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Registered Education Savings Plans: Then and Now

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Registered Education Savings Plans: Then and Now
(Background Paper)

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REGISTERED EDUCATION SAVINGS PLANS: THEN AND NOW

1 INTRODUCTION

The federal government officially created the Registered Education Savings Plan (RESP) program in 1974. Since then, there have been numerous changes to the program, increasing its popularity and encouraging Canadians to save more for their children's post-secondary education.

This background paper highlights the key changes to the RESP program since its inception, along with the rationales and discussions surrounding these modifications. It then summarizes the current program and presents an overview of provincial education savings incentives, as well as the key results achieved since the introduction of RESPs.

2 HISTORY

2.1 1972–1974: Recognition as a First Step

In 1972, the Tax Review Board sided with a taxpayer, Jack Harvie Quinn,[1] ruling that he did not have to treat as income the interest from an investment he placed in a trust account managed by the Canadian Scholarship Trust Foundation.[2] This trust account was intended to fund his son's post-secondary education.

The federal government appealed to the Federal Court, which upheld the decision.[3] In his award, Justice Heald determined that the interest should not have been included in Mr. Quinn's taxable income since he had never received it within the meaning of the *Income Tax Act* (ITA),[4] and that he did not have absolute ownership of it because it was subject to a contractual restriction.[5] Although the amount in question was minimal ($110 for the 1970 tax year), the federal government took the matter to court, since almost 40,000 taxpayers were in a situation similar to Mr. Quinn's, and their total investments were valued at over $26 million, including accrued interest of over $6 million.[6]

In light of the Federal Court ruling, the government had two options: either accept the ruling or amend the ITA in order to treat this accrued interest as taxable income.

2.2 Official Creation

The government eventually decided to incorporate RESPs into tax legislation, retroactively to 1 January 1972, through Bill C-49, An Act to amend the statute law relating to income tax, introduced at first reading in the House of Commons on 20 December 1974. The bill took into account Justice Heald's determination in *Canada v. Jack Harvie Quinn*.

The basic structure established at that time is still in place today: the subscriber enters into a contract with a promoter to save in order to finance a beneficiary's post-secondary education by making contributions that are held in a tax-free trust account.[7] While the subscriber cannot deduct contributions on his or her tax return in the year they are made, they are tax-free when paid to the beneficiary or, if not paid to the beneficiary, when they are repaid to the subscriber. However, the realized return (just like government contributions established later) must be included in the beneficiary's taxable income for the year in which the withdrawal is made.

2.3 Key Changes to Registered Education Savings Plans Since Their Creation

2.3.1 1996: Increased Annual and Lifetime Contribution Limits

On 6 March 1996, during his budget speech before the House of Commons, the Honourable Paul Martin, Minister of Finance, outlined planned changes to the RESP program:

> [T]o encourage parents to save for their children's education over the long term we are proposing to increase the annual limits on contributions to registered education savings plans from $1,500 to $2,000, and the lifetime limit from $31,500 to $42,000.[8]

2.3.2 1997: New Increase to the Annual Contribution Limit and Greater Program Flexibility

In 1997, the government doubled the annual contribution limit from $2,000 to $4,000, with the passage of Bill C-28, Income Tax Amendments Act, 1997.[9]

The bill also amended the ITA to allow a subscriber to transfer the contributions and accumulated return in an RESP to a registered retirement savings plan (RRSP) if the beneficiary does not pursue a post-secondary education.

The Minister of Finance, the Honourable Paul Martin, gave the following rationale for the proposed change:

> [W]e have found that some parents may be reluctant to invest in RESPs because they fear losing their investment if their children do not pursue higher education. Therefore we are allowing individuals to transfer unused RESP income into their RRSPs if they have room.[10]

2.3.3 1998: Introduction of the Canada Education Savings Grant

On 1 January 1998, the federal government officially introduced into tax legislation the Canada Education Savings Grant (CESG), which provided government assistance equal to 20% of new contributions to an RESP, to an annual maximum of $400. This assistance was to be repaid if the beneficiary did not pursue post-secondary education.

