

Own house sooner while paying less tax



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Western economies are susceptible to recessions approximately every 15 years. While most Canadians will never face a bigger debt in their lifetime than their mortgage payment, which can span a 20-25 year period, they are rarely provided with strategies that will lessen this burden.

As economic times change from good to recessionary and back again, the debt load of the Canadian property owner is always present. Currently 3.5 million mortgages in Canada are non tax-deductible. The question that many Canadians ask themselves and their financial advisors is, 'Does it have to be this way?'

The quick answer is no. To take advantage of mortgage debt and find tax relief, the mortgagor needs to take control of their financial situation. One method which is fully tax deductible is to write off mortgage interest as an investment

expense. Few Canadians know or understand how to leverage this tax strategy, which is readily available and can increase one's net worth (return on equity) and save thousands of dollars, while shaving years off mortgage payments.

The typical mortgage strategy concept on its own is simple, but the knowledge and tools require a sophisticated understanding of how to take advantage of a number of tax-saving strategies. What clients want today is a road map that will maximize their financial resources. Unfortunately the advice they usually receive only applies to one area of their financial life at a time, be it tax planning, investment management, insurance or whatever else. Rarely is a multi-disciplinary approach taken. This would allow the individual to combine multiple strategies to gain maximum results by implementing a solution that addresses the client's essential needs.

Today's savvy clients are demanding their advisors provide a more blended tax saving approach. This approach not only will increase personal profits while lowering expenses, but further allow a client to utilize all their assets. Getting more out of every dollar is the ultimate end game. Mortgage interest deductibility provides this additional benefit of holding an investment portfolio while owning a home simultaneously.

How does this work? This strategy requires clients to sell off

their non-registered investment portfolios to pay off or pay down their mortgages, and then borrow the equal amount again for the purpose of investing. The client's debt does not increase, but this debt conversion process allows the client to turn non-deductible mortgage payments into deductible interest payments.

This concept allows the mortgagor to save upwards of hundreds of thousands of dollars in interest payments, and take years off their mortgage, while placing their hard-earned money back in their pocket.

By looking at the following example one can see how tying a mortgage to an investment portfolio offers the best tax savings road.

Let's say Client A invested \$200,000 in his portfolio, and his shares have dropped in value. Today, Client A's investment portfolio is worth \$150,000 due the market decline, which created a paper loss of \$50,000.

Client A also holds a mortgage for \$150,000 and is paying five per cent per year, or \$7,500 after-tax interest. If Client A is in a 46 per cent marginal tax bracket, it actually costs him \$13,889 of pre-tax income to pay the \$7,500 interest cost after tax per year. By selling off his \$150,000 investment portfolio, using these funds to pay down his mortgage and then turning around and borrowing \$150,000 to re-invest, Client A will save \$6,389 per year in tax dol-

lars.

Now the loan, for Canadian Revenue Agency purposes, has been reclassified from being a mortgage to an investment loan.

Client A re-invests in the same investment portfolio as before. Using a six per cent rate of return compounded over five years, the \$150,000 grows to \$200,734 and earns back \$50,734 which he lost on paper when the investment markets went down.

For this example, let's round the figure off to \$50,000. Now let's assume Client A sells his investments and receives a \$50,000 capital gain, which is written off against the \$50,000 capital loss he took five years earlier. It's at this moment, Client A receives a 23 per cent tax savings or \$11,500, which would have had to be paid as his capital gains tax on the \$50,000 to CRA.

Let's assume that Client A invests his entire \$6,389 of the tax savings from restructuring his mortgage to an investment loan into his RRSP and it earns him six per cent compound yearly for five years. Client A will have invested \$31,945 of his tax savings into his RRSP during this period, which will have earned an additional \$6,231 to a total value of \$38,176 at the end of the five-year period.

If we sum up the two savings together (\$38,176 + \$11,500), this individual is wealthier utilizing the portfolio/mortgage strategy by \$49,676. The savings would not

have been possible if he had not combined these strategies of realizing the capital loss on his portfolio, making interest on his mortgage deductible and re-investing the tax saving in his RRSP.

By implementing this model, we can create a worthwhile tax saving plan while becoming mortgage debt free sooner.

Obviously, this approach requires a specialty in areas such as accounting, mortgages evaluation, investment management, and tax. Many clients and their accounting professionals will need to seek educational services to aid them in the setup and maintenance stages.

Therefore, it is worth the time and money to hire the right professional consultants to assist in the design, implementation and maintenance of this solution.

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