

# The TaxLetter®

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Your Guide to Tax-Saving Strategies

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## TAXSTRATEGY

### *Your RRSP as Lender*

# A Refresher

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A few years ago I wrote on the ability to borrow from your RRSP, and the response to the article was quite unexpected. In fact, in the fifteen + years that I have been writing for The TaxLetter, this is the one article that spurred a lot of emails to me regarding the ability to actually use your RRSP as a personal credit facility. We all know that withdrawing from your RRSP before it's time results in a punitive tax hit to you; so if there is a legitimate way to access your RRSP funds before you "turn of age", then I guess that will make for a popular topic. And since there have been some small updates to certain strategies since I last wrote on this issue, I thought it

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might be worthwhile to do a little refresher on the topic, and provide an update on the practicalities of actually borrowing from your RRSP .

Essentially, there are three ways to access your RRSP funds prematurely without triggering a penalty:

1. The Home Buyers' Plan
2. The Lifelong Learning Plan
3. The "RRSP Mortgage

#### **The Home Buyers' Plan**

If you need money from your RRSP because you are buying a home, this plan is the alternative to an out and out withdrawal. A tax-free withdrawal of up to \$25,000 can be made under the "Home Buyers' Plan" (previously this amount was capped at \$20,000). Basically, the withdrawal is designed to apply only if you - and your spouse, if married legally or common-law - are "first-time"

home buyers (a four-year look-back rule applies - see below). The withdrawal must be repaid in equal installments over 15 years - to the extent that a minimum repayment for a year is not made, the shortfall is taxed in your income. The 15-year repayment period commences in the second calendar year following the calendar year of the RRSP withdrawal, but payments made in the first 60 days of a year count as repayments for preceding year. For example, if you make a withdrawal in 2018, you must commence making RRSP repayments under the Home Buyers Plan by March 1, 2021.

There's no specific restriction on "doubling up" on the withdrawal e.g., where a home is held in co-tenancy. For example, a husband and wife may together withdraw up to \$50,000 (i.e., up to \$25,000 from each spouse's plan).

You're generally eligible for the plan provided that:

- you've never participated in the program before;
- you've signed an agreement to build or purchase a qualifying home;
- the home (or a replacement property) is bought or built by October 1 of the year following the year in which you've received the funds from the RRSP or (extensions are available in some instances); and

• you intend to occupy the home as your principal place of residence within one year of buying or building the home.

Finally, a “look-back” rule prohibits ownership of an owner-occupied home by you or your spouse (including a “common law” spouse) for a period of four years or so.

Is a Home Buyers Plan withdrawal a good idea? The big problem with the home buyer’s plan is that you could be caught in a cash-flow crunch that could lead to tax penalties down the road. Firstly, the cash-flow drain due to repayments to the plan may impinge on your ability to make your regular - tax-deductible - RRSP contributions in the future. So, without the RRSP write-off, your tax bill could go up. Worse still, if the required Home Buyer’s Plan repayment - which is not deductible - is not made on a timely basis, then you’ll suffer a further taxable benefit. Even harsher rules may apply if you pass away or cease to be a Canadian resident. (Note: Restrictions apply to deductions for ordinary RRSP contributions if made less than 90 days before the withdrawal.)

If you or your spouse are about to drop into a low tax bracket (e.g., there are plans to retire from the workforce), the Home Buyers’ Plan may make more sense. For example, the taxable benefit resultant from non-repayment may result in little or no adverse tax consequences under these circumstances.

Having said this, participating in a Home Buyers’ plan is usually a better bet than an out-

right withdrawal from your plan, which is a straight add-on to your taxable income in the year of withdrawal – the only problem is whether \$25,000 is enough in this real estate market!

### **The Lifelong Learning Plan**

Tax-free withdrawals from RRSPs are also allowed to support what the government calls “lifelong learning.” Taking a page from the “Home Buyer’s Plan,” you can withdraw up to \$10,000 per year from your RRSP, to a maximum of \$20,000 over a 4 year period, if you or your spouse is enrolled in a qualifying educational or training program (normally full-time for at least three months during the year).

