Planning for a child's education costs

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Recognizing the dramatically increasing costs of a university education, you may want to start setting funds aside as soon as possible for your children or grandchildren.

The strategy you choose often largely depends on your financial means, the children's ages and the length of time left to save. For instance, parents or grandparents sometimes have extra money to jump start an education savings program for older children. On the other hand, parents with young children typically need to focus on paying down a mortgage, paying for daycare costs and saving for retirement, and may have to take a gradual, long-term approach to education funding. You may want to consider tax strategies as well.

No matter your stage in life or family circumstances, there are education-funding strategies available. You may even choose a combination of strategies.

Registered Education Savings Plan (RESP)

The most popular way to save for a child's education, while keeping control of assets, is to become the subscriber and make contributions to an RESP with the children named as beneficiaries. An RESP offers some tax advantages and government grants (federal, and provincial where applicable) that make this an attractive way to save. Although an RESP is subject to contribution limits and various other restrictions, it can be very effective under the right circumstances. You can also use an RESP in combination with other savings options.

RESP rules[1]

- The lifetime contribution limit is $50,000 per beneficiary, and there are no annual contribution maximums
- Contributions may qualify for a Canada Education Savings Grant (CESG) from the federal government that will be paid directly into the RESP. CESGs are available with respect to beneficiaries who are Canadian residents until the end of the year in which they turn 17
- Up to $500 in an annual grant is available with respect to each eligible beneficiary (20% of the first $2,500 of annual contributions to an RESP)
- Up to $1,000 in an annual grant may be received if there is unused grant room available from previous years (20% of the first $5,000)
- The maximum lifetime CESG amount with respect to each beneficiary is $7,200
- To receive a CESG, you must complete a separate government grant application for each beneficiary (the promoter of the RESP typically prepares the applications)
- Contributions for children ages 16 and 17 are eligible for grants only if:
  - At least $100 was contributed per year in any 4 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

Unused basic CESG amounts may be carried forward until the end of the year in which the child turns 17. Even if an RESP has not been opened for the child, CESG grant room is still accumulated.

- Taxes on income earned are deferred, but contributions are not tax-deductible
- Contributions can be withdrawn tax free, but when money that is earned within the RESP is withdrawn it is included in income (whose income depends on what type of withdrawal it is)
- Educational Assistance Payments (EAPs) are taxed in the child's hands if educational requirements are met Note: EAPs are made up of government assistance and income earned in the plan.
- Accumulated income that is paid back to the subscriber is known as an Accumulated Income Payment (AIP). Generally, an AIP may be paid if all beneficiaries are age 21 or older, are not pursuing post-secondary education and the RESP is at least 10 years old, or if all beneficiaries are deceased, or if the plan has been open for 35 years. AIPs are subject to tax at the subscriber's tax rate plus a 20% penalty surtax[2]. In addition, the withdrawal may trigger a repayment of any government grants. AIPs cannot be paid to a subscriber who is a non-resident. If an AIP can be paid, rollovers may be available:
  - The subscriber may roll up to $50,000 of AIP into their own RRSP or a spousal or common-law partner RRSP if RRSP contribution room is available
  - Since 2014, subscribers may roll over investment income earned from the RESP to a Registered Disability Savings Plan (RDSP) for the beneficiary, up to the RDSP lifetime contribution limit, provided the beneficiary meets required conditions and the holder and beneficiary of the RDSP agree. The rollover will not earn Canada Disability Savings Grants (CDSG) and any CESG, and Canada Learning Bonds (CLBs) 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

[1] Note that beneficiaries who are residents of Quebec also have access to the Quebec Education Savings Incentive (QESI), which would provide an additional 10% of the first $2,500 of annual contributions to an RESP. The QESI also offers the same catch up rules and requirements for 16- and 17-year-olds as the federal CESG. The lifetime maximum QESI is $3,600 per beneficiary.
[2] Penalty tax of 12% for Quebec residents.

Death of the last RESP subscriber

One important thing to remember is that the RESP, other than the government grants, forms part of the subscriber's assets. This means it is available to the subscriber's creditors. It also forms part of the deceased subscriber's estate, unless it is a joint RESP with a right of survivorship in a jurisdiction that recognizes that. A person holding a child's assets, as guardian or as trustee, cannot put the child's assets into an RESP unless the child is the subscriber or unless the trust specifically authorizes it.

