



# A GOOD EDUCATION: THE BEST INVESTMENT

A summary of your options



NATIONAL  
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FINANCIAL



## TABLE OF CONTENTS

<b>1 A Good Education: The Best Investment</b>	<b>2</b>
<b>2 Paying For Education: Three Ways to Get There</b>	<b>4</b>
<b>3 Investing Today for The Future</b>	<b>6</b>
Option 1: The Education Savings Plan	7
How Education Savings Plans Work	7
The Canada Education Savings Grant	8
Types of Education Savings Plans	9
Education Savings Plans: You Were Asking?	10
Tips for Education Savings Plans	13
Education Savings Plans: Multiple Choice	13
Option 2: "In Trust" Accounts	15
"In Trust" Accounts: The Tax Advantages	15
Setting Up an "In Trust" Account	16
Formal vs. Informal Trusts	16
"In Trust" Accounts: You Were Asking?	17
Tips for "In Trust" Accounts	18
<b>4 How Much Is Enough?</b>	<b>19</b>
<b>5 A Final Comparison</b>	<b>20</b>



## A Good Education: The Best Investment

*How important is a post-secondary education to your children or grandchildren? Consider that the Canadian government itself has said that, by the year 2000, a full 65 percent of all new jobs in Canada will require a post-secondary education.<sup>1</sup> With statistics like these, it's no secret that children today, more than ever, will have to look to formal education to make it in the real world.*

And education doesn't come cheaply. In 1988, roughly \$1,300 would cover the annual tuition for one year of post-secondary studies. Today, just ten years later, those tuition fees have more than doubled, to over \$3,000. The truth is, tuition costs have increased at a pace more than 5 percent above general price inflation over the last decade. With government spending reaching new lows, you can count on education costs to continue increasing at a rate rivaled by little else.

The bottom line? You can expect four years of post-secondary education, which currently costs about \$49,000<sup>2</sup> (including tuition, books, room and board, and other costs), to cost upwards of \$120,000 in 18 years' time. It's going to take some work to pay for these costs – and make no mistake, your child or grandchild will need your help. Not to worry. With some planning ahead of time, educating your child or grandchild can be as easy as 1-2-3.

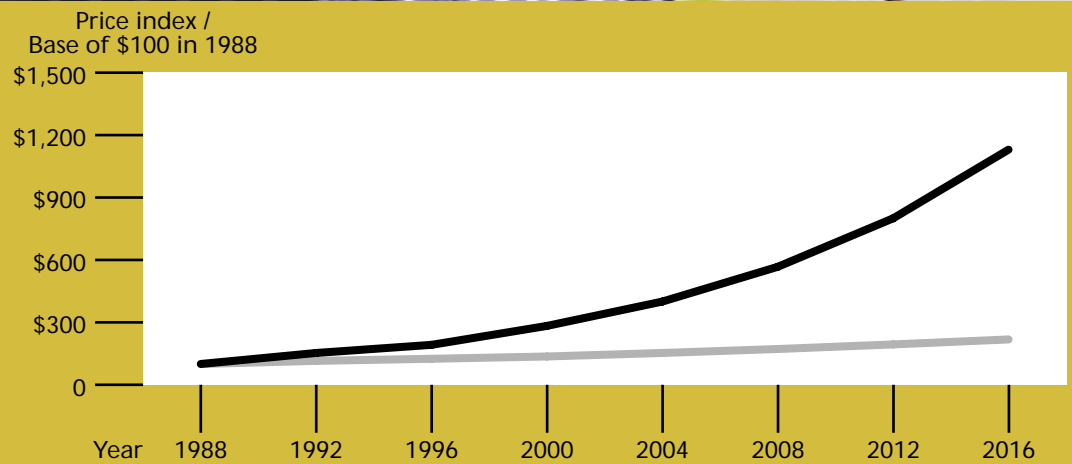
<sup>1</sup> Source: *Agenda Jobs and Growth: A New Framework for Economic Policy*, Federal Department of Finance, October, 1994.

<sup>2</sup> Source: Canadian Federation of Students.

# Education: The Investment



## The Rising Cost of Tuition vs. Inflation



### Tuition Increases

*SOURCE: Statistics Canada. Figures for 1998-2016 forecast an annual increase of 9.06%. Tuition costs increased, on average, 9.06% annually between 1987 and 1997 according to Statistics Canada.*

### Inflation (Consumer Price Index)

*SOURCE: Statistics Canada. Inflation represented by increases in the Consumer Price Index. Figures for 1998-2016 are forecasts at an annual increase of 3%.*



## Paying For Education: Three Ways to Get There

*Finding the money to assist your children with their education can seem like a daunting task. When it comes to paying for this essential head start in life, you have three options: pay as you go, pay later or pay now.*

### 1. Pay As You Go

Paying as you go could mean writing a cheque for as much as \$30,000 each year that your child attends college or university, depending on how old he or she is today – not exactly an appealing prospect! Paying as you go could mean that you will have to sacrifice other lifestyle expenditures to make those educational payments. Can you afford to cut your annual expenses by such a hefty sum for the duration of your child's post-secondary education? Very few of us could manage payments of this magnitude.

### 2. Pay Later

Paying later means taking advantage of student loan programs offered by various levels of government as well as by some post-secondary educational institutions. It may also mean borrowing from a financial institution to meet the costs of education. However, the huge debt load resulting from

borrowing to pay for four or five years of post-secondary education will be a very heavy burden for any graduate just entering the labour force. In fact, the average student debt load for a graduate of a four-year post-secondary education program in 1990 was \$13,000. This figure has since risen to \$25,000!<sup>1</sup> And considering that your child will have to pay accrued interest as well, paying later actually means paying significantly more.

### 3. Pay Now

The most sensible option is to pay now – to put money aside today while your children are still learning their ABCs – and to invest that money wisely so that it grows during the time that remains before the tuition bills start rolling in. By paying now and allowing compounding to work its magic, your child's post-secondary education will represent a much smaller out-of-pocket outlay.

Whether you are looking to provide for all or just a portion of your child's education costs, the earlier you start the investing process, the more likely you are to be successful in providing that help. The key is to start investing today for the future.

