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Give the Gift of Education

Like most people, you want the best for your family. That includes helping your younger family members get the post-secondary education they need to succeed in life.

Unfortunately, a higher education means higher costs. Since 1991, tuition fees at Canadian colleges and universities more than doubled¹. And this trend may not improve any time soon.

But you can help your family members achieve higher education — and the success that comes with it — with an Education Savings Plan (ESP)².

An ESP is a tax-deferred savings plan designed to provide a tax-efficient method of saving for a post-secondary education. Contributions of up to \$4,000 per beneficiary can be made each year. And the federal government, through its Canada Education Savings Grant (CESG) program, will kick in an extra 20% to a maximum of \$400 per year for each qualified beneficiary to a specified maximum. The contributions grow tax-free until the beneficiary withdraws the funds to help cover educational expenses. The investment income and CESG are taxable at the time of the withdrawal in the hands of the beneficiary, which means the taxes will likely be relatively low.

That makes the ESP very smart, indeed.

The Basics

The “subscriber” to the plan is the individual or spouses who open the plan and make contributions. The “beneficiary” of the plan is the individual or individuals who are designated to receive the funds — both accumulated investment income and CESG — from the plan for the purposes of pursuing post-secondary education. Of course, certain qualifications must be met.

Two of the more common types of ESPs are the Family and Individual plans:



The Family Education Savings Plan (Family ESP) allows the subscriber to name one or more beneficiaries in the same plan. These plans require that each beneficiary be related to the subscriber by blood or adoption. One of the main advantages of setting up a Family ESP is that the funds in the plan do not have to be shared equally among the beneficiaries.

The Individual Education Savings Plan has one subscriber and only one beneficiary. There are no relationship requirements for the beneficiaries with this type of plan. Individual plans are not offered by RBC Dominion Securities, but are available at Royal Bank Action Direct, Royal Bank of Canada and some other financial institutions.

The Family ESP is the only plan that RBC Dominion Securities offers, and it allows you to jointly open a plan with your spouse. The information in this booklet refers to the Family ESP.

Enrolling Beneficiaries in a Family ESP

You can enrol one or more family members under the age of 21 in a Family ESP. The family members must be related to you, the subscriber, by blood or adoption, which includes your children, grandchildren and siblings. Nieces, nephews, the subscriber or the subscriber's spouse are not permitted as beneficiaries under the Family ESP, but they do qualify as beneficiaries under the Individual ESP.

To be eligible for enrolment in the plan, a beneficiary must have a valid Social Insurance Number (SIN). A beneficiary can be a resident or non-resident of Canada. However, the beneficiary must be a Canadian resident to be eligible for the CESG. New beneficiaries can be added to the plan at any time, as long as they meet the criteria.



ESP Tip

Since an ESP can only remain open for up to 25 years, it may be advantageous to open a new plan for very young beneficiaries rather than adding them onto an existing plan that has already been open for a number of years.

The beneficiaries of an ESP are also permitted to have more than one ESP. For example, parents and grandparents can contribute to different plans, as long as the annual and lifetime contribution limits for each beneficiary are not exceeded. The Canada Customs and Revenue Agency (CCRA) will charge the subscribers a 1% per month penalty for any contributions in excess of the maximum limits. Once the overcontributions are removed the 1% per month penalty will stop, but penalties already incurred will still have to be paid.

Making Contributions

Each year, you can contribute up to \$4,000 per beneficiary into an ESP. In total, you can contribute as much as \$42,000 for each beneficiary during his or her lifetime. The contribution deadline is December 31 of each year, and unused contribution room cannot be carried forward to future years. Contributions to the plan are not tax deductible but may be withdrawn tax-free at any time. You can continue to make contributions until the year before the beneficiaries turn 21 or the \$42,000 lifetime limit is reached. Although the plan is closed to new contributions after this point, it can remain open for up to 25 years.



ESP QUICK FACTS

- The annual contribution limit per beneficiary is \$4,000, subject to a lifetime maximum of \$42,000 per beneficiary. These contribution limits exclude any grants received through the CESG program.
- The annual contribution deadline is December 31.
- Unused contribution room cannot be carried forward to future years.
- Contributions to the plan are not tax deductible, but can be withdrawn tax-free at any time. This may trigger a refund of the CESG.
- CCRA charges a penalty of 1% per month on any contributions in excess of the annual limits.

