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RESPs – What to Do if Junior Stops Studying

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POST-SECONDARY FUNDING — Your client started a Registered Education Savings Plan (RESP) for their child, but the child is not pursuing post-secondary studies. Before worrying about the tax penalties, your client should be made aware of their options:

Wait

RESPs generally have a maximum life of 35 years. The beneficiary of an RESP can use the funds set aside for them until that period expires, says Robert Viau, a financial security advisor in Laval. "A significant portion of those who decide not to pursue post-secondary education at age 16 or 18 end up studying later on when they realize it's in their interest to do so. I myself went back to school at 26, so I know what I'm talking about. Also, RESPs are accepted for a number of vocational diplomas."

Change the beneficiary on the RESP

If the child is dead set against pursuing post-secondary studies, the client may change the beneficiary on their RESP. A number of tax rules apply in these scenarios, and it is best to consult with a specialist.

There is no tax on contributions when the new beneficiary is a sibling of the former beneficiary and is under the age of 31 before the transfer.

Outside of these conditions, a different set of rules applies: upon the change of beneficiary, the contributions paid in the name of the former beneficiary are regarded as having been paid in the name of the new beneficiary on the initial contribution date. If the new beneficiary already has an RESP, this can result in an excess contribution—for example, when the contribution limit of $50,000 per beneficiary is exceeded.

Transferring money between beneficiaries is a simple process if the RESP is a family plan. These plans allow for multiple beneficiaries, on the condition that the beneficiaries are related to the subscriber by blood or adoption.

Additionally, assets can be transferred between RESPs. Once again, a number of rules similar to those outlined above apply.

Cash out the RESP

If the child does not pursue post-secondary studies and no change of beneficiary is made, the contributions are returned tax-free to the subscriber and the grant money is taken back by the governments. “There is no interest payable on grant money returned to the government,” explains Sylvain Chartier, tax specialist and financial planner at National Bank Financial.

The investment income generated by contributions and grants, which the tax authorities call Accumulated Income Payments (AIPs), can be transferred into an RRSP belonging to the subscriber or the subscriber’s spouse, subject to a transfer limit of $50,000.

“If a parent sees that post-secondary education isn’t likely to be in their child’s future, they can terminate their RESP subscription to generate unused subscription rights,” explains Julie Doyon, Senior Director of Tax Services at PwC.

If the client does not have unused contribution room on their RRSP, of if they have an AIP exceeding $50,000, they can expect to pay a supplementary tax of 20% (12% federal and 8% provincial). “At the highest marginal tax rate, this additional tax of 20% can raise the overall tax rate to an enormous 68%!” Chartier explains.

Donate the money to a foundation

If the client wants to avoid this tax on the AIP, they can always make a tax-free donation to a designated educational institution in Canada.