TAX BULLETIN

RESPS: SAVING FOR YOUR CHILD'S EDUCATION

As a parent, you're concerned with the ever increasing costs of post-secondary education. You want your child to have at least the same opportunities you had — if not better opportunities! And, you want to know what options you have to save for your child's education.

This bulletin describes Registered Education Savings Plans (RESPs) — a tax-effective way of saving for your child's education. RESPs are attractive due to their flexibility and because they enable you to tap into the federal government's Canada Education Savings Grant (CESG) and the Canada Learning Bond (CLB). On the provincial front, British Columbia has a savings incentive programs to assist with and encourage education savings, called the B.C. Training and Education Savings Grant (BCTESP). Québec has also implemented an education savings progam called the Québec Education Savings Incentive (QESI). Each of the available provincial plans are linked to RESPs and will be discussed later in the bulletin. As well, we will consider prescribed rate loans and "in-trust" accounts — alternative ways of saving for your child's future.

Though the rules for RESPs are fairly complex, we believe understanding how they work is useful because of the important benefits RESPs provide to those interested in funding their children's future education.

Abbreviations used in this bulletin:

EAP — Educational Assistance Payment
AIP — Accumulated Income Payment
BCTESP — B.C. Training and Education Savings Grant
CCB — Canada Child Benefit
CCBYCS — Canada Child Benefit Young Child Supplement
CESG — Canada Education Savings Grant
CLB — Canada Learning Bond
CRA — Canada Revenue Agency
CSA — Children's Special Allowance
NCBS — National Child Benefit Supplement
QESI — Québec Education Savings Incentive
RESP — Registered Education Savings Plan
RDSP — Registered Disability Savings Plan
RRSP — Registered Retirement Savings Plan
SIN — Social Insurance Number
TOSI - Tax on Split Income

August 2021

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We have prepared this bulletin in a question and answer format, attempting to anticipate the questions you will have about RESPs, CESGs, CLBs and the provincial savings plans. The questions are categorized under major headings so you can quickly find the information you are looking for.

Although we have tried to deal with as many issues as possible, you may have a question that is not covered by the material in the bulletin. Contact your BDO advisor for help with any questions that you may have.

Part A — RESP basics

A1. What is an RESP?

To put it simply, RESPs are an agreement between you, as plan "subscriber", and the plan "promoter" for an individual (the plan "beneficiary") who can generally benefit from the funds contributed to and the income earned in the RESP. In most cases, the beneficiary is your child or grandchild, but you can also name a spouse or even yourself as beneficiary (see question A11). RESPs are offered by various companies (typically financial institutions or mutual fund companies) that act as "promoters" and are registered with the government to ensure conditions are met for favourable tax treatment.

Under the terms of the plan, you make contributions over a period of years and the promoter manages and invests the contributions, as well as the accumulated income earned on the contributions. If the RESP qualifies for the CESG, the CLB or one of the provincial savings plans, the promoter will invest the money from these deposits as well.

When the RESP beneficiary pursues a post-secondary education, the promoter pays out Educational Assistance Payments (EAPs) to the beneficiary from the income accumulated on the RESP contributions, as well as the CESG, CLB and provincial savings plan amounts and income earned on them. Because subscribers make contributions to RESPs from after-tax dollars, these contributions are generally returned to the subscriber or paid to the beneficiary free of tax. Unless otherwise stated in this bulletin, we have assumed you will be using an RESP to save for your child's education.

Unlike your Registered Retirement Savings Plan (RRSP), contributions to an RESP are not deductible. Despite this, RESPs still provide the following benefits:

- **Tax deferral** — Earnings on RESP investments accumulate without tax. This helps you save for your child's education much faster, since savings compound much more quickly if the investment return is not subject to tax.
- **Income splitting** — When the accumulated income is paid out from the RESP as an EAP, it will be taxed in your child's hands. With available federal tuition tax credits, and provincial tuition and education tax credits (depending on the province or territory), as well as lower marginal tax rates, your child should pay much less tax on this than you would on this income.
- **CESG deposits** — If the RESP qualifies, the federal government will add an additional 20% to the RESP (up to certain annual and lifetime maximums). As well, the federal government provides an additional CESG for low and middle-income families. We discuss the rules for the CESG in Part C of this bulletin.
- **CLB deposits** — Children born in 2004 and later from a low-income family may be entitled to a CLB, which is added to the RESP. The CLB is also available for children under the care of an agency receiving the Children's Special Allowance (CSA). We discuss the rules for the CLB in Part D of this bulletin.
- **Provincial plans** — Where qualifications are met, the BC and Québec governments will provide additional amounts to the RESP. We discuss the provincial plan rules in Part E of this bulletin.

A2. What kinds of RESPs are available?

When you read brochures prepared by RESP promoters, you'll notice that they refer to many types of RESPs. But RESPs can be broken down into two broad categories, which we'll refer to as:

- individual plans, and
- group plans.

Individual plans

Of the two general RESP types, individual RESPs are more straightforward. There are two kinds of individual plans — non-family plans and family plans. A non-family plan is a plan you set up for just one beneficiary, and there are no restrictions on who can be a beneficiary of such a plan. A family plan can have more than one beneficiary; however, each beneficiary must be connected by blood or adoption to each living subscriber under the plan or have been connected to a deceased original subscriber.

Under these types of plans, as you make RESP contributions each year the funds are deposited for the benefit of a specific child (the beneficiary). As investment income is earned, it is also deposited into the RESP account. When your child pursues a post-secondary education, the accumulated income is paid out as an EAP. The amount of income available to the child will be based on the performance of the investments you select.

Government incentives and income earned on those incentives will also be deposited into these types of plans. This will be discussed in more detail later in the bulletin.

Historically, family plans have provided additional flexibility for parents and grandparents who are saving for a number of related children and grandchildren, as these plans allow subscribers to allocate plan assets among related children, subject to certain conditions. However, since 2011 subscribers of non-family individual plans have been provided with the same flexibility to allocate assets among siblings. Transfers that occur after 2010 between individual RESPs for siblings are allowed without tax penalties and without triggering the repayment of CESGs and CLBs, provided that the beneficiary of a plan receiving a transfer of assets had not attained 21 years of age when the plan was opened.

