Mackenzie INVESTMENTS

EDUCATION PLANNING GUIDE

RESPs, RRSPs, TFSAs and other financial strategies

Table of contents

The cost of post-secondary studies

Many parents see education as the launching pad to a better career and a better life. But it comes at a cost. The University of Toronto has estimated the costs of one year at university at $21,950. Here's a summary of their calculation:

Tuition* and fees	$6,550
Residence fees, including a meal plan	$11,000
Books and supplies	$900
Personal expenses	$1,000
Spending money (varies per student)	$2,500
Total	$21,950

*Costs will vary depending on the program of study.
(Source: University of Toronto's A Guide for Parents: Student Financial Planning and Support 2011-2012)

And the costs are going up. Over the last decade, university costs have been outpacing inflation. Here is an estimate of the future cost of education for a child born in 2011, using a 3% inflation rate:

University costs for one year (see left)	$21,950
Multiplied by 4 years	$87,800
Assumed annual inflation of 3% over 18 years	$149,500

According to Statistics Canada, the post-secondary education inflation rate was 8.1% a year between 1982 and 2002. Erring on the conservative side and using an inflation figure of 5% and 7% for tuition costs only in the above example, the future cost of education becomes $211,300 and $296,760 respectively!

So, how are you going to fund that degree? Over the next 16 pages we'll explain the five main ways to save.

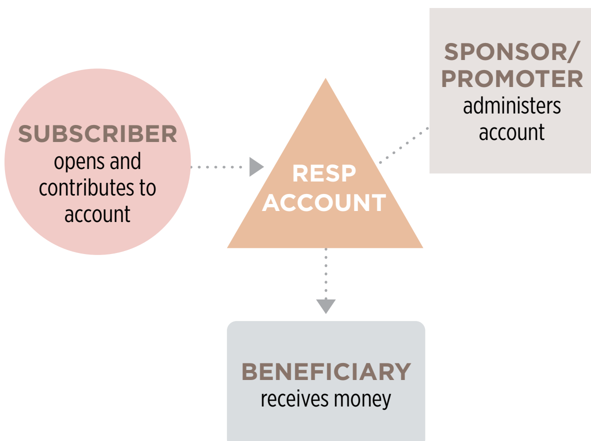
5 ways to fund an education

	What is it?	Advantage	Disadvantage	Contribution limit
1 RESP	Tax-deferred savings account	Tax-deferred growth and government grants (CESG)	RESP rules are complex	Lifetime maximum of $50,000
2 RRSP	Opportunity to withdraw from RRSP through Lifelong Learning Plan	Tax-free withdrawal	Must pay back 1/10 every year after school is completed; otherwise counted as income for the year	Can withdraw $10,000 a year for a total of $20,000
3 Informal trust	A trust account	Income splitting potential; easy to set up	If set up incorrectly, could have undesirable tax consequences	No maximum
4 Formal trust	A trust account created from a trust deed	Income splitting potential; tax treatment is certain	Expensive to set up	No maximum
5 Gifting	Parents give money directly	Cash gift – no tax consequences	Capital gift – must pay tax on disposition	No maximum

1 Registered Education Savings Plans (RESPs)

What are RESPs?

The Registered Education Savings Plan is a tax-deferred savings account, which allows a subscriber to save money for a beneficiary's post-secondary education.



Over the past 10 years, RESPs have undergone significant changes and are now one of the most useful education savings vehicles for children. Although contributions are not tax deductible, earnings accumulate in the plan tax-free. Once paid out, the earnings are taxed in the hands of the beneficiary. Presumably, the child will be in a low tax bracket when the funds are withdrawn, and will therefore pay little or no tax.

To open an RESP account, both the subscriber and beneficiary will need Social Insurance Numbers (SIN).

RESP terms and details

The subscriber: The individual or public primary caregiver* who enters into the RESP contract with a sponsor.

Joint subscribers: Spouses may be joint subscribers to an RESP.

The beneficiary: The individual or individuals whose future education is being funded. Beneficiaries are taxed on any government monies and growth withdrawn for their benefit. Contributions can be withdrawn tax-free. Family plans allow the subscriber to name more than one beneficiary on the plan; otherwise the RESP will have only one beneficiary per plan.

Contributions: The subscriber contributes funds to the RESP account for the beneficiary.

Ownership: RESP contributions always belong to the subscriber.

If subscriber dies: The subscriber's contributions form part of his or her estate and are distributed according to will instructions. The RESP contract can provide for the subscriber's executors, administrators or other legal representatives to continue the plan on behalf of the deceased. If this is the case, the designated person becomes the new subscriber. This person is then responsible for tax on any over-contributions.

If subscriber divorces: The former spouse may acquire the subscriber's rights under a court order and become the new subscriber. If the latter remarries, the new spouse can become a joint subscriber.

*Note: Legislation introduced in November 2005 allows specified corporations (such as Children's Aid Society) to act as subscriber on an individual RESP.

RESP basics

Contribution limit: As of 2007, there is no longer an annual contribution limit but instead, a lifetime maximum contribution limit of $50,000 per beneficiary.

Contribution period: Contributions can be made over a 31-year period, and the RESP must be matured and fully paid out within 35 years after it was established. For disabled beneficiaries, termination can be extended to 40 years.