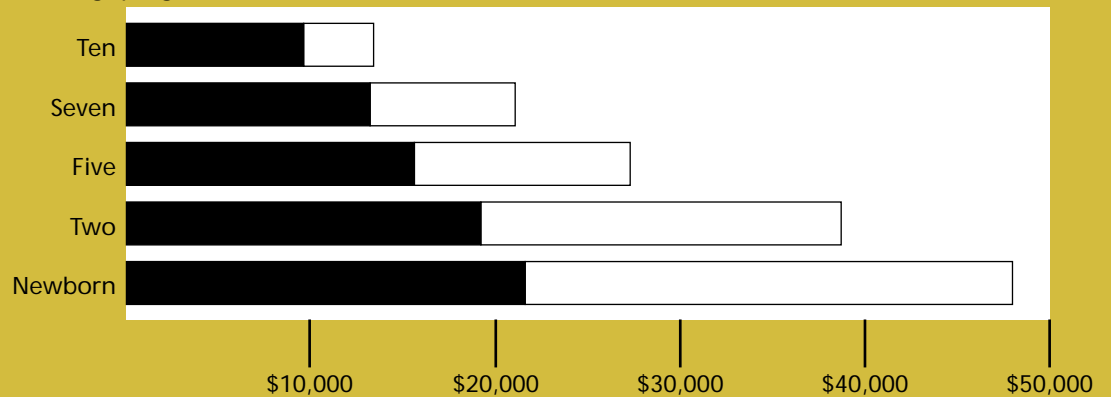
<sup>1</sup> Source: *The Canadian Opportunities Strategy*, Federal Department of Finance, February, 1998.

# for Education: Ways to Get There



Compare  
the Value of  
\$100 Invested  
Monthly

Age of child at  
beginning of monthly  
savings program



**NOTES:**

1. Assumes investment growth of 8% per annum, compounded monthly.
2. Contributions are made monthly until child is age 18.
3. All figures are before taxes.

Total capital invested

Growth on capital



## Investing Today for the Future

*Investing today for the future education of your child or grandchild will pay big dividends later when it comes to writing those cheques for tuition, books, room and board, and other expenses. But let's face it, the tax collector can make your job tough. In fact, if you put your savings in a regular bank or investment account, up to half your returns will be lost to taxation – which means you'll have to more than double the amount you set aside to meet future education expenses.*

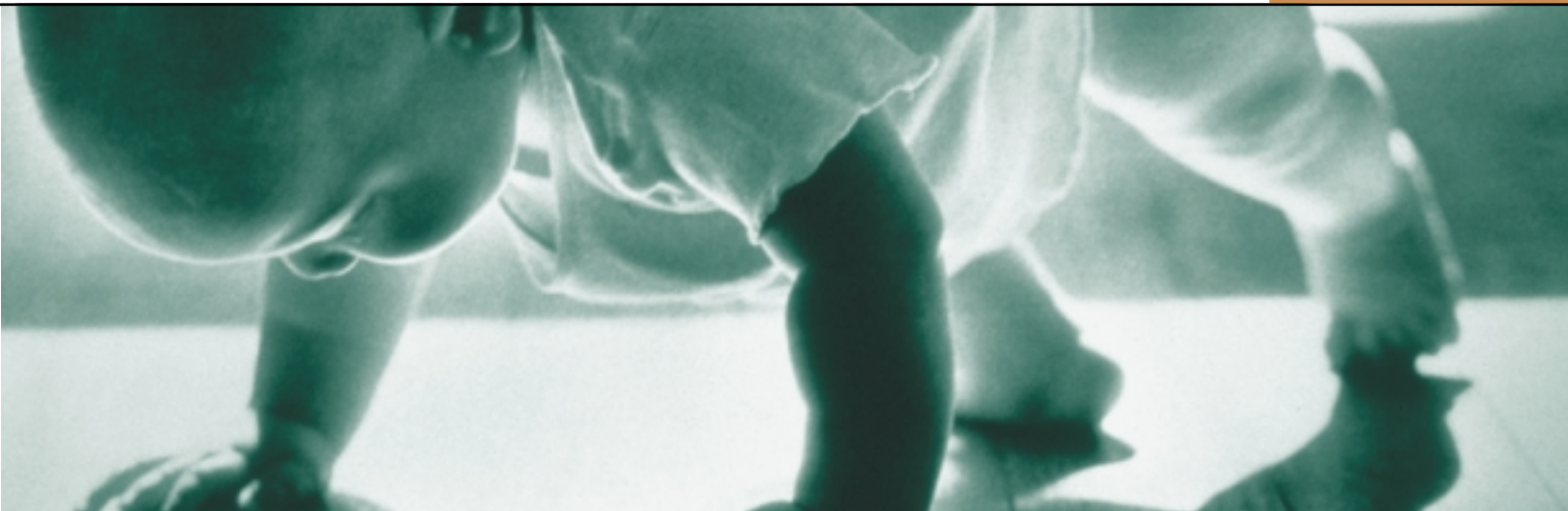
What about simply putting money into an account registered in your child's name? Granted, your child's marginal tax rate is probably a good deal lower than your own, but tax authorities have all but closed the door on this option. Attribution rules apply to investment income – meaning that all simple interest and dividend income earned on money you give to your minor child and invest in his or her name will be taxed in your hands at your marginal tax rate. The same is

true if you lend your child money for no consideration, or at an interest rate below Revenue Canada's prescribed rate.

Income attribution applies to such transfers between any non-arm's length persons and a child, and that includes parents, grandparents, aunts, uncles, siblings and spouses. These attribution rules eliminate a good part of the tax advantage you might hope to obtain by going this route.

Fortunately, there is a solution to this dilemma; or, to be more exact, two solutions: the Education Savings Plan, and the "in trust" account. The following is an explanation of these two tax-effective ways of saving for your child's post-secondary education.

# g Today for the Future



## Option 1: The Education Savings Plan

# Option 1

*In the past, Education Savings Plans (ESPs) were looked upon by many as an ineffective way to save for an education. But things have changed – significantly. Since 1996, our government has been changing how ESPs work, and today these plans are more flexible than ever. Are ESPs worth a second look? You bet.*

### How Education Savings Plans Work

An ESP is simply a trust with three parties: the subscriber, the beneficiary and the plan sponsor. The subscriber is the person, typically you as a parent or grandparent, who contributes capital to the ESP. The beneficiary, usually your child or grandchild, is the person of your choice who, upon enrolling in a qualifying post-secondary program, will receive the investment returns earned by your contributions. The plan sponsor is simply the financial institution offering the ESP. As a subscriber, you are entitled to contribute up to \$4,000 for each beneficiary each year to an ESP – to a lifetime maximum of \$42,000 for each beneficiary.

