RESP: Invest $25,000 in 10 Annual Installments and Get $75,000

Description

It is just two months before the start of the academic year. According to Statistics Canada, the average cost for graduate programs was $7,056 in 2019/2020. The cost of the program depends on the field of study, the university, and the province. However, you can reduce the actual cost your child pays for the degree programs by availing several grants and financial assistance offered by the Canadian government.

The government has put a Registered Education Savings Plan (RESP) that encourages young parents to save for their child's college education.

How the RESP works

A good way to understand the RESP is through an example. Jerry and Jessica is a married couple and has a five-year-old boy named Jack. Under the Canada Child Benefit (CCB), they receive up to $6,400 annually until Jack turns six and then $5,400 until he turns 17.

They decide to open an RESP account and put $2,500 from the CCB payments in this account. The Employment and Social Development Canada (ESDC) credits $500 every year (20% of the contribution) under the Canada Education Savings Grant (CESG). It offers a maximum CESG grant of $7,200 and another $2,000 in Canada Loan program. The grant amount if unused is returned to the government.

When Jack turns 15, his RESP will have $34,000 in contributions:

- $25,000 in his parent's contribution, which is entirely from the CCB payments, and
- $9,000 in government grants.

Please note, there is always a maximum limit in government plans. Jerry and Jessica can contribute up to $50,000 for a maximum of 30 years in the RESP. Even relatives, guardians, and friends can contribute as little as $10 to the RESP. It can be a perfect birthday gift for your niece/nephew or grandchildren.

How to build your RESP portfolio

An RESP is for your long-term financial goals. It allows your investment to grow tax-free. Your investment income becomes taxable only when you withdraw it.

A good way to build your RESP portfolio is by investing in growth stocks that give handsome returns in the long term. If it's too much work to identify a few good stocks, you can invest in the **iShares S&P/TSX Capped Information Technology Index ETF** (TSX:XIT).

The XIT ETF gives you exposure to some of the best tech stocks trading on the **Toronto Stock Exchange.** The ETF has outperformed the market in the COVID-19 pandemic. Some of its top stock holdings like **Shopify** and **Descartes Systems** benefitted from the pandemic-driven lockdown. The ETF has delivered an average annual return of around 20% in the last 10 years.

If you had invested $2,500 every year in the ETF for the last 10 years, you would have $75,000 in your RESP. Your contribution would be $25,000 and your accumulated income from the ETF would be around $50,000.

Use your RESP money wisely

Coming back to the previous example, Jack uses $35,000 from the RESP to pay for his five-year bachelor's program. He still has money left in his RESP. He decides to wait for a few years before pursuing further studies. The RESP gives him the flexibility to do so. He can continue the account for 35 years before it expires.

However, Jack decides not to pursue further studies. Meanwhile, the balance of $40,000 in the RESP portfolio continued to grow for another 10 years at a rate of 10% and is now close to expiry. As Jack doesn't need more money for education, Jerry and Jessica can withdraw this amount or use it for retirement savings.

If they decide to withdraw the amount, they will have to show the amount earned from investment as their taxable income and pay an additional 20% tax on the investment income. They can avoid this tax bill by transferring up to $50,000 of the investment income in their Registered Retirement Savings Plan (RRSP). The CRA allows RRSP contributions to be deducted from the taxable income.

Family's takeaway

A Canadian family can build savings for their child and their retirement by investing a portion of the government benefits. Even a small investment of $2,500 a year for the long term can help you retire rich.

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