Source: http://www.finance-investissement.com/nouvelles/developpement-des-affaires/reee-le-risque-de-la-cotisation-des-grands-parents/a/42528

Grandparents Contributing to RESPs Face Risks

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IQPF CONGRESS – Grandparents contributing directly into a Registered Education Savings Plan (RESP) for their young grandchildren will be faced with a tax risk should the child end their education early.

Grandparents should instead give the money to the parents, who can make the RESP contributions for their children and thereby avoid the risk. This advice was given by Sylvain Chartier, tax specialist and financial planner at National Bank Private Wealth 1859, at the Congress of the *Institut québécois de planification financière* (Quebec Financial Planning Institute / IQPF).

This situation is due to the tax rules that apply to RESPs. When a child named as a beneficiary on an RESP stops studying and no change of beneficiary is made, the funds accumulated in the RESP must be redistributed. Contributions are returned to the subscriber (the grandfather, for example), while governments collect the grant money.

Income from investment can be returned to the subscriber without tax consequences under certain conditions: the subscriber may transfer up to $50,000 into their RRSP or donate the income to an educational institution.

“But by the time the grandson turns 16 and decides not to pursue post-secondary studies, it may well be the case that grandpa is already over 71 and is no longer permitted to make RRSP contributions,” Chartier explains.

If grandpa opts not to donate the investment income, he will be required to pay a supplementary tax on top of his regular tax rate that amounts to 12% federally and 8% provincially. “At the highest marginal tax rate, this additional tax of 20% can raise the overall tax rate to an enormous 68%!” Chartier says.

To avoid this tax risk, Chartier suggests that grandparents give the education money to their sons or daughters, who can then contribute the funds to their children’s RESP. This means that if a child decides to end their studies at age 16, the child’s mother or father would be able to transfer the accumulated investment income into their RRSP.

“So if at age 14 or 15 I see that my son doesn’t seem like someone who will pursue post-secondary studies, I know I have the right to transfer the funds into an RRSP. I can then take the investment portion in my RRSP,” Chartier notes.