CIBC Wood Gundy

Planning For A Child's Education Costs

ADVISORY SOLUTIONS

Recognizing the dramatically increasing costs of a university education, many people would like to start setting funds aside as soon as possible for minor children or grandchildren. And, of course, they would like to use the most tax-effective savings strategy possible. The strategy chosen often largely depends on their financial means, the children's ages and the length of time left to save. For instance, older parents or grandparents sometimes have excess capital to quick-start an education savings program for older children. On the other hand, younger parents with young children typically need to focus on paying down a mortgage and saving for retirement, and may have to take a gradual, long-term approach to education funding.

Regardless of your stage of life or family circumstances, you should know that there are education-funding strategies available. You may even choose to implement a combination of strategies.

Registered Education Savings Plans

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

RESP Rules

- The lifetime limit on the amounts that can be contributed to RESPs is $50,000 per beneficiary. Annual contribution maximums do not apply.
- For contributions made to an RESP, the federal government will pay a Canada Education Savings Grant (CESG) directly into the RESP. CESG accumulates for a child until the end of the year in which the beneficiary turns 17.
- From 2007 on, the maximum annual CESG amount a beneficiary can receive is $500 (20 percent of the first $2,500 of annual contributions) or up to $1,000 if there is unused grant room available from previous years. The maximum lifetime CESG amount each beneficiary is eligible to receive is $7,200.
- From 1998 to 2006, up to $400 was added annually to the grant room for each eligible child since 1998 (or since birth if the child was born after 1998). From 2007 on, up to $500 in annual grant is available for each eligible beneficiary (or since birth if the child is born after 2007).
- To receive CESG, a separate government grant application must be completed (one per beneficiary).
- Contributions for children age 16 and 17 are eligible for grants only:
    - If they have amounted to at least $100 per year in any four years before the year the child reaches age 16, or;
    - A minimum of $2,000 has been contributed before the year the child reaches age 16. Also, the grant has been enhanced starting in 2005 on the first $500 of contributions if family net income is below certain levels. Unused basic CESG amounts may be carried forward until the end of the year in which a child turns 17. Even if an RESP has not been opened for the child, grant room is still accumulated.

- Taxes on income earned are deferred, but contributions are not tax-deductible.
- Contributions can be withdrawn tax-free but may trigger a repayment of CESG unless the beneficiary is attending a post-secondary school and has received an Education Assistance Payment (EAP).
- Accumulated income is taxed in the child's hands if educational requirements are met.
- Generally, if all beneficiaries are age 31 or older and not pursuing post-secondary education, and the RESP is at least 10 years old:
- The subscriber may roll up to $50,000 of Accumulated Income Payment (AIP) to his or her own RRSP or a spousal RRSP to the extent RRSP contribution room is available, or;
- Accumulated income can be recovered subject to tax at the subscriber's tax rate plus a 20 percent penalty surtax.

Group RESPs ("Tontine Plan")

Some group RESPs, such as the "scholarship fund" type of RESPs, may require you to forfeit ownership of your earnings if a child does not pursue post-secondary education. With group RESPs, funds are pooled together with the contributions of other subscribers with children of the same age. The pooled funds grow tax-free over time and the pooled funds are divided between those still in the plan at maturity, providing arrival payments for up to four years of post-secondary education. These are usually long-term contracts in which you are agreeing to a specific contribution schedule. There is very little flexibility with these plans, and it is important for you to obtain full disclosure of your plan's details.

Tax-Free Savings Accounts

In 2009, the introduction of the Tax-Free Savings Account (TFSA) provided a new option to assist in saving for a child's education. Canadian residents 18 years of age and older can contribute up to $5,000 each year to a TFSA, 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 grant, 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 Educational Assistance Payment (EAP).

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

Features And Benefits Of A TFSA

- $5,000 in annual contribution room (indexed annually after 2009)
- 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
- Unused contribution room can be carried forward indefinitely

Invest In Your Own Name

You may prefer to save for a client's future education needs, while retaining ownership and complete discretion over all of the funds. One way to do this is to simply invest in a non-registered account held in your own name. Unfortunately, if you invest in your own name, 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 ultimately distributed.