The Canada Education Savings Grant (CESG)



ESP Tip

Each beneficiary earns \$2,000 of “grant-eligible” annual contribution room for each year from the latter of 1998 or the year of birth, including those years prior to becoming an ESP beneficiary. That means from Jan. 1, 1998 (or year of birth, if later) onward, the individual accumulates grant contribution room even if an individual was not named as a beneficiary of an ESP during those years.

GROWING YOUR ESP WITH THE CESG

Each year, the federal government will contribute up to \$400 per beneficiary to an ESP through the Canada Education Savings Grant (CESG) program. The amount the government contributes is equal to 20% of what you contribute, up to \$400 per year. Every qualified beneficiary can receive this grant up to and including the year they turn 17. The CESG is a bonus from the government, and is above and beyond the regular ESP annual contribution limits.

To take full advantage of the CESG, you should contribute at least \$2,000 per year per beneficiary. But if you are unable to do so, ESPs offer the advantage of “catching up” in later years, where the government will pay up to \$800 per beneficiary in a given year. To learn more, see the section on “Maximizing the CESG with Carry Forward.”

There is a lifetime limit of \$7,200 on the amount of CESG money that can be paid out to each beneficiary. For example, if \$5,000 in CESG was paid into an ESP for each of two beneficiaries, for a total of \$10,000 in grants, and only one beneficiary pursues post-secondary education, then only \$7,200 of the grants may be paid to the qualifying beneficiary. The remaining \$2,800 of the CESG in the plan would have to be refunded to the government.



CESG QUICK FACTS

- The annual CESG is 20% of a subscriber’s contribution to a maximum of \$400 per beneficiary per year up to the end of the year in which the beneficiary turns 17. To learn about special rules for 16 and 17 year olds, see “Special Conditions for 16 and 17 year olds”
- The lifetime maximum for the CESG is \$7,200 per beneficiary
- The annual grant-eligible contribution room per beneficiary is \$2,000 each year from the latter of 1998 or the year of birth of the beneficiary.
- The grant-eligible contribution room can be carried forward each year to produce a maximum grant of \$800 per beneficiary in a given year.
- For the plan to be CESG-eligible, the beneficiary must be a resident of Canada and have a valid SIN.

Maximizing the CESG with Carry Forward

If you were unable to maximize contributions for one or more years, you can carry forward unused grant room to catch up in later years on missed contributions. The amount of the carry forward depends on the contributions you make in the current year.

The CESG can only be paid to the plan on the first \$2,000 of the contribution each year. Keep in mind that you can actually contribute up to \$4,000 per year, but the CESG only counts on the first \$2,000. Therefore, you can carry forward unused grant room on an annual contribution of less than \$2,000.

THE FOLLOWING DESCRIBES HOW THIS WORKS:

Let's assume that this year you make contributions totaling \$1,000:

Contribution	\$1,000
CESG (paid this year—20% of \$1,000)	<u>\$ 200</u>
Total contributions and CESG paid to plan	\$1,200
<i>Eligible grant room that can be carried forward (usable in a future year):</i>	<i>\$1,000</i>

Now let's assume that next year you make contributions totaling \$3,000:

Contribution	\$3,000
CESG (20% on first \$2,000)	\$ 400
CESG (from grant room carried forward—20% of \$1,000)	<u>\$ 200</u>
Total contributions and CESG paid to the plan	\$3,600
<i>Eligible grant room that can be carried forward (usable in future year):</i>	<i>\$ 0</i>

While unused grant room can be carried forward, the maximum CESG that can be paid in a given year is still \$800.



SPECIAL CONDITIONS FOR 16 OR 17 YEAR OLDS

In order to be eligible to receive grant funds where the beneficiary was 16 or 17 years of age this year, at least one of the following conditions must have been met:

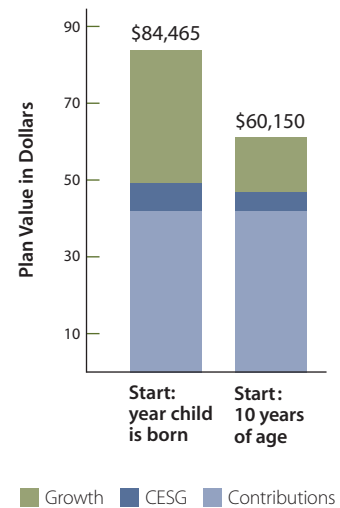
- A minimum of \$2,000 in cumulative contributions have been made, and not withdrawn, to an ESP on behalf of the beneficiary before the year in which the beneficiary was 16 years of age, or
- A minimum of \$100 of annual ESP contributions have been made, and not withdrawn, to an ESP on behalf of the beneficiary in any four years before the year in which the beneficiary turned 16 years of age.

