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The Global Students

Michael Nairne, Serious Money

Buenos Aires, Shanghai, Prague, Rome, London. The academic programs abroad for children of affluence read like a retiree's dream list for globetrotting.

By the time these teenagers graduate from high school, many of them will have spent several summers abroad earning course credits while being enriched by their exposure to new cultures, languages and people.

So, it's not surprising that many of these teens are opting to take their entire university educations outside Canada. It's a wonderful idea, but carries a hefty price tag. Annual tuition fees for international students at universities in the United States can easily be in the range of US$35,000 a year. Throw in the cost of residence or an apartment, student fees, books, health care and travel, and the total cost can top US$50,000 a year.

Even for affluent families, this is a big nut. I have talked to wealthy parents who have funded more than $250,000 per child for their children's university educations. They are glad they did it but many were caught off-guard by the cost. Worse yet, in some cases, this hefty expenditure materialized as the parents were heading into retirement.

Hence, a priority for most affluent families with children is an education plan that allows for university abroad. Like all good plans, it should lay out goals, time frames and amounts, as well as the specific investment strategy. It should also be integrated into the overall wealth plan of the family, particularly with respect to taxation and cash flow.

A key funding vehicle today is a registered education savings plan. Although contributions to an RESP are not tax-deductible, income in the plan compounds tax-free. From an affluent family's perspective, the $50,000 in lifetime contributions allowed per beneficiary creates a material tax avoidance opportunity.

An RESP is particularly appropriate to house corporate and high-yield bonds that would be taxed at the top marginal rate in the parents' hands.

Since the federal government will fund up to 20%of annual RESP contributions, to a limit of $500 in grants per year (a lifetime grant limit of $7,200), the tax-deferral benefits of larger contributions have to be weighed against the value of the grant. Typically, under the current rules at today's interest rates, it makes sense to make some large contributions early in the plan's life for very young children. Overall, properly funded from birth, it's now possible to build an RESP with an expected value in excess of $125,000 per child.

The beauty of this plan is its tax effectiveness. The original contributions can be withdrawn tax-free. Although both the accumulated income and grants are taxed as regular income in the hands of the student when educational assistance payments are made from the RESP, other tax credits are available to offset this income, such as tuition fee, educational and textbook credits. Given the sizeable credits available, there may also be an opportunity to shelter distributions to the student from a family trust.

But a heads up is in order. There are limitations on the programs and institutions outside Canada that qualify for RESPs, as well as for the tuition and other tax credits. Visa issues and other cross-border tax issues can also rear their heads. RESPs have other risks and limitations so you should consult your professional advisor.

Finally, the asset mix of an RESP must be managed over time -- you can't just put it on autopilot. U.S. dollar investments may be preferred at some point. As a teen approaches university age, short-term, high-quality bonds should be favoured. You want certainty of funds when your global student heads abroad.

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