

FINANCIAL LIFE STAGES / RETIREES

INCOME TAX

Don't let your nest egg get fried

How you dip into your RRSP can have a big impact on how much the taxman takes, **MARJO JOHNE** writes

You've spent years contributing to an RRSP and now you're retired and ready to start dipping into your nest egg. Unfortunately, so is the taxman, who can take as much as half of the RRSP money you withdraw, depending on your total income each year and where you live.

While you can't avoid paying taxes on pension income, financial experts say there are ways to minimize the portion Canada Revenue Agency takes from your RRSP money.

Ted Rechtshaffen, president and chief executive officer of TriDelta Financial Partners, a financial planning company in Toronto, offers what he considers to be the first guideline. "Everybody's financial situation is different," he says.

"But the general rule is that you would first want to use money that is not tax-sheltered before using tax-sheltered money."

Canadian law requires RRSP-holders to either cash out their money or convert the RRSP into a registered retirement income fund (RRIF), or into a life or term annuity when they reach the age of 69.

Most people choose the RRIF route, which comes with a minimum withdrawal requirement based on the age of the fund-holder and the RRIF's fair-market value of the fund at the start of the year. The required withdrawal amount increases as you age.

If you have other sources of income, such as dividends, stocks or real estate, then tap into these first and take out only the minimum required amount from your RRIF, advises Mr. Rechtshaffen.

Why? Because pension income — whether it's money from a RRIF, an annuity or a company pension plan — is taxed as regular income, which works out higher than tax on dividends or capital gains from stocks or real estate.

"In Ontario, for example, at the highest tax rate you'd be paying about 46 per cent on earned income, versus capital-gains tax which would be about 23 per cent," says Mr. Rechtshaffen. "Dividends from Canadian companies would be taxed a little bit higher than capital gains but still less than pension income."

Withdrawing only the minimum required amount also allows the rest of your money to continue to grow tax-free in the RRIF.

Ken Ingraham, a resident of Unionville, Ont., who retired from Royal Trust 17 years ago, is following Mr. Rechtshaffen's advice and withdrawing only the minimum amount from his RRIF.

"I consider the RRSP money as an extra — we use it to go on trips to Florida and things like that," says Mr. Ingraham, whose wife is also retired. "If I didn't have the RRSP I'd be all right because of my [company] pension."



It's smart to tap other sources of income, such as dividends, stocks or real estate, before withdrawing money from your registered account during retirement, says Ted Rechtshaffen, president and chief executive officer of TriDelta Financial Partners.

Don Nilson, a principal at Vancouver-based tax accountants Nilson & Co., says retired couples can also reduce their minimum RRIF withdrawal amount — and consequently, their taxes — by choosing to have Canada Revenue Agency

calculate their withdrawals based on the age of the younger spouse.

The time to do this, says Mr. Nilson, is when you convert your RRSP into RRIF.

"When you convert, you have to make a one-shot election to use

your age or the age of your spouse as the basis for CRA's calculations for how much you have to take out throughout the rest of your life," he explains.

"It could be a good idea to opt under your spouse's age if you don't need to withdraw as much or if you want your money to last longer."

If you have already converted your RRSP to a RRIF and now wish you had submitted the younger partner's age as the basis for calculation, don't despair, says Mr. Nilson: "Transfer your RRIF to a new one and re-elect to use your younger spouse's age under the new application."

But what if you need to take more than the minimum requirement from your RRIF? Should you just accept the fact that you'll be taxed at the going rate for earned wages?

Yes and no, say the experts. There's no getting around the federal and provincial tax brackets that are set in the stone of Canadian law, but there are ways to shave a few dollars off your income-tax bill.

One way is to take early advantage of federal and provincial tax credits, which apply to the first \$2,000 of pension income (an increase from the previous \$1,000 ceiling). For Canadians 65 years or older, these credits apply to certain types of pension income, but not to money taken directly from an RRSP.

Instead of waiting until you're 69 to roll your RRSP into a RRIF, many experts recommend setting up a RRIF at age 65, putting in \$10,000 of your RRSP money and then withdrawing \$2,000 each year until you turn 69. This provides you with up to \$2,000 of pension income tax-

free or nearly tax-free for five years. A federal government plan to allow pension-income splitting could also help retired couples lower their taxes, says Karen Yull, a principal with Grant Thornton LLP, a tax accounting firm in Toronto.

The proposed change would let couples aged 65 years or older split income from an RRSP, RRIF or lifetime annuity under a registered pension plan. (Couples under age 65 can split income from an RRSP converted into a lifetime annuity.)

"So if you're getting \$40,000 a year in annuity and your spouse didn't contribute to a plan, then when you file your tax return you can elect to transfer half of your \$40,000 to your lower-income spouse," says Ms. Yull.

To get the most out of their RRSPs, Canadians should have a tax strategy in place years before they plan to retire, says Mr. Nilson.

As an example, he cites a 65-year-old widow with an income of \$15,000 a year but close to \$1-million in RRSPs from her deceased husband. When the woman turns 70, the minimum withdrawal formula for RRIF income would push her into a much higher income tax bracket. To lower her income in her later years, Mr. Nilson suggested she start cashing in some of her RRSPs, but not so much that she goes up another tax bracket.

"By withdrawing some of the money now, she'll be paying 21.6 per cent on that income," says Mr. Nilson. "But doing this now lowers the minimum withdrawal amount she'll have to take out in the future."

Special to The Globe and Mail

Online bonus: Converting your RRSP

One of the most important decisions an RRSP-holder faces is what to do with the money in the retirement savings plan at age 69. For complete details about why you need to convert your RRSP and the main options

available, as well as details about how to withdraw money from a registered retirement income fund (RRIF), see "How to turn on the money spigot" at www.theglobeandmail.com/partners/fee/lifestages/

Does your retirement plan have zero protection against a market downturn?

If the market takes a turn for the worse, will you be left with a depleted portfolio and zero time to recover? After you retire, would a downturn significantly reduce your retirement income?

Yet is locking in your money the only way to protect it and create a reliable income? Will you still need access to potential market growth to ensure your savings last? We're with you in providing the

solution — IncomePlus. It turns retirement thinking on its head.

Turn this ad on its head to see how.

Manulife Investments
With you every step of the way*

*First 10 years only, provided certain conditions are met. Bonuses are not deposits, they increase the amount that is guaranteed for withdrawal. The Manufacturers Life Insurance Company (Manulife Financial) is the issuer and guarantor of the GF Select contract which offers the IncomePlus benefit. Manulife Investments is the brand name identifying the personal wealth management lines of business offered by Manulife Financial and its subsidiaries in Canada. Manulife and the block design are registered service marks and trademarks of The Manufacturers Life Insurance Company and are used by it and its affiliates including Manulife Financial Corporation.