Group plans

The other basic type of RESP is a group plan (also referred to as an "Education Fund" or a "Scholarship Fund"), which is a set of individual non-family plans that are administered based on a specific age group. Similar to an individual plan, you make regular contributions to a group plan that are deposited for the benefit of your child, along with the accumulated investment income. Note that for a group plan, the amount and frequency of contributions stay the same as long as the beneficiary has not turned 18. The main difference between group and individual plans is how each calculates the amount of accumulated income available to the student when he or she goes to college or university. In a group plan, when each plan matures, contributions are returned to the subscribers and the total investment earnings of the plan are transferred to an account for all of the plans that matured in the year. Prior to July 2005, each year of post-secondary education covered by the plan was generally given an equal part of the funds transferred from the matured plans, and these equal parts were divided among the beneficiaries who qualified to receive EAPs in each of their post-secondary years of education. With the introduction of the additional CESG, amounts received will differ as limitations have been placed on the beneficiaries who can receive the government incentives. Specifically, the basic and additional CESG deposits, the CLB and certain provincial plan amounts, and earnings on those incentives can't be shared among beneficiaries of a group plan.

The RESP rules allow a subscriber to recover RESP income when a child doesn't go to college or university (which we'll discuss later in this bulletin). Most individual plans allow for these income recovery rules, while some group plan promoters have made changes giving group plan subscribers more flexibility when a child doesn't pursue a post-secondary education. Keep in mind that it is important to carefully review the terms and conditions of any RESP before signing, as the treatment of accumulated income varies.

A3. Who can be an RESP subscriber?

Generally, an RESP subscriber must be an individual. Practically speaking, the subscriber is usually a parent, relative or friend of the RESP beneficiary. There is generally only one plan subscriber, though spouses can be joint subscribers.

An RESP subscriber may also be a public primary caregiver (for example, certain child welfare organizations) who may establish an RESP on behalf of a child in care. Note that rules specific to these

caregivers are not discussed in this bulletin. For more information, contact your BDO advisor.

A4. Does it matter who sets up an RESP for my child?

From a practical point of view, the person saving for a child's education (usually the child's parents) will be the RESP subscriber. However, if others are saving for your child's education, the choice of subscriber becomes relevant.

For example, let's say you and your parents are all saving for your child's education. As we'll discuss in Part B, the lifetime RESP contribution limit is tracked on a per-beneficiary basis. So, the amount you and your parents can contribute to an RESP for your child will be restricted to one lifetime contribution limit. Where the total amount being saved by you and your parents will exceed this limit, you'll need to decide who will be using an RESP and who will be saving money outside the plan.

Although this decision will depend on a number of factors, such as the marginal tax rate for you and your parents, there are some specific RESP rules to keep in mind. In question F2, we point out that RESP beneficiaries can be changed without penalty as long as the old and new beneficiaries are both related to the subscriber by blood or adoption. Consequently, if your parents have other grandchildren, they could name another grandchild as beneficiary should your child not go on to college or university, even if that grandchild is a beneficiary of another RESP. However, when naming another beneficiary, it is important to note that there are restrictions on who can receive the additional CESG, CLB and certain provincial plan amounts, and the earnings on those incentives, if they are applicable. These restrictions will be discussed later in this bulletin.

Another factor to consider is that it may also be possible to transfer accumulated RESP income to the subscriber's RRSP when the beneficiary doesn't pursue a post-secondary education. These rules are discussed in more detail in question G6. In this case, you'll want to be the RESP subscriber if your parents will be too old to have an RRSP if and when RESP income is returned.

A5. How will I know if someone else sets up an RESP for my child?

Plan promoters must notify beneficiaries (or their parents where the beneficiary is under 19 and lives with their parents) within 90 days of the establishment of an RESP on their behalf. As part of the notification, the promoter must give the beneficiary the name of the subscriber. This rule is important because of contribution limits. For example, let's say your sister establishes an RESP for your child as a gift. If you did not know that your child was a beneficiary of that RESP and you set up an RESP for the child as well, and both of you are making contributions, there is a risk that the lifetime contribution limit would be exceeded. Note as well, that anyone wanting to establish an RESP for your child will likely need to contact you as the parent, as your child's social insurance number (SIN) and date of birth will be required in order to register the RESP.

A6. Can the plan subscriber be changed once the plan has been set up?

Generally, the subscriber can't be changed after the plan has been set up. However, changes are allowed in the following situations:

- **Marriage breakdown** — If a spouse or former spouse acquires the subscriber's rights under an RESP due to marriage breakdown, that spouse can become the RESP subscriber.
- **Death of subscriber** — In the event of the death of a subscriber, the deceased's estate may become the subscriber. As an alternative, the surviving spouse (or another person) can replace the original subscriber on death.

You'll need to check the terms and conditions of your RESP as well, to see if these changes are allowed under the terms of the plan.

A7. Can I set up an RESP with more than one beneficiary?

As we discussed earlier, you can set up a family plan with more than one beneficiary. Under this option, each beneficiary must be related to the subscriber by blood or adoption. You are related by blood to your children, grandchildren, great grandchildren, brothers, and sisters. However, this group does not include yourself or your spouse. As

well, a beneficiary must be under 21 at the time of being named a beneficiary or be a beneficiary under another RESP that allows more than one beneficiary at any time. Contributions to family plans in respect of a beneficiary are generally only allowed where the beneficiary is under 31 at the time of the contribution. Another rule to remember is that only family plans where all the beneficiaries are siblings can receive the additional CESG, CLB and certain provincial plan amounts.

A8. Can I add a beneficiary to a family plan once it has been set up?

Yes (subject to plan restrictions), so long as the beneficiary is under 21 and is related to the subscriber by blood or adoption, the beneficiary can be added. So, as additions to your family come along, they can be added as beneficiaries to a family plan RESP. Keep in mind however, that as noted in A7, payments for the additional CESG, CLB and certain provincial plan amounts can only be received by the plan where all of the beneficiaries are siblings.

A9. One of my children lives overseas with their mother. Can I establish an RESP for them?

An individual can be designated as a beneficiary (and contributions can be made on that person's behalf) only if their SIN is provided before the designation (or contribution) is made and the individual is resident in Canada when the designation (or contribution) is made.

There are a couple of exceptions to this rule. Designation as a beneficiary and contributions will still be allowed if:

- a contribution is made by way of a transfer from another RESP that the individual was a beneficiary of immediately before the transfer, even if the beneficiary is not resident in Canada (but a SIN will still be required), or
- the plan was entered into before 1999, in which case existing beneficiaries can be non-residents and need not have SINs.

If either of these exceptions apply, contributions are permitted, but they will not qualify for the CESG.

Since your child is not resident in Canada, you cannot establish an RESP for them at this time. If they return to Canada and have a SIN, you can name them as an RESP beneficiary.

A10. How long can I contribute to an RESP?

Contributions to a non-family plan can be made to an RESP for 31 years following the year the plan is set up, or possibly an earlier date, if amounts have been transferred from an existing RESP.

For family plans, a contribution can be made in respect of a beneficiary only if the beneficiary is under 31 at the time of the contribution or if the contribution was made by way of a transfer from another RESP that was a family plan.

Both types of plans must provide that the plan terminates at the end of the 35th year following the year in which the plan was entered.

