THE GLOBE AND MAIL

FINANCIAL FACELIFT

Should this medical resident, 27, repay debt or build investments?

DIANNE MALEY
Special to The Globe and Mail
PublishedFriday, Dec. 13 2013, 7:17 PM EST
Last updatedSunday, Dec. 15 2013, 9:15 PM EST

Brian, age 27, is on the threshold of a career as a physician with his gaze fixed firmly on the future.

As a second-year medical resident in Ontario, his income is still relatively modest and he has some debt related to his training. He's been keeping his expenses low and focusing on paying off his $50,000 student loan so that he has only about $5,500 left to go. In addition, he owes his parents $21,000.

More Related to this Story

- FINANCIAL FACELIFTA retirement plan geared for the open road
- Retirement and RRSPsLiving in retirement: The cost of helping my kid graduate debt-free
- ROB CARRICKSeniors' rising debt: A legacy no one wants to leave behind

He wonders, as his income rises, if he should continue this focus or if he should begin building savings and investments.

As it stands, his net income is about $54,000 a year. Once his residency is complete and he becomes a specialist, he could gross up to $400,000 a year.

"My goal is to pay off the debt as fast as possible before building investments and RRSPs," he writes in an e-mail. "Should I be using this money to do something else instead?" He has substantial unused federal and provincial tuition tax credits, which he expects to use up over the next couple of years.

In time, he wants what most young people want – to buy a house, get married and start a family.

We asked Marc Lamontagne, a financial planner at Ryan Lamontagne Inc. of Ottawa, to look at Brian's situation.

What the expert says

By paying off his debt first, Brian is doing the right thing, Mr. Lamontagne says.

"His parents had enough faith in him to lend him the funds for his post-secondary education and he is repaying that faith," the planner says. Given his age, Brian has plenty of time to save for other goals such as a house purchase and eventually, retirement, he adds. "He will certainly have the resources to achieve them."

Once the debt is paid off, Brian wonders whether he should shift his focus to a registered retirement savings plan or a tax-free savings account.

Brian's current marginal tax rate is next to nothing because of his tuition tax credits, the planner says. But once he is finished he residency, he will jump to the highest marginal tax bracket in Ontario of 46 per cent.

"Therefore, he should defer any RRSP contributions until then to get the biggest bang for his tax buck," Mr. Lamontagne says. In the meantime, Brian can invest in a TFSA up to his 2014 limit of $31,000, plus an additional $5,500 a year starting in 2015.

Once Brian takes full advantage of his TFSA room, he could begin making RRSP contributions even though he is in a relatively low tax bracket. This would allow him to take advantage of the tax sheltering of the investment income and capital gains earned inside an RRSP, the planner says. Brian could wait to claim the deduction on his tax returns in a subsequent year when his tax rate is higher.

"This is based on a little-known tax rule that allows you to indefinitely defer claiming the RRSP deductions to some future year," Mr. Lamontagne says. Another advantage to putting money into an RRSP is he could borrow back up to $25,000 under the federal Home Buyers' Plan when he buys his first home.

As Brian's income rises, he plans to look into incorporating and building his assets within his professional corporation.

"Using a corporation as a way of lowering and deferring taxes can make sense, though I would not rush into it because it can be complex," the planner says. It makes most sense when someone has paid off his mortgage, is "maxing out" his RRSP every year and is looking for an additional tax-advantaged investing vehicle, the planner says.

Over the course of his career, Brian can keep taxes to a minimum by holding interest-bearing securities in tax-sheltered accounts such as RRSPs and TFSAs and equity investments in a non-registered account or, in time, his professional corporation.

A good source of information on investing within a corporation is MD Management, owned by the Canadian Medical Association, which provides free financial planning advice to its members, Mr. Lamontagne says.

Client situation

The person

Brian, age 27

The problem

How to lay out a financial plan to repay debt and build savings and investments as his career progresses.

The plan

Pay off the loans, take full advantage of a TFSA and then begin saving for the long term.

The payoff

The knowledge that he is making the most of his financial situation and taking advantage of all the available tax breaks.

Monthly net income

$4,500

Assets

His education

Monthly disbursements

Rent $400; transportation $100; groceries, clothing $235; minimum LOC payment $23; vacation, travel $100; personal discretionary $80; cellphone $34; professional association $60. Total: $1,032. Surplus: $3,468

Liabilities

Line of credit $5,500; loan to parents $21,000. Total: $26,500

Read more from Financial Facelift [http://www.theglobeandmail.com/globe-investor/topic/Financial-Facelift].

Want a free financial facelift? E-mail finfacelift@gmail.com [mailto:finfacelift@gmail.com]

Some details may be changed to protect the privacy of the persons profiled.

More Related to this Story

- FINANCIAL FACELIFTCouple seek a coherent plan to ensure steady retirement income
- FINANCIAL FACELIFTCouple's health concerns make for tough choices
- RetirementIs it wise to borrow for an RRSP?

Topics:

- Financial Facelift