MILESTONE
INVESTMENT COUNSEL INC.

2 Berkeley Street, Suite 309
Toronto, Ontario
M5A 4J5

E: admin@mstone.com
T: 416-365-3111
F: 416-365-7964

The Registered Education Savings Plan

The Registered Education Savings Plan (RESP) is an excellent avenue for your family to save for a child's postsecondary education. However, because of its many features and rules it is important to develop an understanding of how the plan works in order to ensure you get the most out of it.

Contributions & Grants

One of the main benefits of the RESP is the Canada Education Savings Grant (CESG) matching provided by the federal government. Here are the details:

- The CESG is awarded on up to 20% of the annual contributions to the plan, to a maximum of $500 per year, and so the required annual contribution to earn the maximum grant is $2,500.
- The lifetime maximum grant awarded per child is capped at $7,200.
- If you miss a year, CESG room can be carried forward to future years, but the maximum CESG paid in any year is $1,000.
- Grant room accumulates until the end of the year that the child turns 17.
- The lifetime contribution limit to the plan is $50,000.
- The plan contributions and grants grow tax free in the RESP.
- While the subscriber may withdraw their own contributions without being taxed, the withdrawal of any income earned (growth & grants) from an RESP is taxed in the hands of the child.

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Contribution & Investment Strategies

A popular contribution strategy is to manage annual contributions such that the CESGs are maximized as early as possible to ensure the longest runway for tax deferred growth of the grant money. It is also optimal to make the contributions early in the calendar year to enjoy the longest possible investment horizon for your RESP. The subscriber can start making contributions as soon as the child is born. The education funding goals and financial circumstances of the family should be taken into consideration in developing the appropriate asset mix for the plan's investments. Generally, the longer the time horizon until cash needs to be withdrawn to pay for school, the higher the risk allocation that can be considered for the plan. As annual contributions are made, this is an opportunity to review the suitability of the mix and refine it as necessary. For cash flow planning purposes, it's typical to adjust to a more conservative asset mix as enrollment for postsecondary school approaches, and contributions in later years as well as investment income can be used as a sources of funds to do so.

The Importance of a Withdrawal Plan

Withdrawals from the RESP are classified as either Educational Assistance Payments (EAPs) or return of contributions. EAPs are taxable income to the child when they become a student and include both the growth on the plan assets as well as any grants received. These withdrawals can be used to cover postsecondary school expenses such as tuition, transportation, and books. The RESP provider will ask to see proof of enrollment at a qualified education institution before authorizing an EAP, but receipts for expenses are not required. Qualified education institutions include universities, colleges or other institutions in Canada that are designated under the Canada Student Financial Assistance Act. Approved foreign programs are also allowed if enrollment is at least 13 weeks.

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Here are some EAP details to be aware of:

- Payments are limited to $8,000 within the first 13 weeks of enrollment in a full-time program. After this initial period, EAP requests of any amount can be made as long as the student is still enrolled.
- For part-time studies the EAP limit is $4,000 for every 13-week period of enrollment.
- Students in both full-time and part-time programs can receive payments for up to six months after the end of enrollment.

To minimize tax and avoid penalties a withdrawal plan should be made prior to the start of school. While the RESP provider tracks the breakdown of contributions, grants, and income in the plan you can contact the government for verification on the amounts to be absolutely sure of the balances.

In most cases EAPs are the first funds that should be accessed as there are penalties and taxes applied to these amounts if they are never used. Specifically, unused grants are returned to the government and income is taxed in the subscriber's hands at their marginal tax rate **plus 20%** as an Accumulated Income Payment (AIP). To avoid taxes, AIPs can be transferred to a subscribers RRSP if there is contribution room to do so, but the unused grants are lost forever and so it is important to draw down this portion of the plan as early as possible.

While EAPs are taxable, because the student is in school, they often have very limited taxable income from other sources. Coordinate EAPs with expected income of the child (e.g. summer jobs, co-op programs) to ensure that withdrawals are within the student's personal tax exemption and deductible school expense amounts.

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Expenses over and above the optimal EAP withdrawal amount for a given period can be covered by the original contributions, which can be withdrawn tax free and sent to either the subscriber or student. While contributions can be taken out of the plan all at once without penalty, if they aren't needed, they should be left in the plan to take advantage of further tax deferral.

Be sure to contact Milestone for guidance on RESP specifics.

Additional Notes:

Lower income families can receive more CESG in earlier years, ranging from 30%-40% on the first $500 contribution. Lower income families can also receive the Canada Learning Bond (CLB) to lifetime maximum of $2,000 without making any contributions.