Education Savings Plans offer three very powerful advantages over regular savings, which make them much more effective solutions to the high cost of post-secondary education.

### Advantage 1:

Although the contributions you make to an ESP as a subscriber are not tax deductible, they compound in a tax-sheltered environment, just like an RSP. All investment returns, including capital gains, interest and dividends, accumulate tax-free, meaning that they can grow far more quickly than regular savings.

### Advantage 2:

Once the ESP's beneficiary enrolls in a full-time qualifying post-secondary program of studies (or part-time for disabled beneficiaries), education assistance payments consisting of the plan's accumulated earnings are paid out to the beneficiary. These education assistance payments are deemed to be income in the beneficiary's hands and taxed as such at his or her marginal rate. Your beneficiary's tax bracket will undoubtedly be a good deal lower than yours, so this can represent a considerable tax saving.

### Advantage 3:

Thanks to the 1998 Federal Budget, contributions to an ESP for a qualifying child will now attract a grant from the federal government – called a Canada Education Savings Grant. That's right, for every dollar that you contribute to an ESP, the federal government will contribute 20 cents – to a maximum of \$400 – for each year that your child is age 17 or under throughout the year. That's an automatic 20 percent return – before you even get started making your investment work for you!

### The Canada Education Savings Grant

Beginning January 1, 1998, any contributions made to an ESP for a child will earn a Canada Education Savings Grant (CESG) from the federal government, up to and including the year the child reaches age 17. The grant is equal to 20 percent of the contributions made to the ESP, to a maximum of \$400 each year. In other words, the first \$2,000 of ESP contributions will attract a grant at 20 percent from the government. Don't expect a cheque in the mail though. Grant payments will be made directly to the ESP on a regular basis.

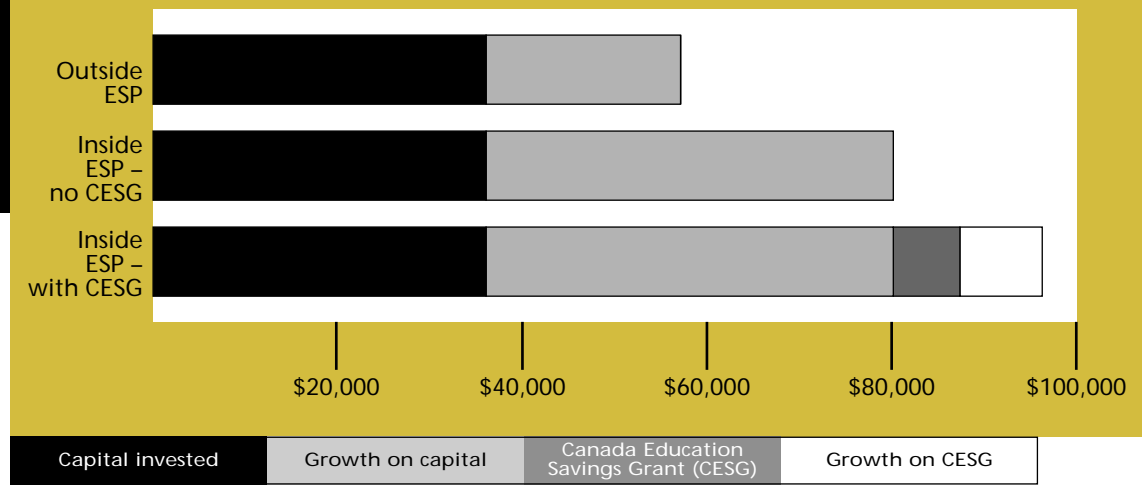
The CESG is a distant cousin to your RSP in the way it works. Specifically, each child age 17 or under in the year is entitled to CESG contribution room of \$2,000 per year. If no contributions are made to an ESP in a given year, that contribution room is carried forward to any future year. Once you do happen to make a contribution to the ESP (and, under the general ESP rules, the maximum contribution is \$4,000 each year), the contribution room is used up and a grant is provided at 20 percent of the contribution room used. Any contributions over and

above the CESG contribution room cannot be carried forward to attract a CESG payment in a future year. Consider Jamie's story.

Jamie is four years old in 1999, and his CESG contribution room for 1999 is \$2,000. In February 1999 Jamie's father made an ESP contribution of \$1,200 for Jamie. A CESG payment of \$240 (20% of \$1,200) is paid directly to the ESP. A few days later, Jamie's grandmother made a \$2,500 contribution to another ESP on behalf of Jamie. Since only \$800 of Jamie's CESG contribution room is available at the time of Grandma's contribution (his father used up \$1,200 of it), only \$800 of her contribution qualifies for a CESG payment, and Jamie's grandmother's contribution will attract a grant of \$160 (20% of \$800). The remaining \$1,700 of her contribution will not qualify for a CESG payment this year – or in the following year. By the way, if no contributions other than Jamie's father's were made, the remaining \$800 of Jamie's CESG contribution room would be carried forward for use in a future year.

It is important to separate in your mind the CESG rules and the ESP rules. While the CESG rules allow any unused CESG to be carried forward for use in any future year, the ESP rules impose a maximum annual contribution of \$4,000 to an ESP. The result is that the most you will receive in CESG payments in any given year will be \$800 (20% of \$4,000). To ensure that Canadians are making use of ESPs on a regular basis, there's another catch to be aware of. If you're hoping to put money into an ESP for a child who is age 16 or 17 in the year, you're going to receive CESG payments only where one of two conditions are met: (1) a minimum of \$2,000 in ESP contributions must have been made on behalf of the child before the year he or she turns age 16, or, (2) a minimum of \$100 in annual ESP contributions must have been made on behalf of that child in any four years before the year the child turns age 16. The message is clear: Make an ESP a regular habit if you want the benefits of the CESG.