Withdrawal of principal amount: The principal contributions to an RESP are not tax-deductible and can be withdrawn tax-free any time.

Tax-deferred growth: The growth (capital gains, dividends and interest income) in the plan remains tax-sheltered for the life of the plan until it is paid out as educational assistance payments to the beneficiary.

Penalty for over-contributions: Over-contributions in excess of the lifetime limit ($50,000) are subject to a penalty tax of 1% per month. Overpayments are based on total contributions made by all subscribers for a beneficiary. If, at month-end, the total contribution made by all subscribers to all RESPs for the same beneficiary exceeds the lifetime limit, every subscriber is liable to pay a portion of the 1% penalty tax. Tax is payable within 90 days of the end of the year in which the overpayment is made.

EXAMPLE **Penalty for RESP over-contribution**

The following contributions were made on behalf of 11-year-old Rebecca.

Rebecca's mother (January)	$30,000	57% of contribution
Rebecca's grandmother (May)	$23,000	43% of contribution
	$53,000	100%
Total lifetime limit	$50,000	
Over-contribution	$3,000	
Penalty (May until end of December)	$3,000 x 1% penalty x 8 months = $240	
Rebecca's mother must pay	$137 (57% x $240)	
Rebecca's grandmother must pay	$103 (43% x $240)	

Rebecca's mother is responsible for a greater proportion of the penalty tax even though it was Rebecca's grandmother who caused the overpayment.

Canada Education Savings Grant

The Government of Canada provides further incentive to individuals saving for their children's education through the Canada Education Savings Grant (CESG), introduced in 1998. The government will make a matching grant of 20% of the first $2,500 contributed each year to the RESP. To be eligible, the beneficiary must be under 18 years of age and also have a SIN number.

To encourage lower income families to save, the government provides an additional CESG based on net family income.

Net family income	Additional CESG	Basic CESG	Total
Below $43,561	First $500 x 20% = $100	$2,500 x 20% = $500	$600
$43,561 to $87,123	First $500 x 10% = $50	$2,500 x 20% = $500	$550
Over $87,123	First $500 x 0% = $0	$2,500 x 20% = $500	$500

Figures are for 2012

CESG basics

Grant room accumulates: As of 1998, grant room accumulates for a child regardless of whether he/she is the beneficiary of an RESP.

Maximum lifetime grant: The maximum lifetime grant per RESP beneficiary is $7,200.

Carry forward amounts: If a subscriber does not make a contribution in any one year, unused Basic CESG grant room can be carried forward for use in another year, to a maximum of $1,000 per year.

Maximum annual grant: The maximum contribution available for the CESG is $2,500, resulting in a maximum annual grant of $500 (unless there is a carry forward amount – see above).

Eligibility: Because CESGs began in 1998, only children born in 1998 or later can qualify for the full amount of the grant, unless the child is enrolled in a family plan (plans with several beneficiaries, all of whom are related to the subscriber by blood or adoption).

Family plans and CESG: Family plans provide additional flexibility for the subscriber because the CESGs paid into the plan in respect of one beneficiary, can be re-allocated to other beneficiaries. The ceiling of $7,200, however, still applies to each beneficiary. To ensure that family plans do not provide unintended benefits, no contributions may be made to a family plan in respect of a beneficiary who is added to that plan when that beneficiary is 21 years of age or older.

EXAMPLE **Carry forward of CESG amount** (based on family income of over $87,123)

Year	Grant room added each year	Accumulated grant room	RESP contributions	Basic CESG 20% rate	CESG paid	Carry forward to next year
2010	$500	$500	$0	$0	$0	$500
2011	$500	$1,000 ($500 + $500)	$1,000	$200	$200	$800 ($1,000 - $200)

Donna's daughter Claire is born in March 2010. Donna opens an RESP in 2011 and contributes $1,000.
The government deposits a $200 CESG into Claire's RESP that same year ($1,000 x 20%). So far, her unused Basic CESG grant room that can be carried forward is $800 ($500 for 2010 + $300 for 2011).

Year	Grant room added each year	Accumulated grant room	RESP contributions	Basic CESG 20% rate	CESG paid	Carry forward to next year
2012	$500	$1,300 ($800 + $500)	$2,500 (Donna) $2,500 (Grandmother)	$500 $500	$1,000	$300 ($1,300 - $1,000)

In 2011, Claire's accumulated grant room is $1,300 ($800 from 2011 + $500 for 2012). In February 2012, Donna contributed $2,500 into Claire's RESP and receives a CESG of $500. In May of the same year, Claire's grandmother contributed $2,500 to another RESP on behalf of Claire, and another $500 CESG is paid into the RESP – for a total of $1,000 CESG in one year, which is the maximum grant that can be paid in one year. Claire still has unused grant room of $300 ($1,300 - $1,000) that can be carried forward.

Year	Grant room added each year	Accumulated grant room	RESP contributions	Basic CESG 20% rate	CESG paid	Carry forward to next year
2013	$500	$800 ($300 + $500)	$5,000	$1,000	$800	$0

If Donna contributes $5,000 to Claire's RESP in 2013, the RESP will receive a CESG of only $800, and not $1,000 ($5,000 x 20%). The accumulated grant room for 2013 is $800 ($300 + $500). The additional $1,000 contribution made by Donna in 2013 cannot be carried forward to attract a CESG in a future year.