In his 1998 budget speech, the Minister of Finance, the Honourable Paul Martin, explained the program, stating:

> As a result of the initiatives we are taking, RESPs will now be among the most attractive savings vehicles available for a child's education. We believe that RESPs will soon come to be considered as essential for future planning as registered retirement savings plans are now.
>
> They represent one of the best things parents can do for their children, one of the best things grandparents can do for their grandchildren – it speaks to the partnership of generations.[11]

However, on 3 February 1998, during debate in the House of Commons, the New Democratic MP for Halifax West, Gordon Earle, raised one of the weaknesses of the CESG:

> While this may be a laudable move, I remind the hon. member [Jerry Pickard, Chatham-Kent—Essex] that many families cannot afford to have RESPs. There are many families in Canada who are living at a subsistence level, yet their children are worthy of education as well.[12]

2.3.4 2004: Introduction of the Additional Canada Education Savings Grant and the Canada Learning Bond

In 2004, the government introduced the Additional CESG and the Canada Learning Bond (CLB).[13] The Additional CESG provided low-income families with additional assistance of between 10% and 20% on the first $500 contribution to an RESP. The CLB offered these families an initial $500 grant and additional $100 grants per year for up to 15 years without requiring a contribution, only the opening of an RESP.[14] However, these grants were repayable if the beneficiary did not pursue post-secondary education.

The introduction of the Additional CESG and the CLB received strong support in the House of Commons, with 273 votes for and only 19 votes against.[15] Conservative MP for York—Simcoe, Peter Van Loan, said the following with respect to the introduction of both measures:

> I am pleased that this bill has the support of the Progressive Conservative Party. We feel that further education is a priority if we are to have a prosperous future for each and every Canadian, and for our society.[16]

However, the New Democratic MP for Halifax, Alexa McDonough, believed that the proposed measures did little to address the depth and seriousness of the tuition and student debt crisis. She also said that the proposed measures were discriminatory and she asked the following:

> If the objective is to level the playing field for every young person in this country wanting to access post-secondary education, would [the Minister] not agree that there are discriminatory measures built into the legislation? For example, there is the requirement that unless a child is a resident of Canada throughout the whole 18 years that these provisions would kick in, then they are not eligible for [funding].[17]

2.3.5 2007 and 2008: Minor Changes

In 2007, the federal government made minor changes to the program:

- the annual contribution limit was eliminated (2007);
- the lifetime contribution limit was increased to $50,000 (2007);
- the annual maximum CESG was increased from $400 to $500 (2007); and
- the maximum time limit that an RESP may remain open was raised from 31 to 35 years, and a six-month grace period was introduced so that funds from an RESP can be paid to a beneficiary up to six months after they have completed their post-secondary education (2008).

2.3.6 2008: Making Contributions Deductible?

On 5 March 2008, Bill C-253, An Act to amend the Income Tax Act (deductibility of RESP contributions),[18] which made RESP contributions tax deductible, was passed by the House of Commons and referred to the Senate for further consideration.

On 15 May 2008, during the Senate's consideration of Bill C-253, the Honourable Consiglio Di Nino said the following:

> Indeed, the reaction to Bill C-253 in the editorial and opinion pages of major newspapers right across Canada has been almost universally negative, and has pointed to the flaws in the bill that I will examine in the course of my remarks today.
>
> For instance, the *Toronto Star* rhetorically asked:
>
> Is a tax dodge, built upon another tax dodge that, in turn, is topped up by Ottawa, the best way to help university and college students, especially when the wealthiest parents will inevitably receive the most help?
>
> *The Globe and Mail* was also highly critical of the bill as it would:
>
> … stick the young recipients with the tax bill for the entire amount that they withdraw, when they tap the funds. That would be an enormous burden for many students. Worse, the bill would push Ottawa dangerously close to a deficit.
>
> The respected C.D. Howe economist Finn Poschmann, writing in the *Financial Post*, was adamant in his opposition to Bill C-253, remarking:
>
> To make RESP contributions deductible is an expensive and unnecessary proposition, and would not sit coherently with other parts of the tax system.[19]

Although the Senate held several sessions on Bill C-253, it did not have to vote on it. Bill C-50,[20] introduced in the House of Commons on 14 March 2008 and given Royal Assent on 18 June 2008, provided that if Bill C-253 received Royal Assent, the provisions of that bill would be simply repealed.

3 THE CURRENT PROGRAM

Table 1 below summarizes the current RESP program.

Table 1 – Summary of the Current Registered Education Savings Plan Program, 2016

Deductions	None
Taxation	Contributions are tax-free at time of withdrawal. The return and government grant portion is included in the beneficiary's income at time of withdrawal.
Annual contribution limit	None
Lifetime contribution limit	$50,000
Time limit	35 years
Canada Education Savings Grant (CESG)	20% of annual contributions up to $500 per year and a lifetime maximum of $7,200.
Additional CESG	10% to 20% of the first $500 in annual contributions, based on family income.
Canada Learning Bond	$500 upon opening and $100 per year for 15 years.

Source: Table prepared by the authors using data obtained from the Canada Revenue Agency, *Registered Education Savings Plans*, Income Tax Information Circular No. IC93-3R2, 4 May 2016.

