

# Make your mortgage Tax Efficient!

By Brian Poncelet, CFP  
<http://www.mortgageplans.ca>

NOTE: this strategy should not be confused with the Tax-Deductible Mortgage

What if you could make your mortgage tax-efficient like our US neighbors? Well you can, by converting your “bad debt” (mortgage, car loan, credit card bills) into efficient debt.

## Step 1

The first step is to get a “re-advanceable” mortgage. This is commonly known as a HELOC (home equity line of credit). Where can you get one and who offers this? The answer is very few banks and mortgage brokers can offer this in an automated way. Mortgage brokers may talk about the Smith Maneuver or Tax Efficient Mortgage (they may refer to it as the Tax Deductible Mortgage, which is technically incorrect) but will often charge you more than \$1,000 in set-up fees and then a monthly administration fee, or they will advise you to set up this plan over the internet! The banks will not monitor this Tax Efficient Mortgage. The key is to find a certified financial planner (CFP) who works with a reputable bank which does not charge any fees and can make this plan automated.

## Step 2

The second step begins now that you have the right mortgage. Let’s start the conversion process using an example. Assuming a \$200,000 mortgage at 5.5% amortized over 25 years costs \$1,228 per month. After the first month, \$311.51 is deducted from the principal. This amount is re-advanced to you in the form of a line of credit. Do you take the \$311 and invest this into mutual funds to make it Tax Efficient? No, if you take the whole amount and invest this interest will be due on the whole \$311. A better way is to invest \$300 and leave the \$11 to cover the interest charges. This is known as interest capitalization. Interest on interest is tax-deductible when the purpose of the loan is for investments, such as mutual funds, that can generate an income. Mortgage brokers currently do not offer the right product to make this work for you unless they charge you a fee!

## Step 3

The third step involves line 221 of your tax return: Carrying charges and interest expense. Once you have received your tax refund, apply this amount against your mortgage principal.

Repeat step 2.

## Step Four

Let’s review by looking at an example: the Jones family.

Expense Totals	Payments (monthly)	Interest Rate
Mortgage - \$230,000	\$1,433	5.65%
Visa - \$15,000	\$400	18%
Line of Credit - \$18,000	\$120	8%
RRSP loan - \$18,000	\$450	6%
Total \$281,000	\$2403	

If we put all of the debt into a mortgage of \$281,000 with a variable rate of Prime minus .85% (6-.85% = 5.15%), the new monthly payment is \$2,228 (\$174 less than under the current debt structure). Assuming an average rate of return of 8% on the investments, the tax refunds will grow to approximately \$6,720 based on a 40% tax bracket.

At the end of 13.5 years, the investments will have grown to \$393,500 and the Jones family will still have home mortgage of \$281,000 that is Tax Efficient. The difference is a net gain of \$112,500 achieved by actually making lower monthly payments than under the original plan. If the family then chose to liquidate the investments in order to pay off the mortgage, capital gains taxes would be due. However, there would still be a net gain of \$90,000.

### **To recap**

- Talk to a Certified Financial Planner who has experience in setting up these Tax Efficient mortgages.
- Get a HELOC (one that can capitalize interest charges).
- Pay no set-up fee or monthly administration for a Tax Efficient Mortgage.
- Use your tax refunds to put against the mortgage once a year.

What else should you watch for in the “free seminars” put on by other mortgage brokers or financial planners? Please read my Blog regarding the “High Cost of the Smith Maneuver” and the Return of Capital mutual funds.