Saving for your child's education without losing any sleep

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With tuition fees averaging $6,373 a year and likely to keep rising faster than salaries, worrying about the cost of a child’s education can cost you a good night’s sleep even before there’s a little bundle of joy to demand a bottle at 3 a.m.

Fortunately, saving for post-secondary education in Canada is easy – thanks to Registered Education Savings Plans, better known as RESPs. If you have kids and you want to help them finance their studies, then setting up an RESP is, quite simply, a no-brainer, says Noel D’Souza, an independent financial planner with Money Coaches Canada.

RESPs: Just do it

There’s plenty to love about RESPs.

First, there’s the free money, notes D’Souza. Thanks to the Canada Education Savings Grant (CESG), RESP contributions are eligible for a 20 per cent top-up of up to $500 per year for a lifetime maximum of $7,200, which can be accumulated by the end of the calendar year in which the child turns 17. Quebec, Saskatchewan, and B.C. also have additional provincial incentives for parents opening RESPs.

Second, there’s the fact that every dollar you put into an RESP grows tax-free. The ceiling for RESP contributions is $50,000 per child, and while that money isn’t tax-deductible as it would be for RRSPs, it does earn interest income on a tax-deferred basis. If you were to put in the maximum contribution and invest the funds, it’s quite possible you’d be looking at over $100,000 by the time Junior heads to college, says D’Souza.

Once it’s time to withdraw the money, double-taxation rules prevent the taxman from touching the share of the funds that constitutes your original contributions, which came from your after-tax income. The rest of the funds – made up of grants and interest income – will be taxed based not on your marginal tax rate but your child’s rate, which will likely be considerably lower.

The third reason to open an RESP is that there are very few downsides. RESPs can be used to finance a variety of higher-education programs, not just university.
And if your 18-year old high-school graduate were to decide that more school really isn’t in the cards, you can withdraw your RESP contributions without any tax consequences.

You'll have to forfeit all government grants, but you get to keep any capital gains and interest income. The catch is that investment income would normally be subject to income tax, plus a steep penalty tax. However, you can work around that by transferring any unused funds from an RESP to your RRSP, provided you have enough contribution room.

Which RESP?

It's hard to go wrong by opening an RESP, but there are many kinds of RESPs out there: Which one is best for you?

There are three types of RESPs: individual, family and group plans. Individual plans, as the name implies, are for a single child. Family plans allow you to save for multiple children in a single account and easily transfer any money left over by one child to other siblings. You can set up both individual and family plans at a bank, a credit union, a mutual fund company or an investment dealer. Group plans, on the other hand, pool your contributions with those of other investors and are offered by group-plan dealers.

Parents should watch out for the fine print that comes with group plans, which have added restrictions and fees, says D'Souza. These plans typically redistribute income from unused RESPs to other participants in the plan, meaning you might lose any investment income on your principal if your child doesn't go school.

"My preference is for the simpler, individual or family plans that you can get at your bank," says D'Souza.

Banks offer a number of investment options for family and individual plans. There are all-in-one solutions for parents who don't have the time, the inclination, or the expertise to constantly monitor and tinker with their portfolio. There are mutual fund RESPs, which provide a comprehensive selection of savings, income, and growth funds. There are also RESP Guaranteed Investment Certificates (GICs), which can have terms ranging from one to five years and provide guaranteed principal and interest. GICs are an ideal option to draw down risk as college enrollment approaches.

Finally, for do-it-yourself investors, some banks may offer No-Fee RESPs where you can choose from a wide range of investments, including stocks, ETFs and mutual funds, with no opening and no annual administration fees.

A post-secondary education is expensive. But with so many good savings options, there's no need to lose sleep over it.