Special CESG rules for students aged 16 or 17

Beneficiaries who are aged 16 or 17 will receive a CESG only if:

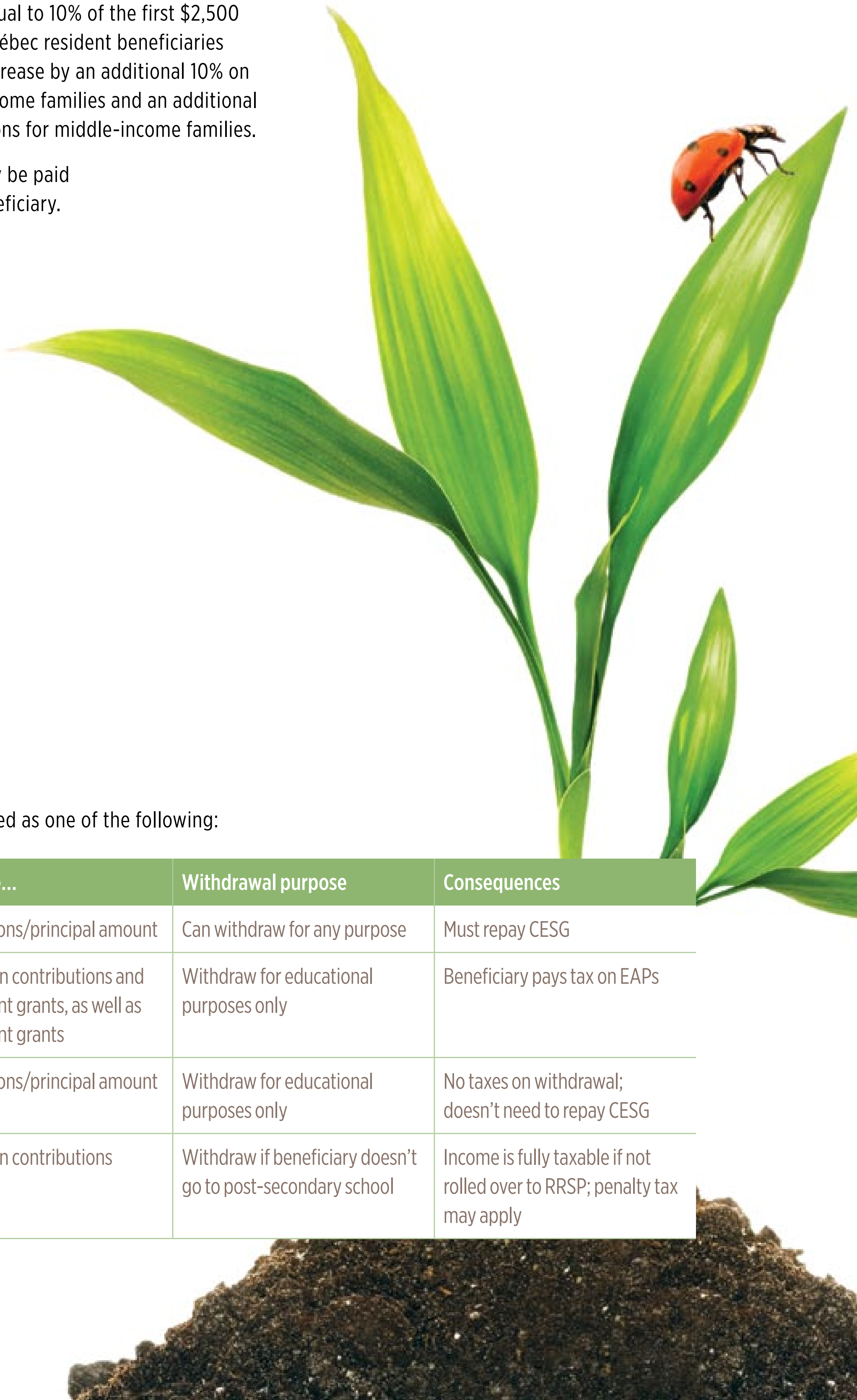
- Contributions to all RESPs made in respect of the beneficiary totalled at least $2,000 before the year in which the child turns 16 years of age; or
- If there were contributions made in respect of the beneficiary of at least $100 per year in any four years before the year in which the child turns 16 years of age.

Québec Education Savings Incentive (QESI)

In 2007, the Québec government announced changes that would provide a greater incentive for Québec families to use RESPs as an education savings vehicle for their children. Like the federal CESG, Québec will offer a refundable tax credit, paid annually, into an eligible beneficiary's RESP based on contributions and family net income.

More specifically, the tax credit will be equal to 10% of the first $2,500 of annual contributions to an RESP for Québec resident beneficiaries under the age of 18. The tax credit will increase by an additional 10% on the first $500 of contributions for low-income families and an additional 5% on the first $500 of annual contributions for middle-income families.

The lifetime maximum tax credit that may be paid into an RESP is limited to $3,600 per beneficiary.



