The “bigger bang” RRSP strategy

Crunch the numbers with your advisor to see if an RRSP loan is right for you.

AS THE CALENDAR YEAR WINDS DOWN, many Canadians start thinking about contributing to a Registered Retirement Savings Plan (RRSP). Whether they make a single lump-sum contribution each year or contribute year-round with a “top up” before the annual RRSP deadline,[1] there’s a strategy that can help save more taxes this year and provide a head start on tax-deferred compounding.

The first step is to work with an advisor to determine how much to contribute to help reach retirement goals. Of course, not everyone has enough cash on hand to contribute that ideal amount. In that case, there are two options:

1. Contribute an affordable amount now and contribute the resulting tax refund when it arrives.

Let’s say someone with a marginal tax rate of 40 per cent has $7,000 ready to contribute during the first 60 days of 2016 to claim a deduction on his/her 2015 tax return. The tax refund of $2,800 ($7,000 x 40 per cent) can be contributed when received and claimed on his/her 2016 tax return. This is a better strategy than simply spending the refund, because it results in a total RRSP contribution of $9,800. However, there is an alternative.

2. Contribute a higher amount now, using an RRSP loan, and pay off the loan with the resulting tax refund.[2]

Taking out an RRSP loan in the amount of the estimated tax refund makes it possible to contribute a higher amount during the first 60 days of the year. The loan can then be paid off in full when the tax refund arrives. The result is a bigger tax refund for the 2015 tax year and more money growing earlier in a tax-deferred plan.

[1]The RRSP deadline is 60 days after the end of the year. [2]This strategy assumes that there are no other factors that would impact the total tax refund.

Sample calculations

Here's how to calculate a loan amount that can be completely repaid with the tax refund:

$$\frac{\text{(cash on hand x marginal tax rate)}}{\text{(100\% – marginal tax rate)}}$$

In our example (for illustration purposes only):

$$\frac{(\$7{,}000 \text{ x } 40\%)}{60\%} = \$4{,}667 \text{ loan}$$

Borrowing $4,667 boosts the total RRSP contribution to $11,667 from $9,800 – an extra $1,867 – and the entire amount can be claimed as a deduction on a 2015 tax return.

Tax refunds generally take no more than eight to 10 weeks to arrive – and returns filed early and electronically are often processed by the Canada Revenue Agency within 10 days. Even if a refund takes a full 90 days to arrive, the cost of the RRSP loan is minimal – in this example, just $40.

What to look for in an RRSP loan

Many institutions offer RRSP loans at very competitive interest rates, and some will defer the payments long enough so that you have plenty of time to receive your refund before making the first installment. Interest accrues on the outstanding balance, but the loan can be paid in full without penalty at any time.

Ideal candidates

An RRSP loan strategy is best suited for those who:

- Want to make an RRSP contribution in the first 60 days of the calendar year
- Have less cash on hand than the amount of the RRSP contribution they want to make
- Have sufficient RRSP contribution room to accommodate the top-up provided by the RRSP loan

Speak with your advisor

Carefully evaluate the pros and cons of an RRSP loan strategy with your advisor. If you decide together that it is an appropriate approach for you:

- Calculate your estimated tax refund for the year
- Apply for an RRSP loan in that amount
- Use the tax refund to repay the RRSP loan

Cost-benefit analysis

Cost	
Refund ($11,667 x 40%)	$4,667
Loan repayment	$(4,667)
Interest for 90 days	$(40)*
Cost	$40

Benefit			
Reinvest refund		**RRSP loan**	
Cash (deduction claimed in 2015)	$7,000	Cash (deduction claimed in 2015)	$7,000
Refund (deduction claimed in 2016)	$2,800	Loan (deduction claimed in 2015)	$4,667
Total RRSP contribution	$9,800	Total RRSP contribution	$11,667

*This example assumes an RRSP loan interest rate of 3.50 per cent. For illustration purposes only. Borrowing to invest in an RRSP may not be appropriate for everyone. You will need the financial means to meet your loan obligations in full. Talk to your advisor to find out more about the advantages and obligations of borrowing to invest.

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