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Think twice before paying off your debt with RRSPs

BY MIKE GRENBY, SPECIAL TO NORTH SHORE NEWS MARCH 3, 2013

SHOULD YOU CASH RRSP TO PAY OFF DEBT?

- With too much red ink, bankruptcy might be better choice

- Judge turns down woman's "medical" withdrawal appeal

- Mortgage in RRSP could free up funds

AS this year's Registered Retirement Savings Plan contribution season draws to a close, make sure you know about the perils of taking money out of your plan for the wrong reasons.

"More than one-quarter of debtors who come through our doors are 55 and older," said Blair Mantin, a senior vice-president of E. Sands & Associates, a trustee in bankruptcy. "These 'Grandpa Debtors' are especially vulnerable when it comes to the temptation to withdraw RRSPs to pay off debts."

Mantin said unfortunately after these folks pay income tax on their RRSP withdrawals, there often isn't enough money left over to eliminate their debts and they end up declaring bankruptcy anyway. RRSPs can be protected from creditor claims, said Mantin, urging people to get advice about bankruptcy options before cashing in RRSPs.

In another situation, a recent tax case involved a woman who as a last resort had taken $105,000 out of her RRSP to pay for back surgery in Switzerland because she couldn't get it done in Canada.

She had tried previously to get a mortgage on her home but had been turned down.

The judge also refused her appeal and she had to pay the tax on her RRSP withdrawal.

Only later did she realize she could have borrowed the money from her self-directed RRSP through setting up a mortgage in accordance with the tax department's rules.

You can get a tax break if you use RRSP money to buy a home or pay for education. But again, make sure you follow the rules.

I must admit I once took money out of my RRSP to avoid having to go back into debt. We had worked hard to pay off our mortgage and I felt it was worth the loss of the future RRSP growth to stay out of debt. Also, at the time, special general averaging rules minimized the tax I had to pay on the RRSP withdrawal.

However, if I had it to do over, I would have borrowed again and left the RRSP alone. Over the long term, the loss of all that tax-free compounding growth in the RRSP was just too high a price to pay.

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