Withdrawals

Withdrawals from an RESP can be classified as one of the following:

Types of withdrawals	Which are...	Withdrawal purpose	Consequences
Refund of contributions	Contributions/principal amount	Can withdraw for any purpose	Must repay CESG
Educational assistance payments	Earnings on contributions and government grants, as well as government grants	Withdraw for educational purposes only	Beneficiary pays tax on EAPs
Post-Secondary Education Capital Redemption	Contributions/principal amount	Withdraw for educational purposes only	No taxes on withdrawal; doesn't need to repay CESG
Accumulated income payments	Earnings on contributions and grants	Withdraw if beneficiary doesn't go to post-secondary school	Income is fully taxable if not rolled over to RRSP; penalty tax may apply

Refund of contributions

What are refunds of contributions? A subscriber can withdraw contributions at any time for non-educational purposes.

What are the restrictions?

- Any contributions made before 1998 that are removed from a plan that has received a CESG will generally attract a CESG repayment equal to 20% of the amount withdrawn (with a ceiling equal to the total of CESGs received to date in the plan).
- Contributions made to any RESP during the remainder of the year of withdrawal, or in the following two years in respect of such beneficiaries, will not be eligible for the grant. In addition, the beneficiaries will not accumulate CESG contribution room for the specified period.

When don't the restrictions apply?

- The total withdrawals of contributions in the year are $200 or less
- There is an eligible transfer to another RESP
- The withdrawal is to reduce an over-contribution position

EXAMPLE **Family plan and CESG repayment**

Barbara sets up a family plan for her three children: Alison, Scott and Elizabeth. For the years 2003 through 2010 inclusive, Barbara contributes $6,000 to the family plan ($2,000 on behalf of each beneficiary).

Each year $1,200 ($6,000 x 20%) of CESGs is paid into the plan for a total of $9,600 of CESGs after 8 years. In 2012, Scott goes to university, but Alison and Elizabeth decide to open their own business, and not to pursue post-secondary education.

Scott is able to receive all of the investment earnings in the plan; however, he is only entitled to $7,200 of the CESGs. The remaining $2,400 must be repaid to the government.

Common questions about Educational Assistance Payments

What are they? Educational Assistance Payments (EAPs) are amounts paid out to a beneficiary once that beneficiary is enrolled full-time or part-time at a designated educational institution. They consist of the earnings on the contributions, the earnings on the grants, and the grants themselves. They do not include principal contributions, which always belong to the subscriber.

Are there restrictions on payout amounts? EAPs made during the first 13 weeks of a beneficiary's education will be limited to a total of $5,000. After the beneficiary has completed 13 consecutive weeks of a qualifying educational program, the beneficiary will be permitted to receive any amount of EAPs.

How much is paid out? The subscriber decides how much is to be paid out in respect of each beneficiary, and can specify what part of the payment is income and capital.

How much of it are the grants? A specific portion of each EAP will be considered attributable to grants paid into the plan, based on the ratio of grants paid into the plan to total investment earnings in the plan.

What's the maximum grant payout? A maximum of $7,200 of Canada Education Savings Grants per beneficiary can be paid out. This limit is relevant to beneficiaries only where CESG money is "shared" with other beneficiaries, for example in family plans. In this regard, each RESP will be required to limit to $7,200 the total portion of EAPs paid as CESGs.

Post-Secondary Education Capital Redemption

What is a PSE? A Post-Secondary Education Capital Redemption is a withdrawal made from the principal amount. As long as the money is used for educational purposes, the CESG does not need to be repaid.

Accumulated Income Payments

If a beneficiary named by a subscriber does not pursue higher education, and no replacement beneficiary has been named, the subscriber may receive the investment income under certain conditions.

What is an Accumulated Income Payment? An AIP is a payment to a subscriber from earnings on the contributions and earnings on the grants. They do not include contributions since principal contributions always belong to the subscriber. They also do not include grants since grants would generally be returned to the government.

When can subscribers take AIPs?

- The plan must have been in existence for at least 10 years
- All beneficiaries must be at least 21 years of age and not pursuing higher education
- The subscriber must be resident in Canada

CRA will have the discretion to waive the "10-year" and "age 21" conditions for paying AIPs where a beneficiary has either died or suffers from a severe and prolonged mental impairment that prevents him or her from pursuing qualified education.

What are the tax consequences? When withdrawn, the AIP is fully taxable at the subscriber's marginal tax rate.

Can the subscriber avoid the tax consequences? The subscriber may choose to transfer this AIP to his or her RRSP or to a spousal RRSP, if the subscriber has enough RRSP room to absorb the amount of the transfer. The maximum amount of AIP that can be transferred to an RRSP to avoid penalty tax is $50,000 per subscriber. Furthermore, the RESP must be wound up by March 1 of the year following the first AIP. A transfer of an AIP to an RRSP will not require any withholding tax by the sponsor, provided that the following form is filled out:

- CRA Form T1171 "Tax Withholding Waiver on Accumulated Income Payments from RESPs" – For a copy, please visit *www.cra-arc.gc.ca/E/pbg/tf/t1171*

What if the subscriber does not have sufficient RRSP room? All or part of the AIP can be taken as cash, subject to the following rules:

- The AIP received will be included in the income of the subscriber for that year, and regular tax will be paid by the subscriber at his or her marginal tax rate
- The AIP will be levied a penalty tax of 20%
- The grant must be repaid to the government

If a subscriber does not have any additional RRSP contribution room, AIPs may be subject to tax from 56% to 70%, depending on which province or territory the subscriber lives in.

