



Is an RRSP Loan Right for You?

By: Mike Magreehan

AN RRSP IS AN EXCELLENT TOOL TO ASSIST YOU IN SAVING FOR YOUR RETIREMENT. The tax-deferred compound growth, coupled with the tax-deductions received on your contributions, makes it a very attractive investment vehicle.

Due to many financial demands, you may find it difficult to maximize your RRSP contribution. A loan can help you maximize your contribution and reduce your taxes. If you plan to retire someday, proper planning today is crucial.

GUIDELINES TO CONSIDER

Before adding to any existing debt, you should ask yourself: "Can you repay the loan in full within one year?"

A common sense rule of thumb is that an RRSP loan should not extend beyond one year. You might find yourself continually playing catch-up and therefore needing a loan the following year. Interest on an RRSP loan is not tax-deductible, and you should make it a priority to repay your loan as soon as possible.

The application and approval process is generally quite easy. When selecting the right RRSP loan, you should ensure that you are able to borrow at prime (currently 4.25%), and have the flexibility to make extra payments without penalty.

Some RRSP loan providers allow you further flexibility, in that they allow you to defer your first payment for 90 days. This feature allows you to make your RRSP contribution, file your tax return, and receive your tax refund, all before your first payment is due. You can then apply your tax refund directly to the loan.

If you pay your loan off after several months, you should continue to make your allotted payment but direct it to your RRSP instead. You will benefit from dollar-cost-averaging and the following year you will have to borrow less (if any) to top up your RRSP. Generally, within a few years, you might not need a loan at all.

By understanding and using the tax system effectively, you can maximize both your contribution and your tax savings.

Consider the following scenario. Assume your income is between \$31,000 and \$67,000 (i.e. a 31% marginal tax rate). If you have \$5,000 saved for an RRSP contribution, you should borrow \$2,250, for a total contribution of \$7,250. An RRSP contribution of \$7,250 will earn you \$2,250 refund (31% of \$7,250), which in turn, can be used to pay off the \$2,250 RRSP loan. This strategy allows you to contribute more to your RRSP at a minimal cost to you.

Today, many Canadians have accumulated considerable "unused" RRSP contribution room. If you do not maximize your RRSP contributions each year, the unused portion is not lost; rather, it is accumulated and can be carried forward and used in future years. A loan can help eliminate this unused amount.

As with any investment or financial decision, there are many things to consider. Seek the counsel of a qualified financial advisor skilled in the area and understands your unique situation.

Mike Magreehan, BBA, CFP is an investment advisor with Canaccord Capital in Waterloo, ON. Tel: 519-886-1060.

Email: mike_magreehan@canaccord.com