

Tax Tip

Week of August 29, 2011

Mortgages and self-directed RRSP's

The income tax act lists various assets that are qualified investments to be held in a RRSP and mortgages are an allowable investment. Although the terms of the mortgage must be arm's length, it is quite acceptable to place your own mortgage inside a RRSP.

The benefit of transferring a mortgage to a RRSP is based upon acquiring the spread between financial institution's borrowing and lending rates. For example, a bank may charge a 5% rate of interest on five-year mortgages, while paying 3 % on guaranteed investment certificates for the same period. In such a transaction, the bank's spread is 2%. If a self-directed RRSP purchased a five-year G.I.C., it would earn approximately 3%. However, if the mortgage were held in a RRSP, one would make the mortgage payments to the RRSP and since the rules require the rate of interest to be at fair market value, the rate charged would be 5%. The benefit in this scenario would be the additional 2% rate of return. On a \$50,000 RRSP investment, the additional benefit would be:

$$5 \text{ year G.I.C.} \quad \$50,000 \times 3\% = \$1,500$$

$$\text{Mortgage} \quad \$50,000 \times 5\% = \underline{\$2,500}$$

$$\text{Potential Benefit} = \$1,000$$

Before deciding whether or not to pursue this strategy, one must consider the various trade-offs that must be made in terms of out of pocket and opportunity costs. Although it will vary by individual, the start-up costs may be in the \$1,000

to \$1,500 range. A further consideration of placing a mortgage in a RRSP is whether one believes a fixed rate of return is the appropriate investment vehicle for a RRSP. If a standard five-year G.I.C. will return 3%, the mortgage transfer may add an additional two per centage points. If one is satisfied with a 5% rate of return, this vehicle may be appropriate, but many individuals invest in equities, mutual funds or bonds in hopes of achieving higher level of returns.