Making the Most of Your Family ESP

COMPOUND GROWTH—BENEFITS OF STARTING EARLY

Compound growth makes it a smart move to start saving for the education of family members as soon as you can. Say you establish an ESP for your child in the year he or she is born, and contribute \$2,000 at the end of each year until the child is 21. This would result in total contributions of \$42,000 and CESG of \$7,200. Assuming a 5% rate of return (for illustrative purposes), the total value of the ESP, including CESG, will be \$84,465 at the end of year 21.

Alternatively, if you contribute the same amount but do not begin until the child is 10 years old, the total ESP will only be worth \$60,150 at the end of year 21. However, in this case the plan will receive only \$4,400 in CESG.



Your contributions to a Family ESP grow on a tax-deferred basis. That means you do not pay taxes when you sell one investment within an ESP to purchase another, or on the income generated by the ESP until it is withdrawn. Over time, this can give your ESP a big boost.

FUNDING STRATEGIES — MAXIMIZING CONTRIBUTIONS VERSUS MAXIMIZING CESG

The annual CESG that can be paid for each beneficiary is maximized with a contribution of \$2,000 (20% of \$2,000 = \$400). However, a subscriber can contribute up to \$4,000 for each beneficiary each year. As a result, it is possible that an ESP can be fully funded before the CESG is maximized.

As the subscriber, you must make the decision whether to maximize your contributions, and therefore enjoy the benefits of tax-deferred growth for a longer period, or to maximize the CESG, and therefore enjoy the grants. The strategy you choose will depend on your own financial situation. Your Investment Advisor can help you make an informed choice.

The following tables illustrates two of many different funding strategies. Depending on your objectives, you could choose to use either one of these strategies, or a combination of both.

SCENARIO 1 > Maximize contributions as early on as possible

Assume the beneficiary was born this year and you wish to make the maximum contribution of \$4,000 per beneficiary as soon as possible.

Result: \$4,000 will be contributed each year for 10.5 years. The plan will be fully funded in the 11th year and will have received capital of \$42,000 (lifetime maximum) and CESG of \$4,400.

Calendar Year	Contribution Amount	Grant-Eligible Contribution Room	CESG Paid
Year 1	\$4,000	\$2,000	\$400
Year 2 – Year 10	\$36,000	\$18,000	\$3,600
Year 11	\$2,000	\$2,000	\$400
Total	\$42,000		\$4,400

SCENARIO 2 > Maximize CESG

Assume the beneficiary was born this year and you wish to maximize the CESG and make contributions of \$2,000 per year for 21 years—the maximum length of time allowed to make contributions for a beneficiary.

Result: \$2,000 will be contributed each year for 21 years. The plan will be fully funded in the 21st year and will have received capital of \$42,000 (lifetime maximum) and CESG of \$7,200.

Calendar Year	Contribution Amount	Grant-Eligible Contribution Room	CESG Paid
Year 1	\$2,000	\$2,000	\$400
Year 2 – Year 18	\$34,000	\$34,000	\$6,800
Year 19	\$2,000	-	-
Year 20	\$2,000	-	-
Year 21	\$2,000	-	-
Total	\$42,000		\$7,200

Note: An alternative strategy would be to contribute \$4,000 in Years 1, 2 and 3, plus \$2,000 in Years 4 to 18 and make no contributions in Years 19, 20 and 21. In this case, the plan would be fully funded in Year 18 and the CESG received would still be \$7,200.

INVESTMENT FLEXIBILITY — FULL-SERVICE FAMILY ESPs

A full-service Family ESP offers you maximum flexibility and investment choices, plus personal advice from your Investment Advisor.

With a full-service ESP, you retain control over how your money is invested. You can choose investments that offer greater long-term growth potential, such as equities and equity mutual funds. You can also choose more conservative investments, such as bonds or balanced mutual funds.

Your Investment Advisor can help you choose the most appropriate investments for your ESP.

