# Using Your RRSP Before Retirement

Wolters Kluwer

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As everyone knows, registered retirement savings plans (RRSPs) are intended to provide a means by which Canadians can save for their retirement on a tax-deferred basis. The rules governing RRSPs allow taxpayers who make contributions to such plans to deduct the amount of those contributions from their income. Investment income earned inside the RRSP by those contributions is not taxed as it accumulates, but all funds withdrawn from the RRSP, whether they represent original contributions or investment income earned, are taxed when they are withdrawn from

the plan.The fact that amounts contributed to an RRSP are intended to provide an income in retirement doesn't mean, of course, that withdrawals can't be made before one's retirement date. Generally speaking, however, withdrawing funds from an RRSP before retirement isn't a good idea. Amounts withdrawn can't be re-contributed, and so both the withdrawal and the future investment income which the withdrawn funds would have earned are permanently lost. Are there any circumstances in which making an RRSP withdrawal for purposes other than creating retirement income can be said to make good financial sense? Yes, in some cases. A withdrawal made for other purposes may be justified when the use to which the withdrawn funds will be put will actually have a positive long-term impact on the taxpayer's net worth or income earning potential. Recognizing this fact, the federal government has created two types of plans which allow taxpayers to make RRSP withdrawals before retirement with a minimum of adverse tax and financial consequences. Where a withdrawal is made from a taxpayer's RRSP to finance the purchase of a first home, or to pay for the taxpayer's post-secondary education, the usual rules with respect to RRSP withdrawals do not apply and special tax treatment is provided. Generally, those special rules allow taxpayers to make withdrawals without paying tax on the amounts withdrawn, and to re-contribute those withdrawn amounts to the RRSP over a period of time.

## Home Buyers' Plan

For Canadians trying to purchase their first home putting together the required down payment, when Canadian house prices in most markets are at record highs, is often the biggest hurdle. And, if that weren't enough, changes made to the rules governing the financing of home ownership over the past few years have set the bar even higher.

In 2008, 2010, and 2012, the federal government, concerned that borrowing by Canadians was reaching unsustainable levels and that borrowing secured by home equity was a particular problem, tightened the rules with respect to lending practices for home purchases.

Where a home is purchased anywhere in Canada with a down payment of less than 20%, the purchaser/borrower is required to obtain government-backed mortgage loan insurance, administered by the Canada Mortgage and Housing Corporation (CMHC). Premiums for that insurance are paid by the borrower, and the cost of such premiums is often added to the amount of mortgage principal. The new rules put in place between 2008 and 2012 place additional requirements and restrictions on would-be home purchasers who have less than a 20% down payment and who must therefore obtain CMHC insurance.

Until the summer of 2008, it was possible to buy a home in Canada with a zero down payment (in other words, the entire cost of the home was borrowed) and to amortize repayment of that cost over up to 40 years, a time frame which put most purchasers past the traditional retirement age of 65 by the time the mortgage was paid off. The successive changes implemented by the federal government have whittled away at those practices. In order to obtain CMHC insurance on a residential home purchase, borrowers are now required to have at least a 5% down payment. And, under current rules, the maximum amortization period on a residential mortgage is 25 years. More stringent borrowing requirements are also imposed on would-be home purchasers, in terms of the percentage of income which monthly costs related to housing (mortgage payments, property taxes and home heating) and other debt repayment obligations are permitted to consume.

All of these changes, while they make good financial sense, leave the would-be first time home purchaser further and further behind when it comes to putting together a sufficient down payment and carrying a mortgage. For those who have already saved funds within an RRSP, however, there is another option in the form of the Home Buyers' Plan, or HBP. Essentially, the HBP rules permit a first time home buyer to borrow up to a certain amount from his or her RRSP to use for a down payment.

The HBP isn't new, but in 2009 the federal government made some changes to enhance its usefulness. In the federal budget brought down in January of 2009, it was announced that, effective for withdrawals made after January 27, 2009, the maximum permitted withdrawal from an RRSP under the HBP would be increased from $20,000 to $25,000, and the limit remains at $25,000 today.


