Should I put $55,000 towards debt or in a TFSA?

Ask an Expert: First consideration is how much that debt is costing you

by Janet Gray
January 7th, 2018

Q. I am single and set to retire next year. I also have a $55,000 inheritance coming to me shortly. Should I take this money and pay off my outstanding debt, which is about $50,000? Or put the money into a Tax-Free Savings Account (TFSA), which I haven't started to contribute to yet? I will have a modest income in retirement that will be enough to get by on but not much more than that. I also have only about $30,000 in savings. What's the best course of action for me?

— *Daniela in Halifax*

A: That's a great question Daniela. So let me make some assumptions. Assuming that the $50,000 is personal consumer debt at interest rates of about 20% or higher (which is what is charged on many department store credit cards), I suggest paying off that debt. In one year, you would save $10,000 in interest at 20%. That alone could increase your monthly cash flow by $833. You could then turn around and use that monthly saving to contribute to your TFSA.

If, however, the $50,000 has a lower interest rate (mortgage, line of credit or loan) then you want to look closer at the interest rate you are paying on the debt versus the interest/investment return you could be earning once invested. For instance, if you are paying 5% interest on your $50,000 debt, but then invest it for a return of just 2%, it would be better for you to pay off the debt that's at 5%.

However, if you were paying 2% interest on the debt and could invest it and get 5%, in investment returns it would be better to invest it. Of course, it doesn't have to be an all-or-nothing strategy. You could use part of the inheritance money towards the debt and part of it to put into your TFSA. Just make sure that you have adequate cash flow in retirement so you don't create additional debt.