Qualifying programs

A qualifying educational program is defined as post-secondary and is offered by a recognized educational institution. The program must run no less than three consecutive weeks if in Canada; outside Canada, the minimum is 13 weeks. Furthermore, a full-time student must spend at least 10 hours a week on courses or work in the program. Although there is no specific list of schools yet developed by the government, the following may qualify:

- Universities inside and outside of Canada
- Community colleges
- Vocational and technical colleges and institutions certified by Human Resources and Skills Development Canada (HRSDC) to help individuals develop skills for a particular occupation. Subscribers should contact CRA to confirm eligibility

Residency rules

Subscriber

The subscriber does not have to be resident in Canada when the plan is opened or when contributions are made; however, he or she must be resident in Canada to receive an AIP.

Beneficiary

Beginning in 2004, the beneficiary must be a resident in Canada when the plan is opened, when contributions are made, or to receive EAPs, and they must have a valid Social Insurance Number. Non-residents receiving an EAP from a pre-existing plan will generally be subject to a 25% withholding tax. However, a beneficiary must be a Canadian resident to receive grant money. Furthermore, the beneficiary must be resident in Canada at some time during the year to qualify for grant room in that particular year.

RESP PLANNING STRATEGIES

STRATEGY 1

Consider the options available to maximize the value of the RESP

Since the annual RESP contribution limit has been removed and the lifetime maximum limit has been increased to $50,000, many people have wondered whether it is better to:

- Make an initial lump sum $50,000 RESP contribution (and thus forfeit all future CESGs), or
- Maximize the grant of $7,200 by spreading out the annual contribution over 15 years (It will take 14.4 years to obtain the maximum CESG of $7,200 when annual contributions of $2,500 are made).

The answer to this question is best answered with examples to support the various options available.

EXAMPLE

Lee, 38, is beginning her peak earning years and has a daughter Sara, who was born in 2011. She wants to set aside money for Sara's education and wants to know how to best maximize the savings for educational purposes. She knows that if she contributes the maximum limit of $50,000 today, she will collect the $500 CESG for this year and benefit from many years of deferring tax on the investments. At the same time, she will forego all future CESGs. Her second option is to spread the same $50,000 investment over the life of the RESP and collect the maximum CESG possible. With the help of her financial advisor, she reviews both options:

1) Make an initial contribution of $50,000 (the maximum) to the RESP

Lee makes an initial contribution of $50,000 and attracts the $500 CESG for the current year, which was paid into Sara's RESP. Assuming a 5% annual rate of return, the value of Sara's RESP at age 18 is equal to $121,534.

2) Spread the $50,000 over 18 years and collect the CESG

Lee invests the $50,000 into an In Trust For (ITF) account (see p. 16 for details) with Sara as the beneficiary of the plan. Each year, $2,500 is transferred from the ITF into an RESP (where Sara is named as a subscriber and beneficiary) to take advantage of the annual CESG until the maximum CESG is paid (at age 14). Under this option, Sara will collect the maximum $7,200 CESG and the value of the RESP after 18 years is equal to $108,370. However, after 18 years the value of the ITF account will be equal to approximately $109,500. Therefore, the combined value of the RESP and ITF account is $217,870 ($108,370 in the RESP plus $109,500 in the ITF account).

In this case, Lee is better off investing the lump sum of $50,000 into an ITF account and transferring money into the RESP on an annual basis in order to collect the CESG.

Note: This analysis assumes investments in the ITF account comprise of 100% deferred capital gains. In addition, both options allow the income to be taxed in Sara's hands and it is assumed that Sara has no other sources of income and is able to shelter any RESP income and/or capital gains from the ITF from tax due to claiming the basic personal exemption.

STRATEGY 2

Consider investing in both an RESP and a Tax-Free Savings Account (TFSA)

As illustrated in Strategy #1, in order to maximize the value of education savings, it may be best to invest the lump sum of $50,000 into a non-registered investment and transfer enough money into an RESP on an annual basis to collect the maximum CESG. However, those who do not have the financial resources to implement this strategy may consider investing in both an RESP and a Tax-Free Savings Account (TFSA). Therefore, a parent may consider contributing at least $2,500 per year (to collect the maximum annual CESG of $500) and any additional funds (up to $5,500 (2013) per year) into a TFSA. Since a TFSA cannot be established for a minor, the parent will be the TFSA plan holder and could earmark some or all of the TFSA assets for the child's education savings.

The benefits of this strategy are:

- The individual will receive the benefit of the CESG, which is only payable on the first $2,500.
- The additional funds contributed to the TFSA provide increased flexibility. The investment income and withdrawals from a TFSA are tax-free. Withdrawals from the TFSA create additional contribution room in the subsequent taxation year.
- The funds in the TFSA can be used for non-educational purposes such as a down payment on a home.
- When the child reaches age 18 and begins to accumulate TFSA contribution room, the parent could choose to withdraw from their own TFSA to fund the child's TFSA. This allows the child to build up additional funds as well as provide the parent with more TFSA contribution room in the future.

