Source: http://www.finance-investissement.com/nouvelles/produits/un-reee-de-26-000-enti-rement-financ-par-l-tat-ou-presque/a/43166

How to Build a $26,000 RESP Financed Entirely by Government (Kind of)

08/07/2012 - 08:14 - GUILLAUME POULIN-GOYER

POST-SECONDARY FUNDING – With the help of government, the parents of newborns can build up a Registered Education Savings Plan (RESP) that will be worth over $26,000 when their child turns 18, without having to pay a single cent—or nearly so.

All they have to do is to take the $100 they receive monthly from the federal government (until the child turns six) thanks to the Universal Child Care Benefit (UCCB) and transfer it into an RESP, says Fabien Major, who recently detailed a strategy along these lines on his blog.

For each dollar contributed by the parent, the federal and provincial governments add grant money amounting to $0.20 and $0.10, respectively. For the total contribution of $7,200 ($100 times 12 months, multiplied by 6 years) invested in this manner, the governments will contribute $1,440 and $720, respectively, for a total of $9,360.

Lower-income families may even be eligible for an additional grant, the Canada Learning Bond (CLB), up to a maximum of $2,000, Major explains.

Let's say your clients are not eligible for this grant but they receive the other ones. If they invest the amount from the UCCB into an RESP every month between the child's birth and age six and allow the funds to grow at an annual rate of return of 7%, Major's calculations suggest these will accumulate to $26,553.

"A reader of my blog wrote to me and told me I was taking it too far with the 7% figure. It's true that there won't be a lot of investments paying 7% this year. But looking at the long term, I found a fund package that has generated annual returns of 7% over 15 years. For example, the TD Canadian Bond Fund has paid 7.75% per year, net of fees, over the past 20 years," Major explains.

The idea came to Major from conversations he'd had with parents he knew. "Over 75% of them tell me they intend to put the $100 monthly payment into a bank account and give it all to their child at age 18. In my view, that was wasteful."

Plan for taxes

Fabien Major's strategy doesn't explicitly account for taxation. The UCCB is a form of taxable income that gets added to parents' income and benefits. "The parent has to accept the tax, but it's a negligible amount on the total. What also needs to be understood is that if the accumulated funds are handed over to the child and the child then spends the money within a three-year span, the child will not have to pay tax [if they have little or no other income]," Major says.

Dany Provost, tax specialist and Vice President of Planium financial services firm, has two comments about Major's strategy. First, unlike the commonly spread myth, the money withdrawn from the RESP by a student is not without tax consequences. "If the child has high enough income when cashing out their RESP, they may lose some refundable tax credits. These include Quebec's work premium and Solidarity Tax Credit and the federal government's GST Credit. Even if there's no tax to pay, some money will be lost. If the student has no income but receives large tax credits, they may see these diminish. It's not a tax, but a loss of [credit] transfers, in the same way that funds from the Guaranteed Income Supplement are withheld," Provost says.

Second, the UCCB is taxed at the parent's marginal tax rate, Provost explains in an e-mail.

Nonetheless, certain approaches can be taken to reduce this tax bill. The UCCB can be declared by a spouse with lower income, both federally and in Quebec, Provost says. The benefit can also be declared for a dependent child in a single-parent family, but only on the federal level.

Be aware of inflation

Before offering this to a client as a cure-all solution, advisors should inform clients about the erosion of purchasing power entailed by this strategy. Let's take the example of a parent who starts an RESP today. In 18 years, the $26,553 accumulated will be worth $18,590 in today's dollars, assuming an annual inflation rate of 2%.

An error appeared in an earlier version of this article. Information on the impact of UCCB transfers on variations in tax-related items, such as the GST Credit and the Solidarity Tax Credit, was inaccurate and has therefore been removed. We apologise for the error.