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Financial Focus

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RESP: What Happens if They Don't Go to School?

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The Registered Education Savings Plan (RESP) is a popular way for parents and grandparents to help cover the cost of education. It is a flexible program, with government grants and tax perks, all going towards the education of the beneficiary. Often parents and grandparents start saving for the child's education when they are young, but what happens if they grow up and decide post-secondary school is not for them? Or if they do attend post-secondary but don't require all the funds in the RESP, what happens to the remaining money? We will tackle those questions and provide a few tips so you can get the most from a RESP.

To provide some context for our discussion, a quick summary of the RESP... The main attraction of the account is the Canada Education Savings Grant (CESG). You are permitted to contribute up to $2,500 a year and the government will add 20% ($500) in CESG to the account. The maximum CESG a child can receive is $7,200. Depending on the number of children you have and your household income, you might even qualify for additional government support for your child's education. The eligibility criteria for the Canada Learning Bond (CLB) are adjusted every year, and at the moment, if you have 3 kids or less and have a 2020 family income of under $48,535, you qualify for the additional funds.

The year in which the child turns 18, the government stops adding to the RESP, and in addition, there are special criteria that must be met in order to qualify for the CESG when the child is 16 and 17. All of the money, yours and the governments, gets invested in the RESP and grows on a tax deferred basis. Once the child is in a post secondary program, they can access the funds. The money can be used to cover tuition, books, living expenses, travel costs, anything related to their education. When the money is withdrawn it is taxed in the hands of the beneficiary, usually at this point the child is a student and in a low-income tax bracket so the tax is not a big issue.

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To answer the question what happens if they don't go to school, we need to understand the three buckets that make up the RESP: 1) your contributions, 2) the government's money and 3) any growth that has been earned. If the child does not pursue post secondary education, or if they do but don't use all the RESP money, any government money remaining (both CESG and CLB) will go back to the government, and your contributions as well as the growth come back to you. You have already paid tax on your contributions so there is no tax hit on that money, however there is tax on the growth. In fact, there is a penalty; the growth is taxed at your income tax rate plus an additional 20%.

If you have RRSP room, you can roll the growth into your RRSP and avoid the tax hit. You are also permitted to donate the RESP investment growth to an educational institution. So, a school and their students can benefit, and you avoid the additional tax.

It is important to mention that a RESP can remain open until the beneficiary is 35. Often, we encourage people to wait, lots can happen from the ages of 18 to 35, so don't be too quick to close the RESP.

The type of RESP is also important. You can open an individual plan with just one beneficiary, but if there are multiple children in a family you can also use a family plan. In my view, that is the preferred option. With a family plan if one child does not go to school or does not use the full amount of funds, the money can go to the other beneficiaries. It is important to note that no beneficiary can receive more than the maximum $7,200 of CESG, so even with a family plan, if one child does not go to school it is possible some of the grant money will go back to the government. However, in a family plan your contributions and the investment growth can be readily shared with the other beneficiaries.

The last tip to manage a RESP is to be strategic with your withdrawals. There are two types of withdrawals. You can withdraw your contributions, called a post-secondary education (PSE) withdrawal, or your can withdraw the government grant and investment growth, called an education-assistance payment (EAP). There are rules that govern how much EAP you are allowed to take, but, in my view, it is a good idea to do as much EAP as you can, so you can use up the government grant and investment growth first. That way, if there is any money remaining in the RESP it will be your contributions which can come back to you without being taxed.

There are quite a few details with RESPs, so it is best to chat with your financial professional to ensure you are using the program in a way that best fits your financial plan.

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