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Financial Planning Options For Your Children's Education

A well thought-out education plan will help you realize your financial objectives for your children's education with the least amount of stress to your current income. As the cost of educating children continues to rise it becomes more important to begin planning early so that adequate funds are available when your child reaches the post-secondary level.

Saving strategies for a child's education require special consideration because children are considered minors and cannot own property directly. There are several methods available which can help you achieve your educational objectives. Here are but three methods to consider:

- Registered Education Savings Plans (RESP's)
- The "In Trust For" Account
- Buying Universal Life Insurance

Registered Education Savings Plans (RESP's)

The Federal government has provided special tax benefits and incentives for those saving for post-secondary education. While you do not get a tax deduction for contributions to a Registered Education Saving Plan (RESP), the investment income earned by the RESP is not subject to income tax until the funds are withdrawn. When the funds are withdrawn, the investment income must be used for the designated educational purposes and is taxable to the student, not the contributor.

Effective January 1, 1998 the federal government provides a Canada Education Savings Grant (CESG) equal to 20% of the first $2,000 of annual contributions to an RESP for children up to the age of 17. The maximum annual grant is $400 creating a maximum total grant of $7,200 (20% x $2,000 x 18 years) per child. You may carry forward any unused grant "contribution room" to future years.

An RESP will:

- Allow you to take advantage of the Canada Education Savings Grant.
- Generate a greater pool of savings over a shorter period of time since your savings are tax-sheltered until withdrawn.
- Reduce your future taxes. It allows you to shift the growth generated by your contributions to your children, where it will be taxed at a lower rate when withdrawn.
- Enable you to invest your savings based on your individual needs, so you can achieve the right balance between long-term growth and protection of capital.

"In-Trust-For" Account

It is possible for you to save for your children's future education costs and achieve significant tax savings without an RESP, depending on the type of investments you choose.

This strategy involves opening a regular investment account in your own name "In Trust For" your child and investing in equities that produce capital gains while minimizing interest and dividends. Although any "first generation" interest or dividend income is still taxable in your name, the amount should be relatively small.

More importantly, any realized capital gains will be taxed in your child's name, so the total tax payable on any income from this account should remain low for several years. If the money in the account belongs to the child (i.e., Child Tax Benefit payments, inheritance proceeds, job earnings), then any interest and dividends are also taxed in the child's name as well as any realized capital gains.

Although this type of informal trust account is not fully tax-sheltered like an RESP, you will be able to access the growth portion at any time for any purpose that benefits your child, and not just to pay for expenses while your child is pursuing a higher education. More importantly, there is no annual contribution limit to an "In Trust For" account.

It is important to note that upon reaching the age of majority, your child is within their rights to assume full control over their account. Parents who want more control over the funds and wish to avert some of the potential drawbacks of an informal trust, can enter into a written trust arrangement or formal trust

Funding Education Costs with Universal Life Insurance

Some parents use universal life insurance policies to finance their children's education costs. ***Universal Life Insurance policies*** have two components—a life insurance portion and an investment fund, in which investment income can compound tax-free until it is withdrawn. In this strategy, parents take out a universal life policy on themselves, joint life, first to die. The policy would also have some term coverage lasting 18 years. The funds contributed to this universal life policy can grow free of income tax.

If either of the parents die prior to the child attaining age 18, the term insurance would be paid free of all taxes to the survivor. At 18, the parents give the policy to the child. The child is able to withdraw funds from the investment account in the policy to supplement her education costs. Some of the amount withdrawn will be taxable, but at the student's tax rate, which may be zero percent.

The advantages of a universal life insurance policy are:

- if the supporting parent should die, the life insurance component will pay a death benefit that can be adequate to fund the child's education;
- even if the supporting parent is disabled and unable to continue making premium payments;
- the accumulated funds are under the parent's control and need not ever be given to the child;
- the accumulated funds can be used for any purpose and need not be used only for "designated educational purposes";
- there are many investment alternatives available using the insurance companies' segregated or guaranteed funds;
- income tax on the investment income is deferred until the funds are removed from the policy;
- the policy can be transferred from the parent to child without any income tax implications to the parent; and
- the policy can be used to provide funds for another child if the original beneficiary does not go on to a post-secondary education

The cost for all of this is the premium for the policy. However, the universal life policy has all of the tax advantages of an RESP.

With so much riding on a good education, and on your decisions, it's important to get sound advice on all aspects of your education savings program from an independent financial planner.

The information contained in this commentary is designed to provide you with general information only, and is not intended to be comprehensive advice applicable to the circumstances of any individual. We strongly urge you to seek professional assistance before acting upon information included herein.

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