When is a loan right for you?

**YIVA VAN BUUREN**

It’s a common scenario at tax time — the accountant preparing your personal tax return calls to say that you owe money ... and you should buy RRSPs to reduce the tax bill. If extra funds are not available, should you rush out and get a loan?

"Unfortunately, most people make RRSP loan decisions on the spur of the moment," says Stephanie Holmes-Winton, CEO, The Money Finder, Halifax, and a member of Advocis, The Financial Advisors Association of Canada. "And it should really be a thought-out part of their financial plan."

Reducing your tax bill is one of the reasons why many people buy RRSPs — and that makes sense, says Anthony Williams, Canadian Institute of Financial Planning, vice-president of academic affairs. A lump sum RRSP loan will help reduce your gross income, which reduces the amount of taxes you owe.

At the same time, putting a lump sum amount in all at once allows your money to grow more over time, Williams said, because it’s in there longer — compared to if you put in the same amount but made monthly contributions.

Another reason people take a large sum RRSP loan is because it may trigger a tax refund, but that can work against you, too, if you aren’t careful.

Here are three scenarios where you might want to re-consider an RRSP loan:

- **You aren’t a disciplined money manager.** "Borrowing money to get a tax refund and then spending the refund on ‘whatever’ is not recommended," Holmes-Winton said. "You end up paying the loan back with after-tax dollars plus interest."

- **It’s better to apply the refund cheque to the RRSP loan and lower the principal.** Some banks structure RRSP loans so the first payment won’t apply until after you get the tax refund.

- **The new monthly payment will not be manageable.** A loan means there is a debt obligation and you will have to have the cash flow to make the monthly payment. Some people have to supplement their income, Holmes-Winton said, by using credit cards and lines of credit and they end up in worse shape.

The loan costs more than you think.

Sometimes there are payment free periods of time, but extra interest costs or administrative fees. Always read the fine print, and don’t rush into anything.

Contributions. Program allows you to upgrade your education

**MICHELLE WILLIAMS**

In recent years, the number of Canadians of all ages starting over in new careers has hit an all-time high. Maybe you have always wanted to explore new opportunities — or perhaps you have been caught in your company’s downsizing and you need to establish yourself in a new vocation. The quandary is how to support yourself and your family while you retrain.

"A new government program is making education upgrading easier for Canadians," explains Serena Cheng, director of Wealth Management and investment adviser with Richardson GMP in Toronto. "The Lifelong Learning Plan (LLP) allows you to take out up to $10,000 annually from your RRSPs to a total of $20,000 in more than a four-year period for you or your spouse, but not for your children’s education. The best part — you will continue to be sheltered from paying taxes on the withdrawal. You will have to repay your RRSP over a 10-year period; any funds not repaid after the 10-year deadline will count as income and be taxed.

To participate in the program, there are conditions to meet. While you can use the funds to pay any expenses, you must be registered full time (disabled individuals may be registered part time) in a qualifying program at an approved educational institution. You must reside in Canada and complete your program before 71 years of age.

Participation in the LLP program is available as many times as you want over your lifetime, provided you pay back your RRSP contributions before you apply for a new program. Typically, repayments must start in the fifth year after the first withdrawal to avoid tax penalties. "This plan is a great incentive to get retrained if you are starting over in a new career, but you want to make sure you see yourself moving into the particular field you’re training for before you decide to dissolve your assets," Cheng said. "It would be a shame to lose out on the deferred growth of your RRSP and discover part way through the program that this isn’t the field for you."

For more information on the Lifelong Learning Plan and more ways to use RRSP contributions to train for a new career, contact a certified financial planner or your local financial institution.
Homebuyers can take advantage of new plan

**RSPs can be a good way to finance a home purchase.**

**Pool your savings with a spousal RSP**

When one person in a married or common-law couple has a much higher income than the other, it’s a great idea to open a spousal RSP, especially if you intend to retire before age 65, says Dean Owen, a personal financial adviser in Saskatoon and past chair of ADVOCIS, The Financial Advisors Association of Canada.

A spousal RSP allows a couple to build up the pool of savings for the person with the lower income so that at retirement there are equal amounts of RRSPs.