## The Value of Education Savings Plans and Canada Education Savings Grants



### NOTES:

1. Assumes investment growth of 8% per annum, compounded monthly.
2. Assumes monthly contributions of \$166.67 (\$2,000 per year) for 18 years.
3. Assumes an average tax rate of 40%.
4. Canada Education Savings Grant equals 20% of the contributions made to the ESP, to a maximum of \$400 each year.

## Types of Education Savings Plans

There are three general types of ESPs: group plans, individual plans, and family plans. Each offers a different degree of flexibility.

### Group Plans:

This type of ESP, often called a “scholarship trust”, is one in which your child is just one of many – perhaps thousands – of beneficiaries, most of whom are not related to each other. While group plans offer many of the same benefits of other ESPs, they generally differ in three key ways. First, you’ll typically have no control over where the money inside the ESP is invested. Investments are made by the plan sponsor and generally include conservative securities such as government bonds, guaranteed investment certificates, treasury bills, and insured first mortgages. Second, if your child decides not to pursue an education, you’ll receive your capital contributions back, but the accumulated growth on that capital accrues to all the remaining beneficiaries in the plan. Finally, there may also be restrictions on changing beneficiaries, and resuming post-secondary studies after they have been temporarily interrupted.

### Individual Plans:

An individual plan ESP can be set up for a single beneficiary. This type of plan offers more flexibility than a group plan in that you will not be limited in your investment choices. For example, your Investment Advisor is able to

assist you in setting up such an ESP with any number of mutual fund companies. While you will be limited to funds offered by the particular company you choose, the choices are usually broader than what a group plan offers. Most importantly, the choice of mutual funds within the fund family is yours. An investment option that is even more attractive is the self-directed individual plan, which can be opened directly with our firm. A self-directed plan allows you to make virtually any investment of your choice in the ESP. Talk about flexibility!

### Family Plans:

A family plan ESP is simply a plan under which you may designate a number of different beneficiaries, with the caveat that each beneficiary must be related to the subscriber by blood or adoption. A family plan offers the same investment flexibility as an individual plan. That is, you will be able to choose from any variety of investments, depending on whether your family plan ESP is administered by a mutual fund company, another financial institution, or is a self-directed ESP of the type we offer. A benefit offered by a family plan that is not available from any other plan is the ability to allocate the ESP’s investment earnings to the beneficiaries in any proportion you want. If, for example, three children are named beneficiaries and only one pursues post-secondary education, all the investment returns in the ESP can be allocated and paid to that one student. This is not possible under a group or individual plan.

## Education Savings Plans: You Were Asking?

**Q** *Who can be a beneficiary?*

**A** A distinction must be made between individual plans and multiple-beneficiary plans – often referred to as family plans. Individual plans let you choose anyone as beneficiary – even yourself, your spouse, or a non-related person. Under a family plan, each beneficiary must be related to the subscriber by blood or adoption. This generally includes your children and grandchildren, or brothers and sisters. The blood relation does not include nieces or nephews (although an individual plan may be set up for a niece, nephew, or any other beneficiary for that matter). Also note that in terms of beneficiary eligibility for a family plan, you do not have a blood link with yourself or your spouse. New family plans require that all beneficiaries named when the plan is opened be age 20 or younger at that moment. Where additional beneficiaries are added at a later date, they must be age 20 or younger on the date they are added as beneficiaries. Finally, contributions are prohibited for beneficiaries under a new family ESP once age 21 is reached.

**Q** *As a subscriber, how much can I contribute?*

**A** The maximum annual contribution per beneficiary is \$4,000. For example, if you name your three children as beneficiaries in a family plan, you could contribute a maximum of \$12,000 a year to that one ESP. Total contributions over the life of the plan are capped at \$42,000 per beneficiary.

**Q** *Which schools qualify?*

**A** Any post-secondary educational institution (college, university or CEGEP) in Canada or abroad qualifies, as do many trade and technical schools. Beneficiaries must be enrolled in a full-time study program to qualify for an education assistance payment from an ESP (or part-time for disabled beneficiaries). For ESPs set up prior to 1999, the education program must generally run at least three consecutive weeks (13 weeks for schools outside of Canada) with at least ten hours of courses per week. For new ESPs registered in 1999 or later, the education program must generally run for at least three months, unless the program is at least three

weeks long and one of these two conditions are met: (1) educational assistance payments do not exceed \$5,000, or (2) the payment is approved by the Department of Human Resources Development. Enrollment in certain correspondence courses also qualifies a beneficiary to receive education assistance payments from an ESP.

**Q** *How are education assistance payments made to my ESP's beneficiary?*

**A** In order for an education assistance payment to be made, you must provide proof of the beneficiary's enrollment in an eligible program of studies when the payment is requested. As the plan's subscriber, you retain complete control over the timing and amounts of these payments. However, it should be noted that education assistance payments made in the first three months of schooling cannot exceed \$5,000. Investment returns earned in an ESP lose their character when paid out, which means that there is no preferential tax treatment for dividends and capital gains. All amounts paid out as education assistance payments will be taxed as income at the beneficiary's marginal rate.

**Q** *If I have several beneficiaries, does the income have to be split equally among them?*

**A** With a family plan, the income can be allocated to eligible beneficiaries in any manner. If one of the named beneficiaries does not pursue post-secondary education, all of the income can be paid out to those beneficiaries who do.

**Q** *Can I replace one of the beneficiaries designated when the ESP was opened with someone else at a later date?*

**A** Generally speaking, yes. However, you would have to check the terms and conditions of your particular ESP to ensure that the plan's trust agreement allows this, and under what conditions. For instance, our ESPs accommodate a change of beneficiaries at any time. Virtually anyone can be designated as a replacement under an individual plan ESP. For a family plan, the replacement beneficiary must be related to the subscriber by blood or adoption. To avoid possible penalties, the replacement beneficiary for a family plan must be 20 years of age or younger when

designated, and he or she must be a brother or sister of the beneficiary being replaced.

**Q** *What happens to the capital that I contribute to the plan?*

**A** The capital you contribute to the plan will be returned to you at any time upon request, with no adverse tax consequences. However, should you request a reimbursement of capital before winding down the ESP, this capital may not be put back into the plan other than as a regular contribution subject to the annual and lifetime contribution limits of \$4,000 and \$42,000 per beneficiary, respectively.

