

RESPs: Saving for post-secondary education



By Randy Ray

If you have a son or daughter heading to university in the near future – possibly at an out of town school – you may not have nearly the money needed to cover the cost of earning a degree.

Sure, you have some money in a Registered Education Savings Plan (RESP), but like most parents, probably not enough.

Why don't parents save more? Because most have a pile of other financial obligations over the years, including a mortgage, car payments, saving for retirement and funding the educations of other children, not to mention food, clothing and the occasional family vacation. If you want your youngsters to receive a post-secondary education, listen to the experts and set up an RESP, start saving early and put away as much money as you can. As RESP expert Patricia Lovett-Reid, a senior vice-president at TD Waterhouse, once told me: "With children the days are long but the years are short... with every passing year, parents are reminded that it will not be long until they need to come up with thousands of dollars to help their kids get through some form of post-secondary education." Lovett-Reid underlines her point by noting that a year of university or college education for a child living away from home can cost as much as \$19,000. Ouch!

Luckily, RESPs can help you sock money away for your child's education. And with the federal government kicking in cash it has never been easier to build a nest egg to help cover rising post-secondary education costs. Recent changes make the task a bit easier.

If you're new to the RESP game, here's how the system works. In 1998, Ottawa began granting 20 cents for every dollar Canadians invest in an RESP, to a maximum of \$400 per year, per child, until the beneficiary reaches age 17, based on a maximum annual contribution of \$2,000. In the 2007 federal budget, the government sweetened the pot, boosting the maximum yearly contribution eligible for Canada Education Savings Grant (CESG) to \$2,500 up from \$2,000, for a maximum \$500 annual grant.

In addition, the \$4,000 maximum annual contribution was scrapped and the lifetime maximum contribution was boosted to \$50,000 from \$42,000.

So, if you place \$1,000 in an RESP this year for newborn Johnny, the feds will kick in \$200; if you invest \$2,000 for newborn Susie, Ottawa will contribute \$400. If you make the same contributions until age 17, by the time they're ready for college or university, that's free money totalling \$3,600 for him and \$7,200 for her, plus the return you will earn on the investments.

If you can afford more, Lovett-Reid, of course, suggests you go for it. The following examples should help convince you of the need to start early. They'll also demonstrate how more contributions now, equals more money later....

In example No. 1, you win the lottery or your kid's grandparents cut a cheque for \$50,000 and you make one lump sum payment before your child turns one. Based on a seven per cent return and the government grant money, your child at age 18 will have an RESP worth \$170,686. (One downside to investing \$50,000 in one fell swoop is that you qualify for only \$500 in grant money, versus a maximum of \$7,200 if you invest the money gradually).

...In example No. 2, your lottery win is smaller or the grandparents hand you a cheques for only \$16,500, which you use to make a lump sum payment into an RESP right after your child is born. Then, you contribute \$2,500 annually until age 13 and \$1,000 at age 14 to hit the \$50,000 maximum. Calculating the government grant and interest earned, your total at age 18 is \$143,777.

...In example No. 3, you break down the \$50,000 into equal annual payments of \$2,778 and a final payment of \$2,774 at age 17. Your total when the time comes to apply for university will be \$117,133.

...In example No. 4, you can't afford \$2,778 annually, so you invest about half, that is, \$1,389 a year. Cutting your contributions by 50 per cent means your kid's nest egg will be \$60,633.89, considerably less than had you invested the larger yearly amount.

...In example No. 5, you procrastinate and don't start contributing to an RESP until your child is 10. At that point, still determined to invest the \$50,000 maximum, you invest a lump sum of \$19,000 and from ages 11 to 16 you contribute \$5,000 a year and a final \$1,000 at age 17 to reach the maximum

investment. Your total, again based on a seven per cent annual return and grant money from the government, is \$84,786.

The moral of the story, of course, is start early and contribute as much as you can each year. That's easier said than done, but well worth it, if you can do it. RESP funds can be used for full or part-time study in a qualifying program at a post-secondary educational institution. A qualifying educational program is a course of study that lasts at least three weeks in a row, with at least 10 hours of instruction or work each week.

Beginning in 2007, a payment may also qualify 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 three 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.

You may be wondering if it is a better idea to set up a trust fund for your child's education or purchase savings bonds. Not really. The problem with these is that the contributor usually pays tax on any earnings. In addition, many investment vehicles chosen by parents, such as Canada Savings Bonds and guaranteed investment certificates, pay abysmally low rates of interest.

For moms, dads, grandparents, or whoever contributes to an RESP, contributions are not deductible from income as is the case with a Registered Retirement Savings Plan (RRSP).

But on the bright side, the growth within an RESP is tax-free until the money is withdrawn by the student, at which point little tax is usually paid because the student has minimal income.

In addition, there are ways of sheltering the gains inside an RESP from tax if your child does not go to college or university and you can even transfer an RESP within your family from a child who will not seek a post-secondary education to one who will.

I certainly am not recommending RESPs are right for everyone: your accountant or financial advisor can offer that advice. But I'm hopeful you'll do your homework and determine if they're appropriate for your children.

When setting up an RESP, contributors can decide where the money is invested, which means they can take as much or as little risk as they are comfortable with,

says Lovett- Reid. Those who want safe investments can place their money into Guaranteed Investment Certificates; those looking for higher returns can place the money in mutual funds or stocks or even strike the right balance between equities and fixed income, depending on their risk tolerance.

Don't be scared off by financial experts who insist you donate the maximum every month. If you can afford only \$25 or \$30, go for it. A \$30 monthly contribution is \$360 a year, plus \$72 from the feds, for a total of \$432, plus whatever interest you earn. It might not pay for a medical or engineering degree but it's a start. And it can be built on later when you have more money. As you get used to living without that money, increase it every month is one tip most accountants and financial experts preach.

And don't worry that you will lose much of your investment if your kids decide against a post-secondary education: money set aside in a family plan RESP for a child who decides to forgo a higher level of education can be transferred to a sibling or, alternatively, subject to the rules, parents who have contribution room can move up to \$50,000 from an RESP into their Registered Retirement Savings Plans without paying a tax penalty.

To find out how to set up an RESP, or to get advice on saving in other ways for your child's future, contact your financial advisor or financial institution. Most will send you printed material or Web sites where there's plenty of useful information.

To find out more about RESPs, contact the Canada Revenue Agency toll-free at 1-800-959- 8281 or visit www.cra-arc.gc.ca/tax/individuals/topics/resp/menu-e.html

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