AN ASSET ALLOCATION STRATEGY

To maximize your Family ESP, consider an asset allocation strategy.

Studies show that the key to investment success is asset allocation—how you balance cash, bonds and equities. Generally, equities offer higher return potential over the long term, but have greater fluctuations in value over the short term. On the other hand, cash and bonds typically provide lower, but more predictable returns.

By balancing your ESP between the three main asset classes, you can manage risk, while taking advantage of the higher return potential offered by equities. Your Investment Advisor can recommend an appropriate balance for your ESP.



Unlike a Registered Retirement Savings Plan (RRSP), an ESP has no foreign content restrictions. That means you can take advantage of the greater return potential and risk-reduction benefits offered by global diversification.

CREATING AN ASSET ALLOCATION STRATEGY FOR YOUR FAMILY ESP

Your Investment Advisor can design an asset allocation strategy that makes sense for your ESP.

STEP 1> Determine your investment time horizon

How many years do you have to invest before your beneficiaries start post-secondary education? The longer you have, the more you can invest in equities or equity mutual funds.

Historically, equities have offered superior returns over the long term, but with greater volatility. Over longer periods of time—five to 10 years—this volatility tends to even out. If you have less time to invest, it might be best to pursue a more conservative asset allocation strategy that includes less volatile investments, such as bonds or balanced mutual funds.

STEP 2> Determine your tolerance for risk

If you are comfortable with some risk—and your beneficiaries will not be starting post-secondary education for a while — consider allocating a larger portion of your Family ESP to equities or equity mutual funds.

STEP 3> Create and monitor your asset allocation strategy

The right mix of assets depends on your personal situation. Knowing your investment time horizon and how much risk you are willing to take is essential to creating an appropriate asset allocation strategy for your ESP. Over time, your strategy may need some fine-tuning. You may need to adjust your asset mix to reflect changing market and economic conditions, time horizon or risk tolerance.

For instance, as your beneficiary gets closer to finishing high school, it might make sense to shift into more conservative investments. Your Investment Advisor can help you make the appropriate choices.

Withdrawing from Your Family ESP



ESP Tip

With a Family ESP, the investment income does not need to be shared equally among the beneficiaries in the plan. Instead, you can direct more to a beneficiary whose educational expenses are higher.

MAXIMUM FLEXIBILITY WHEN THE TIME COMES

The Family ESP offers a great deal of flexibility when it comes to making payments to the beneficiary. Once the student is enrolled in a qualified full-time post-secondary education or training program, the grants plus investment income can be released as Educational Assistance Payments (EAPs) at the discretion of the subscriber.

Most Canadian universities, colleges and other educational institutions qualify as post-secondary institutions. What's more, many universities and colleges outside of Canada also qualify—provided that the courses are at least 13 weeks in length and lead to a degree. Call your local CCRA office to find out if an educational institution qualifies under this program.

If you have more than one beneficiary in your Family ESP, you can decide how much each beneficiary receives. This way, you can direct more to a beneficiary whose educational expenses are higher. In theory, all of the plan's growth and CESG contributions—up to a maximum of \$7,200 for the CESG portion—may be directed to one beneficiary.

For the funds to be released, you are required to provide a signed withdrawal form. The beneficiary must provide proof of current full-time enrolment in a qualifying educational program at a post-secondary institution, as well as additional information as required by Human Resources Development Canada. The funds must be used to cover the beneficiary's educational costs and the CCRA requires that EAPs for large amounts be reviewed for reasonableness. Consequently, you may be required to provide additional documentation to demonstrate how the funds will be used.



Once a beneficiary is enrolled in a qualified post-secondary program, the grants plus the investment income in the plan can be released as Educational Assistance Payments (EAP). Up to a maximum of \$5,000 in EAP is allowed in the first 13 weeks of enrolment.

For plans opened after 1998, up to a maximum of \$5,000 in EAP is allowed in the first 13 weeks of enrolment in the educational program, with no specific limits thereafter (subject to reasonableness, as described above). EAPs cannot continue beyond the plan termination date. Remember — the plan can only be open for up to 25 years.

The CCRA requires that you designate an educational institution to receive any income (excluding grants) that remains in the plan upon its closure. This designation may be changed at any time. It is important to note that any income donated to the educational institution is not considered a charitable donation for tax purposes.

WHAT IF YOUR BENEFICIARY DOESN'T PURSUE A HIGHER EDUCATION?