**Q** *What kind of expenses can education assistance payments from an ESP be used for?*

**A** Educational assistance payments from an ESP to its beneficiary are intended to be used for tuition, books, room and board, transportation and any other expenses incurred during a course of full-time post-secondary studies. The beneficiary must declare the amounts received as income, but at this time, no accounting of how such amounts are spent is required.

**Q** *How long can an ESP “last”?*

**A** ESPs have terms up to 25 years but you may not contribute past the 21st year following the year in which the plan is opened.

**Q** *Can the same person be named beneficiary of more than one ESP?*

**A** The same beneficiary can be named in more than one plan. However, there is usually no advantage in doing so, since the total amount contributed for a given beneficiary to all plans for which he or she is named beneficiary cannot exceed the annual limit of \$4,000, or \$42,000 in a lifetime.

**Q** *What happens if my beneficiary doesn't undertake post-secondary studies?*

**A** Your first option is to simply replace your beneficiary with another who is more interested in the benefits of a post-secondary education. With a family plan, naming two or more children related to you by blood or adoption as beneficiaries at the outset

will allow the earnings of the ESP to be used by any beneficiary who happens to choose post-secondary education.

Where the ESP has been in existence for at least 10 years, and all designated beneficiaries have reached the age of 21 and are not pursuing post-secondary education, as a subscriber you may elect to pay yourself any unused assets remaining in the plan – and not just your original capital contributions, but the accumulated earnings as well. In this event, you should note that there will be a significant tax liability when you withdraw earnings accumulated in the ESP. Your original capital contributions are withdrawn tax-free, but any accumulated earnings withdrawn are taxed once as income at your current marginal rate, and then subjected to an additional 20 percent penalty tax. The Minister may waive the 10-year and 21-year time requirements if the request for the accumulated income payment is made because a beneficiary's impairment will prevent attendance at a post-secondary educational institution.

There is one practical option available to avoid paying tax and the 20 percent penalty on the accumulated earnings when you make withdrawals as a subscriber. A lifetime maximum of \$50,000 of such accumulated earnings payments may be transferred to your RSP or into a spousal RSP provided that you have enough RSP contribution room to cover the amount. You'll avoid income tax and the penalty on amounts transferred to your RSP this way. Anything in excess of the amount transferred to the RSP will be subject to income tax plus the 20 percent penalty.

Note that where an accumulated earnings payment is withdrawn from an ESP by its subscriber, the plan must be terminated by February 28 of the following year.

Finally, if you feel philanthropically inclined, you can always donate the accumulated investment earnings to the post-secondary educational institution of your choice. Unfortunately, since these are pre-tax earnings, such a donation will not give rise to a tax credit, although you will avoid paying tax or penalties on those earnings.

**Q** *When and how will Canada Education Savings Grants be paid?*

**A** All CESG payments will be made directly to the ESP, on a quarterly basis. At the end of each quarter, financial institutions will report details of all contributions received during the quarter to the government, which remits the grants in the following month. Note that for a contribution to attract a CESG, the beneficiary must be a Canadian resident and, before receiving the grant, have a valid social insurance number.

**Q** *What happens to the CESG payments if a beneficiary does not pursue post-secondary education?*

**A** The original principal portion of the CESG payments must be repaid to the government if a beneficiary does not attend a full-time qualifying educational program. The accumulated earnings on the grant need not be repaid.

**Q** *Are there other situations where the CESG must be repaid?*

**A** The principal portion of the CESG payments received by the ESP must be repaid in the following situations: (1) when original capital contributions are withdrawn from the ESP for non-educational purposes, (2) when the ESP is terminated or revoked, (3) when a payment of ESP income is made for non-educational purposes, (4) when a beneficiary under the plan is replaced (except where the new beneficiary is 20 years of age or younger and either the new beneficiary is a brother or sister of the former beneficiary or both beneficiaries are related to the subscriber by blood or adoption), and (5) when there is a transfer from the ESP to another ESP involving either a change of beneficiaries or only a partial transfer of funds.

**Q** *Can I somehow obtain CESG payments using pre-1998 ESP contributions?*

**A** No. You've got to be careful here. The government has set up the CESG rules so that you will not be able to convert unassisted contributions (contributions

for which no CESG payments were offered) into contributions for which CESG payments are given. For example, if you were to make a tax-free withdrawal of your pre-1998 capital contributions made to an ESP, you would not be able to use that money to then re-contribute to an ESP to obtain a grant. Specifically, any withdrawals after February 23, 1998 of unassisted contributions for non-educational purposes, or transfers from one ESP to another, will result in restrictions on future CESG payments. In fact, any contributions made to an ESP in the year of such a withdrawal, or in the following two years, in respect of all of the plan's beneficiaries, will not be eligible for the CESG. In addition, the beneficiaries will not be entitled to new CESG contribution room for those two following years. These restrictions won't apply where the withdrawals of unassisted contributions are less than \$200 in the year, or where there is a full transfer of assets held in an ESP from one plan to another ESP and there is no change in beneficiaries.

**Q** *Does the CESG payment reduce the amount I could otherwise contribute to an ESP?*

**A** No. The \$4,000 annual and \$42,000 lifetime ESP contribution limits are not affected by the CESG payments received. That is, the CESG payments may be provided over and above these maximum ESP contributions.

**Q** *Is there a lifetime limit on CESG payments that may be received?*

**A** Sure there is. The most any beneficiary can receive in CESG payments is \$400 for each year that the beneficiary is age 17 or under. This translates into a lifetime maximum of \$7,200 (\$400 times 18 years) per beneficiary. Similarly, the maximum CESG payments a beneficiary may withdraw from an ESP as part of his or her educational assistance payments is \$7,200. This ensures that no single beneficiary, particularly under a family plan where ESP assets can be allocated from one beneficiary to the next, will receive more than his or her fair share from the government.

## Tips for Education Savings Plans

**Tip 1:** Start an ESP as early in the child's life as possible to maximize the tax-sheltered compounding and the CESG payments available.

**Tip 2:** If there is a spread of six years or more between the oldest and youngest beneficiaries, set up a separate ESP plan for these beneficiaries. The reason is simple. An ESP must be wound-up after it has existed for 25 years. You don't want to run into a situation where the plan must be wound-up before the youngest beneficiary has finished his/her post-secondary education.

