TriDelta
Private Wealth

The Canadian Retirement Income Guide

Maximizing your retirement income while minimizing your taxes

Introduction

When you retire, not only does your daily routine change, but your pay cheque stopping really makes you take notice. With the traditional pension becoming less of a reality for many Canadians, building a steady retirement income is a key part of any financial plan.

In this Guide, you will learn about some of the best ways to build your own retirement "paycheque" using the resources you already have. Common questions about different retirement income streams will also be answered, and tax minimizing tips will be provided along the way.

We provide you with some of our best insight on when to draw from RSPs, how to access government pensions and where to find other sources of cash flow. We trust that you will learn some new concepts from this Guide and we look forward to hearing from you.

How much income will I need?

Before you determine your different sources of income and how to amalgamate this into a strong retirement "paycheque," you need to calculate how much retirement income you will require.

This is an individual exercise, not based on rules of thumb. The place to start is to review your current expenses, and to determine if there are expenses that you know will change between now and retirement (child care, RSP/Pension savings, transportation costs, debt charges, etc.).

To help with this, you can use the TriDelta Budget Worksheet found here. This worksheet is easy to complete, and will cover off most if not all of your annual expenses.

The Nine Sources of Retirement Income

1) Government Pension Plans

The two basic sources of government retirement income are the Canadian Pension Plan (CPP) and the Old Age Security (OAS). You have already contributed to your CPP on every paycheque to date, and the OAS is a "social security" program, based on your earnings level. In order to make the most out of this income, here are a few tips:

Canada Pension Plan (CPP): The CPP is taxable, and payments are automatically provided to retirees starting at age 65 (although CPP can be started anywhere from age 60 to 70). You might choose to start withdrawing your CPP at the age of 60, although there are some costs for this in terms of lower pension. Factors to help determining whether to draw CPP relate to your current cash flow needs as well as your overall health and family genetics. If you think you will not have a long life, take the CPP at 60. If you think you will be around in your 90's, maybe wait until age 70 to take it.

For spouses or common-law partners who are together and receive CPP, retirement pension benefits might be "shared." Because the CPP is taxable, this sharing may be good tax-efficient planning. If you are able to split your CPP income with a spouse with lower-income, you will both be taxed less as a result.

For example, Doug and Arlene (both 68 years old) have been married for 40 years. Doug worked as a teacher and is now retired. His annual income includes an Ontario teachers' pension of approximately $40,000 per year and CPP benefits of approximately $10,000 per year. Arlene has minimal income. By applying to share their CPP retirement pension payments they can realize combined tax savings of over one thousand dollars. People with their eye on early retirement need to take a careful look at changes to the Canada Pension Plan brought in earlier in 2011, as they could prompt some to put their CPP decisions on hold.

Old Age Security (OAS): The Service Canada website outlines the eligibility for OAS as well as the application process. In addition to having lived in Canada for a number of years (10+ for partial benefits, 40+ for full benefits), the most important eligibility criteria is your income level.

Using 2011 data and figures, here is a chart of OAS Eligibility:

Yearly Net Income	OAS Eligibility
>67,688	Full OAS
$67,688- $109,674	Partial OAS
$109,674+	No OAS

You might initially think that you will not likely qualify for OAS; however there are ways to maximize your Old Age Security. You just need to be able to minimize your yearly taxable income below the thresholds. Some high level ways of doing this would be to draw down RSP funds before you turn 65, but after you finish working. Others include changing your investment mix for your non-registered investments so that they are generating less income (both interest and dividends). You can generate all of your investment income within your RSP. You might also choose to use specialized life insurance to allow funds to grow tax sheltered outside of an RSP. These will all lower your taxable income without impacting your wealth – other than possibly adding OAS to your income stream.

DO YOU KNOW? A report from the federal Task Force on Financial Literacy earlier this year said that roughly 160,000 eligible seniors do not receive Old Age Security (OAS) benefits. This represents almost $1-billion in benefits that are unclaimed.

2) RRSP/RRIFs

A second basic source of retirement income is your RRSP or RRIF. RRSPs grow in tax-sheltered accounts, but when you start to withdraw from it, the funds are taxed as income. At the age of 72, your RRSP evolves into a RRIF. The government mandates that you must withdraw at least 7.48% (or more) of your RRIF yearly and pay taxes on it.

When it comes to your RRSP, be as tax smart as possible. The very basic idea is that you want to minimize your tax bill.

Therefore:

a) Start withdrawing early. If you wait until 72 to start drawing out of your RRSP/RRIF, you might leave your estate a massive tax bill
b) If you have lower income years during your retirement, withdraw larger amounts of RRSP in those years. In higher income years, withdraw less. Typically this would be most effective in the years between retirement and age 72 – especially before age 65.
c) There are specialized strategies like the RRSP meltdown to effectively draw out money. This requires you to create a tax deduction equal to the amount of money withdrawn. Because it requires leveraged investing, you might require professional advice before undertaking the strategy.

DO YOU KNOW? If you pass away and have a spouse as the beneficiary, your RRSP/RRIF rolls over to them tax free. However, the year the second spouse dies, the entire value of your RRSP/RRIF is considered one year's taxable income. If you have $500,000 in your RRIF at the time of second death, the government could receive roughly $212,000 of it in taxes!