How to invest in an RESP and a TFSA:

RESP	Tax-Free Savings Account
• Investments compound on a tax-deferred basis • Hold tax-disadvantaged investments, e.g., investments that generate highly taxed investment income such as interest and/or foreign income • Bonds, GICs • Longer-term investments	• Investment income and withdrawals are tax-free • Withdrawals create additional TFSA contribution room • Hold tax-disadvantaged investments, e.g., investments that generate highly taxed investment income such as interest and/or foreign income • Bonds, GICs • Depending on intentions for this account, shorter-term or more liquid investments to allow flexibility

Before any investments are purchased, it is important to prepare an overall investment plan and determine the risk tolerance. Once the investor's asset allocation is determined, the appropriate investment vehicles can be purchased and allocated in a tax-effective way between the RESP and the TFSA.

STRATEGY 3

Register the RESP with joint subscribers

It is recommended that the RESP be made joint with a spouse, primarily for one benefit:

If none of the beneficiaries pursues post-secondary education, the subscribers can transfer the AIPs to either or both spouses' RRSPs, based on their combined RRSP contribution room. The transfers to the RRSP do not need to be in equal amounts to each of the spouses. There is a limit of $50,000 per subscriber that can be transferred to an RRSP if there is contribution room available.

(Note: Subscribers on RESPs should **not** be U.S. persons for tax purposes, as Grants, Bonds and growth are taxed annually on a U.S. tax return.)

STRATEGY 4

Spread AIPs over two years

As discussed earlier, a subscriber (and spouse) can transfer, in certain circumstances, an Accumulated Income Payment (AIP) from an RESP to an RRSP, if there is sufficient room in the RRSP. If these payments are not sheltered from tax, they may be subject to tax at rates from 56% to 70%, depending on which province or territory the subscriber lives in. If a subscriber and/or spouse are expecting to receive accumulated income payments from an RESP within the next few years, the following strategies are suggested:

- The subscriber and his or her spouse should consider not making any RRSP contributions in the year or two leading up to the AIP. This will build up some RRSP contribution room, which can be used to absorb some or all of the AIP.
- As mentioned previously, an RESP must be terminated before March 1st of the year following the year of the first AIP. It is therefore possible and advantageous to spread an AIP over a two-year period. If the subscriber has no RRSP contribution room, the AIP can be spread out over a two-year period to take advantage of graduated marginal tax rates. If the RESP is joint with a spouse, the spouse with the lower tax rate can report the AIP. The AIP does not need to be equalized between spouses. If the subscriber is transferring the AIP to his or her RRSP, a transfer over two years may allow the individual to generate new RRSP contribution room in the second year.

EXAMPLE

In 1995, Peter and Gail established a joint RESP for their daughter Kelsey. Kelsey turned 21 in 2011, and decided that she was not going to pursue post-secondary education. The total income in the plan is $22,000. Peter and Gail decide to transfer the AIP of $22,000 to their RRSPs. Both Peter and Gail have a 50% marginal tax rate. Their combined contribution room for 2011 is only $12,000. If they take the full AIP in 2011, only $12,000 will be transferred to their RRSPs. The remaining $10,000 will be subject to tax at their marginal rate of 50% plus a penalty tax of $2,000 ($10,000 x 20%). To avoid this penalty tax, Peter and Gail can spread their AIP over a two-year period and take only $12,000 in 2011. Because they are still working and earning RRSP room, they will generate additional RRSP room of $12,000 in 2012. This will enable them to take a second AIP of $10,000 before March 1, 2012, and thus they will avoid tax completely on the full $22,000 AIP.

STRATEGY 5

Open a new plan (after 1998)

If an individual already has an existing RESP, which was opened before 1998, it may be a good strategy to open a new RESP plan for the following reason:

If the money is withdrawn as an AIP, it will trigger a repayment of the grant. Grants must be repaid if the funds are not used for educational purposes. However, if two RESPs are opened, the RESP opened before 1998 will not include any grant monies and, therefore, will not be "tainted" with contributions made in 1998 or later, which do generate grant money. Contributions to an RESP opened before 1998 are called "unassisted" contributions and contributions made to an RESP opened in 1998 or later that received a grant are called "assisted" contributions. If two plans are opened – one with the pre-1998 unassisted contributions and one in 1998 or later with assisted contributions – an individual can withdraw from the unassisted plan and not trigger a grant repayment. If there is only one RESP plan however, a withdrawal will be deemed to come out of the "assisted" contributions and thus trigger the grant repayment.

STRATEGY 6

Coordinate RESP contributions with other subscribers

It is important to be aware that contributions in respect of a beneficiary must not exceed the maximum limits, otherwise the penalty tax is imposed (refer to example above on over-contributions). To avoid this potential tax, subscribers must ensure that they coordinate and track their contributions with other subscribers.

STRATEGY 7

Contemplate the use of an RESP for an adult to attend school

An RESP can be used by an adult to save money, on a tax-deferred basis, if he or she is seriously contemplating school at some point in the future. There is no upper age limit for beneficiaries on individual plans. This strategy makes sense when an individual has already maximized his or her RRSP contributions, and wants to use an RESP to save additional monies tax-free. Of course, the grant is not available to an adult; however, for those who are certain that they will return to school one day, this could be a good strategy. Note, however, that an RESP cannot remain open for more than 35 years, or 40 years for disabled beneficiaries.

2 RRSPs: Lifelong Learning Plan

What is the Lifelong Learning Plan?

Lifelong learning is important today to preserve future income. Some individuals may have limited resources to spend for retraining, and their most readily available source of funds is their RRSP.