**Tip 3:** Consider holding foreign securities in your ESP to maximize investment returns. Although the types of investments that you may hold in an ESP are restricted to the same investments eligible for your RSP, there are no foreign content restrictions on an ESP, compared to the 20% limit with an RSP.

**Tip 4:** Contribute at least \$4,000 every two years to an ESP to maximize receipt of the CESG payments available. If, for example, you allow the CESG contribution room to build up over three years (\$6,000 of CESG room at \$2,000 of room for three years) you will not be able to use up all that room. The reason is that, under general ESP rules, you are not entitled to contribute more than \$4,000 in a year. The strategy, then, is to ensure that the CESG room available does not exceed \$4,000 in any year. This can be accomplished by contributing at least \$4,000 every two years to an ESP.

**Tip 5:** Ensure that every ESP is in existence for at least ten years. This will provide you with the option of transferring ESP earnings to an RSP later if you have the RSP contribution room and you want to make this transfer because a child does not follow post-secondary studies. The 10-year requirement may be waived when a beneficiary has an impairment.

**Tip 6:** If you are a grandparent looking to set up an ESP, consider giving the cash to your own adult child, and then having your child subscribe to the ESP for your grandchild instead. It is more likely that your own child will have the ability to transfer those ESP earnings to an RSP later if your grandchild chooses not to attend post-secondary school. This is the case since you may be over age 69 – and without an RSP – by the time your grandchild decides not to attend school. Keep in mind, however, that the capital contributed to the ESP in this case is returned to your child – and not you – if your grandchild does not attend school. You have given up all rights to the capital. This strategy may also help to reduce probate fees in provinces where these fees apply.

### Education Savings Plans: Multiple Choice

Your Investment Advisor offers three ESPs to suit your needs:

- Our *Fully Guaranteed Investment* ESP;
- Our *Portfolio* ESP;
- A variety of mutual fund ESPs.

### Our *Fully Guaranteed Investment* ESP

No risk, no fees! Just like our *Fully Guaranteed Investment* RSP, the *Fully Guaranteed Investment* ESP allows you to choose from investments issued by, or directly guaranteed by, Canada's federal or provincial governments, which you hold to maturity.

The range of eligible investments includes savings bonds, treasury bills, bonds, stripped coupons and retirement savings bonds. These securities typically provide a higher return than GICs and term deposits of equal term, and carry an unlimited guarantee

when held to maturity. Conventional deposits such as GICs and term deposits are usually available with terms of five years or less, whereas with the government-guaranteed securities described above you can choose from terms of 30 days to 30 years. This flexibility in choice of maturities is particularly useful when considering long-range projects such as saving for a child's post-secondary education.

Opening a *Fully Guaranteed Investment* ESP costs nothing, and you pay no ongoing administration fees or transaction fees. Your part of the bargain is simply agreeing to restrict your choice to the list of eligible investments, and to hold these investments until they mature. Note that a \$25 administrative charge is levied for adding or substituting beneficiaries. \$50 is charged for a partial transfer, and \$100 for a complete transfer of your ESP to another financial institution.

You may also include GICs and term deposits in your *Fully Guaranteed Investment* ESP on the occasions they prove attractive. However, choosing this option means accepting a lesser guarantee. Term deposits and GICs are protected only up to \$60,000 (capital and interest) by the Canada Deposit Insurance Corporation or the Quebec Deposit Insurance Board, institutions which in turn are indirectly backed by the government. Securities issued by the government benefit from an unlimited guarantee when held to maturity.

#### **Our *Portfolio* ESP**

Our *Portfolio* ESP is a self-directed plan that gives you the widest range of vehicles in which to invest your contributions: bonds, stripped coupons, treasury bills, stocks, mutual funds... the list is virtually endless. This type of plan allows you to take a truly diversified approach to managing your ESP investments. With the help of your Investment Advisor, you can put together a portfolio of securities perfectly suited to

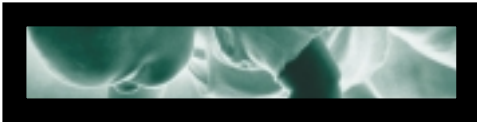
your objectives, time horizon and risk tolerance. The makeup of your *Portfolio* ESP is then carefully monitored and adjusted where appropriate, to capitalize on market trends and new investment opportunities as they arise.

Since the real benefits of our *Portfolio* ESP can only be enjoyed when your plan is large enough to enjoy the flexibility that this product offers, we recommend that you consider it when you have accumulated at least \$10,000 in ESP capital, or expect to reach that level in the near future. You maximize the tax advantage of your *Portfolio* ESP when you concentrate on investments generating interest or dividend income. However, growth-oriented securities such as common stocks and equity mutual funds can be added at your option to improve your returns and benefit from the reduction in volatility that exposure to all asset classes provides over the long term.

The annual administration fee for our *Portfolio* ESP is \$50. Note that this fee should be offset by tax savings as early as the first year of operation, even for an individual (single-beneficiary) plan. Your tax savings increase with each additional year, making the flexibility of our *Portfolio* ESP all the more affordable. A \$25 administrative charge is levied for adding or substituting beneficiaries. \$50 is charged for a partial transfer, and \$100 for a complete transfer of your ESP to another financial institution. Normal commissions apply on securities transactions.

#### **Mutual Fund ESPs**

A number of the major Canadian fund companies offer ESPs that allow you to invest in their underlying mutual funds. On the plus side, mutual fund ESPs are usually inexpensive, with annual administration fees in the \$0 to \$25 range, and funds are an excellent way of putting together a well-diversified portfolio even if your means are modest. However, in the specific context of ESPs, the fact that your investment choices are limited to mutual funds is something to consider carefully.



## Option 2: "In Trust" Accounts

# Option 2

*Before deciding to hop on the ESP bandwagon, it will be worth your while to understand a thing or two about the ESP's main competition – the "in trust" account. An "in trust" account is simply an investment account opened for the purpose of setting aside money for a child's future – often to pay for a child's education. In order to compete with the ESP, the "in trust" account must also offer a tax-efficient method of investing for the future.*

### "In Trust" Accounts: The Tax Advantages

We mentioned earlier that attribution rules apply to all dividend and interest income earned on amounts that you have given to a minor child, lent for no consideration or lent at a rate below Revenue Canada's prescribed rate. However, these attribution rules do not apply to capital gains earned on money that you have given to your child or grandchild. This opens the door to one of the few remaining possibilities for income splitting – an "in trust" account.