4 PROVINCIAL INCENTIVES

Four provinces – Quebec, Saskatchewan, Alberta and British Columbia – have also created incentives on top of those provided by the federal government. These various programs are briefly outlined below.

4.1 QUEBEC: QUÉBEC EDUCATION SAVINGS INCENTIVE

Introduced in February 2007, the Québec education savings incentive[21] is a refundable credit deposited directly into the RESPs of Quebec beneficiaries. They receive an amount equal to 10% of the contributions paid into the RESP over the course of a year, up to an annual limit of $250 and a lifetime limit of $3,600. Since 2008, this amount can also be added to accumulated rights from previous years, up to a maximum of $250 per year.

An additional amount of up to $50 per year, based on family income, is also available to low- and middle-income families.[22]

4.2 Saskatchewan: Saskatchewan Advantage Grant for Education Savings

Since 1 January 2013, the Government of Saskatchewan has provided a grant of 10% on contributions to an RESP, up to a maximum of $250 per year and $4,500 over a child's lifetime.[23]

4.3 Alberta: Alberta Centennial Education Savings Plan

Starting in 2005, the Government of Alberta provided the children of Alberta residents, born or adopted after 2004, with a $500 grant deposited directly into an RESP. Added to this were grants for all children of Alberta residents when the children reached 8, 11 and 14 years of age. A minimum of $100 had to have been deposited in the child's RESP before each grant request was accepted.

In March 2015, the Government of Alberta announced that the program would no longer be available as of 2015–2016.[24]

4.4 British Columbia: Training and Education Savings Program

Since 2013, British Columbia has provided, through its training and education savings grant program, a one-time $1,200 grant, deposited directly into the RESP of children born after 2006 and residing in the province. The grant must be claimed between the child's sixth birthday and the day before the child's ninth birthday.[25]

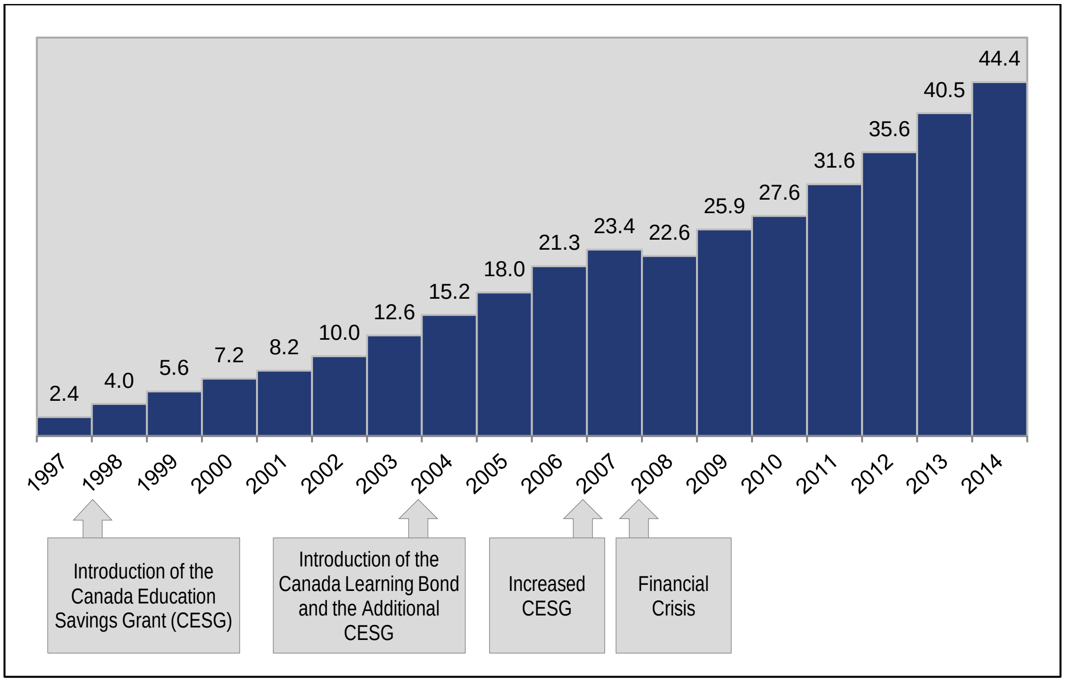
5 RESULTS ACHIEVED

Before the CESG was created, only 4.7%[26] of Canadians under 18 years of age had an RESP, compared to 51.3% in 2013.[27] The amounts that Canadians have invested in RESPs have risen from an accumulated total of $2.4 billion in 1997 to close to $45 billion in 2014, an annual average increase of roughly 20%.

