Borrow your way to tax freedom

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When I moved back to Canada four years ago — temporarily, I thought — I used to drive around in my old banger, thinking how the clatter of the world was somehow muffled in this country, which was why the old song echoed loud. Should I stay or should I go? Because no matter how I made the calculations, living here meant voluntary poverty and restriction, to which, put plainly, I had grown unused. Plus, there was a kind of dysthymia everywhere, the upper registers of emotion seemed dampened, and along with most of the ex-pat Canadians I knew, I considered that Canada had removed itself from the realm of what was really going on, and had settled, all smug and cosy, for the second-rate. Not my ancestors' Canada, more like pod-Canada.

Well, in the event, as the English so puzzlingly say, I stayed and one of the reasons is because of the man I first met on the AM radio of my antique station wagon. Between the muted clatter and the depression, there he was promising that I could deduct my mortgage interest from my taxes ...

Hmmmm, I thought. Perhaps not quite so restricted after all.

Fraser Smith became a friend as much as one can have a friend who towers a foot above you with some of the girth and all of the benevolence of Santa Claus, and who constantly harasses one into giving speeches which one *hates*. But we found we had many things in common, first among them was a peculiar and furious desire to get Canada back up on its hind legs and let ordinary folk take back control of their lives. He said, the first time we met — as grandly as such a thoroughly modest man could — that one of these days he was going to gift all Canadians with his method of guerrilla financial planning. That day has arrived.

Fraser taught me that the average homeowner in Canada, with a $200,000 mortgage will, at the 40% tax bracket — which is way easy to reach here, especially given a two-earner household — end up having to earn $700,402 pre-tax dollars, to pay off that $200,000 mortgage. It is hard, therefore, to say with any authority at all that — with the $300,000 the government takes, and the $200,000 the bank takes — we are free.

Most people, says Fraser, end up their working lives as house rich and cash poor. And even David Chiltern and George Clason, authors of, respectively, *The Wealthy Barber* and *The Richest Man in Babylon*, who recommend that you put away 10% of your gross income, can't help you. That $700,000 charge will defeat everyone but the most bitter and miserly of median income workaholics, especially when you add in dental school for just one kid. Financial commentator Garth Turner recommends you pay off your house, then borrow against it for investment money. Still means that you've got to earn that $700,000 first.

"Government," says Smith, "stands on one shoulder blade, and the banks stand on the other, pressing us down. There are $460-billion mortgage dollars in Canada, bringing in 7% a year for 25 years. With taxes and living costs we barely have enough money to breathe. Oh yes, once in a while, we get some hope, and they promise to lower taxes, but it's not ever enough. And saving 10% out of what we earn is difficult. Add putting away 20% of your income to an RRSP and it's impossible."

This is how it works. With your mortgage at a maximum 75% of the value of your house, you go to a credit union and borrow up to 95% of your equity. With that money, you make investments. The interest on all loans made for investment is tax deductible. You then pay down your mortgage the exact amount of the refund, and borrow that money again, making further investments. Your tax refund increases, so the next year, you pay down your mortgage more. And so on. The average family can, using this method, pay down their mortgage in as fast as five years, instead of 25, and can have a bundle of income producing investments. Really simple. Really lovely. And legal several times over, thanks to RevCan, which has tested the deductibility of investment interest several times and, in November 2002, lost in the Supreme Court of Canada. Lovely and legit.

The New York Times last week estimated that it now takes an American family about five generations to climb from one class to another. Too long, and entirely the fault of repressive tax-happy government. Especially when the markets average a 10% increase every decade. Which is where *The Smith Manoeuvre* can pop a family right through the class barrier in one generation, no problem. University tuition and living expenses? No problem. Graduate school? Ditto. Start a business? Equally possible. Social engineering? Massive amounts of income redistribution from a command and control supposedly liberal government? Not necessary, thank you.

Here's how that works: Every month, instead of paying into a savings or investment account, pay down your principal mortgage as much as you can. At the same time, borrow money on your house equity, and invest. Capitalize your interest costs, making interest on the interest deductible. Einstein said, the eighth wonder of the world is compound interest, why not let it work for you?

Fraser, with the help of the bankers at Vancity Credit Union (the second-largest credit union in the world), has been engineering this feat for all kinds of people for years, from chefs and hostesses, to school principals and corporate presidents. His just-published book is clean, spare and witty. Order it, get yourself to a financial planner, drag her off to a friendly credit union and starve those spendthrift socialists up in Ottawa right out of office.

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