

Fun with Mortgages. Want to learn how to save yourself some solid cash on the biggest purchase you'll ever make in your life? Read on. BY MATT O'GRADY

BIG PAYBACK

Playing hardball with the taxman.

In his popular book *The Smith Manoeuvre*, self-published last year, Fraser Smith puts the cost of home ownership in stark relief: to pay off a modest mortgage of \$200,000—over 25 years, at 7 percent interest—a homeowner will fork out \$420,241 in principal and interest payments; for those in the 40 percent tax bracket, over \$700,000 in income is needed to pay back the bank. In some jurisdictions, notably the United States, the interest portion is tax deductible, making the burden somewhat less heavy. But not in Canada.

Smith, a Victoria financial strategist, has found a way to beat the taxman, converting “bad debt” (non-deductible interest debt) into “good debt” (tax-deductible interest debt). In Canada, if you borrow money to invest, from which you expect to earn income, that loan is tax deductible. Interest from most other loans, including mortgage loans, is not; the Smith Manoeuvre, simply put, is a “creative, legal strategy” of getting around that obstacle. Here’s how it works. First, another loan account is set up, from which you begin borrowing back and invest-

ing the amount of your monthly principal payments. That borrowed money constitutes an investment loan, and the interest on that loan is tax deductible. Then, each year when the tax refund for the investment loan arrives, you take this money and make an extra payment on your mortgage—then immediately re-borrow the amount of the principal payment to invest again. And so on and so on. In short order, the “bad debt” is retired, replaced by “good debt.” A few caveats. If you have less than 25 percent equity in your house, your bank—or any other bank—will be less than eager to loan you more money; many first-time homebuyers will not be able to implement the Smith Manoeuvre for several years. Then there’s the issue of mechanics: big banks have been reticent to help homebuyers implement the Manoeuvre, preferring to stick to the tried and true, leaving smaller lenders like VanCity and Coast Capital to pick up that business. (With increased competitive pressures, look for that attitude to change.)

The bottom line? On that modest \$200,000 mortgage, a refund cheque for \$5,481—every year for the rest of your life. Good debt, indeed.