While the rules governing HBPs can be detailed in their application, especially when it comes to any special circumstances or any contravention of those rules, the concept of the program is straightforward. A first-time home buyer who has entered into an agreement to purchase or build a home can withdraw up to $25,000 from his or her RRSP to purchase that home. The amount withdrawn is not taxed on withdrawal, as it usually would be, but must be repaid to the RRSP, without interest, over the subsequent 15 years, with the amount of each annual repayment prescribed by law. Where the first-time home buyer is married and his or her spouse is also a first-time home buyer, the spouse can also withdraw up to $25,000 from his or her RRSP and both withdrawals can be pooled to come up with a down payment of up to $50,000.

There are some additional rules, as follows. The home purchased using funds borrowed under the HBP must be bought or built before October 1 of the year following the year of withdrawal. As well, the borrower (and his or her spouse, where applicable) must intend to occupy the home as the principal place of residence no later than one year after buying or building the home—the HBP is not intended to provide funds to purchase or build rental residential accommodation. There is, however, no minimum period of time that the buyer must live in the home.

The concept of a "first-time home buyer", while seemingly self-explanatory, is in fact more flexible than it first appears. For purposes of the HBP, a first-time home buyer can actually be someone who has previously owned and lived in a home, as long as that home ownership ended more than four full calendar years prior to the time a withdrawal under the HBP is made. For instance, an individual who wishes to participate in the HBP by making a withdrawal during 2016 will be considered a first time home buyer if he or she had not owned a home that was occupied as a principal residence after the end of 2011, the four full required calendar years being 2012, 2013, 2014, and 2015. Where the prospective home owner is married (including a common-law partnership), the same requirement applies to that person's spouse.

Whatever the amount withdrawn from the RRSP under the HBP (and there is no minimum withdrawal, only a maximum one), that amount must be repaid over the subsequent 15 years. The first repayment is required in the second year following the year of withdrawal so, in the case of the example above, where the withdrawal is made in 2016, the first repayment must be made in 2018. Each repayment is generally 1/15th of the amount withdrawn so, a maximum withdrawal of $25,000

would mean an annual repayment amount of $1666.66. The taxpayer doesn't have to keep track of where he or she stands with respect to the repayment schedule—each year, the taxpayer will receive, along with the Notice of Assessment issued by the Canada Revenue Agency (CRA) after the annual return is filed, an HBP Statement of Account. That Statement of Account will summarize the total HBP withdrawals, amounts repaid to date, the current HBP balance and the amount of the next repayment which must be made. Such repayments are made by making a contribution to the taxpayer's RRSP during or within 60 days after the end of the year for which the repayment is required, and designating part or all of that contribution as an HBP repayment on Schedule 7, which is filed with the tax return for that year. If the taxpayer does not make the repayment when and in the amount required, any outstanding amount is added to income for the year and taxed at the taxpayer's top marginal rate.

The basic HBP rules, as outlined above, are quite straightforward in concept. There are however, a myriad of procedures which must be followed and forms which must filed in order not to run afoul of those rules, and such a contravention, when it occurs, can be costly. Taxpayers who are contemplating making a withdrawal from their RRSPs under the HBP would be well advised to seek professional assistance—perhaps from the financial institution at which the RRSP is held, or from another financial professional who is familiar with the HBP requirements.

## Lifelong Learning Plan

If buying a home is the single biggest purchase most Canadians make in their lifetimes, the cost of acquiring a post-secondary education must run a very close second. So, it's not surprising that the other RRSP withdrawal program approved by the federal government is intended to help with the costs of financing such an education, through the Lifelong Learning Plan (LLP). The LLP is structured in much the same way as the HBP, although the permitted withdrawal amounts and repayment period requirements are different.