In essence, the idea is to give money to your child or grandchild, who then invests it in vehicles that generate mainly capital gains. Any simple interest or dividend income will be taxed back to you. However, the capital gains will be taxable in the child's or grandchild's hands. The investments are intended to grow over time and could be used by the child for education purposes when that time comes.

Generally speaking, your child will be in a very low tax bracket, and if this is the child's only source of income, he or she can earn up to \$9,200 in capital gains each year without having to pay any taxes. Had this \$9,200 of capital gains been taxed in your hands, the bill could have been as high as \$3,600. Obviously, an annual tax saving of \$3,600 compounded over the years will represent a considerable sum by the time your child has reached the age of 18. Also, while simple interest and dividend income is subject to attribution, amounts earned by reinvesting that income are not. So if your child does reinvest simple interest or dividend payments received on which you are required to pay the tax, any compound interest or dividends earned can be taxed in the child's hands with the same tax savings described above.

## Setting Up an “In Trust” Account

One small problem remains – a minor (i.e. someone younger than age 18 or 19, depending on the province) cannot enter into a legally binding contract. Since the purchase of investments such as stocks, bonds and mutual funds involves a contract with the vendor, most financial institutions will not accept a minor as a client. This is where the notion of an “in trust” account comes into play. By setting up an “in trust” account, a parent or grandparent can transfer cash to, and make investment decisions on behalf of, a minor. The minor is the beneficial “owner” of the assets in the account, while the adult retains the responsibility of making the investment decisions. Note that from the moment the cash is transferred into the “in trust” account, all investment decisions must be made for the benefit of the minor, and the adult donor gives up all rights to the assets. Once the age of majority is reached, the child takes control of the account, and from that point onward, attribution no longer applies to any dividend and interest income earned by the assets in the account.

Setting up the account is fairly simple. As a parent or grandparent, you sign the forms and provide investment instructions for the account after consulting with your Investment Advisor. Typically, the registration of the account identifies the adult and the child as follows: “Name of Adult” “In Trust” for “Name of Child”. It is important to ensure that a legal transfer of cash or securities between the parent or grandparent and the child has taken place. Be sure to arm yourself with proper documentation showing that the cash or investments have been transferred from the adult to the child with no strings attached that would allow the assets to be eventually returned to the donor. To avoid Revenue Canada questioning the validity of the transfer to your child, it is a must that the trustee and the donor not be the same person. For instance, a grandparent may be the donor and a parent the trustee, or one spouse may donate the cash to the trust with the other spouse acting as trustee. Also, keep in mind that when the “in trust” account is funded by a gift of assets other than cash, this will be considered a disposition of these assets by the donor at fair market value on the date of transfer for tax purposes. Such a disposition could result in a taxable capital gain.

What are the drawbacks of the “in trust” account from the perspective of financing your child’s post-secondary education? First and foremost, CESG payments are not available for “in trust” accounts. Second, the simple interest and dividend income earned in the account will be taxable in the hands of the donor, although this pitfall can be avoided by investing in stocks and equity mutual funds to generate primarily capital gains. Finally, remember that all assets in the account belong to the child. At age of majority, control over the account reverts to the child, leaving him or her free to use the assets as desired. If you are not comfortable with control over what may amount to a significant sum reverting to your child or grandchild at this age, you might wish to consider the use of a formal trust, described below.

## Formal vs. Informal Trusts

What we have described above is an informal trust, since the only evidence of the trust relationship is the registration of the account, and any documentation relating to the transfer of cash or other assets to the account. A formal trust can be created by a legal document known as a deed of trust. This document identifies the donor (called the settlor), the trustee, the beneficiary and the assets of the trust. A formal trust can be used for situations where you don’t want control over the assets to revert to the beneficiary as soon as he or she has reached age of majority. The deed of trust can specify how the trust’s assets are to be invested, how long the trust is to continue, and how and when the assets are to be distributed to the beneficiary. For instance, the deed of trust could specify that the trustee controls disbursements of income to the beneficiary from age 18 to 25 for the purpose of paying for post-secondary education, and that control over the trust’s assets reverts to the beneficiary once he or she reaches age 26. Formal trusts can vary in complexity, and typically require legal expertise to ensure that the deed of trust is properly drafted. Formal trusts are appropriate when you wish to delay the shift in control over the assets to the beneficiary beyond the age of majority, or when the amount in the trust is substantial.

## **"In Trust" Accounts: You Were Asking?**

**Q** *If I am the donor, can I also be the trustee of the "in trust" account?*

The idea behind an "in trust" account is to have the child pay the tax on any capital gains earned in the account. If you don't accomplish this, then an "in trust" account hasn't served its purpose. To ensure that the child pays the tax on any capital gains, the donor has to, in the words of Revenue Canada, "divest, deprive, or dispossess" him or herself of title over the funds. If your name, as the donor, remains on the account with the child's, then you'll run into problems. Revenue Canada will attack you under subsection 75(2) of the Income Tax Act, which applies if your consent is required before assets in the account are disposed of. And this will certainly be the case if you remain as trustee on the account.

**Q** *Is it necessary to file a tax return for an "in trust" account?*

Our tax law requires that every trust file a tax and information return annually. An informal trust is, in fact, a trust (albeit an "informal trust"), and would therefore appear to be caught under the requirement to file a tax and information return annually. Currently, Revenue Canada is not enforcing this requirement, presumably because the tax dollars to be recovered are relatively small given the size of most "in trust" accounts. Revenue Canada's leniency could change if "in trust" accounts were to become significant in size.

**Q** *Do I have to file a tax return for my child who has earned capital gains from an "in trust" account?*

Normally, an individual who is not taxable is not required to file a tax return. An exception, however, is when capital gains have been realized. As a result, you should file a tax return each year that there are realized capital gains to report in the hands of the child.

