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RRSP STRATEGY

Three smart ways to…

Tap into your RRSP

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We all know the cardinal rule relating to RRSP withdrawals before maturity: DON'T DO IT! The tax hit on withdrawals from your RRSP has always been a huge obstacle for using it as a source of cash.

However, there are three strategies that effectively allow your RRSP to make a "loan" to you, rather than an actual withdrawal: the Home Buyers' Plan, the Lifelong Learning Plan and the RRSP mortgage.

These strategies may not always make sense; however, compared to an out-and-out withdrawal, they usually do, since you have a chance to restore the withdrawal to your RRSP without penalties.

The Home Buyers' Plan

If you are buying a home and need money, there is an alternative to a straight withdrawal from your RRSP: the Home Buyers' Plan (HBP). Up to $25,000 can be withdrawn tax-free under the plan, although it's important to note that it only applies if you (and your spouse, if married legally or common-law) are first-time home buyers. A five-year look-back rule also applies - see below for more details.

Moreover, your RRSP contributions must remain in your RRSP for at least 90 days before you can withdraw them under the HBP, or they may not be deductible.

The withdrawal must be repaid in equal installments over 15 years; if a minimum repayment for a year is not made, the shortfall is taxed on your income.

The 15-year repayment period commences in the second calendar year following the year of the RRSP withdrawal, but 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 2014, you must start making RRSP repayments under the HBP by March 1, 2017.

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 (up to $25,000 each).

Generally speaking, those eligible for the plan will have:

- Never participated in the program before;
- Signed an agreement to build or purchase a qualifying home;
- Bought or built the home (or a replacement property) by October 1 of the year following the year in which they've received the funds from the RRSP (extensions are available in some instances);
- Intentions to occupy the home as their 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 five years or so.

Essentially, you are not considered a first-time home buyer if, at any time during the period beginning January 1 of the fourth year before the year of the withdrawal and ending 31 days before the date of withdrawal, you or your

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spouse or common-law partner owned a home that you occupied as your principal place of residence.

There are some exceptions to the "first time home buyer" condition that apply only if you are a person with a disability and require funds to acquire a home to better suit your needs (or if you are doing so on behalf of a person with a disability who is related to you).

The big problem with the HPB? You could be caught in a cash-flow crunch that may lead to tax penalties down the road.

First, the cash-flow drain (due to repayments) 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 Buyers' Plan repayment – which is not deductible – is not made on a timely basis, 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, possibly when you retire from the workforce, the Home Buyers' Plan may make more sense.

For example, the taxable benefit 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 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 Buyers' Plan, withdrawals of up to $10,000 per year can be made from your RRSP (to a maximum of $20,000 over a four 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.

Is a Lifelong Learning withdrawal a good idea? The answer is similar to the HBP. 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 often makes 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 $11,038 (for 2013) 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. Rather, 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 mortgagor 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 only require that the loan must be secured by Canadian

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real estate.

So the loan might be used, for example, to provide financing for a new business (but the mortgage insurer must first approve of the use). 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, so when it comes to this sort of thing, you're best is to go with Genworth or AIG.

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

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) and get a tax deduction based on the amount of your contribution.

Tax Tip #2. It is 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 or rental property. However, it may not always be possible to get mortgage insurance in these circumstances. ❐

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