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Are you getting the most out of your RESPs?

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Education savings plans can mitigate tuition but add to tax headaches

Convinced that a registered education savings plan was the best way to save for her child's future, Lisa Nabieszko opened one shortly after her daughter was born in 1999.

Twelve years later, Ms. Nabieszko says she has since had problems with the account, which has lost money in market downturns.

"I really believe in RESPs," says the Toronto freelance consultant. "My big challenge was finding a place to move my RESP to ... where my principal would be protected."

RESPs, investment accounts to save for your kids' college or university tuition, can be topped up by grants from the government and grow tax-free. They have been around in their current form since 1998.

Mike Holman, the author of *The RESP Book [http://www.moneysmartsblog.com/resp-book-education-savings-plans-canadians]* and writer of the Money Smarts blog [http://www.moneysmartsblog.com], says that since more kids with bigger accounts have started attending post-secondary education, withdrawing from RESPs has emerged as a major issue for parents. "When accounts were small, there was not enough money to cause problems. But people with larger accounts might run into tax issues," he says.

Despite the 13-year run of RESPs, there is still plenty of confusion around how they work. Independent financial planner Rona Birenbaum says RESPs are popular with her clients, who don't want their kids to graduate with the burden of debt.

Their appeal lies with not with their tax-sheltering aspect, but with the government grant. "When people understand that that they get a 20 per cent gift from the government," she says, "it becomes a no-brainer."

But many RESP investors think the money must be used solely for tuition, to pay for university or college, and that's a huge source of confusion, says Ms. Birenbaum. In fact, as long as people can provide evidence that their child is enrolled in an eligible institution, the money can be used for any aspect of their support, including lodgings, books, technology needs or travel.

Parents, she adds, do not need to hang on to receipts: "The Canada Revenue Agency is not auditing every single expenditure they will make with money from their REPS. They acknowledge that parents will be responsible for using this money for a wide range of needs."

Some investors don't know that the last year to make an RESP contribution is when their child is 17, while others are under the mistaken impression that a contribution to an RESP will generate a tax refund for them, Ms. Birenbaum says. In reality, the government money is never in your hands - it goes straight into the RESP.

Other parents, like Ms. Nabieszko, struggle to figure out how to invest their RESP funds and where they can and cannot open an RESP account. "I would go to websites for different banks, try to find out who offers them and who did not. That became an exercise in frustration."

Mr. Holman says most financial institutions offer RESP accounts, but others, including ING and PC Financial, do not.

His advice for parents is to make sure the RESP is invested in safe investments such as GICs, high-interest savings accounts, short-term bond funds and money-market mutual funds.

"When your child is young, it is okay to take on some risk and invest in stocks and mutual funds," Holman says. "When the child is about to attend school, there is not enough time to make up any investment losses and the money should be invested in safe securities."

When it comes to withdrawing, some of the money is taxable and some is not, Mr. Holman says, so parents should do their own research and consult a qualified adviser.

Other useful things to know are that withdrawals can be made before your child starts classes and that as long as he or she is still eligible for grants, you can continue to make contributions and receive grants in the RESP account, even while doing withdrawals.

Top four RESP misconceptions

1. RESP grants are only available for families with very low incomes
Wrong. The income thresholds for these grants are surprisingly high. If your family's net income is $83,088 or lower, you might be eligible for additional RESP grants.

2. Only parents can open an RESP account for their child
In fact, RESP accounts can be opened by anyone, even if they are not related to the child. Permission from the parent is needed by the parent, though, for someone else to open an account.

3. RESPs are just for full-time college or university programs
Actually, RESPs can be used for a wide variety of trade or business schools. Part-time education is also eligible. Click here [http://www.canlearn.ca/eng/saving/resp/program.shtml] for a list of eligible institutions.

4. Contribution room is determined by birthday
Contribution room is actually determined by calendar year. If a child is born on the last day of 2010, they will be eligible for $500 of RESP grants for 2010. Once 2011 rolls around, they are eligible for another $500 of grants for 2011. The last day a child is eligible for an RESP grant is December 31st in the year during which they turn 17 years of age.

5. Siblings can only share RESP money in a family RESP
Not true. Siblings can share RESP money between individual accounts if the account subscriber is the same on both accounts.

Financial blogger Mike Holman.