CJA PROFESSIONAL SERVICES
ACCOUNTING, TAXATION, BUSINESS VALUATIONS & GENERAL BUSINESS CONSULTING

The RRSP Loan Examined– Should You Borrow to Contribute to your RRSP?

Its January or February and its time to start thinking about your annual RRSP contribution. No doubt you are being inundated with RRSP offers from financial institutions. With so many options available, it is often hard to choose where you should invest your cash. But what happens if you want to contribute to your RRSP, but you don't have the cash? Should you take out a loan? Should you take advantage of the offer you just received in the mail: "Dear Mr. Smith: You have been pre-approved for an RRSP loan of up to $15,000 at 6%"

In many instances, this may be advisable. But first some background information.

When you contribute to your RRSP, you are able to deduct that amount from your income, ultimately lowering your total tax bill. Chances are that you have already paid the taxes on that income through your regular deductions from your employer. If that is the case, you may be expecting a cheque from Mr. Harper after filing your tax return.

If you don't have the cash to make an RRSP contribution however, you may consider borrowing money to make the contribution, which will (hopefully) result in a big tax refund. The idea would be that you would use the refund to pay down your loan. You will then have lowered your overall tax bill, plus you will have an investment growing on a tax free basis until retirement. Its win-win, right?

What you must consider though, is that to borrow the money to contribute to your RRSP, there is an interest cost. So you must balance that with the prospects of earning a return on your RRSP. If you borrow $10,000 to contribute to your RRSP at a rate of 6%, that is a cost of $600 per year. If you put your tax refund, say $3,000, towards that loan, plus make monthly payments over the next year to payoff the amount relatively quickly, you will have minimized your interest costs. In this scenario, there is a good chance the long term benefits will outweigh the short term costs.

The problem arises, however, when you aren't able to pay back that loan in a reasonable amount of time. If you are borrowing at 6%, but the return on your RRSP is only 5%, its actually costing you money to have an RRSP which is NOT the purpose of it. You have to be realistic with yourself in terms of the amount of time it will take you to pay back your RRSP loan.

At a time when interest rates are near record lows, the RRSP loan is extremely attractive. But things can, and will, change fast. That 6% interest rate can become 8%, 9%, 10% in no time if you don't stay on top of that loan. I've even seen individuals take out an RRSP loan, let it fall behind, and then roll the loan into their mortgage so that they are paying it off over 25 years. In that case, you're paying to have an RRSP. That is clearly not advisable.

The bottom line is, if you wish to take out an RRSP loan, consider the cost of the loan and what you expect to earn on your RRSP. Use any refund that you get to pay down the loan and try to pay off the loan within a year.

If you find that every February you are needing to borrow to make a contribution to your RRSP and then spend the rest of the year paying it off, you might consider a different tactic. Instead of making regular loan payments, why not make regular RRSP contributions? This has

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has two main benefits. For starters, instead of paying off a loan all year and paying interest on it, you are making regular contributions to your RRSP so that come February, you aren't scrambling to come up with the cash to make your annual contribution. Secondly, this gets the money into your RRSP sooner so that it starts growing on a tax-free basis. While a few months might not seem like a lot, over 20 or 25 years, that can amount to big $$$. In addition, if you make regular contributions, you can apply to the Canada Revenue Agency to lower the amount of income tax withheld from your paycheque so you don't have to wait until next April to get your refund.

One other thing I always advise my clients to do, is to check if your employer has a group RRSP plan. Most employers do, and in many cases, they will even match contributions up to a certain amount. If that is the case, its really a no brainer! The contributions come right off of your pay cheque so you don't even have to think about it and your employer tops them up! Plus, your employer will automatically reduce the amount of income taxes being withheld on your paycheque so the money is in your pocket now, not next April when you file your tax return.

If you are considering an RRSP loan and have questions on whether it is right for you, Chris Alexander can be reached at 905-334-6674 or chris@cjaps.ca.

About the Author:

Recognized in 2009 as one of the "Top CA's Under 40" in Ontario, Chris is a Chartered Accountant and Chartered Business Valuator with more than nine years of finance and accounting experience working with organizations that have ranged from large publicly listed NYSE and TSX companies to small owner-managed businesses and individuals.

Chris earned his Chartered Accountant designation while working for Deloitte & Touche LLP in Toronto. In 2009, he was recognized by the Institute of Chartered Accountants of Ontario as being one of the "Top CA's Under 40" in Ontario, being a recipient of the ICAO's prestigious Award of Distinction.

Chris earned his Chartered Business Valuator designation while working for a boutique business valuation firm in Toronto. He is recognized by the Canadian Institute of Chartered Accountants as being a specialist in the field of business valuations.

Chris is involved in the training of new CA students as a seminar leader at the ICAO's School of Accountancy. Chris has previously marked the practice and end of school exams for the School of Accountancy.

Chris also teaches part-time at the School of Business and Economics at Wilfrid Laurier University.

Chris is a board member and the Assistant Treasurer of the Oakville Parent-Child Centre, a charitable organization in Oakville focused on supporting, nurturing and empowering families, children and their caregivers.