The federal budget of 1998 announced an education funding plan called the "Lifelong Learning Plan", and since 1999, RRSP withdrawals have been allowed for education purposes and skills enhancement. Eligible individuals can make tax-free withdrawals from an RRSP (other than a locked-in RRSP) to finance full-time training or education for themselves or their spouses.

Rules pertaining to the Lifelong Learning Plan

- **Withdrawal limit:** Individuals can withdraw a maximum of $10,000 in a single year from their RRSPs. More than one withdrawal may be made in a given year from any number of RRSP accounts, provided that the annual limit is not exceeded. The total amount withdrawn from the RRSP must not exceed $20,000.
- **RRSP owner:** Either the student using the funds, or his or her spouse, must be the owner/annuitant of the RRSP.
- **Full-time program only:** The withdrawals must be used to finance "full-time training or education" for the annuitant or his or her spouse. The enrolment must be a qualifying educational program of at least three month's duration, at an eligible institution.
- **Disabled student:** A disabled student, who is entitled to the disability amount, may qualify as a student under the plan, whether or not he or she is studying on a full-time basis.
- **Repayment rules:** RRSP withdrawals must be repaid over a 10-year period, without interest, in equal or greater installments to any RRSP in which the recipient is the annuitant. The first repayment must be made no later than 60 days after the fifth year following the year of the first withdrawal. Amounts not repaid must be included in the annuitant's taxable income in that year.
- **Participation frequency:** There is no specific limit on the number of times an individual may participate in the plan. However, an individual may not participate in a new plan before the end of the year in which all repayments from any previous participation have been made.
- **Canadian residents only:** Recipients under the plan must be Canadian residents. Amounts outstanding will generally be included in income for the year if the recipient dies or becomes a non-resident of Canada.
- **RRSP deduction:** No deduction will be allowed for an RRSP contribution made less than 90 days before its withdrawal under the plan. Due to this, any existing pre-authorized contribution plans should be suspended until after the LLP withdrawal.

Who can benefit from the Lifelong Learning Plan?

- A student who has had good summer jobs for several years, and has contributed annually to his or her RRSP (or whose parents have contributed on his or her behalf).
- A child who works in a family business and has earned income each year to allow for RRSP contributions.
- A person who has been in the workforce and is going back to school to enhance his or her career.

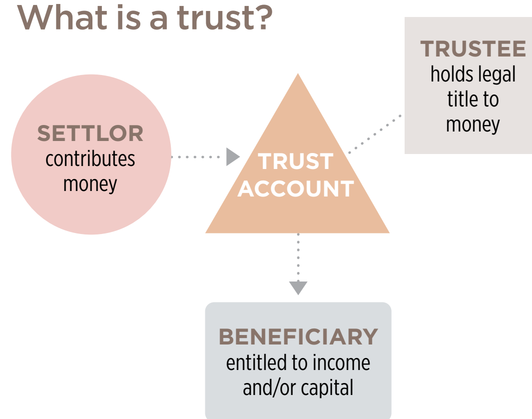
3 Informal trusts

What are informal trusts?

Informal trusts are set up with financial institutions. Typically, the accounts are created in the name of the parent (the settlor) "in trust" for the particular child (the beneficiary). A minor child cannot be legally bound to a financial contract, so the parent enters into the contract on behalf of the child. As well, an adult (the trustee) generally makes all the investment decisions on behalf of the child.

There is no legal requirement that the settlor and the trustee be different people. For example, a parent could simply declare and document that he or she is holding funds in trust for his or her children, and a trust would thereby be created.

What is a trust?



A trust is an arrangement whereby one or more persons (the trustees) hold legal title to property (the trust property) for the benefit of other persons (the beneficiaries).

The person who creates the trust is called the settlor, or the contributor.

Investment income splitting potential

The main purpose of an informal trust is to set aside funds for the benefit of the child to use at a future date once that child has reached the age of majority. This strategy accomplishes income splitting in two ways:

1. All primary interest and dividends are attributed back to the contributor. Capital gains and secondary income are taxed in the hands of the child

- Put growth-oriented investments in the trust. Because growth-oriented investments typically do not generate interest or dividend, it's advantageous to invest in such types of investments in the trust. When growth-oriented investments are sold, the result is a realized capital gain, of which only 50% is taxable.
- Take capital gains periodically. By crystallizing capital gains from time to time, any potential tax liability is absorbed by the child's personal tax credits. For the year 2013, a child with no other income will have a basic personal credit of $11,038, which will cover $22,076 in capital gains ($22,076 x 50% = $11,038).

2. When investments are sold, the child pays tax on capital gains

The earnings in the trust are usually not paid out to beneficiaries until college or university. When the student needs money for college or university, the investments in the trust (e.g., the mutual funds or individual stocks) can be sold for the purpose of giving the money to the child for educational payments.

The sale of these growth-oriented investments results in a capital gain for tax purposes, of which only 50% is taxable. In the year of the sale, the student must report this capital gain on his or her tax return. As illustrated at left (see heading "Take capital gains periodically"), assuming the student has no other income, more than $22,000 in capital gains can be realized tax-free on a yearly basis for education. Accordingly, tax that otherwise would have been paid on the growth of the investments inside the trust, may be eliminated entirely.