Withdrawals are repayable to the RRSP over a period of 10 years in equal installments; otherwise there will be a taxable benefit. Repayments must normally commence in the year following the last year of full-time enrolment, or in the sixth year after the first withdrawal, if earlier.

If you do not have an RRSP, you can’t set one up and then immediately make a withdrawal under the lifelong learning plan; the contribution must be in the RRSP for at least 90 days before you can deduct it from your income. If you already have an RRSP, you must also wait 90 days from the date of any contribution before you can get the deduction and withdraw the funds.

Is a Lifelong Learning withdrawal a good idea? The answer is fairly similar to the Home Buyer’s Plan. Having to fund RRSP repayments will, no doubt, interfere with your ability to make regular - tax-deductible - RRSP contributions. This prob-

lem could come at a time when you’re in a higher tax bracket than when the RRSP withdrawal was made. If this is the case, it may often make sense to “pass up” the “lifelong learning” opportunity and make an ordinary taxable withdrawal from your RRSP to fund education, then make a regular tax-deductible contribution when the workforce is re-entered. The basic personal exemption will now cover off \$11,635 of taxable income, not to mention tuition and education tax credits which may also be available to shelter the withdrawal.

### **The RRSP Mortgage**

The Home Buyers’ and Lifelong Learning Plans are not true loans (instead, tax penalties apply if you don’t restore the funds to your RRSP within applicable time limits) - but the RRSP mortgage is. You can take out a loan from your RRSP provided that it is insured by the CMHC or a public mortgage insurer (such as Genworth Financial Canada or AIG United Guaranty Canada). This is an exception to the rule that an RRSP cannot hold the mortgage of the plan-holder or a family member.

You might use your loan to pay down your mortgage. So instead of paying mortgage interest to the bank, you pay yourself. In this case, your benefit is largely based on the difference between the interest rates you’d otherwise pay on your mortgage (i.e., this is what you “save”) and the return you’d make on your RRSP if you didn’t follow this strategy. In addition, if you are paying more into your RRSP than the return you would make on a conventional investment,

you will have more money compounding in your plan on a tax deferred-basis.

There is no tax rule that you have to use your RRSP loan to pay down your mortgage, or even put the money into your home, for that matter - the tax rules require that the loan must be secured by Canadian real estate. So the loan might be used, for example, to provide financing for a new business (the mortgage insurer must approve of the use, though). What's more, if the money is used for business or investments, the interest should generally be tax-deductible to the borrower. (The CMHC does not allow these "equity take out" loans, though; so when it comes to this sort of thing, you're better best is to go with Genworth or AIG.)

According to CanRev, the "RRSP mortgage" - which must be secured by Canadian real estate - must have normal com-

mercial terms, including market interest rates.

Now you might be thinking that this is a great idea, and how do you sign up? Well, word of caution. Obtaining an RRSP mortgage is not as easy as it may seem. For one thing, the insurance providers such as Genworth tend to be very particular about when they would provide insurance, especially as some believe that when you borrow from your own RRSP, there may be a higher risk of default. Why? Well, some people may think that when they are borrowing from themselves, then maybe it's not such a big deal if one or two payments are missed. However, CRA in addition to the mortgage insurers would have an issue with this since you would effectively be taking money tax free from your RRSP without repaying it.

**Tax Tip #1.** One interesting use of an RRSP mortgage

could be to make a catch-up contribution to your RRSP - that is, if you haven't maxed out on your RRSP contributions in the past. It works like this: your RRSP makes you a mortgage loan. Then you put the proceeds right back into your RRSP - as a catch-up contribution, that is - and you get a tax deduction based on the amount of your catch-up contribution.

**Tax Tip #2.** It's possible to make an RRSP mortgage loan to another family member. It is also possible (theoretically, at least) to do the RRSP mortgage manoeuvre based on a second mortgage or even a vacation property. However, it may not always be possible to get mortgage insurance in these circumstances as the insurers tend to shy away from the risk associated with a non-income producing property (especially if it is already subject to another bank's mortgage). ■