01/23