Canadians: 3 Ways to Pay Off Your Debt in 2021

Description

According to a **CIBC** survey, debt repayment was Canadians' top financial priority for 2020. It's likely to remain the same in 2021.

A recent *StatCan* report showed that the average Canadian household debt-to-income ratio was 170. That means that most Canadians have $1.7 in debt for every dollar of income. The amount is surprisingly down from the fourth quarter of 2019, but it's still a fairly high ratio.

If you're one of the many Canadians with debt you urgently want to get rid of, you're not alone. As CIBC's survey shows, many other Canadians are in the same boat you are. And you have options. Whether you want to pay off your debt faster or just pay less interest, you can lessen the burden you face in 2021. In this article, I'll explore three options to help you do just that.

Option #1: Refinancing

Refinancing is when you borrow at a lower interest rate to pay off higher interest rate debt. People commonly do this to get lower interest rates on their mortgages, but it can be done for any type of debt. Imagine that you had the following debts:

- Credit card one: $5,000, 19% interest rate
- Credit card two: $10,000, 19% interest rate
- Car loan: $15,000, 3% interest rate

This debt load would incur about $3,300 in annual interest: $2,850 from the cards, and $450 from the car loan. If you re-financed all of this with a single $30,000 2% interest loan, you'd pay just $600 in annual interest. That would save you $2,700 a year! Not only would your interest be reduced, but you'd be able to pay your loan off quicker.

Option #2: Consumer proposal

A consumer proposal is a legally binding agreement with a licensed insolvency trustee. In it, you agree to pay off your debt in a reasonable timeframe. Sometimes, you can get relief on a portion of your debt with a consumer proposal. For example, you may be able to get an arrangement where you pay off only 80% of your debt. If you get such a reduction, you may be able to pay off your debt faster.

Option #3: Holding investments in a TFSA instead of an RRSP

Another good idea for paying off debt faster is to hold your investments in a TFSA instead of an RRSP. When you cash out investments, you can use the proceeds to pay off debts. RRSP withdrawals come with a tax penalty while TFSA withdrawals don't. So, you get more cash from the same initial amount of money when you withdraw from a TFSA.

Imagine that you held $50,000 worth of **Shopify** (TSX:SHOP)(NYSE:SHOP) shares in an RRSP and had $50,000 worth of debt. Theoretically, you could sell the SHOP shares and pay off the debt that way. But whenever you withdraw from an RRSP, you have to pay taxes on the withdrawal. On a $50,000 withdrawal, you'd pay a 30% withholding tax immediately. You could later have to pay more tax than that if your marginal tax rate is higher than 30%. So, that's $15,000 — or more — shaved off your proceeds right there. In the end, you get $35,000 — not enough to pay off your $50,000 debt.

If you held those SHOP shares in a TFSA, it would be just the opposite. You'd pay $0 in taxes, withdraw the money, keep the money, and be able to pay off your entire debt with it — all because you chose to hold Shopify stock in a TFSA instead of an RRSP. So, if you're investing with a goal of paying off debt, choose the TFSA. The RRSP is just not as suitable for such an investment goal.

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