“Basically, it’s a smart tax move with the intention of income splitting,” says Anthony Williams, vice-president of academic affairs, Canadian Institute of Financial Planning. “You’re shifting income from the higher income earning spouse to the lower income earning spouse with the objective of reducing the accumulative family tax bill.”

How does it work?

The spouse with the higher income opens — and contributes to — a spousal RSP in the partner’s name. How much the contributor puts into the RRSP depends on what their contribution limit is that year. If it’s $20,000, for example, they can put the entire amount into their own RRSP; they can put the entire amount into the spousal RRSP; or they can split the amount between the two plans. But they can’t go over the limit, Owen said.

While the contributor gets the tax deduction today, “the idea is to even out your retirement savings so you can keep the taxes you pay when you are retired as low as possible,” Owen said. Instead of withdrawing $60,000 from one person’s fund, for example, each person withdraws $30,000 and is taxed at a lower tax bracket.

One caveat is that funds must not be withdrawn for at least three years. If they are, the money is attributed back to the contributor who pays the tax bill. When withdrawal occurs after this attribution period, the tax is paid by the owner.

**Michele Williams**

Your dream home just posted a “For Sale” sign — but your assets are tied up in RRSPs. Do you let this opportunity pass you by?

“We don’t,” says Serena Cheng, director of Wealth Management and investment adviser with Richardson GMP in Toronto. “RRSPs can be a great way to finance a home purchase. If you’re a first-time buyer, take advantage of your RRSP investments to buy a home with the federal Home Buyer’s Plan.”

Home Buyer’s Plan (HBP) is a government program that allows first-time buyers to withdraw as much as $25,000 from RRSP contributions to buy or build a home for themselves or a related disabled person. “The biggest benefits are that you don’t have to pay taxes on this amount, and you have 15 years to pay it back to your RRSP fund,” Cheng said. “And if you are purchasing the home with your spouse or partner, you can each withdraw $25,000.”

One firm condition is that payments to reimburse your account must be at least 1/15th of the amount each year. If you can’t repay annually, you must pay tax on the amount. Among the other conditions: You must reside in Canada and purchase your home in Canada; the home must be your primary residence; you must be a first-time buyer or have not owned your principal residence for a period of at least five years; and you must be participating in this plan for the first time.

“The HBP is a good way to get your hands on cash for a down payment, but one disadvantage is that you do lose out on the deferred growth of your RRSP,” Cheng said. “You also have to be committed to paying it back on schedule to protect yourself against tax penalties.”

For more information on the Home Buyer’s Plan and more ways to use RRSP contributions to purchase your home, contact a certified financial planner or your local financial institution.

**Talbot Boggs**

While the registered retirement savings plan (RRSP) is a great vehicle to help Canadians save for their retirement, there are some pitfalls that investors may not know about and should try to avoid.

Many people, for example, confuse their contribution limit with the deduction limit.

The deduction limit is set at 18 per cent of your previous year’s earned income, up to a dollar limit, which changes every year. The maximum dollar limit for the 2012 tax year is $22,970, up from $22,450 in 2011, and will rise to $23,820 in 2013. It is contained in the notice of assessment that you get each year from the Canada Revenue Agency after you have filed your return.

Another pitfall can be saving too much in your RRSP and having too many accounts. An RRSP of between $700,000 and $2 million, for example, may sound great, but that money will be taxed at some point. A retiree with such a large plan would be in the 46 per cent tax bracket and would have their Old Age Security (OAS) clawed back.

Having your financial assets spread over several accounts can lead to a disorganized investment strategy, duplication, inappropriate asset allocation and paying more fees than if all investments were consolidated in one account.

Waiting to the last minute to make your contribution is another common pitfall. It can lead to making emotional decisions or parking the money for too long on the sidelines. By contributing early or making regular contributions during the year you get the tax-sheltered returns starting sooner and get the advantages of dollar cost averaging.

Many people also may be investing in the wrong things in their RRSP. As a general rule, it’s better to invest in fixed income in your RRSP and equities outside of your RRSP in a non-registered account.

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**Michelle Williams**

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