An initial caveat: parents who are struggling with the ever-increasing costs of putting children through post-secondary education may see the LLP as part of the solution. Unfortunately, that's not the case: withdrawals can be made from an individual's RRSP under an LLP only for the purpose of financing post-secondary costs for that person or for his or her spouse or common law partner, but not for the children of either spouse. Of course, there's nothing to prevent a parent from making an RRSP withdrawal in order to help a child with post-secondary education costs, but those withdrawals won't qualify for LLP treatment—in other words, they will be fully taxed on withdrawal, and no repayment of those amounts to the RRSP will be permitted. It's also possible, of course, for the post-secondary student to withdraw funds from his or her own RRSP using an LLP in order to finance education costs, but the reality is that very few individuals in their early 20s have sufficient funds in an RRSP to make such a plan realistic. In most cases, an LLP will be of value to an older taxpayer who has amassed some savings in an RRSP and is now contemplating a return to school, perhaps as the result of a planned mid-life career change or for retraining to upgrade skills following a job loss from a downsizing or corporate restructuring.

## The basics of the LLP

As with the HBP, the basic rules governing LLPs are quite straightforward. Any Canadian resident who is under the age of 71, has funds in an RRSP and is enrolled in full-time studies at a post-secondary institution can withdraw up to $10,000 per year, to a lifetime maximum of $20,000. No tax is payable on amounts withdrawn from the RRSP, but all such withdrawals must be re-contributed, in prescribed amounts, over a 10-year period.

The lifetime maximum can be withdrawn from an RRSP in a single withdrawal, or through several such withdrawals. Once the initial withdrawal from an LLP is made, additional withdrawals can be made (up to the $20,000 lifetime limit) each year until January of the fourth year after the year the first withdrawal took place, as long as the taxpayer making the withdrawal continues to meet the LLP requirements, and the 10-year repayment period has not begun. Those LLP requirements call for the participant in the plan to be enrolled on a full-time basis in qualifying educational program at a designated educational institution. Each of those terms requires some explanation.

Whether someone is a full-time student is determined by the educational institution at which the student is enrolled, as each such institution has its own set of rules to make such a determination. Generally, the educational institution will require that a student be taking a minimum number of courses (usually 3 to 5) each semester in order to be considered a full-time student. A designated educational institution is a university or college that qualifies for the education amount claimable on the annual tax return. While the listing of such institutions is lengthy, it can generally be assumed that a college or university which is located in Canada and receives public funding will qualify for purposes of the education amount and therefore for purposes of the LLP. Where there is a question about whether a particular institution qualifies as a designated educational institution, that information can be obtained by calling the CRA's individual tax enquiries toll-free telephone line at 1-800-959 8281. Finally, a somewhat circular definition provides that a qualifying education program is an educational program offered at a designated educational institution.

Interestingly, although a taxpayer must meet the LLP requirements outlined above (i.e. full-time student enrolled in a qualifying educational program at a designated educational institution) in order to participate in an LLP, there is actually no requirement that the funds withdrawn from an RRSP be used to pay for education-related costs. As long as the plan participant meets all of the LLP conditions when he or she makes the withdrawal, the funds withdrawn can be used for any purpose.

## Repaying LLP withdrawals

All RRSP withdrawals made through an LLP must be repaid over a ten-year period. The date on which that repayment period commences will vary, depending on the student's circumstances, and the latest time that a student will be allowed to start making such repayments is the fifth year after the first withdrawal was made. Essentially, the CRA determines when a student must begin the repayment process by checking that student's annual tax return. The CRA checks to determine whether the student was entitled to claim the education amount on that tax return as a full time student for at least three months. If the student does not meet that threshold requirement two years in a row, the repayment period will start in the second of those two years. If the student continues to meet that requirement, then the repayment period starts in the fifth year after the first LLP withdrawal.

Unfortunately, it can be seen that providing flexibility with respect to when the LLP repayment period starts necessitates a certain amount of complexity in the rules. Consequently, those rules are most easily understood or explained by means of a flow chart or decision tree, as in the following, adapted from a chart and examples which appear in the CRA guide to the LLP.

### *Step 1*

**Is this the year of your first LLP withdrawal?**

If **no**, go to Step 2.

If **yes**, you do not have to start repaying your LLP withdrawal this year.

### *Step 2*

**Is this the fifth year after your first LLP withdrawal?**

(If you made your first LLP withdrawal in 2011, then 2016 would be the fifth year after your first LLP withdrawal.)

If **no**, go to Step 3.

If **yes**, you have to start repaying your LLP withdrawals this year.