It is worth noting that there are different rules for specified plans which are provided for disabled beneficiaries. In general terms, a specified plan is a single-beneficiary plan under which the beneficiary qualifies for the disability tax credit in the 31st year following the year the plan was entered into. As well, no other individual can be designated as a beneficiary after the 35th year following the year the plan was entered into. In addition, no contributions (except transfers from another RESP) may be made to the plan at any time beginning in the 35th year following the year the plan was entered into. This type of plan does not have to be terminated until the end of the 40th year following the year in which the plan was entered.

A11. I have been working for several years and I am thinking of leaving my job to get a university degree. Can I set up an RESP for myself?

You can set up an RESP where you are both subscriber and beneficiary. This could be beneficial if you'll be saving money for university over a number of years because you'll be earning investment income on those savings while you're working and the income won't be taxed. You can then receive the accumulated income as an EAP when you go back to school. With personal and tuition tax credits, you may pay little or no tax on the accumulated income.

You can also use a similar strategy for saving for a spouse’s education if either you or your spouse are set up as a subscriber. Because of your age, however, you (or your spouse) will not be eligible for the federal and provincial education savings grants and incentives.

A12. I am a U.S. citizen living in Canada. Can I set up an RESP for my child?

There is no residency requirement for RESP subscribers. However, a subscriber needs to provide a SIN when the promoter applies to have the RESP registered. U.S. citizens or Green Card holders resident in Canada can invest in RESPs — but doing so may have negative consequences for U.S. tax purposes. The main disadvantage is that, unlike RRSPs and Registered Retirement Income Funds, as a U.S. citizen, you cannot elect to defer the taxation of income earned in an RESP. Since an RESP may be a foreign trust for U.S. tax purposes, you may be subject to special U.S. reporting requirements for foreign trusts. Lastly, there is an element of double taxation, because for U.S. tax purposes the plan income will be taxable to you as the contributor and for Canadian tax purposes the income will generally be taxable in the hands of your child when they go to university or college.

So, you may want to consider an RESP for your child in order to take advantage of the government grants and incentives. However, in this situation it would be better for another relative in Canada (who is not a U.S. citizen or Green Card holder) to set up the RESP. For example, if a U.S. citizen marries a Canadian and they have a child (who is not a U.S. citizen); contributions by the parents of the Canadian spouse could be made for their grandchild, thereby avoiding the negative U.S. tax issues.

Part B — RESP contribution rules

B1. How much can I contribute to an RESP for my child?

Prior to 2007, there was an annual contribution limit of $4,000 for each beneficiary. In 2007, the $4,000 limit was eliminated. Lifetime contribution limits do apply and depend on the calendar year in which the contributions are made. For 2007 and subsequent years, the cumulative lifetime contribution limit is $50,000. The limit for 1996 to 2006 was $42,000. These contribution limits apply to all RESPs set up for your child. As we’ll discuss in Part C, although there is no longer an annual contribution limit, there is a limit on the amount of contributions that will be eligible for the CESG each year. So, the timing of contributions can impact the CESG. You should also note that CESG and CLB payments, as well as payments made under a designated provincial program, are not included in determining whether an individual’s lifetime RESP contribution limit has been exceeded.

B2. My mother and I both set up RESPs for my child. What are the consequences if our combined contributions exceed the lifetime RESP limit?

The contribution limits discussed in question B1 apply for all plans set up for the same beneficiary, so all subscribers must share the contribution limits for your daughter. Therefore, the total amount you and your mother contribute for your child will have to be compared to your child’s lifetime RESP limit. If your combined contributions exceed this limit, you and your mother will each be liable to pay a 1% per month penalty tax on your share of the overcontribution. The tax is payable within 90 days after the end of the year in which the overcontribution is made.

It should be noted that overcontributions can be withdrawn by the subscriber. This reduces or eliminates the penalty tax. However, you should note that the amount withdrawn will still count towards the beneficiary’s $50,000 lifetime RESP limit even though it was withdrawn.

B3. When should I make my RESP contribution?

Your RESP contribution for a particular taxation year must be made during that calendar year. Unlike an RRSP, an RESP contribution made during the first 60 days following a taxation year will not count as a contribution for the previous year.

Planning tip *— You can maximize the accumulated income in an RESP by making contributions early in the year. This will provide a larger amount of money for your child’s education and will also maximize the income splitting potential provided by RESPs.*

B4. Should I borrow to make RESP contributions?

You can borrow to make an RESP contribution — but you won't be able to claim the interest expense as a tax deduction. So, borrowing doesn't make sense from a tax point of view. Borrowing could make sense when you're nearing year-end and you expect to have enough money for an RESP contribution in a few months. By borrowing and making a contribution now, you'll ensure CESG room is not carried forward. As we discuss in question C3, you won't be able to use up CESG room accumulated over several years quickly.

Part C — Canada Education Savings Grant

C1. How does the CESG work?

The Canada Education Savings Grant (CESG) is a federal grant that is added to your child's RESP as contributions are made. The amount of the grant is equal to a percentage of the RESP contribution, to an annual maximum. An additional CESG for low and middle-income families is also available. First, we'll discuss the basic CESG program, and then we'll explain how the additional CESG program works.

The basic CESG program

The basic CESG is equal to 20% of RESP contributions made, to an annual maximum basic CESG of $500 per beneficiary. In other words, to earn the maximum $500 basic CESG in any given year, $2,500 of RESP contributions must be made on behalf of the beneficiary. This annual maximum is referred to as the "CESG room". If a beneficiary has unused CESG room from a previous year, the amount of the grant paid for the year may exceed $500. We'll discuss these rules further in question C3. The maximum lifetime CESG grant for a beneficiary is $7,200.

Your child is entitled to the basic CESG regardless of whether you've actually set up an RESP for your child, so you don't have to rush out and immediately set one up for a child born late in the year. As well, the basic CESG room accumulates regardless of whether an RESP is established for the child — it's just that the sooner you actually set up the RESP, the sooner the investment income starts to accumulate on the CESG.

Note also that to qualify for the grant, your child must:

- be a Canadian resident at the time of the contribution, and
- have a SIN.

You can apply online, by mail, or in person for a SIN for your child at Service Canada. For more information, check the Service Canada website at: https://www.canada.ca/en/employment-social-development/services/sin.html

Finally, contributions to an RESP must be made before the end of the calendar year in which your child turns 17 year of age to be eligible for the basic CESG. Note that there are restrictions for beneficiaries who are between the ages of 15 and 17, which we'll discuss in question C2.

