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TAXSTRATEGY

Borrowing from your RRSP

Can you?

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Borrowing these days can be pretty painful. Gone are the low interest rates and that variable rate you got a couple of years ago. Either one of these can cause heartburn. So, it's no wonder that I keep thinking about an article I wrote a while back about the ability to borrow from your RRSP. In fact, I received a call out of the blue from someone who had read my article asking about how that could work. So I thought it would be worthwhile to dust off my article and do a 2023 version it.

The golden rule we all know is -- Don't withdraw you're your RRSP before it's time. Otherwise you can be hit with a hefty tax penalty (this is because one can actually lower their tax bill when contributing to an RRSP). But, with every rule, there are always exceptions. In this case, three of them. Essentially, you can access your RRSP funds prematurely without triggering a penalty as follows:

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 $35,000 can be made under the "Home Buyers' Plan" (prior to March 2019, this amount was capped at $25,000). Basically, the withdrawal is designed to apply only if you or 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. Payments made in the first 60 days of a year count as repayments for the preceding year. For example, if you make a withdrawal in 2023, you must start making RRSP repayments under the Home Buyers Plan by March 1, 2024.

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 $70,000 (i.e., up to $35,000 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 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

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"common law" spouse) for a period of four years or so. If you are not considered a first-time buyer now, you may be considered a first-time home buyer later, once the four-year period has passed. For example, if in 2017 you sold the home you lived in before, you may be able to participate in 2023, or if you sold the home in 2018, you may be able to participate in 2024.

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, you'll then 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 resulting from nonrepayment may result in little or no adverse tax consequences under these circumstances.

Participating in a Home Buyers' plan is usually a better bet than an outright withdrawal from your plan, which is a straight add-on to your taxable income in the year of withdrawal.

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 are 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 in 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 problem 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. You can then make a regular *tax-deductible* contribution when you re-enter the workforce. The basic personal exemption will now cover off $15,000 of taxable income (for 2023), 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). However, the RRSP mortgage is a true loan. You can take out a loan from your RRSP provided that it is insured by a mortgagor insurer. Canada Mortgage Housing Corporation (CMHC) is the main one, but two others that I am aware of are Sagen (formerly Genworth Canada), and Canada Guaranty Mortgage Insurance Company. This is an exception to the rule that an RRSP cannot hold the mortgage of the planholder 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 issue is a non-tax one, though you need to make sure that the mortgage insurance company will consent to the use of the borrowed funds. For example, the CMHC does not allow these "equity take out" loans. It will also have restrictions on the type of real estate being purchased as well as the total purchase price. So, it might be worth speaking to the other companies.

According to CanRev, the "RRSP mortgage" - which must be secured by Canadian real estate - must have normal commercial terms, including market interest rates.

You might be thinking that this is a great idea and wondering whether to sign up? Well, a word of caution. Obtaining an RRSP mortgage is not as easy as it may seem. For one thing, the insurance providers tend to be very particular about when they would provide insurance, especially, as some believe, that when you borrow form 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 would also have an issue here since you would effectively be taking money tax free from your RRSP without repaying it. So, I cannot stress that while this loan is possible, in practice it may be harder to achieve than you would initially think.

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 a mortgage loan to you. Then, you put the proceeds right back into your RRSP - as a catch-up contribution - 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). ❏