SCENARIO 1 > Other beneficiaries

If your beneficiary decides not to pursue higher education, but there is another beneficiary in the plan, then upon enrolment in a qualifying educational program, that other beneficiary can be paid all the income in the plan as well as up to \$7,200 of the CESG.

SCENARIO 2 > Add a beneficiary

If there are no other beneficiaries in the plan, you can add a new qualified beneficiary at any time. By doing this, you avoid losing the CESG already paid into the ESP, as long as the new beneficiary has not reached the CESG lifetime limit.

SCENARIO 3 > No other beneficiary named

If another beneficiary is not named, **contributions** are returned to you tax-free, since you've already paid tax on this money. In addition, the CESG paid to the plan must be refunded in full to the federal government.

The **investment income**, on the other hand, can be treated in one of three ways, or a combination of the following:

A) ACCUMULATED INCOME PAYMENT (AIP) ROLLOVER

You can transfer up to \$50,000 of investment income earned in the ESP to your personal or spousal RSP, provided that at the time of the transfer you have unused RSP contribution room available. You will be issued a T4A for the income, but will also be issued an offsetting tax receipt for the RSP contributions. This way, you delay paying tax on the investment income until it is withdrawn from your RSP.

All of the following requirements must be met to qualify for an AIP Rollover or AIP (option B):

- > the plan must be in existence for at least 10 years
- > all beneficiaries—past and present—must be 21 years of age or older and not attending post-secondary education
- > the subscriber must be a resident of Canada at the time the AIP is made (see section on "Residency Requirements for the Subscriber")

B) ACCUMULATED INCOME PAYMENT (AIP)

Another option is to withdraw the investment income from the ESP in the form of Accumulated Income Payments (AIPs). The AIPs are taxed at your marginal tax rate (varies by province), plus an additional surtax of 20% on the gross amount of the AIP received less the amount transferred to an RSP on an AIP rollover, if any.

C) DESIGNATED EDUCATIONAL INSTITUTION (DEI) PAYMENT

Your third option is to donate the investment income from the plan to a qualifying educational institution. While this payment is a philanthropic gesture, it is not considered a charitable donation for tax purposes.

Other Important Information for the Subscriber

CAN THE SUBSCRIBER WITHDRAW CONTRIBUTIONS FROM THE ESP?

You can withdraw cumulative contributions to the plan at any time for any purpose. The withdrawals are not subject to tax, as the contributions were made with after-tax dollars. The withdrawal amount cannot exceed the plan value less the net grant in the plan. However, any such amounts withdrawn while the beneficiary is not attending a post-secondary institution may result in a clawback of a portion of the CESG received. It is also important to note that once contributions are withdrawn, they cannot be returned to the plan at a later date.

RESIDENCY REQUIREMENTS FOR THE SUBSCRIBER

You can subscribe to an ESP if you are a resident of any country except the United States. However, if you are not a resident of Canada, you should be aware that there may be tax implications in your home jurisdiction. You should therefore seek advice on the tax implications in your country of residence. Residents of the United States are not permitted to subscribe to an ESP, as RBC Dominion Securities is not licensed to offer this product to them.

In addition, as a non-resident you will be ineligible for Accumulated Income Payments (see section on “What if Your Beneficiary Doesn’t Pursue a Higher Education?”). This means that if the beneficiaries do not pursue post-secondary education or if there is any growth left in the plan once all beneficiaries have completed their post secondary education, then only the contributions will be returned to you. The accumulated income in the plan will go to the designated educational institution.

WHAT HAPPENS IF THE SUBSCRIBER DIES?

The administration of the Family ESP will be assumed by a successor subscriber on your behalf. The plan can then continue without any interruption until it must be closed.



RBC Dominion Securities Family ESP

BACKED BY THE RESOURCES OF CANADA'S LEADING FULL-SERVICE INVESTMENT DEALER

Your Investment Advisor is committed to helping you—and your family—achieve success in life. That's why we offer the Family ESP as an additional service to you. Through your Investment Advisor, you have access to the full range of investments for your Family ESP, plus technical assistance from our team of ESP experts.

Contact your Investment Advisor today to learn why our Family ESP gets top marks.



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¹ Source: Canadian Federation of Students

² An ESP will become a Registered Education Savings Plan (RESP) once an application has been approved and registered with the Canada Customs and Revenue Agency (CCRA)

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