When the subscriber dies, standard estate processing procedures may apply, including a requirement 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 after the sole subscriber's death, the estate representative will be required to provide details about how to administer the RESP. If there are no instructions about 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 (which may need to be transferred to a designated educational institution or be subject to penalty tax), with contributions paid to the estate representative to form part of the estate assets.

If 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 representatives to continue to operate the RESP, then the estate representatives must sign the appropriate documentation to take over as the subscribers.

Tax-Free Savings Account (TFSA)

A TFSA is another option to help save for a child's education. If you haven't previously contributed to a TFSA and have been over age 18 and a Canadian resident since at least 2009, you can contribute up to $69,500 to a TFSA, as of 2020. The TFSA dollar limit for each of 2020 and 2021 is $6,000.

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. You can use the amounts saved at any time for any purpose.

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[3]. In contrast, a withdrawal of income and government grants from an RESP is taxed in the hands of the beneficiary when the RESP beneficiary is attending a post-secondary institution and the withdrawal qualifies as an EAP. Withdrawals of RESP contributions to the subscriber are tax free, but any withdrawals of accumulated income to the subscriber are not only included in the subscriber's income, but also subject to a penalty tax.

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 to an RESP to receive maximum government grants and directing the rest of your education savings to a TFSA.

- $6,000 annual TFSA dollar limit from 2019 to 2021 ($5,000 from 2009 to 2012, $5,500 from 2013 to 2014, $10,000 in 2015, $5,500 from 2016 to 2018)
- Tax-free growth on investments
- Funds can be withdrawn at any time (subject to any investment specific restrictions) 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 indefinitely

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 the funds. One way to do this is to simply invest in a non-registered account held in your own name. However, 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 have control over if, why, when and to whom your assets are ultimately distributed.

Transfer ownership of assets using a trust

A trust is an arrangement where a settlor transfers ownership of property to a trustee with instructions as to how the property should be handled for the benefit of one or more beneficiaries. The trustee would invest the funds and then could use the income to pay for the beneficiary's education-related expenses. Depending on how the trust is structured, the income could effectively be taxed in the hands of the children.

[3] Penalty taxes may apply in certain circumstances, such as over-contribution and non-qualified investments being held within the TFSA.

Features and conditions of education funding options

Features and conditions	RESP	TFSA	Invest in own name	Formal trust
Owner retains control?	Yes. The decision to make an EAP is totally within the subscriber's control. The beneficiary must meet requirements for an EAP (income and government grants) to be from an RESP.	Yes	Yes	No
Unlimited savings / contributions?	No, there is a lifetime $50,000 contribution limit per beneficiary.	No, contribution room is personal to each holder. TFSA dollar limit for 2020 is $6,000.	Yes	Yes
Government grant?	Yes	No	No	No
Withdrawals are taxable in the child's hands on an ongoing basis?	Yes, all income and grants are eventually taxed as regular income to the child if paid as an EAP (if education requirements are met). The child may be in a lower tax bracket.	No	No	Yes, if the trust is structured correctly and income and gains distributed to or for the benefit of the child (subject to attribution rules).
Tax-sheltered / deferred invest-ment returns?	Yes	Yes	No	No, but a child's personal tax credit could result in a certain amount of capital gains, or income in the case of adult children, distribut-ed each year to be tax free.
Flexibility to fund the child's needs?	Yes, the subscriber controls if, why, when and to whom assets are distributed. In the case of income and grant payments, certain criteria must be met before payments can be made.	Yes, the holder controls if, why, when and to whom assets are distributed.	Yes, the parent controls if, why, when and to whom assets are distributed.	Yes, income can be paid to a child or for a child's benefit at any time, subject to the terms of the trust document.
Requires filing of trust tax returns?	No	No	No	Yes
Subject to investment restrictions?	Assets must be qualified investments, and must not be prohibited investments, as defined by the Income Tax Act.	Assets must be qualified investments, and must not be prohibited investments, as defined by the Income Tax Act.	No	Yes, as determined by the terms of the trust document.
Set age and criteria for child to receive assets?	Based on EAP requirements.	No	No	Yes, as determined by the terms of the trust document.

We’re here to help

You have choices when planning to save for your child’s education. Depending on your financial situation and time to save, an RESP, TFSA, non-registered account, trust or a combination of these may be right for you.

Your CIBC advisor has the knowledge and expertise to help you decide which strategy may best help you achieve your education savings objectives. To learn more, speak with your CIBC advisor today.

For more information

Talk to a CIBC Advisor at any banking centre
Call 1 800 465-CIBC (2422)
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