# RESP - New Rules, New Planning Opportunities

*Registered education savings plans (RESP) were designed to assist in saving for a child's post-secondary education. Contributions to an RESP are not tax-deductible; however, the investment income that is produced in the plan can grow on a tax-deferred basis until money is withdrawn to fund the child's education. The investment income is then fully taxable as regular income in the hands of the beneficiary. Generally the taxes payable on amounts withdrawn from the RESP are minimal, because the beneficiary is in a lower tax bracket and can make use of the education and tuition credits.*

Funding a child's post-secondary education in Canada may be an expensive proposition that requires planning. The 2007 federal budget introduced a number of significant changes to RESPs providing increased flexibility for those saving for a child's post-secondary education.

## New RESP rules

Changes were made to the contribution rules and the Canada Education Savings Grant (CESG):

- Elimination of the $4,000 annual RESP contribution limit;
- Lifetime maximum RESP contribution increased to $50,000 from $42,000;
- Maximum annual CESG increased to $500 from $400 based on 20% on the first $2,500 of contributions; and
- If the beneficiary has CESG carry forward available, the maximum annual grant payable in any year is increased to $1,000 from $800.

The new rules give investors increased flexibility to structure their education savings. With the elimination of the $4,000 annual contribution limit, an investor who has available funding may choose to make a lump-sum payment of $50,000 to an RESP to take advantage of the tax-deferred growth however the subscriber will forgo the opportunity to receive the maximum CESG.

Alternatively, an investor who wants to maximize the CESG could use a combination of a lump-sum contribution of $15,000 to an RESP while investing the remaining $35,000 in a non-registered account. Annual withdrawals of $2,500 from the non-registered account would be used to fund the RESP. Using this strategy allows the subscriber to maximize the $7,200 in CESG, however they forego maximum tax deferred growth in the account.

## Lump sum contribution vs. maximizing CESG

Table 1 compares the values after 18 years of a $50,000 lump sum RESP contribution with a combined strategy using a $16,500 lump sum RESP contribution followed by subsequent annual contributions of $2,500 funded by $33,500 which is invested in a non-registered account.

The table depicts the results for a top taxpayer living in Ontario using different portfolio mixes.

**Table 1**

| Asset Model/Rate of Return | Asset Mix[2] | Lump-Sum RESP[1] | Maximize CESG | | |
|---|---|---|---|---|---|
| | | | RESP[1] | Non-Reg[3] | Total |
| **Safety (3.55%)** | 75% cash 25% fixed income | $94,622 | $90,964 | $5,865 | $96,829 |
| **Conservative Income (4.70%)** | 80% cash and fixed income 20% equity | $115,433 | $105,896 | $9,787 | $115,682 |
| **Balanced Income (5.05%)** | 70% cash and fixed income 30% equity | $122,580 | $110,925 | $11,465 | $122,390 |
| **Balanced (5.58%)** | 55% cash and fixed income 45% equity | $134,203 | $119,010 | $14,264 | $133,274 |
| **Balanced Growth (6.10%)** | 40% cash and fixed income 60% equity | $146,612 | $127,530 | $17,364 | $144,894 |
| **Growth (6.80%)** | 20% cash and fixed income 80% equity | $165,034 | $139,993 | $22,175 | $162,168 |
| **Aggressive Growth (7.50%)** | 100% equity | $185,628 | $153,698 | $27,797 | $181,495 |

1. Note: a portion of the RESP may be taxable
2. Equity returns may include dividend income, capital gains, and/or deferred gains
3. After-tax value of the non-registered account

The results from Table 1 suggest that there is no significant difference between investing a lump sum in an RESP vs. maximizing the CESG, for an Ontario resident at the top marginal tax rate.

It is important to note that different results may be attained depending on the assumptions used including the child's age, rate of return, the mix of investments (interest, dividends, capital gains), as well as the tax rate of the investor.

What is clear is that the cost of post-secondary education is rising, in many cases faster than inflation. Therefore, early saving is the key component to a successful education saving strategy.

## How much to contribute to maximize CESG and tax-deferred growth

In the example above, we compared a $50,000 lump sum contribution with a $16,500 initial lump-sum contribution followed by annual contributions of $2,500. The $16,500 contribution is the maximum amount that an investor needs to contribute upfront to an RESP to maximize the tax-deferred growth and to receive the maximum CESG of $7,200 for a child born in 2012. For children born prior to 2012, the maximum lump-sum amount that needs to be contributed to an RESP to maximize tax-deferred growth and receive maximum CESG is shown in Table 2.

**Table 2: Maximum 2012 Contribution to Maximize CESG and tax-deferred growth**

| Year of Birth | Age in 2012 | Maximum Lump Sum Contribution in 2012 | Lifetime maximum CESG that can be received |
|---|---|---|---|
| 2012 | 0 | $16,500 | $7,200 |
| 2011 | 1 | $19,000 | $7,200 |
| 2010 | 2 | $19,000 | $7,200 |
| 2009 | 3 | $19,000 | $7,200 |
| 2008 | 4 | $19,000 | $7,200 |
| 2007 | 5 | $19,000 | $7,200 |
| 2006 | 6 | $19,000 | $7,200 |
| 2005 | 7 | $19,000 | $7,200 |
| 2004 | 8 | $19,000 | $7,200 |

| Year of Birth | Age in 2012 | Maximum Lump Sum Contribution in 2012 | Lifetime maximum CESG that can be received |
|---|---|---|---|
| 2003 | 9 | $19,000 | $7,200 |
| 2002 | 10 | $19,000 | $7,200 |
| 2001 | 11 | $20,000 | $7,000 |
| 2000 | 12 | $25,000 | $6,000 |
| 1999 | 13 | $30,000 | $5,000 |
| 1998 | 14 | $35,000 | $4,000 |
| 1997 | 15 | $40,000 | $3,000 |
| 1996 | 16 | $50,000 | $0 |
| 1995 | 17 | $50,000 | $0 |

Note: The lifetime maximum CESG that can be received is based on the maximum lump sum contribution and assumes future contributions to maximize the available carry forward CESG room.

It is worth mentioning that the CESG was introduced in 1998. Until 2006, the maximum CESG payable per beneficiary was $400 in a calendar year. If no contributions were made to an RESP the grant room was carried forward and could be paid in a future year to a maximum of $800 per calendar year. The 2007 budget increased the maximum grant to $500 and the maximum payable when a carry forward exists to $1,000 per calendar year. The CESG is payable up to the year a beneficiary reaches age 17 (subject to special rules at age 16 and 17). The lifetime maximum limit of $7,200 remains unchanged.

## How late is too late to benefit from the full $7,200 in Canada Education Saving Grant?

A common question often asked is how late can an RESP be set up for a beneficiary to still benefit from the maximum Canada Education Savings Grant of $7,200? Table 2 shows that a beneficiary cannot be more than 10 years old when an RESP is started in order to receive the maximum CESG of $7,200. This is true for 2012 and subsequent years.

As with most financial planning questions, the answer to which education savings strategy is best depends on the individual's specific situation and the financial assumptions used. You should consult with your financial advisor to help you determine what is right for you.

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