**Q** *Can I transfer the assets of an "in trust" account to a formal trust later?*

While there is nothing under our income tax law that will prevent you from transferring assets from one trust to another, provincial trust law is an issue. When you set up the informal "in trust" account, you have what is known as a "bare trust". Under this arrangement, the only authority of the trustee is to invest the funds on behalf of the child until the assets revert to the child once age of majority is reached. In fact, beneficial ownership of the assets in the account has passed to the child from the outset, and the donor has no right to place conditions on these assets after-the-fact. By transferring the assets to a formal trust, you are altering the trust arrangement, which could be in violation of provincial trust law. Even if you were to make the transfer, there would be a deemed disposition at fair market value of the assets in the "in trust" account under our tax law. This could result in a taxable capital gain.

**Q** *Can I transfer the assets of an "in trust" account to an ESP?*

No. When you set up the "in trust" account, you set up a trust arrangement that cannot be changed without the concurrence of the child beneficiary – and this concurrence would have to be ratified once the child reaches age of majority. If, for example, you were to transfer your "in trust" account assets to an ESP and the child did not pursue post-secondary education, you would be able to take back those assets from the ESP. This would not have been permitted under the terms of the "in trust" arrangement, so you would have effectively circumvented the initial trust arrangement established when the "in trust" account was set up. This is not permitted.

## Tips for “In Trust” Accounts

**Tip 1:** Be sure to focus on assets that will generate capital gains rather than interest or dividends when investing in an “in trust” account. Choose stocks or equity mutual funds that invest in stocks to accomplish this. This way, you’ll minimize the interest or dividend income that will be attributed back to you – the donor.

**Tip 2:** Always ensure that the donor to the “in trust” account is not the same person as the trustee. The trustee is the person whose name is on the account with the child. This way, you’ll likely avoid problems with Revenue Canada later.

**Tip 3:** Always be sure to name the child beneficiary on the “in trust” account. For example, “John Doe in trust for Jimmy Doe” would suffice. However, “John Doe in trust” would not. If you fail to list the individual child, you could run into a problem under subsection 75(2) of the Income Tax Act which will tax the donor on all income in the account if the beneficiary can be named later.

**Tip 4:** Set up a formal trust rather than an “in trust” account if the amounts in the account are expected to be significant down the road, or if it is important to maintain control over the assets once the child has reached the age of majority.

**Tip 5:** Use an “in trust” account if it will not be possible to save enough for a child’s education through use of an ESP alone. This can often be the case where you are starting to save for a child’s education at a late stage.

**Tip 6:** A combination of an “in trust” account and an ESP may make sense where you’re not sure which method is best in saving for a child’s education. In addition, if you choose to use both vehicles for investing, and you are holding both interest-bearing and equity investments when setting aside money for your child’s education, you should consider holding the interest-bearing investments inside the ESP where they will grow tax sheltered, and the equities in the “in trust” account where all capital gains will be taxed in the child’s hands.



## How Much Is Enough?

*You already know that your child or grandchild's education is going to cost a lot of money. But how much, exactly? And how much should you be investing today for the future to ensure the costs are covered?*

Is this an eye-opener for you? You can see that, the earlier you start, the easier the investing becomes. So visit your Investment Advisor today to start a program of saving for that special child in your life.

Investing to Cover Expected Education Costs	Age Of Child	First Year Of Post-Secondary Education	Expected Education Cost For Four Years*	Monthly Investment Required To Save Enough For All Education Costs Based On Expected Rate of Return		
				8%	10%	12%
				Under 1	2017	\$127,700
1	2016	120,300	279	226	182	
2	2015	113,500	293	241	197	
3	2014	107,100	310	258	214	
4	2013	101,100	328	278	234	
5	2012	95,600	350	301	257	
6	2011	90,400	376	327	284	
7	2010	85,600	407	358	315	
8	2009	81,100	443	396	353	
9	2008	76,900	488	442	399	
10	2007	73,000	545	500	457	
11	2006	69,300	618	573	530	
12	2005	65,900	716	672	629	

\* SOURCES: Statistics Canada and Association of Universities and Colleges of Canada. Assumes tuition fee increases of 9.06% annually and increases in other costs of 3% annually. Figures assume student lives away from home. These figures assume that investments are to cover 100% of education costs. To the extent the student pays for some costs, the amount saved monthly can be reduced proportionately.



## A Final Comparison

*Still not sure which is best for you – the ESP or the “in trust” account? Here’s a report card on them. Ask your Investment Advisor for a recommendation based on your specific circumstances.*

Education Savings Plans vs. “In Trust” Accounts	Education Savings Plan	“In Trust” Accounts
	<b>Contribution limits</b>	\$4,000 per beneficiary per year. Lifetime maximum of \$42,000 per beneficiary.
	<b>Investment options</b>	No restrictions under a self-directed plan. Investment fund or savings account plans generally offer one type of savings vehicle or mutual fund family. Group plans generally offer no options.
	<b>Government assistance (CESG)</b>	Canada Education Savings Grant is available. The grant is 20 percent of contributions made within the child’s “grant room” – normally a maximum grant of \$400 annually.
	<b>Control over assets</b>	The trustee of the account controls how the money is invested. The assets, however, belong to the child at all times. The assets must be held for the child until age of majority is reached, then the control reverts to the child.
	<b>Use of assets</b>	A beneficiary must use the earnings for qualifying post-secondary education, otherwise earnings revert to the subscriber. If earnings are returned to subscriber, income tax plus a 20% penalty will be due by the subscriber on the accumulated growth inside the plan, unless the earnings are transferred to the subscriber’s RSP.
	<b>Recovery of capital</b>	Contributor has no right to recover assets in the account since they belong to the child.
	<b>Taxation of earnings</b>	Assets grow tax-deferred over the years. Student will pay tax on withdrawals of earnings when enrolled in a qualifying educational program.
	<b>Tax filings</b>	Simple interest and dividends taxed in hands of contributor annually. Capital gains and compound interest and dividends are taxed in the hands of the child annually.
		No annual filings required until withdrawals of earnings are made from the ESP, then the beneficiary must file a return to declare the withdrawals.
		Must file a return for the child to report any taxable capital gains. Technically, a trust tax return should be filed annually, although Revenue Canada has not, to date, been enforcing these filings for “in trust” accounts.

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