RESPS CAN BE FOR GRANDPARENTS TOO

Now retired, Arthur and Sandy Beckett take special pleasure in watching the growth of their grandchildren Sarah and Nathaniel. Grandparenting gives the Becketts many of the joys of parenthood without the responsibilities of being parents. They worry, however, about their own children's ability to save for the grandchildren's education. "Our children are heavily burdened with a mortgage, car payments and face continuing increases in the cost of living. No matter how well-intentioned, we can see that they simply don't have the resources," says Sandy. It's true. Young families find it difficult to pay the bills and at the same time secure their retirement and save for their children's education.

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As grandparents, we may see that our adult children are not in a financial position to contribute to an education savings plan. A recent report suggests that while 63% of families with children 12 and under have RESPs, 25% contribute $200 or less per year. While better than nothing, this will not meet the future costs of education. A recent estimate from the Office of the Superintendent of Financial Institutions Canada estimates that by 2036 the cost for four years in college could top $138,400. With such shortfalls, student debt is a likely outcome. The Becketts are among a growing number of grandparents taking matters into their own hands by funding Registered Education Savings Plans (RESPs) for their grandchildren.

Retirees often have non-registered money that is being taxed on dividends, interest and capital gains. The Becketts have thought about their own resources and believe they can afford to make contributions to a Family RESP for Sarah and Nathaniel. The plan is to take some of the money that was being taxed for the retiree and put it into an account that is tax sheltered and also attracts a 20% government grant. "Why pay tax on savings that we will likely outlive and give to our children and grandchildren anyway," says Arthur. "Not only will the savings grow tax free in the RESP, but the government will kick in too."

Arthur refers to the federal Canada Education Savings Grant (CESG), which the federal government pays when an RESP contribution is made. The CESG matches 20% of contributions made to an RESP up to maximum annual grant of $500 per plan beneficiary. Contributions of $2,500 each year will attract the maximum CESG. RESP rules allow more to be contributed but will not attract further grants in the same year.

While RESPs can earn substantial returns, grandparents should be mindful of the plan's limitations and their own family dynamics.

What are the options? First of all, there are both Individual RESPs and Family RESPs.

1. ***Individual RESPs*** are ideal if you only have one grandchild. An Individual RESP can be used to save for a grandchild or for a child who is or is not related to you by blood or adoption (nieces, nephews, cousins). This plan is also ideal for families with large age differences

between children, or for stepchildren or step grandchildren.

2. ***A Family RESP plan*** can have more than one beneficiary. The beneficiaries of this type of plan have to be under 21 and connected to the subscriber of the plan by either blood or adoption. It can be children or grandchildren. If more than one beneficiary is appointed, then you can allocate the contributions to each beneficiary.

Plan holders, called “Subscribers,” should be aware that RESPs are limited to a lifetime maximum contribution of $50,000 per beneficiary. This should not be confused with the $7,500 lifetime contribution cap on the CESG.

While the government limits its annual CESG contribution to an RESP to $500 per year, the eligibility for CESG grant money starts at birth. Many potential beneficiaries have already accumulated considerable grant room by the time an RESP is considered. In these cases, contributors can maximize the current year’s grant, then make additional contributions to maximize one more missed year. In this way, a contribution of $5,000 earns a CESG of $1000.

Subscribers should be wary of overcontributing to an RESP and incurring the overcontribution penalty of 1% per month on the excess contribution. It may be a while before the error is noticed, by which time the penalty has grown to an ugly number. Check to see if there is already an RESP in place elsewhere within the family and whether there are any on-going contributions. If there is more than one plan, or if there are multiple contributors to a single plan, mistakes can happen. Often enough, kitchen table accounting between family members can lead to misunderstandings.

In most cases, children will use the RESP funds for post-secondary education costs. Subscriber contributions flow tax free while CESG and growth are taxable. Any taxation on the withdrawals is taxable to the beneficiary. As most students have modest earned income, taxation, if any, is very low.

RESPs can remain open for 35 years, so if a child does not initially use the funds, they can be kept in place should they change their mind a few years

A Retirees’ Primer for RESPs

THINK ABOUT YOUR ABILITY TO CONTRIBUTE

Do you have a considerable non-registered investment that are being taxed? Based on your financial plans, are these more than you anticipate needing for your own support? Do you plan to make a gift of these savings to your grandchildren? If so, then you should talk with a financial planner to set up an RESP.

TIME MATTERS

Start early to allow time for the plan’s investments to compound. As the plan has 20 years to grow, Grandparents should not be too conservative with the investment strategy.

DETERMINE WHO’S CONTRIBUTING

If multiple grandparents and parents will be contributing to an RESP, determine how much each party plans to pay. This will avoid unintentional overcontribution penalties.

