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*ESTATE*PLANNING

RESPs: Free Money for Higher Learning

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"They represent one of the best things parents can do for their children, one of the best things grandparents can do for their grandchildren – it speaks to the partnership of generation."

Paul Martin, 1998 budget speech introducing Canadians to the Canada Education Savings Grant

It's that time of year. Summer is over and your kids or grandchildren – young adults really – are furthering their studies. You are thrilled they've discovered what they want to do with the rest of their lives as they head off to university or college and concerned about the ever-rising costs of a post-secondary education.

As it is with most future costs - like buying a house - the best way to get into good financial shape is to start planning early.

Most parents and grandparents manage to put aside a modest sum every month to help fund their child's education. But when the child heads off to university, in town or away from home, they suddenly realize that a more meaningful amount of money is required and regret not having socked away more.

Here's the good news: when it comes to financing post-secondary educations, strategies are available to reduce the burden on your pocketbook.

Reduce education expenses

One of the best vehicles to use is a Registered Education Savings Plan (RESP), created by the federal government in 1974 to encourage families to put aside money to finance the education of their children.

And with the soaring cost of university tuitions, accommodations, books and spending money, planning for that amount is essential.

Consider these current figures: According to Statistics Canada, tuition fees in Canada rose by an average 3.3 per cent for undergraduate domestic students in the last school year.

Canadian citizens studying in Canada can expect to pay average tuition fees of $6,838 per year for an undergraduate degree, and $7,086 per year for a graduate degree.

Does your child want to be a doctor? The cost of a medical education in Canada easily exceeds $100,000 when education-related and non-education expenses (such as accommodations) are taken into account.

Studying outside Canada for a medical degree – such as Ireland, where many Canadian young people are now studying – runs about $45,000-$50,000 a year.

What about law school? Legal education has become significantly more expensive as each university levies its own costs. Take the example of law school tuition at Western University in London, Ontario, where annual tuition alone last year approached $24,000.

Don't forget to add on accommodations: on-campus accommodations, for example, easily run

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from $4,000-$7,500 a year.

As we all know, costs never go down, so you must take inflation into account if you are planning 18-20 years in advance.

Plan ahead

Now you understand the importance of planning ahead.

As an example, using a RESP, a family can begin to save a modest $100 a month. Assuming that savings begin at birth and an average annual return of three per cent, the RESP can amount to more than $30,000 by the time the child is 18.

There are two kinds of RESPs: you can manage the investment yourself or have it cared for professionally.

If your investment isn't properly diversified, a market correction can wipe out a big chunk of your savings and not be there when you need it.

Step one is getting a social insurance number for the child. You can then get him/her enrolled in an RESP program. Individual RESPs work for just one beneficiary; family plan RESPs can be set up to benefit more than one child from the savings.

There is no annual limit on how much you can deposit into an RESP every year, but the lifetime maximum is $50,000 per child. For the first $2,500 you contribute each year, you will receive a maximum 20 per cent Canada Education Savings Grant (CESG), which in this case would be an additional $500 each year. If you put in anything over that, you will not receive a grant, but invested wisely it will continue to grow tax free.

The grant applies to the first $2,500 in contributions a year, so it's important that at least that $2,500 is put in every year to maximize the basic CESG. You can also carry-over unused contributions from the previous year, up to the first $5,000 in contributions.

Some people might like the idea of using a pre-authorized payment of just over $200 a month to maximize the government grant.

Unlike an RRSP, there is no tax refund per se, although that $500 will help the investment to grow further.

Those who have not maximized their grant every year can put up to $5,000 in a given year to collect that grant that they haven't collected yet, says Steve Placey, branch manager with Canadian Scholarship Trust Plans (CST) Consultants Inc., a distributor and investment manager of Canadian Scholarship Trust Plans.

When the money is eventually withdrawn to pay for post-secondary education, it is taxed in the hands of the beneficiary, who in most cases pays little or no tax.

Placey recommends university-bound students going outside the country also avail themselves of RESPs, as long as they are going to a recognized university, college or other educational facility.

CST encourages grandparents to buy RESPs for their grandchildren, in keeping with the theme of building a legacy. "You want to do what you can to help your kids and grandkids, and what better way to make sure your grandkids have an education than helping to put away [money] for that."

He recommends that grandparents open an RESP but also put it in their adult child's name. If the grandchild decides not to go on to a post-secondary school the income can be transferred to the adult child's RRSP – if there is room.

Current RESP rules provide that:

☛ a child who decides to drop out of university and takes a couple of years off can use the RESP later on.

☛ students can go to school part time.

☛ if the child opts to leave post-secondary school altogether, the plan can be transferred to another child.

I bought RESPs for 3 of my kids many years ago. The modest monthly deposits, plus the government-supplied gifts, grew to a significant sum that paid a lot of tuition. My single regret is not having contributed more.

Another great option available to grandparents or parents is the purchase of tax-exempt life insurance for the child. They know it's least expensive when the child is young and healthy.

The life-insurance choice can be especially important if there is a strong family history of illness. With these plans, coverage lasts forever but premiums can be made payable for only a fixed number of years and then the policy is paid up for life.

When the grandchildren are grown, they can obtain more life insurance coverage without a medical exam or requirement to answer any health questions.

While no one wants to even think of a child passing away, in addition to a death benefit, the insurance policy also has a cash surrender value which increases every year that premiums are paid.

The cash surrender value grows with no tax attributed to it.

A parent or grandparent can transfer the policy to a child when they are 18 or 19. Now they can use that cash value to borrow against a loan for school, a mortgage or whatever they want.

The grandparent can pay for the premiums and put the ownership of the policy in the hands of the parents. Should the parents die prematurely the ownership of the policy can then be transferred to the grandchild – without any taxable disposition.

This could be the ideal situation for grandparents who are willing to set aside anything from $2,500 to $10,000 a year for up to 10 years.

There is also the "melt and cascade" strategy, the subject of my December 2015 TaxLetter® article. Grandparents can buy insurance on their adult children, providing protection for their adult children in case of premature death. They can then overfund the life insurance policy to boost the policy's cash value and transfer the policy to their children or grandchildren without a taxable disposition. Again, the cash value can be used by grandchildren during their lifetime for anything from funding education to starting a business.

Some insurance companies allow the purchase of critical illness insurance for children to protect against the financial impact of an illness. Critical illness policies for children are available for up to $250,000 of coverage. The benefit allows a parent to look after the child without worrying about lost income if they need to take a leave of absence from work.

An optional return-of-premium rider will return all the insurance premiums paid if there's no critical illness claim within a prescribed length of time, usually 15 years. The child can use that refund money for education.

Older parents or grandparents should also consider inexpensive joint-last-to-die life insurance that will pay out on their deaths and provide funds for their children or grandchildren to use for education or other purposes. Doing so may well help grandparents create a legacy that their children and/or grandchildren will cherish forever.

Don't do it yourself. Get professional help to navigate the RESP process. The best way to get financial peace of mind starts with advice from an impartial and experienced team that includes your accountant, lawyer and a Certified Financial Planner or Trust & Estate Practitioner.

Our team of experienced advisors is available to help you across the country. Contact us for your no-obligation consultation. ❑

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He guides successful business owners, who are already challenged for time, through the complex process of ensuring the people and organizations they care about are taken care of.
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