This total includes $8.8 billion in CESGs and Additional CESGs provided to over five million young Canadians[28] since these programs were introduced, as well as $605 million to over 700,000 young Canadians since the introduction of the CLB in 2005.[29]

About 17% of Canadian post-secondary students made withdrawals from an RESP in 2013, compared to less than 0.3% in 1998.[30]

Figure 1 – Amounts Accumulated in Registered Education Savings Plans, 1997–2014 ($ billions)



Sources: Figure prepared by the authors using data obtained from Employment and Social Development Canada, "Table 1: RESP Assets and CESP Payments from 1997 to 2013"; *Canada Education Savings Program: Summative Evaluation Report*; and *2014 CESP Annual Statistical Review*.

6 CONCLUSION

The original idea behind RESPs may be attributed to rather imaginative taxpayers whom the federal government eventually decided to support in order to encourage Canadians to save for their children's post-secondary education.

The program was not very popular at first, but a relaxing of the rules and the introduction of government grants gave RESPs a major boost. Today, annual contributions top $4 billion per year, and close to 400,000 Canadian post-secondary students withdraw a total of $3 billion from their RESPs each year.[31]

NOTES

1. *Jack Harvie Quinn v. Minister of National Revenue*, 72 DTC 1413.
2. The Canadian Scholarship Trust Foundation is still in business today.
3. *Canada v. Quinn*, [1973] CTC 258.
4. *Income Tax Act* [ITA], R.S.C. 1985, c. 1 (5th Supp.).
5. *Canada v. Quinn*, para. 17.
6. Ibid., para. 10.
7. ITA, s. 146.1.

8. House of Commons, *Debates*, 2^{nd} Session, 35^{th} Parliament, 6 March 1996, 1725 (Hon. Paul Martin, Minister of Finance).

9. Bill C-28, Income Tax Amendments Act, 1997 (short title), 1^{st} Session, 36^{th} Parliament (S.C. 1998, c. 19).

10. House of Commons, *Debates*, 2^{nd} Session, 35^{th} Parliament, 18 February 1997, 1705 (Martin).

11. Department of Finance, "Assisting Parents to Save for Their Children's Education," *Budget Speech*, Budget 1998, 24 February 1998.

12. House of Commons, *Debates*, 1^{st} Session, 36^{th} Parliament, 3 February 1998, 1055 (Mr. Gordon Earle).

13. Bill C-5, An Act to provide financial assistance for post-secondary education savings, 1^{st} Session, 38^{th} Parliament (S.C. 2004, c. 26).

14. As well, this payment is retroactive to prior years when the child was eligible.

15. House of Commons, *Vote No. 21*, 1^{st} Session, 38^{th} Parliament, 7 December 2004.

16. House of Commons, *Debates*, 1^{st} Session, 38^{th} Parliament, 14 October 2004, 1335 (Mr. Peter Van Loan).

17. Ibid. (Ms. Alexa McDonough).

18. Bill C-253, An Act to amend the Income Tax Act (deductibility of RESP contributions), 2^{nd} Session, 39^{th} Parliament.

19. Senate, *Debates*, 2^{nd} Session, 39^{th} Parliament, 15 May 2008, 1510 (Hon. Consiglio Di Nino).

20. Bill C-50, An Act to implement certain provisions of the budget tabled in Parliament on February 26, 2008 and to enact provisions to preserve the fiscal plan set out in that budget, 2^{nd} Session, 39^{th} Parliament (S.C. 2008, c. 28), cls. 45–48.

21. Revenu Québec, *Québec Education Savings Incentive*.

22. Revenu Québec, *Determining the QESI Amount*.

23. Government of Canada, *Provincial education savings incentives: Saskatchewan Advantage Grant for Education Savings (SAGES)*.

24. Government of Canada, *Questions and answers: Closure of the Alberta Centennial Education Savings (ACES) Plan*.

25. British Columbia, *British Columbia Training and Education Savings Grant*.

26. Kevin Milligan, "Tax Preferences for Education Saving: Are RESPs Effective?," *C.D. Howe Institute Commentary*, Education Paper, No. 174, November 2002, p. 12.

27. Authors' calculation using data obtained from Statistics Canada, "Table 477-0074: Postsecondary savings for children 0 to 17 years old, by province," CANSIM (database), accessed 25 August 2016, and other Statistics Canada data.

28. Employment and Social Development Canada [ESDC], "Table 2: Canada Education Savings Grant," *2014 CESP Annual Statistical Review* [Canada Education Savings Program], 2015.

29. ESDC (2015), "Table 3: Canada Learning Bond," *2014 CESP Annual Statistical Review*.

30. ESDC, *Canada Education Savings Program: Summative Evaluation Report*, 2015.

31. ESDC (2015), "Table 4: Access to Post-Secondary Education," *2014 CESP Annual Statistical Review*.