New Parent and Grandparents: Dependents make all the difference

Executive Summary

Every day new parents and new grandparents are born! It's a magical, busy, exhausting time for all involved.

It can also be a very stressful time for families once the realities of parenthood (and grandparenthood) sink in. Much has changed in the 25-30 years since the parents were babies themselves and the grandparents were actively involved with newborns themselves.

And not all of the changes are financial; not only are car-seats mandatory, there are car-seats for every stage of development, and they have expiry dates!

What you need to know

The annual cost of full-time university in 2016 is approximately $20,000 per academic year when tuition, academic resources (it's not just books anymore) accommodation, meals, travel, and clothing are included.

When this writer attended university his full-time summer job cutting grass for the local school board covered all of his expenses except accommodation since he attended university in his hometown, and stayed at home.

The landscape has changed dramatically, and saving for education is a necessity regardless of the course of study, type of institution and/or province.

Registered Education Savings Plans (RESPs) are the easiest and simplest method to grow education savings in a tax advantaged way. Think RRSP for schooling.

RESPs are owned by the parents, typically, with the child as the beneficiary. The deposits into an RESP are treated as capital, and are withdrawn tax-free for approved educational purposes. That is, since it was after-tax money that you deposited, you can withdraw them without triggering tax.

To induce Canadians to contribute to RESPs growth inside them is not taxed when it occurs AND if contributions are made judiciously, future students can receive an annual grant of up to $500 each year.

The Details

Technically, an RESP is a contract between a Subscriber (parent, grandparent, aunt, uncle, friend) and an institution called the Promoter. The future student is referred to as the Beneficiary. The maximum length of the contract is 31 years. Therefore students are not required to move directly from high school into post-secondary education. Beneficiaries can begin utilizing RESP funds at age 16.

The lifetime contribution limit per Beneficiary is $50,000. This can be spread across multiple accounts up to this lifetime contribution limit. The purpose of multiple accounts and the advantage of the ensuing complexity is unclear, but it is possible.

There is no annual limit, but the grant requirements encourage annual deposits. Details for the Canadian Education Savings Grant (CESG) can be found here, http://www.servicecanada.gc.ca/eng/goc/cesg.shtml, and are summarized as:

- Lifetime CESG limit of $7,200
- Calculated as 20% on the first $2,500 deposited each year ($500 annual limit)
- CESG end on December 31st, in the year the child turns 17 years-old

Since the CESG has an annual limit, the inducement is to make annual, regular contributions.

Many who are able aim to contribute $2,500 or a little over $200/month per Beneficiary to gather the maximum grant of $500. This places $3,000 into the RESP each year.

Since a four-year degree will cost at least $100,000 in 18 years, additional contributions ear-marked for educational uses can be made to a TFSA. The withdrawals and income will not be taxed but they must be held by someone other than the future student since the holder must be 18 years of age.

When it comes time to fund a student's post secondary education (university, college, apprenticeship, CEGEP) a withdrawal is made. Using a prescribed formula, the amount that is Return of Contribution (ROC) that is untaxed, and the amount that is accumulated earnings and grant is calculated.

The accumulated earnings grant portion are taxed in the hands of the student, who presumably would have little or no other earned income and would pay income tax at a lower rate than parents or grandparents.

The Bottom Line

An RESP should be initiated by the subscriber as soon as they get home from the hospital, or as soon after as possible since some identification is required by the custodian.

Contributions should occur on a regular basis (at least annually), but a monthly Pre-Authorized Contribution instills discipline to contribute while preventing the distractions of raising a baby to interfere.

Contributing regularly maximizes the CESG, and lengthens the time-frame where deposits can grow.

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