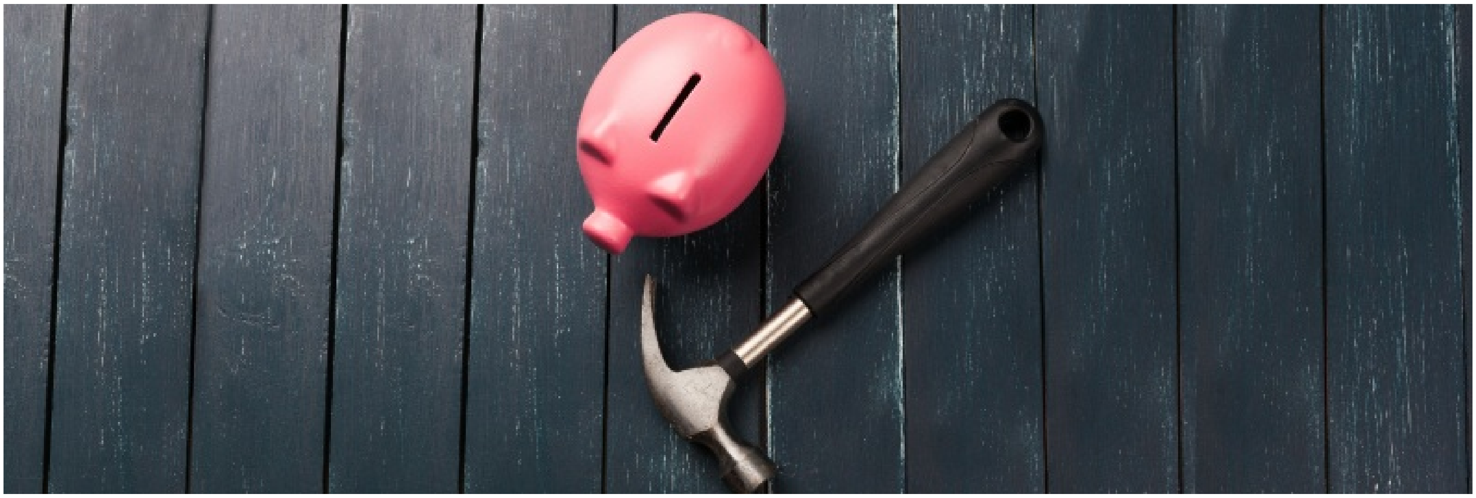
Should you ever use your RRSP or TFSA to pay card debt?



If you have credit card debt, a line of credit, and a pile of expenses, tapping that pot of money sitting locked away in a Registered Retirement Savings Plan or Tax-Free Savings Account can be tempting.

Experts will consistently tell you that savings for your future shouldn't be used as a lifeline, but are there any circumstances that make it worthwhile to withdraw from your retirement funds and tax-free savings accounts?

"You need to weigh the pros and cons of the decision," says Mike Gomes, a certified financial planner at Toronto-based Ironshield. "It's about reviewing the math and deciding what is best for you."

"Lots of clients [have done this], and our advice to consumers is *not* to do it. It's a poor decision, especially if you're in crisis," says Scott Hannah, president of the national Credit Counselling Society. "You don't make the best decisions when you're taking drastic steps."

Here's what to consider before you make any withdrawals from savings to pay down debt.

Early RRSP withdrawals come with penalties
If you're pulling funds out of your RRSP before you retire, you're likely going to face some hefty taxes on your withdrawal.

Right before tax season, Canadians tend to make lump sum deposits into their RRSPs to get the tax break and maybe even get a nice return. Whatever they contribute is deducted from their income that year.

When you *withdraw* funds before retirement, though, the amount is *added* to your income and taxed accordingly.

This is what makes withdrawals such a double-edged sword, Gomes says.

If you're working full-time, whatever you withdraw could be subject to your current income tax bracket. In some cases, the withdrawal could push you into a higher income tax bracket.

"If you wanted to pay off $10,000 to settle a debt, you'd have to take out $13,000 because 30 per cent will go right to taxes and be added to your annual income," Hannah says. "You're getting pennies on the dollar."

"Your RRSP is typically for when you're a senior and in a lower-income category, but there are cases in your working years where RRSP withdrawals may make strategic sense or are a necessity," says Jason Heath, a Toronto-based certified financial planner.

For instance, some of Gomes' clients who pulled from their RRSPs were between jobs, on maternity leave, starting a business or working in low-income roles for the year. In that case, withdrawing from their RRSP and adding that sum to their income didn't come with such steep tax rates.

But more often than not, your withdrawals will be in stages over the years, Gomes says. It's too risky to do one big lump sum withdrawal.

Weigh the RRSP penalty against your interest rates
You need to tally up your debts, how much you're paying in interest, and how long you may be carrying this debt moving forward.

"If you've got high interest rates on your credit card debt at 29 per cent, and you can pull from an RRSP where you'd only be in the 20 per cent tax bracket, it might not be such a bad decision," Heath says.

"Your RRSP is all about compounding interest and its power," Gomes says. "Interest can work in the reverse with credit card debts. It can be devastating."

Pay attention to what your credit card interest rates are and figure out if there's anything you can do to alleviate the burden, such as consolidating your debts, or asking for lower interest rates.

Heath even suggests talking to credit counsellors or bankruptcy and consumer proposal experts.

Keep in mind, if you file for bankruptcy, creditors can't go after funds in your RRSPs. They're exempt unless they were deposited within the last 12 months.

What about TFSAs?
Contributions to your TFSA aren't tax-deductible like the RRSP, but you also don't face taxes when you withdraw. Anything you withdraw is added to your contribution room the following year, so you can always contribute that amount later.

Once again, it comes back to a numbers game.

"If you've got credit card debt at 20 per cent interest, unless you're earning 18 per cent per year on your TFSA investments, you're better off cashing them out and paying down that credit card debt," Heath says.

And it's very unlikely your TFSA is getting you that much interest.

Have a post-withdrawal plan
Hannah says it's unwise to pull from your RRSP or TFSA because it's a Band-Aid solution. It bails you out of a sticky spot without teaching you about what you did wrong, how to budget, and how to make sure you don't return back to square one.

Instead, you could end up racking up more high-interest debts and you won't have your retirement savings or TFSA to turn to anymore. He's seen this happen with too many clients.

"If you pay it off will you just accumulate more debt?" Hannah says. "If you're not sure of your answer, don't gamble on your retirement funds. First get your house in order."