NAME A SUCCESSOR-SUBSCRIBER

There is a chance that grandparents may pass away during the life of the RESP before the child starts university or college. Some RESPs allow you to name a successor subscriber, or such a provision can be added to a will. A trusted person can be named or a testamentary trust. There are benefits and risks to either solution, so proper financial and estate planning advice is critical.

later. In the worst case, if a child does not end up pursuing post-secondary education, you can transfer their amount to another sibling under the age of 21 within a Family RESP.

If no change of beneficiary can be made, the funds in the RESP must be redistributed. The subscriber's contributions are returned to the subscriber, tax free. Similarly, the government takes back its CESG contributions. The remaining accumulated growth in the plan can be transferred tax-free to the subscriber's RRSP. That said, by the time the child is college age, the grandparent subscriber may be over age 71 and unable to contribute to an RRSP or the subscriber may have no remaining contribution room. If an RRSP transfer is not available to the subscriber, the growth is taxed at his/her marginal income tax rate plus a supplementary tax of 20%. Depending on the subscriber's income, the tax rate could be as high as 69.8% in BC.

Consider also what will happen if you pass away during the life of the RESP before your grandchild starts university or college. This may create a problem if the RESP is not addressed appropriately in your will. An RESP is not a trust, like an RRSP, but instead a contractual arrangement between a subscriber and a promoter (usually a financial institution). If there is no surviving joint-subscriber, the RESP becomes part of your estate. If there has been no proper estate planning, the RESP's value will belong to, and most likely paid out to, the residuary beneficiaries of your estate, subject to taxes. This is an unintended outcome.

Some RESPs allow you to name a successor subscriber, or such a provision can be added to your will. A trusted person can be named or a testamentary trust created. There are benefits and risks to either solution, so proper financial and estate planning advice is critical.

To simplify matters, grandparents could make a gift of money to the parents and let the parents act as the subscribers to the plan. If the grandparent has the account number of the plan and written permission from the subscriber-parent, they can make contributions directly to the plan. In this way, coordination issues and complications described above may be avoided.

But if grandparents hand money over to a parent they may worry that they may lose control of the money intended for their grandchild's education. This could be a concern if their adult child is divorced and the grandchild resides with a son or daughter-in-law who is estranged.

Finally, RESPs are intended to allow time for growth within the plan. Grandparents need to not be too conservative with the investment strategy as the plan will be around for 20 years.

RESPs are a very useful investment to help your grandchildren navigate their future, but it is important to understand the regulations around RESPs to maximime the benefit.

Familiarize yourself with RESP terms:

RESP TERMINOLOGY

As with most registered government plans, RESPs have a confusing array of definitions and terms.

EDUCATIONAL ASSISTANCE PAYMENT (EAP)

Money paid from the RESP to the student to help fund post-secondary education. EAPs are considered income and are taxable to the student. This does not include a subscriber's refund of contributions from the RESP.

ACCUMULATED INCOME PAYMENT (AIP)

Money paid to the subscriber out of the plan's earnings, including earnings on the Canada Education Savings Grant (CESG) amount. With only a few exceptions, AIPs, which are made only if the child does not attend college or university, have the following conditions:

- The plan has been in place for 10 years
- No beneficiary is in school
- Beneficiary is 21 years old or older
- The subscriber is a Canadian resident

BRITISH COLUMBIA TRAINING AND EDUCATION SAVINGS PLAN (BCTESP)

The BC Training and Education Savings Plan grant is designed to help families start planning and saving early for their children's education after high school. When a B.C. resident child turns six years old, the Province of British Columbia will put $1,200 into the child's RESP. The BCTESP grant is a one-time grant that requires no matching or additional contributions.

There are 3 basic criteria to receive the grant:

- The child must be born in January 2006 or later.
- The child must be the beneficiary of an RESP.
- The child and parent/guardian must be resident of BC at the time of the application.

FAMILY RESP

An RESP that can have more than one beneficiary. The beneficiaries must be connected by blood or by adoption and must be under the age of 21. A family RESP allows a younger sibling to use the funds should the oldest child decide not to go to university or college.

INDIVIDUAL RESP

An RESP with one beneficiary. This beneficiary does not have to be related and can be over 21, making this an ideal plan for an older student and one that is suitable for a non-family subscriber to set up.

SUBSCRIBER

The subscriber is the individual who contributes to an RESP. Depending on the type of RESP, the subscriber can be a parent, grandparent, aunt, uncle, sibling or friend of the beneficiary. Joint subscribers must be spouses or common-law partners according to Canada Revenue Agency (CRA).

BENEFICIARY

This is the person who has been designated to receive the benefit of the RESP. It is important to note that to receive the CESG, this beneficiary must be a resident of Canada and must have a Social Insurance Number.

ASSISTED CONTRIBUTIONS

Contributions to an RESP made after 1997, for which CESG money was or will be paid.

UNASSISTED CONTRIBUTIONS

Contributions to an RESP for which no CESG was or will be paid.