The additional CESG program

Beginning in 2005, an additional CESG is available on the first $500 contributed to an RESP each year on behalf of a beneficiary who is under 18 throughout the year, if their family's net income is within certain limits. For 2021, the additional CESG that will be paid is as follows:

- 20% of the first $500 contributed in the year if the child's family has qualifying net income for the year of $49,020 or less, or
- 10% of the first $500 contributed in the year if the child's family has qualifying net income for the year that is more than $49,020 but less than $98,040.

Qualifying net income will generally be the primary caregiver's adjusted family net income used to determine eligibility for the Canada Child Benefit (CCB). It should be noted that the annual qualifying net income thresholds are indexed for inflation. Note also that children under the care of an agency are eligible for the additional CESG, based on the agency's entitlement to a payment under the *Children's Special Allowances Act*.

Unlike the basic CESG, the additional CESG does not accumulate for a child — so there is no carryforward from one year to the next. Keep in mind, however, that the maximum CESG that can be paid to an eligible child remains at $7,200 and this includes both basic and additional CESG payments. Therefore, the additional CESG means the child can reach the maximum grant sooner and with fewer and smaller contributions.

The additional CESG will only be paid into an RESP that is a non-family plan or a family plan where all of the beneficiaries are siblings. Note also that if the RESP subscriber is not the primary caregiver (or his or her spouse or common-law partner), consent from the primary caregiver for verification of their family income is required before the additional CESG will be paid on contributions made by such subscribers.

C2. My child will turn 16 this year. Will contributions to their RESP be eligible for the CESG?

When contributions are made for a child who is between the ages of 15 and 17, special rules apply that may restrict CESGs, depending on the timing and amount of contributions made in prior years.

Since your child will turn 16 this year, one of the following two conditions must be met for their RESP to qualify for the CESG this year:

- contributions to all RESPs for your child during prior years totaled at least $2,000 (and this minimum amount has not been withdrawn), or
- contributions of at least $100 per year were made to, and not withdrawn from, RESPs for your child in any four prior years.

If one of these two conditions is met this year, you'll be able to make a contribution next year which will also qualify for the CESG.

Your question also highlights a planning opportunity where a new RESP is being set up for an older child. You'll want to ensure the rules above are met prior to the year your child turns 16. For example, if your child will turn 15 in 2021 and you're thinking about setting up an RESP, you'll want to contribute at least $2,000 before the end of 2021 so that the RESP can earn CESGs in 2022 and 2023.

C3. What happens if I can't contribute $2,500 in a year? Do I lose the CESG room for that year?

If you're unable to make an RESP contribution large enough to earn a full basic CESG in a particular year, the beneficiary's unused basic CESG room is carried forward. But, if you accumulate basic CESG room for more than one year, don't count on being able to catch up right away. Where basic CESG room is carried forward, the maximum grant that is generally available in a year is equal to the least of:

- the amount of accumulated basic CESG room available,
- 20% of your RESP contributions for that year, and
- $1,000.

This means that in addition to using $500 of current basic CESG room, you'll only be able to clear $500 of basic CESG room carried forward. In other words, the maximum contribution that can be made in any given year that will generate a basic CESG is $5,000. Any amount contributed greater than $5,000 in any given year will not generate any further CESG, even if there is CESG room available.

Remember, there is no carry forward of unused amounts of the additional CESG, so those qualifying for an additional CESG should try to contribute $500 where possible.

An example will show how the rule regarding unused CESG room works. Assume Tina's family income is greater than $100,000 each year and she has one child born in 2019. Let's say Tina contributes $500 to an RESP for her child in both 2019 and 2020. Since a contribution of $2,500 per year would qualify for the grant, $800 of CESG room will be carried forward to 2021 ($400 from 2019 and $400 from 2020).

If Tina contributes $6,000 to an RESP in 2021, it will qualify for a CESG of $1,000 being the maximum amount under the formula described above, and $500 of the carried forward room would be used. Note that the portion of the $6,000 contribution more than $5,000 will not trigger the CESG. This will still leave $300 of excess CESG room, which can be carried forward to 2022.

To clear this excess room of $300 and the new CESG room of $500 for 2022, Tina will want to contribute $4,000 in 2022.

The chart below summarizes the CESG room, carryforwards and grants for these years.

Year	Annual CESG room for year	Contribution (A)	Basic CESG: 20% x (A)	Room carried forward to following year
2019	$500	$500	$100	$400
2020	500	500	100	800
2021	500	6,000	*1,000	300
2022	500	4,000	800	0

* Limited to an annual maximum of $1,000.

As this example shows, there is a limited ability to use CESG room carried forward, so you shouldn't let too much room accumulate. In particular, you must start contributing to an RESP no later than the year the child turns 10 to receive the maximum CESG of $7,200.

C4. If I contribute more to an RESP than I need to for a full basic CESG this year, can I carry forward the excess to next year for an additional CESG claim?

If you contribute more than the available CESG room to an RESP, you can't carry the excess contribution forward to another year and use it to earn the grant. For example, assuming your available CESG room for this year is the maximum amount of $1,000 — if you contribute $10,000 to an RESP this year, you can't use $5,000 to get a $1,000 grant this year and the remaining $5,000 in the future to get another $1,000 grant. Consequently, if you're not sure you can contribute an additional $5,000 over the next couple of years, you should consider contributing $5,000 this year and wait to contribute $2,500 each year over the next two years to benefit from the annual maximum $500 CESG.

C5. Before the additional CESGs began, I set up an RESP for my child. I don't have the funds to make contributions this year. Can I withdraw contributions from the old plan and use it to make RESP contributions to a new plan to get the additional CESG?

The government implemented special rules to deter subscribers from withdrawing existing RESP contributions and recycling them to an RESP in hopes of obtaining the additional CESG. These special rules apply to withdrawals from RESPs after March 22, 2004 for non-education purposes where contributions previously qualified for the CESG. The rules stipulate that such withdrawals will result in a beneficiary being ineligible to receive the additional CESG for the balance of that calendar year and for the two subsequent calendar years. This restriction applies to all plans of the beneficiary. It is worth noting that there are exceptions to this rule. In particular, the beneficiary will not lose eligibility for the additional CESG if:

- The withdrawal of contributions occurs when a beneficiary is eligible for an EAP,
- The withdrawal is an eligible transfer (which is a transfer that meets certain conditions), or
- The withdrawal is made to correct an over-contribution of less than $4,000 (across all RESPs) at the time of withdrawal.

If a withdrawal is made from a family plan with multiple beneficiaries and is not covered by one of these exceptions, all the beneficiaries of the plan will be considered ineligible. As well, this restriction will apply to all plans of each beneficiary.

C6. I have set up an RESP for my child to get the CESG. Are there any negative tax consequences associated with an early withdrawal of contributions?

