RESP WITHDRAWALS

Think Strategically

If you have opened a Registered Education Savings Plan (RESP) for the benefit of children or grandchildren, chances are you have been disciplined in contributing over the years to support a child's future higher education. However, have you considered the way in which you will eventually withdraw funds from the RESP? The time will come when RESP funds will be needed for their intended use. Or, perhaps there may be circumstances in which the RESP beneficiary may decide that they will not be pursuing a higher education. As you look forward, here are some potential considerations for withdrawal strategies relating to the RESP.

First, the basics:

Generally, there are three components to the RESP:

i) Original contributions;

ii) Any grants paid by the government, such as Canada Education Savings Grants (CESGs); and

iii) Accumulated income (AI) – any income or gains made on contributions and grants.

Grants and AI may be paid out to the beneficiary in the form of an Education Assistance Payment (EAP), which is taxable in the student's hands. The EAP can only be paid out if the student is enrolled in a qualifying educational program, such as a post-secondary education institution, or a specified educational program (and the student has attained the age of 16 years).[1] A beneficiary is entitled to receive EAPs for up to six months after ceasing enrolment. Original contributions can be withdrawn, tax free, at any time.

Why have a withdrawal strategy?

If RESP funds are not used, there may be tax consequences. Any unused grant money must be repaid and there will be a 20 percent penalty tax (12 percent for residents of Quebec) on top of the regular income tax due on any AI.

As such, consider giving some forethought to your RESP withdrawal strategy:

When a child qualifies for EAPs:

1. **Structure withdrawals early to potentially minimize taxes.** EAPs are taxable in the hands of the beneficiary. Once a beneficiary qualifies, start drawing EAPs early to, at a minimum, use the child's "basic personal amount" each year. This is a non-refundable tax credit, so unused amounts cannot be carried forward. Plan ahead to minimize taxes. Remember that the tuition credit can offset EAP income, and this credit can be carried forward indefinitely for use in a future year; but, other sources of income, such as a summer job, may impact the student's marginal tax rate.
2. **Exhaust EAP payments first.** When you make a withdrawal, you will need to specify the amount that is considered an EAP versus a refund of contributions. Always exhaust EAPs because contributions can be paid tax free at any time.
3. **Draw down EAP funds before the child ceases enrolment.** There is no requirement for which EAP monies are to be used, as long as the child is enrolled in a qualifying post-secondary program. (Note: There is an initial limit of $5,000 for the first 13-weeks of enrolment, or $2,500 for part-time students.) However, if a child decides to drop out of school, EAP payments can only be made until six months after the child has stopped attending the qualified program, so it may be beneficial to withdraw as much as possible to avoid tax penalties on unused funds.

When a child does not qualify for EAPs:

Keep in mind that the RESP can remain open until the end of the calendar year that includes the 35th anniversary of the plan's opening, so a beneficiary could potentially use the funds to pursue qualified studies in the future should education plans change. If the beneficiary will not be attending a qualifying educational program, consider these options:

1. **Transfer the RESP to another child.** If you have a sibling in the family, consider that there will be no tax implications when a beneficiary under the transferring RESP has a sibling (under 21 years of age before the transfer is made unless the receiving plan is a family plan) who is a beneficiary under the receiving RESP.[2] Any excess CESGs must be repaid beyond the $7,200 CESG limit per child.
2. **Transfer AI to a parent's RRSP account.** This can be done on a tax-free basis, thereby avoiding the penalty tax, provided there is Registered Retirement Savings Plan (RRSP) contribution room available (and subject to certain conditions, including holding the account for at least 10 years, with the beneficiary being at least 21 years of age and not enrolled in post-secondary studies). If no RRSP room is available, one option may be to delay collapsing the RESP for a few years (if permissible) to build up a parent's RRSP contribution room. With this transfer, any grants must be repaid.

Footnotes:

1. https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/registered-education-savings-plans-resps/payments-resp/educational-assistance-payments-eaps.html

2. For more details, see https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/registered-education-savings-plans-resps/special-rules/transferring-resp-property-another-resp.html