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# FineAnswers

Answers to questions on tax, finance and management

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TAVANA & CO *Chartered Accountants* Tel: 416-229-2221 Fax: 416-229-2234

web: [www.tavana.ca](http://www.tavana.ca)

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## **WHICH IS BETTER CONTRIBUTE TO RRSP OR PAY-DOWN A MORTGAGE?**

**I have available savings of \$10,000 which I can contribute to my RRSP. Should I paydown the mortgage on my principle residence or contribute to the RRSP?**

Contributing to your RRSP results in an immediate saving in the amount of your current income tax, while paying down your mortgage does not result any immediate cash benefit. However, in order to compare the above alternatives over a longer term we need to know more about the return on your investments, marginal personal tax rates and your mortgage.(for more information on RRSP see our *newsletter*)

**What do mean by, "compare the alternatives over a longer term"?**

The comparison can effectively be made any time in the future. However, you should not select a date in the future beyond 31<sup>st</sup> December of the year you turn (69) sixty nine. The reason is you have to collapse your **RRSP** by that date or transfer it into a **RRIF**.

**Why do you need to know about the return on my investments?**

In order to determine how much your savings or available funds grow over the longer term, namely to the date you wish the comparison be made, you should know the estimates annual return on your investments. To give you an example if your investments grows at a compound rate of 6% per annum it will –approximately - double in 12 years.

**What is my marginal tax rate?**

Your marginal tax rate for each calendar year is the rate of tax that applies to any additional income that you earn. The marginal tax rate depends on your annual income for the year in question and, also, on the amount of the additional income.

**How does my marginal tax rate affect the comparison.**

The greater your marginal tax rate the greater your tax savings on your RRSP

contribution. Your marginal tax rate affects the comparison at three different times. When you make a contribution to your RRSP, during the period of saving and your marginal tax rate at the time you have to collapse your RRSP.

**Why would information about my mortgage be pertinent?**

It is obvious that paying down the mortgage when mortgage interest rates are higher is better than when they are lower. For example if the period at the end of which you wish to make this comparison your mortgage interest rate is a lot higher the rate of return on your investments inside your RRSP compared to another scenario when the mortgage interest rate is lower, the same or a bit higher then it will make a big difference in your decision to paydown the mortgage. It is more likely that you would benefit when mortgage rates are a lot higher.

**Doest the comparison date make a difference?**

Generally speaking longer periods to your comparison date benefits savings inside the RRSP as your investments accumulate tax free inside the RRSP, therefore you benefit more from the deferral of taxes. The taxes on the earnings of your investments inside the RRSP effective work for you and generate additional income, which otherwise would have been zero.

**Is there a rule of thumb that would help me make this decision?**

No. As the factors you should consider are quite a few there is no rule of thumb. Because, most advisors cannot tell with some degree of accuracy which alternative is better – contribute to your RRSP or pay-down your mortgage- they usually suggest that