MEMO

To: Tania Mogen
From: Chris Banning
Date: January 18, 2014

Re: Implications of withdrawing pension funds to finance expansion

You have asked us to provide you with information about the effects of financing your business expansion by withdrawing money from your pension plan instead of borrowing from the bank at an interest rate of 9%.

Comment [RB1]: Here we are assessing the situation.

Pension withdrawal

Your teacher's pension plan is currently worth $65,000. You may withdraw only the full amount in the pension plan, and the proceeds would be taxed immediately. Based on your marginal tax rate of 25%, we estimate that you would pay taxes of $16,250. After taxes, the net cash available for investing in your business would be $48,750 ($65,000–$16,750). According to the cash flow forecast we prepared last November, this amount exceeds your estimated cash requirement of $45.000.

The qualitative factors to consider with this option are:

- Saving for retirement is important for your future financial well-being. Although Aaron has sizable savings in his RRSP account, leaving your pension account alone or transferring it to a locked-in RRSP would provide you with a more secure future.
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- There are no monthly bank loan payments thus eliminating the monthly interest and principal cash payments
- There is less risk as the company will not be taking on additional debt

Bank loan

Even though you are concerned about paying interest on the bank loan, it will reduce your taxable income, so the loan would cost you less than 9%. Assuming at your current marginal rate of 25% the bank loan would cost you only [9% x (1-25%)], or 6.75% after tax.

The qualitative factors to consider with this option are:

- The most significant drawback of borrowing from the bank is that, if your business is unsuccessful, you would still personally owe the money to the bank.

- As the business is a praetorship, the bank will have to power to come after your personal assets to recover the loan if you default on the payments.
- This option will preserve your retirement funds for the future.

Comment [RB2]: Analyse the issues(s)

Conclusion:

We recommend that you borrow from the bank instead of withdrawing money from your pension plan. This will ensure that you have the funds available to expand your business, and the tax deduction will reduce the interest benefit. While this option increase the risk because of the increased debt, you are confident that the new location will lead to increased sales and cash flows.

We will be happy to discuss these issues with you in detail in order to help you make a decision that meets both your short-term and long-term goals.

Comment [RB3]: Conclude and advise