To deter you from withdrawing early, in most cases if you withdraw money from your child's RESP you'll have to pay back CESGs received. For the purpose of the repayment, RESP contributions are broken down into two pools, "assisted contributions" (those qualifying for the CESG) and

"unassisted contributions." Early withdrawals of contributions are paid from the assisted pool first.

Where an assisted contribution is withdrawn, the RESP administrator is required to repay some or all of the accumulated CESGs. The amount repayable is a portion of the assisted contributions (depending on the basic and additional grants received), up to the total accumulated CESGs.

Part D — Canada Learning Bond

D1. What is the Canada Learning Bond? Who qualifies for it?

The Canada Learning Bond (CLB) was introduced by the federal government in the 2004 budget as an educational savings incentive for children whose families qualify for the National Child Care Benefit Supplement (NCBS) and for children under the care of an agency receiving the CSA. After the elimination of the NCBS in 2017, eligibility for the CLB became based on the number of qualified children in the family and the adjusted net family income for the previous year. Adjusted net family income includes the adjusted income of the primary caregiver along with the income of a cohabitating spouse or common law partner and is set annually.

For the 12-month period July 1, 2021 to June 30, 2022, the income eligibility amount for the CLB is based on the following:

Number of children	Adjusted net family income 2021
1 to 3	Less than or equal to $49,020
4	Less than $55,311
5	Less than $61,626
6	Less than $67,942
7	Less than $74,257
8	Less than $80,572
9*	Less than $86,888

Source: ESD Canada, Apply for the Canada Learning Bond (CLB) - Eligibility, Number of children and adjusted net family income, 2021

*Additional adjusted net family income thresholds apply for families with more than 9 children. These thresholds are available on Canada.ca.

The program provides each child born on or after January 1, 2004 with a CLB in each year that the child is eligible, up to and including the year the child turns 15. The amount of the CLB in the first year of entitlement is $500, and any subsequent CLBs will be in the amount of $100, to a maximum of $2,000. To be eligible to receive the CLB, a child must be a resident of Canada immediately before the CLB payment is made. The CLB is payable into an RESP of which the child is a named beneficiary. To qualify, the RESP must be an individual non-family plan or a family plan where all beneficiaries are siblings. Contributions to the RESP are not required to qualify for the CLB.

Note that the CLB will not affect RESP or CESG contribution limits, and no CESG will be paid on the CLB amounts transferred into an RESP. CLB entitlements will be allocated to a specific child and, unlike the CESG, cannot be shared with other beneficiaries in a family plan.

In order to apply for the CLB, an individual primary caregiver or other subscriber must provide their SIN and a public primary caregiver responsible for a child in care must provide their Business Number. A SIN must also be provided for the child.

As with the additional CESG, although any person can subscribe to an RESP for the benefit of a child, only the primary caregiver for a child (or their spouse or common law partner, or the agency receiving the CSA) can authorize the transfer of the CLB into an RESP for the benefit of the child.

To better understand how the CLB works, let's consider a couple of examples. Assume that in 2021 the Smith family welcomes their second child, Terry. Because the Smiths' adjusted net family income for that year is less than $49,020, Terry will be entitled to a $500 CLB at birth. If Terry's parents continue to earn less than the relevant income eligibility amount for each year, including the year Terry is 15, Terry will be entitled to a $100 CLB for each year after 2021, so that their total CLB amounts will be $2,000. If Terry's parents set up an RESP for Terry, income on the CLB amounts would grow at the rate of return applicable to the RESP.

Now let's consider Chris' family. Chris was also born in 2021, and is the family's second child, but in 2021 Chris' family's income is about $50,000, which is above the income eligibility amount for the CLB for one to three children. But, in 2022, 2023, and 2024 the family's adjusted net income is lower, such that it is below the relevant threshold for the number of children in Chris' family. As a result, Chris will be entitled to the first CLB of $500 in 2022 and an additional $100 CLB in 2023 and 2024.

CLB's will have to be repaid to the government if they are not used as an EAP by an eligible beneficiary attending a qualifying post-secondary educational institution.

D2. Money is tight — what if I can't afford to set up an RESP?

To encourage families qualifying for the CLB to set up RESPs, an additional $25 will be paid into the RESP to which the initial CLB of $500 is deposited. This $25 is intended to help recognize the one-time incidental expenses that may be associated with opening the RESP. Remember, to set up an RESP you will need a SIN for the beneficiary.

D3. Must I set up the RESP right away?

No, Employment and Social Development Canada will keep track of CLB entitlements as they accumulate for each child. A CLB in respect of a child can be transferred to an RESP at the request of a primary caregiver any time before the child reaches 18 years of age. However, no interest will be paid on CLB entitlements that have not been transferred to an RESP, so establishing an RESP sooner is more advantageous in order for income to begin to accumulate on the funds.

If CLB entitlements in respect of a child have not been transferred to an RESP by the time he or she reaches 18, the child will have up to three years to open their own RESP and receive CLB funds. In this case, the child will be both subscriber and beneficiary of the RESP. However, once he or she turns 21, the CLB entitlements will be lost if they have not been transferred to an RESP.

Part E — Provincial education savings plans

E1. What is the B.C. Training and Education Grant?

The government of British Columbia announced the B.C. Training and Education Grant (BCTESG) in its 2013 budget as a measure to encourage families to start planning and saving early for their child's post-secondary education or training program.

The BCTESG is a $1,200 one-time only grant paid into an eligible beneficiary's RESP. To receive the BCTESG, the child must be born on or after January 1, 2006, possess a valid SIN and be a named beneficiary of an RESP. The RESP can be either an individual non-family plan or a family plan in which all of the beneficiaries are siblings. Both the child and the child's custodial parent or legal guardian must be ordinarily resident in BC at the time that the application for the BCTESG is made. Subscribers to the BCTESG will have a window of three years to apply; beginning at the time a child turns six and ending immediately before the child turns nine.

E2. What is the Québec Education Savings Incentive?

The Québec Education Savings Incentive (QESI) is another savings program that encourages families to plan and save for their child's post-secondary education. The QESI, which came into effect on February 21, 2007, is a refundable tax credit that is paid directly into an RESP that is opened with a financial institution or another service provider that offers the QESI.

In order to be entitled to the QESI, the child must be less than 18 years old, have a SIN and be resident in Québec on December 31 of the taxation year. As well, the child must be the designated beneficiary of the RESP.

Under the QESI program, an RESP account can receive a basic amount equal to 10% of the net contributions paid into the RESP over the course of the year, up to a maximum of $250 per year. It is worth noting that a child's maximum basic QESI entitlement of $250 accrues annually as of 2007 or from the year of birth (if born after 2007), until the year in which the child turns 17 years of age. Therefore, families who are unable to contribute to

an RESP in a particular year (or whose contributions in a year are too low to give entitlement to the maximum basic QESI) may make up the shortfall in their contributions in a subsequent year by adding a maximum of $250 per year to the basic amount up to a maximum of $500 in any year.

