RESP Withdrawals

A Registered Education Savings Plan (RESP) is a tax deferred savings plan designed to help build a child's education fund. At one time there were many restrictions on the use of RESP investment income that often outweighed the benefits of the tax deferral. With legislative changes in 1998 and, more recently, 2007, it is now a more attractive education savings vehicle.
This article will focus on the rules for withdrawing funds out of an RESP.

Types of withdrawals from RESPs

RESP withdrawals can be designated as one of the following:

1. Educational Assistance Payments;
2. Withdrawals of Contributions (a refund of contributions)
    - As a Post-Secondary Educational Withdrawal ; or
    - As a Non-Educational Capital Withdrawal;
3. Accumulated Income Payments.

1. Withdrawal of Educational Assistance Payments (EAPs)

An Educational Assistance Payment is a taxable withdrawal paid to the beneficiary, to assist with the beneficiary's education at the post-secondary level.

The payment can consist of earnings on contributions, earnings on the Canada Education Savings Grant (CESG), and the CESG itself. It does not include principal contributions made by the subscriber of the plan.

For a payment to qualify as an EAP, at the time it is made, the beneficiary must be currently enrolled full-time or part-time in a **qualifying educational program** at a post-secondary educational institution (either in attendance at the institution or enrolled in distance education courses). A qualifying educational program is a program at the post-secondary school level of not less than 3 consecutive weeks in duration and that requires instruction or work in the program of at least 10 hours a week throughout its duration.

Beginning in 2007, a payment may also qualify as an EAP, at the time it is made, if the beneficiary is at least 16 years old and is enrolled in a **specified educational program**.

A specified educational program is a program at the post-secondary school level that is not less than 3 consecutive weeks in duration and that requires each student taking the program to spend not less than 12 hours per month on courses in the program.

The subscriber decides how much should be paid out in respect of each beneficiary subject to the following restriction:

- For a full time program, during the first 13 weeks of a qualifying education program, the total amount of EAPs that can be made to the beneficiary cannot exceed $5,000.
- For a part-time program, during the first 13 weeks of a specified educational program, the total amount of EAPs that can be made to the beneficiary cannot exceed $2,500.
- A part of each income payment will be attributed to the CESGs deposited to the plan, based on the ratio of the CESGs to total investment earnings.
- A maximum of $7,200 of CESG per beneficiary can be paid out.

What documentation is required from the beneficiary before making an EAP?
The plan promoter (i.e. financial institution) is required to obtain current proof that the beneficiary is enrolled in a qualifying educational program at a post-secondary school level at a designated educational institution, such as a letter from the Registrar's office stating: full-time or part-time status, program type, start date, and duration. Reasonable expenses include payments for housing, tuition, transportation, school supplies and books. The most important factor to consider is whether the expense actually helps the beneficiary further his or her post-secondary education.

2. Withdrawals of Contributions

While the beneficiary is pursing post-secondary education, the subscriber may withdraw his / her contributions at any time without tax implication as a post-secondary educational capital withdrawal (PSE).

If a withdrawal of capital is made while the beneficiary is not enrolled in a post-secondary institution (i.e. a non-educational withdrawal), all associated CESG will be returned to HRSDC as a grant repayment.

These restrictions also apply to a transfer from one RESP to another RESP where the beneficiaries are not the same.

These restrictions will not apply where the total withdrawal of contributions in the year is $200 or less, or there is a full transfer to another RESP with the same beneficiaries.

3. Withdrawal of Accumulated Income Payments (AIPs)

An AIP is an amount, usually paid to the subscriber, of the income earned from an RESP. It includes investment earnings; and CESG investment earnings but does not include the CESG itself.

An AIP can be made if all intended beneficiaries under an RESP are not pursuing higher education by age 21 and the RESP has been in existence for 10 years. Payment can only be made to a subscriber who is a resident of Canada.

The 10-year and age-21 conditions referred to above may be waived if it is reasonable to expect that a beneficiary under the plan will not be able to pursue post-secondary education because he or she suffers from a severe and prolonged mental impairment; or if all beneficiaries in the plan died.

An RESP must be terminated by the end of February following the year in which the first AIP is paid.

Tax Implications

AIPs are taxable income for the subscriber and are fully taxed at the subscriber's marginal tax rate.

In addition, AIPs are subject to a penalty tax of 20% (varies by province), unless transferred to an RSP (if the subscriber has the contribution room). The maximum amount that can be transferred to an RSP is $50,000 per subscriber, but if there are joint subscribers, $100,000 could potentially be sheltered from tax.

Tips

1. On a direct transfer to an RSP or to a spousal RSP, *CRA form T1171 Tax Withholding Waiver on Accumulated Income Payments from RESPs* should be completed to avoid withholding tax on the AIPs

2. If it becomes apparent to you that your child will not pursue a post-secondary education, you may wish to consider refraining from making RSP contributions in the years prior to the year when you expect to take out AIPs, so that you will have the available RSP contribution room for the transfer.

Repaying the Canada Education Savings Grant

If the child named in an RESP does not go on to education after high school, the CESG must be returned to the Government of Canada, unless the RESP is a family plan, in which case the CESG may be used by another child named in the plan up to his or her lifetime limit of $7,200.

The amount to be repaid is the principal amount of the grant but not the accumulated income on the grant. The income earned will be taxed when it is withdrawn from the RESP.

Also, the CESG must be repaid to the government if beneficiaries become non-residents.

RESPs can play an important part in savings strategy for a child's education. Between the tax sheltering of income and the benefit of the CESG, an RESP provides a lot of benefits to help meet a family's education goals. Although RESP savings are intended to assist in covering a child's education costs, funds are accessible if required. However, special attention should be paid to the tax implications of withdrawals.

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