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Strategy looks like a revolution: Making your mortgage tax-deductible

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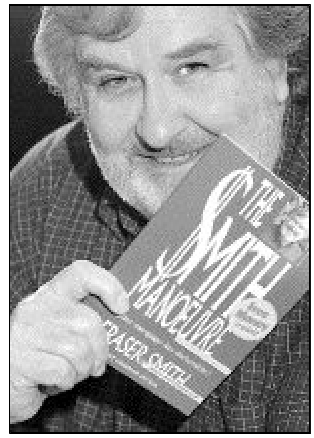

Bruce Stotesbury
CanWest News Service, File / Author Fraser Smith, whose self-published book on making your mortgage tax-deductible has sold 25,000 copies, won converts among mortgage brokers and financial planners in Toronto yesterday.

Four years after Fraser Smith self-published an eponymous book named the Smith Manoeuvre, the mortgage industry has seized on his technique for helping Canadians make home mortgages tax deductible.

About 200 mortgage brokers and financial planners met yesterday in Toronto to team up to exploit the strategy. Some -- like Victoria's John Gallo and Guelph, Ont.'s Walter Dixon -- are building their practices around the technique. This amounts to paying down your mortgage as quickly as possible, then repurchasing securities with a tax-deductible investment loan.

Smith, whose speaking fee has soared to $10,000, says his book has sold 26,000 copies, with 10,000 more being printed. After spreading the word in British Columbia in the 1990s, Smith decided to let the rest of the country in on the secret in 2002, when he retired and wrote the book. It was a brief retirement. Now 68, Smith is about to publish a follow-up called the Smith/Snyder Manoeuvre, aimed at helping Canadians build up personal pensions.

But the buzz in the mortgage business revolves around the first book, which now uses Is your mortgage tax deductible? as the main title, with the Smith Manoeuvre relegated to subtitle status.

Unlike the United States, Canadian mortgages are not normally tax deductible. However, by properly restructuring one's affairs, it's possible to use certain types of flexible mortgages -- the Matrix mortgage from First Line Mortgages in particular -- that gradually convert non-deductible mortgage debt into deductible investment loans.

In a four-hour presentation that began to the beat of George Harrison's Taxman, Smith said wealthy Canadians routinely use such techniques. The average strapped home-owner/taxpayer tends to defer making non-registered investments until the mortgage is paid off. But if they wait until a 25-year mortgage is fully amortized, they'll have no time left to build up a decent investment portfolio. Smith says the Canadian "nightmare" is to pay off a mortgage on retirement day at 65, then go back into debt the next day with a reverse mortgage to fund cash flow.

Smith has a dim view of reverse mortgages, which he says should be used only as a last resort. But the banks are gearing up to market them because they know it's the future.

Smith uses the image of a double elevator to describe his manoeuvre. You start out with a $200,000 mortgage that is not deductible. Every spare dollar is pumped into paying down the principal. With the Matrix mortgage or equivalent, each dollar knocked off principal is pumped back into a loan to buy investments, the interest on which is tax deductible.

Gradually, the mortgage falls to zero and the investment portfolio soars to $500,000 -- assuming 10% returns over 22 years (a net $300,000 if you subtract the debt which remains in place).

Smith doesn't consider this "leverage" because the total debt remains the same -- the real leverage was borrowing to buy the house in the first place.

Karl Straky, president of the Mortgage Training Group Inc., says the technique is "spreading like wildfire" because of referrals from happy customers. "People don't realize that a $300,000 house costs them $1-million after interest and taxes."

Obviously, the big banks aren't greatly motivated to tell consumers about it and the government's revenue arm would just as soon the little people didn't emulate the wealthy in their tax-effective wealth accumulation strategies.

Smith says the technique has never been challenged by any accountant, lawyer or the Canada Revenue Agency. Nor does he expect the CRA to change the rules if the movement gets too popular. That's because the technique requires reinvesting back into the economy.

Strangely, the net result on Canadian society may be more positive than in the United States, where mortgage interest can be deducted with no strings attached. But Americans tend to spend the savings on everyday consumption rather than invest it in securities. Because of Ottawa's stinginess, those disciplined enough to adopt this perfectly legal strategy are forced to invest regularly. In the long run that's arguably best for both the individual and the country.

Smith's Web site at www.smithman.net lists 375 financial planners across Canada already using the technique. He foresees a huge opportunity in the $600-billion Canadian mortgage market. Citing Statistics Canada, Smith says 10.5 million families are evenly split between renters, homeowners with mortgages and those who own their homes free and clear. That means seven million families are prospects.

On the investment side, the technique uses Stone and Co.'s Flagship Growth & Income Fund Canada. It's a blue chip balanced fund that aims to distribute 1% of the investment per month via a tax-deferred Return of Capital method.

Judging by the gleam in the eyes of most attendees, Smith's manoeuvre is the real deal. It may be nothing short of a revolution.

jchevreau@nationalpost.com

Illustration:
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