There is also an increased amount granted for children of low and middle-income households in respect of the first $500 in annual contributions. For children of households with family income of $45,105 or less in 2021, the rate of assistance under the QESI is doubled, from 10% to 20%, for the first $500 paid annually into an RESP. The basic QESI may therefore be increased by up to $50 a year. As well, for children of households with a family income of over $45,105 but not exceeding $90,200 in 2021 the basic QESI may be increased by up to $25 a year — based on a rate of 15% of the first $500 RESP contribution.

The lifetime cumulative QESI limit that applies to a beneficiary is $3,600. This limit applies across all plans of the beneficiary.

Similar to the rules for CESGs, there are special rules for beneficiaries who are 16 or 17 years of age. If a beneficiary is 16 or 17 at the end of the year, certain requirements must be met so that contributions paid with respect to the beneficiary will give rise to a QESI entitlement. These rules apply in the same manner as the requirements for CESGs as discussed in question C2.

The QESI may be recaptured by means of a special tax in certain situations. For example, a special tax may apply to prevent the premature withdrawal of plan contributions or when specific events take place such as the termination of the RESP. A special tax will also apply if the beneficiary's cumulative lifetime QESI limit of $3,600 is exceeded.

Part F — Managing your RESP

F1. What investments can I hold in my RESP?

Since 1998 there have been rules in place regarding what types of investments are "qualified investments" for RESPs. Effective March 23, 2017, these rules were expanded to include penalties for owning "prohibited investments", as well as additional taxes that target certain advantages earned or realized in an RESP as a result of owning such investments. These additional rules were introduced to target certain abusive tax planning arrangements using RESPs.

Generally, you can hold the following "qualified" investments in an RESP:

- cash and bank, trust company or credit union deposits, including GICs;
- shares listed on the TSX Venture, and the Toronto and Canadian Securities Exchanges;
- shares listed on most foreign stock exchanges;
- units of mutual fund trusts;
- shares of Canadian public corporations which are not listed on the stock exchanges noted above;
- options on the purchase of eligible investments;
- most government debt and debt of corporations listed on the Canadian stock exchanges described above;
- investment-grade gold and silver bullion coins, bars and certificates on such investments (effective after February 22, 2005 where certain conditions are met); and
- certain other qualifying debt obligations.

Under the previous set of rules, if a non-qualifying investment was acquired by your RESP before March 22, 2017, then a penalty tax would apply. The penalty tax was equal to 1% per month of all non-qualifying investments held at the end of each month. For investments acquired after March 22, 2017 (or acquired before March 23, 2017 that cease to be qualified investments after March 22, 2017) this tax became equal to 50% of the fair market value of the investment at the time the investment was acquired or became non-qualified. In addition, effective from March 23, 2017, a 100% advantage tax may also be applicable on non-qualified investment income if the income is not withdrawn from the RESP promptly. The CRA also has the right to revoke any RESP that holds non-qualifying investments.

Where an investment held in an RESP is subsequently found to be a prohibited investment, another set of rules will apply. Generally, a prohibited investment for an RESP is an investment to which the plan's controlling interest is closely connected, however other investments may also be considered prohibited. If the RESP acquires a prohibited investment, or if a previously acquired property becomes prohibited, the investment will be subject to a penalty tax equal to 50% of the fair market value of the investment. In addition, a 100% advantage tax may apply on income earned and any realized capital gains in respect of any prohibited investments, regardless of when the prohibited investment generating such income or gain was acquired.

The prohibited investment rules do not apply to property that was held by an RESP on March 22, 2017, and that was a prohibited investment for the plan on March 23, 2017. Certain other exceptions may also apply. The 100% advantage tax on prohibited investment income does not apply to any income earned, or the portion of any capital gain that accrued before March 23, 2017.

Each person who is a subscriber of an RESP will be jointly liable for the taxes on prohibited investments, non-qualified investments and advantages. Note that where an investment is both a non-qualified investment and a prohibited investment, it will be treated as a prohibited investment only.

A subscriber may be entitled to a refund of the 50% penalty tax on non-qualified or prohibited investments if the investment was disposed of or ceased to be a non-qualified or prohibited investment before the end of the calendar year after the year in which the tax arose. This refund will not apply to the 100% advantage tax.

In addition to the tax rules, the terms of your RESP may restrict the range of investments you can hold. For example, a mutual fund company may offer an RESP with little or no fees provided you purchase only that company's funds. An RESP that is fully self-directed offers the most flexibility, but the fees may also be higher.

F2. Can I change a plan beneficiary?

Depending on the terms of the RESP, you may be able to change the plan beneficiary. Except for family plans (where beneficiaries are members of the same family), tax rules generally do not restrict who may be named as a new beneficiary. However, there is an important tax rule that you must keep in mind. If you name a new beneficiary, all contributions made to the plan over the years for the former beneficiary are generally deemed to have been made for the new beneficiary at the time the contribution was originally made. As a result, if the new beneficiary is already an RESP beneficiary under a different plan, a large overcontribution penalty could arise, especially if significant contributions have been made to both plans over the years.

Fortunately, the deeming rule does not apply if the former beneficiary and the new beneficiary are both related to the plan subscriber by blood and both are under 21, or if the two beneficiaries are siblings and the new beneficiary is under 21. In addition, where the old and new beneficiaries are related by blood to the subscriber or are siblings, and the new beneficiary is under 21, the accumulated basic CESG deposits may not be lost (depending on the terms of the plan). Note that there are restrictions on the amount of CESGs that can be paid to one beneficiary as an EAP (see question G7 which discusses this situation under a family plan). Depending on the terms of the plan, the additional CESG, BCTESG grants or the additional QESI may be retained if the replacement beneficiary complies with the sibling-only requirement. Remember also that the CLB can only be paid to a specific beneficiary; however, earnings on the CLB may be shared in a family plan where the other beneficiaries are siblings.

In question A4, we mentioned that having a grandparent act as subscriber could be beneficial. If your parent is the subscriber of an RESP for your child, the size of the group eligible for the exception to the deeming rule that applies when new beneficiaries are named is broadened to include other grandchildren. This could be beneficial for families with just one child. If your child doesn't go on to college or university, then your niece or nephew could be named as a

beneficiary without the application of the deeming rule.

Historically, many group plans did not allow a change in beneficiary under the terms of the plan. However, some group plans may now allow for substitution, so be sure to check the terms of your RESP.

Part G — Payments from an RESP

G1. What types of payments are made from an RESP?

There are generally five types of payments that can be made from an RESP, as follows:

1. **Educational Assistance Payments**

   Educational Assistance Payments (EAPs) are payments to beneficiaries out of RESPs to fund their post-secondary education.

