INVESTMENTS

BY ED REMPEL

Gross up registered savings

Consider borrowing to catch up on unused RRSP contribution room.

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Most clients have limited access to liquid cash. One simple but effective tool advisors can use to help clients contribute a lot more to their RRSPs without shelling out the extra dough is the RRSP refund gross-up strategy.

When it comes to tax refund, clients have three options:

1. spend it;
2. reinvest it; or
3. gross it up.

"Gross up" means temporarily borrowing money to contribute to an RRSP account—this borrowed amount comes back as the client's tax refund. For example, your client, Joe, has $12,000 in cash and is in a 40% tax bracket, but his retirement plan calls for a contribution of $20,000. You can have him contribute the $12,000 and borrow an extra $8,000 from his savings account, a line of credit or an RRSP loan. This will give him a total contribution of $20,000, which should give him a tax refund of about $8,000. The refund can go back into savings or to pay off the line of credit.

The $8,000 can be borrowed for just a month or two—Joe could borrow in February and then file his tax return in early March.

Here's a comparison between contributing to a TFSA account versus using a gross-up strategy for an RRSP contribution for a client in a 40% tax bracket. This table includes the amount that could be withdrawn after retirement if the client were still in the same tax bracket. To see the effects clearly, growth has been excluded.

The table shows:

1. By using a gross-up strategy, we have helped the client contribute 67% more to their RRSP. Clients in a 46% tax bracket—the highest in Ontario—would be able to contribute 85% more;
2. Only with a gross-up do clients get back the $12,000 they started with;
3. Only if you gross-up the RRSP contribution every year is the RRSP as effective in providing retirement income as the TFSA, assuming the client is in the same tax bracket after retirement.

Note: Clients who expect to retire in a similar or higher tax bracket than the one they fall under while they're working—probably about half of Canadians (including clawbacks on seniors)—may benefit more from a TFSA than an RRSP. For such clients, or clients who have used all their RRSP contribution room, using the tax refund to contribute to a TFSA may be a better strategy.

A great use of the gross-up is for clients who have a group RRSP and receive a bonus. If they get a $20,000 bonus, they can put the entire amount into their group RRSP. If they take that bonus in cash and invest it, they'll only have $12,000 to invest. The group RRSP would afford them very few investment choices. However, if they take the bonus in cash and then gross it up by borrowing an additional $8,000 for one or two months, they could invest the entire $20,000 in their RRSP and enjoy a far wider range of investment options.

Usually clients who have a retirement plan in place tend to appreciate the RRSP gross-up more than those working with an advisor who only handles their investments. AER

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RRSP refund strategy

	SPEND	REINVEST	GROSS-UP	TFSA
BEFORE RETIREMENT				
Cash available	$12,000	$12,000	$12,000	$12,000
Borrow from credit line			$8,000	
Tax refund (40%)		$4,800		
Total invested	**$12,000**	**$16,800**	**$20,000**	**$12,000**
AFTER RETIREMENT				
Tax on withdrawal (40%)	$4,800	$6,720	$8,000	0
Net cash available	**$7,200**	**$10,080**	**$12,000**	**$12,000**