### *Step 3*

**Will the LLP student be entitled to the education amount as a full-time student on line 323 of his or her return for at least three months this year?**

If **no**, go to Step 4.

If **yes**, you do not have to start repaying your LLP withdrawals this year.

### *Step 4*

**Was the LLP student entitled to the education amount as a full-time student for at least three months on his or her return for last year?**

If **no**, you have to start repaying your LLP withdrawals this year.

If **yes**, you do not have to start repaying your LLP withdrawals this year.

*Sarah makes LLP withdrawals from 2012 to 2015. She continues her education from 2012 to 2017, and is entitled to claim the education amount as a full-time student for at least three months on her return every year. Sarah's repayment period begins in 2017, since 2017 is the fifth year after the year of her first LLP withdrawal.*

*Joseph makes an LLP withdrawal in 2014 for a qualifying educational program he is enrolled in during 2014. He is entitled to the education amount as a full-time student for five months of 2014. Joseph completes the educational program in 2015, and he is entitled to the education amount as a full-time student for five months on his return for 2015. He is not entitled to the education amount for 2016 or 2017. Joseph's repayment period begins in 2017.*

No matter when the LLP repayment requirement is triggered for a particular individual, all amounts borrowed as part of the LLP must be repaid over the following 10 years. As is the case for taxpayers who participate in the HBP, LLP participants will receive a an LLP Statement of Account each year, which will show total LLP withdrawals, the amount repaid to date, the LLP balance and the amount which must be repaid the following year. When a repayment amount is required for a particular year, it must be made during or within 60 days after the end of that year, and designated as such on a Schedule 7 filed with the tax return for that year. Where a required repayment is not made, or the repayment made is less than the required amount, any shortfall will be included in the taxpayer's income for the year and taxed at his or her top marginal rate.

As with the HBP, the basic rules governing withdrawals made from an RRSP under the LLP program are quite straightforward, but the administrative requirements which must be satisfied to comply with those rules are detailed, and the consequences of going "offside" can be costly. Once again, prudence suggests obtaining advice from a professional familiar with the LLP rules.

## Using both the HBP and the LLP

While making withdrawals from one's RRSP under both the HBP and LLP is something that would likely occur only in a small minority of cases, there is in fact nothing to prevent a taxpayer from utilizing both plans at the same time. Under the rules governing both types of plans, taxpayers are allowed to participate in an LLP even where funds have been withdrawn under the HBP and have not yet been fully repaid. The same rules apply in the other direction as well, providing that withdrawals can be made as part of an HBP by a taxpayer who has already participated in an LLP but has not yet repaid all of the funds withdrawn under that plan.

As well, it's possible to participate in either or both of the HBP and the LLP more than once, assuming that all funds withdrawn as part of earlier participation have been repaid, and that the ordinary requirements of the program (i.e. meeting the definition of a first-time home buyer or a full-time student) are met.

## Conclusion

Like all investment and tax-planning strategies, borrowing money from your RRSP to put together a down payment on a first home or to finance post-secondary education has both upsides and potential downsides. The biggest downside is the permanent loss of investment gains on the money temporarily withdrawn from the RRSP during that period of withdrawal. However, it's also possible that the real estate purchased with the withdrawn funds will enjoy a greater increase in value over that period than would have earned by the funds had they remained in the RRSP. Where the funds are withdrawn to make post-secondary education possible, that education will hopefully result in greater income-earning potential for the taxpayer who undertakes it. Like all investment and tax-planning decisions, a decision on whether to withdraw funds from an RRSP for purposes other than creating retirement income comes down to a personal decision based on one's own circumstances.

The rules outlined above summarize the basic structure and operation of the rules governing the Home Buyers' Plan and the Lifelong Learning Plan. However, anyone contemplating making use of either the HBP or the LLP will need to familiarize themselves with those rules in much greater detail with, as noted, the assistance of professional advisors. A good place to start is with the publications and guides to the HBP and the LLP, published by the CRA, and available on their Web site at www.cra-arc.gc.ca/hbp and www.cra-arc.gc.ca/E/pub/tg/rc4112/rc4112-e.html.