2. **Refunds of payments**

   Contributions to the RESP can be returned to the subscriber or paid to the beneficiary, subject to the terms of the agreement. Such amounts (which are referred to as "refunds of payments") are not subject to tax regardless of who they are paid to, because the contributions were originally made from after-tax dollars.

3. **Payments to a Canadian designated educational institution**

   An RESP may provide for payments to a Canadian designated educational institution.

4. **Payments to a trust**

   Payments to a trust can be made to accommodate transfers of property between RESPs. Note that we will not deal specifically with transfers between RESPs in this bulletin. If you have questions about RESP transfers, talk to your BDO advisor.

5. **Accumulated income payments**

   A payment of income earned from an RESP that does not include one of the above noted payments is generally considered an Accumulated Income Payment (AIP), and is usually paid to the subscriber.

G2. Now that my child is going to university, how do they get money from the RESP I set up and how will they be taxed on the payments received?

Now that your child is going to university, they will be eligible to receive EAPs from the accumulated income in the plan if they are enrolled in a qualifying educational program at a post-secondary educational institution. The program must be at least three consecutive weeks in duration and it must require at least 10 hours of work or instruction each week for the duration of the course.

Before making an EAP payment, the plan promoter will likely want proof that the beneficiary meets the enrollment requirements.

If contributions made to your child's RESP qualified for the CESG, the CLB or one of the provincial plans, the EAPs he receives will be a combination of CESG, CLB, provincial plan deposits and income accumulated on those funds. The portion of the EAP attributed to each of the incentives is proportional to their combined value in the RESP — immediately before the EAP is made.

EAPs received by your child are reported on a T4A supplementary slip. Note that your child won't be taxed on the amount you contributed to the RESP — only on the income earned in the plan and on any government incentives paid out. When they report this income on their tax return, they may pay little or no tax after they claim their personal and tuition tax credits. Note that these payments are not considered scholarship payments for the scholarship exemptions.

G3. My child is attending college on a part-time basis. Are they eligible for payments from their RESP?

A payment may also qualify as an EAP at the time it is made, if your child is at least 16 years of age and is enrolled as a student in a specified education program which covers certain part-time programs. A specified education program is essentially a program at a 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.

G4. Is there any limit to the amount my child can withdraw from an RESP?

The amount that can be paid as an EAP during your child's studies is limited. Until your child has completed 13 consecutive weeks of a full-time qualifying education program, the maximum amount that can be received as an EAP is the lesser of $5,000 and their total allowable education expenses. The $5,000 limit does not apply after the first 13 weeks, provided your child continues to meet the general conditions discussed in question G2. If there is a 12-month period where your child is not enrolled in a qualifying educational program for 13 consecutive weeks, the $5,000 maximum payment restriction will apply again.

The payment limit is different for part-time studies. If your child is eligible for EAPs for a part time program, they will be limited to total EAPs of $2,500 in a 13-week period of enrollment. Therefore, each EAP requested will be assessed to ensure the total of the payment requested and all payments made in the preceding 13 weeks does not exceed $2,500.

Note that the Minister of Employment and Social Development Canada can approve an EAP exceeding the maximum amounts noted above on a case-by-case basis. However, because the limit applies for a short period, it is likely that the Minister will approve a greater amount only in exceptional cases, such as where the cost of tuition for a particular program is substantially higher than average.

Note that there is a six-month grace period for receiving EAPs once a student has completed their studies. In other words, your child can receive an EAP for up to six months after they cease to be enrolled as a student, provided that the payments would have qualified if paid immediately before enrolment ceased.

G5. What happens if my child decides to attend a foreign university?

If your child attends full-time studies at a foreign university they can receive EAPs, provided the program lasts at least three consecutive weeks and that they meet the enrollment criteria specified above. Note that for all other post-secondary educational institutions (including foreign colleges) located outside of Canada, the minimum course duration requirement for full-time studies is extended to 13 consecutive weeks.

Your child's residency for tax purposes is also an important consideration. EAPs paid to a non-resident can't include accumulated CESGs and CLBs. A repayment of CESGs and CLBs will be made to the government when an EAP is made to a beneficiary who is not a Canadian resident. Residency is based on an individual's specific situation and depends on the individual's intention at the time of the move, as well as on personal and social ties to Canada compared to the foreign location, and other factors. *Therefore, your child may want to ensure they keep enough ties with Canada to remain a Canadian resident or they should ensure all EAPs are received and the RESP is collapsed before they become a non-resident.*

From a provincial perspective, EAPs will not include amounts from the QESI program where the beneficiary does not reside in Québec at the time the EAP is made. A special tax will recapture any residual balance in the RESP related to the QESI if the beneficiary does not renew residency ties with Québec during the life of the plan. With respect to grants received under the BCTESG, if a beneficiary does not reside in Canada at the time the EAP is made, there is no requirement to exclude these amounts from the EAP.

The implications associated with emigration can be complex. Consult with your BDO advisor if you are facing these issues.

G6. I have set up an individual RESP for my child. What happens if they don't go to college or university?

If your child doesn't go on to post-secondary education, you still have some options so that you won't lose the accumulated income in the plan. Remember, the alternatives discussed below assume that they are allowed under the specific terms of your RESP.

Assuming your child does not pursue a post-secondary education, the following alternatives are available to you:

- Naming a new beneficiary (which we discussed in question F2),

- Transferring the accumulated income to your RRSP,
- Transferring the accumulated income to a Registered Disability Savings Plan (RDSP), or
- Receiving the accumulated income as a direct receipt.

Before you can transfer the accumulated income to your RRSP or receive the accumulated income as a direct receipt, the following conditions must be met:

1. You must be resident in Canada, and

2. The payment must be made to only one subscriber of the plan (not a single payment to joint subscribers).

As well, one of the following conditions must be met:

(a) Each plan beneficiary for whom you made contributions must be over 21 and not currently eligible to receive EAPs, and the RESP must have been in existence for at least 10 years, or

(b) The payment is made in the year the RESP is required to be terminated. This will be by the end of the 35th year (40th year in the case of a specified plan) after the year the plan was opened, or

(c) All beneficiaries of the RESP are deceased.

When an AIP is made from a plan (regardless of whether it's transferred to an RRSP or if it's received directly), any CESGs, CLBs, SAGES and BCTESG grants must be repaid. Keep in mind, however, that the income earned on these incentives is not returned to the respective governments. Note also that the QESI may be recaptured by means of a special tax.

As well, remember that if the terms of the plan allow it, the promoter can return to the subscriber the original contributions tax-free.