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 titled *Trusts: An Introduction.*

Attribution Rules

Before we begin to discuss strategies using trusts, it is important to understand the tax provisions that may apply when assets are transferred to minor children. Assets are often transferred to other family members primarily for the purpose of income splitting. This is a strategy to achieve tax savings by shifting income to family members in a lower tax bracket. Unfortunately, the government has developed various attribution rules to discourage this practice.

For instance, if you transfer assets to a minor child, grandchild, niece or nephew (by blood, marriage or adoption), any subsequent interest or dividend income earned on the assets is generally attributed back to you for tax purposes. However, capital gains are generally not attributed back to you for tax purposes, nor is second generation income (income earned on attributed income). You should also be aware that the attribution rules do not apply after the death of the transferor, and that relatives who are not resident in Canada are not subject to attribution on transfers to family in Canada.

It is also important to realize that if you transfer appreciating assets (such as stocks and bonds), either to a child or to a trust, the government deems that you have sold the assets at fair market value at the time of the transfer, so there may be a capital gain or loss for you to declare on your tax return.

Switching From One Structure To Another

If you already have an in-trust account in place, or you are thinking about setting one up, you should understand that altering the account or transferring assets from the account to an RESP or formal trust could have negative tax and legal implications. For instance, the in-trust account assets should not be transferred to an RESP as they beneficially belong to the child. (Remember that the subscriber owns an RESP, not the plan beneficiary.) Similarly, transferring assets from an in-trust account to a formal trust may also cause tax and legal problems. Under no circumstances should you transfer any funds between structures without first consulting your tax and legal advisors.

Features And Conditions Of Education Funding Options

	Education Funding Option				
Features And Conditions	**RESP**	**TFSA**	**Invest In Own Name**	**Formal Trust**	**In Trust Account**
Parent retains ownership of assets	Yes (Beneficiary must meet requirements to receive income and government grants from RESP)	Yes	Yes	No	No (if transfer irrevocable)
Unlimited savings/contributions	No (A lifetime $50,000 limit per beneficiary)	No (maximum of $5,000 per year)	Yes	Yes	Yes (but generally advisable to consider formal trust for larger accounts)
Government grant	Yes (a separate government grant application must be submitted for each beneficiary)	No	No	No	Yes (if transfer irrevocable)

	Education Funding Option				
Features And Conditions	**RESP**	**TFSA**	**Invest In Own Name**	**Formal Trust**	**In Trust Account**
Are realized capital gains taxable in child's hands on an ongoing basis	No (all income eventually taxed as regular income to child if education requirements met; child may be in a lower tax bracket)	No	No	Yes	No (but if transfer irrevocable, a child's personal tax credit can make a certain amount of capital gains each year tax free)
Tax-sheltered investment returns	No	Yes	No	No (but a child's personal tax credit can make a certain amount of capital gains each year tax free)	No (assets should probably only be managed until child reaches age of majority)
Flexibility to fund child's needs	Yes	Yes	Yes (parent controls if, why, when and to whom assets are distributed)	Yes (income can be paid to child or for child's benefit at any time)	No
Requires filing of trust tax returns	No (tax-effectiveness depends on child meeting education requirements)	No	No	Yes	No

	Education Funding Option				
Features And Conditions	**RESP**	**TFSA**	**Invest In Own Name**	**Formal Trust**	**In Trust Account**
Subject to investment restrictions under Trustee Acts	No	No (usually can invest in the same properties as an RRSP)	No	No (if trust deed has appropriate investment clause)	Determined by parent; however child may be entitled to receive assets upon reaching age of majority
Set age at which child may receive assets; other wind-up issues	No (assets should be qualified investment as defined by CRA)	No (at the account holder's discretion)	N/A	Determined by trust document	No (if transfer irrevocable)

Estate Planning

Death Of The RESP Subscriber

Upon the death of a sole subscriber, or the joint subscriber who is last to die, the assets held within an RESP form part of the deceased subscriber's estate. Upon death of the last sole subscriber, CIBC Wood Gundy will only deal with the deceased subscriber's estate representative to determine settlement of the RESP.

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