Note that, if the funds deposited into the ITF account originally belonged to the child (e.g., the Canada Child Tax Benefit, or income earned through babysitting or paper routes), the attribution rules do not apply and income is taxed in the hands of the child. It is important to keep separate accounts for these funds and to maintain proper documentation showing the origination of the funds.

Advantages of informal trusts

- Easy to set up at any financial institution
- No costs to set up the informal trust
- No minimum or maximum investment criteria. (The minimum investment varies depending on the investment vehicle used. For example, Mackenzie Investments mutual fund investments require an upfront investment of $500 and minimum additional investments of only $50.)
- No restrictions on the types of investments that can be made in the trust (in contrast to RRSPs for instance, where there are investment restrictions)

EXAMPLE **How an informal trust is set up**

Suzanne uses an RESP to save for her 11-year-old daughter Amanda's education but would like to set aside another $2,000 each year in an informal trust. After consulting with her financial advisor, she does the following:

- At her financial institution, Suzanne sets up an informal trust account as "Suzanne Smith, in trust for Amanda Smith".
- Suzanne names her husband as the trustee on the account (to manage and make all investment decisions) so that the contributor is not also the trustee on the account.
- Suzanne, as the contributor, sets up a pre-authorized chequing plan to automatically transfer $166 monthly from her bank account into the informal trust account.

Disadvantages of informal trusts

- **Improper set-up means contributor must pay all taxes**

  The contributor must adequately show that there has been a true transfer of property, otherwise the Canada Revenue Agency (CRA) could demand that the contributor pay tax on all investment income, including capital gains and secondary income.

  Set up the informal account so that the contributor, the trustee and the beneficiary are three different people. Also, the contributor should refrain from exercising any control over the investment decisions on the account.

- **Assets belong to child at the age of majority**

  When the child reaches the age of majority, that child is legally entitled to claim control of the trust assets, and can use the money as he or she pleases – for example, to buy a new car or to travel.

- **Divorce, death, bankruptcy**

  If a beneficiary dies without a will, the ITF account will be distributed according to the laws of that province. If the trustee dies, a successor trustee will have to be appointed if one is not named in the will. Divorce and bankruptcy can put the ITF account in jeopardy. Legal advice is needed.

- **Potential tax liability**

  Tax liability could potentially arise from informal trust accounts. At the time of writing, CRA had not reassessed on these accounts, and there is little to suggest that it will reassess on a widespread basis. Nevertheless, the potential risks are something to bear in mind.

4 Formal trusts

What are formal trusts?

Unlike an informal trust, a formal trust is created by a legal document known as a trust deed, which identifies the settlor, the trustee(s) and the beneficiaries. The trust deed also specifies how the assets are to be managed, how long the trust will exist, and when the assets (income and capital) are to be paid out to the beneficiaries.

Formal trusts are relatively expensive to set up, as they require the expertise of a lawyer in drawing up the trust deed. Here, we discuss inter vivos trusts, which are trusts that are set up during a settlor's lifetime (as opposed to testamentary trusts, which are established through a will). Inter vivos trusts pay tax at the top marginal rate in each province or territory. Clients considering a formal trust should obtain independent tax and legal advice.

Investment income splitting potential

For purposes of this section, formal trusts will be discussed as they apply to setting aside funds for a child's future education. The attribution rules apply to formal trusts. The tax treatment on the trust earnings is as follows:

- The interest and dividends, whether or not they are actually distributed to the children, are taxed in the hands of the settlor.
- Distributed capital gains (gains paid out to minor children) are taxed in the hands of the minor child. As illustrated earlier, for 2013 over $22,000 can be absorbed by a child's personal credits, assuming that the child has no other income.
- Undistributed capital gains will be taxed in the trust at the highest marginal tax rate (excluding provincial surtaxes).
- Secondary income arising from previous distributions of interest, dividends or capital gains to the child will be taxed in the hands of the child.

Advantages of formal trusts

- The trust assets are controlled by the trustee; if structured correctly, there is no risk of a child obtaining the rights to the assets at the age of majority (and using, for example, assets for non-educational purposes).
- The assets in the trust do not form part of an individual's estate and, therefore, no probate fees are paid on these assets on death.
- Income splitting is possible.
- Potential problems with CRA are eliminated – there is certainty as to the treatment of trust income.
- The existence of a trust deed ensures that the settlor's wishes are carried out.

Disadvantages of formal trusts

- Set-up costs, which vary according to complexity.
- There is limited opportunity for income splitting, because capital gains that are not distributed to minor children are taxed in the trust at the top marginal rate.
- The settlor, upon transferring property to a formal trust, loses control of that property. The trustee has legal title to the property.

5 Gifting

If parents have enough money, they can simply give money to their child once that child enters university.

Tax consequences

Here are the tax consequences of gifting to an adult child for education:

Capital property: If property other than cash is transferred to the child, there will be tax on the disposition of that property. The parent is deemed to have disposed of the property at its fair market value (FMV) and will be responsible for paying tax on any accrued gains since the property was acquired. There is no ongoing tax liability on any income or capital gains generated from the property that is now in the child's hands.

Cash: In the case of a gift of cash to a child 18 years or older, there is no capital gain, so there are no immediate tax consequences associated with this gift. Furthermore, there is no ongoing tax liability arising from the income on that cash gift, except in the hands of the recipient.

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