Transfer the accumulated income to your RRSP

If you qualify for a return of income and you have RRSP contribution room, you can transfer the AIP amount to your RRSP or to your spouse's RRSP (if you are joint subscribers and if he or she has enough contribution room). The maximum amount you can transfer to your RRSP is $50,000. Under this option, you'll include the accumulated income in your income and then claim an RRSP deduction for the amount transferred to your RRSP. Note that the deduction must be claimed in the year you receive the AIP, otherwise a penalty tax will apply, which is discussed below.

Transfer the accumulated income to an RDSP

You may be able to transfer the AIP amount to an RDSP for the benefit of a disabled beneficiary on a tax-deferred basis if, at the time of the election, the RESP beneficiary is also the beneficiary under the RDSP.

To qualify for an RESP rollover, the beneficiary must meet the existing age, residency, and lifetime contribution limit requirements in relation to RDSP contributions. In addition, the plan must not be a Specified Disability Savings Plan.

As well, one of the following conditions must also be met:

(a) The beneficiary is reasonably expected to be unable to pursue post-secondary education due to a severe and prolonged mental impairment,

(b) The RESP has been in existence for at least 10 years and each beneficiary under the RESP has attained 21 years of age and is not eligible for EAP payments, or

(c) The RESP has been in existence for more than 35 years.

Note that the RESP must terminate before March of the year following the year in which the RESP rollover is made. As well, a joint election must be filed by the RESP subscriber and the RDSP holder for the rollover to take place.

Receive the accumulated income directly

The other way to recover the accumulated income is to simply receive the funds directly. This option will appeal to you if you have no RRSP contribution room available or if you are over age 71 (as you would have already collapsed your RRSP).

When you receive the AIP directly, however, you'll be subject to regular income tax on the income. In addition, a 20% penalty tax will be payable. For residents of Québec, the federal penalty tax is 12%

and a separate Québec penalty tax of 8% applies. The penalty tax is charged to offset the benefit of the tax deferral you previously enjoyed.

In question A4, we mentioned that there is a downside to having a child's grandparent be the RESP subscriber. If the grandparent is over 71 when the RESP income is recovered, the grandparent won't be able to use the RRSP transfer option. A cash refund, subject to the penalty tax, will be the only option for recovering accumulated plan income. You may want to consider this when deciding on a subscriber.

Planning tip *— If it becomes apparent your child won't be going on to post-secondary education, you may want to reduce your RRSP contributions in the years prior to the year when the RESP must be collapsed. This will increase the amount you can transfer from the RESP to your RRSP and help you minimize the penalty tax.*

Note that when AIPs are made from an RESP, the plan must be terminated before March of the year following the year in which the first AIP is made.

G7. I have set up a family plan for my two children. I don't think I'll be able to contribute enough to receive the maximum CESG for each child. If only one child goes to college or university, can that child receive all of the accumulated CESG deposits as an EAP?

In the case of a family plan, if one child doesn't go on to post-secondary education, then it may be possible to pay the accumulated CESG deposits on contributions for that child to your other child. However, the CESG amount paid to your other child can't exceed their lifetime maximum.

This may sound complicated, but it becomes much clearer if we look at an example. Let's assume your net family income is greater than $100,000 (therefore your children do not qualify for the additional CESG available to low and middle-income families) and your children were both born after 1997. Therefore, both children can potentially be paid EAPs from a family plan that includes $7,200 of accumulated basic CESGs. However, let's assume you will contribute $20,000 over time for each child. Assuming this amount is contributed evenly over the years, you will have $4,000 of accumulated CESGs in the RESP for each child. When the first of your children goes to college or university, they can receive $7,200 of the accumulated basic CESGs – $4,000 of their own and another $3,200 of CESGs accumulated for your other child. The remaining $800 of your other child's CESG balance will have to be repaid.

Additional rules apply to sharing of provincial incentives and earnings. Speak to your BDO advisor to find out whether a provincial incentive can be shared amongst siblings.

Part H — Other education savings alternatives

H1. What is an "in-trust" account? How can this be used to save for my child's education?

Apart from simply investing money personally, another popular alternative to an RESP is an "in-trust" account. Under this type of arrangement, you can deposit funds into an investment account for a minor child and hold the money in trust until he or she reaches majority. If you choose investments that produce capital gains, such as equity mutual funds, these capital gains will be taxed in your child's hands. With their personal tax credit, your child may pay little or no income tax on this income. If other income is earned in the account, such as dividends and interest, however, this income will be attributed to you and included in your income.

Many ask the question: "Should I use an RESP or an "in-trust" account to save for my child's education?" An important point to keep in mind is that you can use both options. For example, if you are saving $4,000 each year for your child's education, you don't have to put it all in an RESP. You may want to contribute $2,500 to an RESP (to get the CESG) and deposit the rest in an "in-trust" account. Remember that even though RESPs are relatively flexible, there are still conditions that apply. Consequently, a balanced approach may be the best course of action.

H2. What is a "prescribed rate loan"? Is this an option for saving for my child's education?

Another potentially powerful post-secondary education savings option is to lend money to a trust

or the benefit of your minor child, which can then be deposited into a bank account and invested.

Using a trust is advisable for this purpose, as minors cannot generally enter into an enforceable contract. If interest is paid at the prescribed rate in effect when the loan was made, the income in excess of the interest expense will be taxed in the hands of the child.

The prescribed rate, which is calculated based on the average Treasury bill rate for the previous quarter, is set quarterly by the CRA. This rate has remained at 1% since July 1, 2020 (a decrease from the previous rate of 2%, in effect from April 1, 2018 to June 30, 2020), and is expected to remain low in the near future, making now a good time to consider making this type of loan. Note also that once set, the rate remains fixed over the life of the loan.

In order to avoid unintended income tax consequences when employing a prescribed rate loan, the trust must make interest payments annually, and no later than 30 days after the end of the tax year. If interest is not paid on time, then any dividend or interest income earned on the money loaned through the trust will be taxed in your hands. These rules are referred to as the "attribution rules" in respect of non-arm's length loans. You should note that these rules do not apply in respect of capital gains earned on the property invested. In addition, attention should be paid to tax on split income (TOSI) rules where trusts, partnerships or private corporations may be involved.

Setting up a prescribed rate loan will require proper planning and documentation. If you are considering making this type of loan, consult with your BDO advisor.

Summary

Planning for your child's education is important and there are many options available. And, given that the federal government is providing more incentives to save with CESGs and CLBs — it makes sense for you to consider RESPs. For residents of BC and Québec, the provincial education savings incentives are a bonus to keep in mind.

The combination of the tax rules, investment conditions and seemingly unlimited choice of products, however, may make the task of making the best savings decisions seem overwhelming. Remember that your BDO advisor is ready to help you understand the RESP options available and to assist you in planning for your child's education.

The information in this publication is current as of August 5, 2021.

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