3) Non-Registered Investment Accounts and Tax Efficiencies

Cash flow generated from your non-registered investment accounts can come from five sources:

- Capital losses (this is from when you sell an investment for a loss)
- Return of capital (this generates no tax as it is effectively withdrawing your own money from an investment).
- Dividends (this is generated by some stocks and all preferred shares)
- Capital Gains (this is from when you sell an investment for a gain).
- Interest (this is generally from GICs and Bonds)

If you were earning $75,000 a year in Ontario, your tax on each dollar of the investments above would be:

Investment	Tax Amount
Capital Losses	0% or refund
Return of Capital	0%
Dividends	12.5%
Capital Gains	16.5%
Interest	33%

DO YOU KNOW? The biggest retirement question is "Will I run out of money?" To find out if you will run out of money or the likely size of your estate, use this free and simple Tridelta Retirement 100 Calculator to get the answers!

While you can take money from your non-registered account 'tax free', keep in mind that any income or gains will be taxed. The best tax decision on non-registered accounts is to try to avoid interest income as much as possible. You can still maintain a low risk profile by having a high weighting of preferred shares – which pay income as dividends.

4) Tax-free Savings Account

While some view the TFSA as a nice little account that doesn't have much of an impact – the truth will become very different for many retirees. If a couple put $5,000 a year each, into TFSAs that grow 7% a year, in 20 years, their TFSA assets will be $438,000. There is even some talk of raising TFSA annual contribution limits to $10,000, but we will deal with that if/when it comes.

As a reminder, the TFSA is a tax sheltered account, just like an RRSP. The difference is that a TFSA is funded with after tax money. There is no tax refund to put the money in. The benefit is that unlike the RRSP which taxes every dollar that comes out as income, you can withdraw money from the TFSA tax free.

The strategy with the TFSA in its simplest form is to look at any non-registered assets that you have. Other than a modest month to month cash balance, any extra should be moved into a TFSA. This will save you tax, and has virtually no downside. If you need the funds, you can draw them out.

From the perspective of retirement income strategy, the ideal asset structure at the end of your life would be to have all of your assets in a TFSA and/or your principal residence. Other than probate fees, there would be no taxes upon death. In order to achieve that goal, you would want to continue to fund TFSA accounts every year of retirement, and draw on other assets before drawing down from TFSAs if you are able.

5) Defined Benefit Company Pension Plan

If you are fortunate enough to have a company pension plan, this certainly eases some of the strain on retirement income; however, you still have decisions to make. For example, whether you should simply take the monthly pension or transfer to commuted value (i.e. a lump sum amount in a locked-in account) can be confusing.

Here are some questions to ask to determine whether to take a monthly or lump-sum amount:

How long will you (and your spouse) live?	If you predict a long life-expectancy, the pension is better, but if you predict shorter life expectancies, the lump-sum payment is often better as your pension is worthless upon death.
How safe is your pension? Is your pension indexed?	If you think your company might not survive 25 to 30 years (or till the end of your retirement) or if your pension is not indexed to inflation, a lump sum might be smarter. Analysis is required.
What are your tax planning goals?	A monthly pension is inflexible for tax planning. You may want more income at one stage of retirement, less at another. The lump sum amount can give you more flexibility.

Even if taking the company pension is the right decision for you, likely there are decisions around pension guarantees (for example, 10 years of guaranteed pension even if you don't live very long), or having anywhere from 0% to 100% spousal benefits after you pass away.

One of the best pension strategies is to take 0% spousal benefits, and therefore maximizing your monthly payment. With this extra payment, put some or all of it towards a permanent life insurance policy on the pension holder. In this way, if the pension holder dies first, and leaves no pension for their spouse, the spouse will instead receive a large insurance policy that will more than cover the pension in most cases. If the pension holder dies second, rather than leaving nothing to family (as the pension would also die), they will still leave the proceeds of life insurance – paid for from their employer pension.

6) Tapping in to Existing Home Equity

This is often the largest untapped source of retirement income. Many retirees own their homes and most homes have appreciated in value. Instead of letting the money sit and go unused within the house, think about taking out a line of credit or a second mortgage against the house at low interest rates. You can use this cash to generate a stream of monthly income. We suggest that the amount borrowed stay below 30% of the total value of the house, in case house prices plunge or interest rates soar. When you sell your house in 5, 10 or 15 years, you will have paid off the debt anyway. The important thing to remember is that your home is simply an asset. You can choose not to spend any of that asset or you can choose to use it. It is important to know that you have an option to access this value. Otherwise you might be real estate rich, and cash poor – for no good reason.

Do I need to downsize to maintain a standard of living?

Financial considerations should not be the only reason you downsize your home. If you are depending on the value of your home for retirement income, using home equity with a mortgage or a line of credit can be a good option. You might also look into some of the other retirement income streams first. Think about the personal factors when it comes to selling. Are you interested in keeping up with maintenance work after retirement? Would you like to move to a different neighbourhood, perhaps more friendly to your retirement lifestyle?

DID YOU KNOW? Your home equity loan interest can be structured to be tax deductible in many cases, and costs less than non-secured debt.

7) Home Equity - Downsizing Your Real Estate

As your lifestyle changes, downsizing or changing your current real estate can make a lot of sense. The financial key is to truly understand how your overall budget will change in your new residence. In some cases, high condo fees eat up much more cash than the maintenance costs of running a home. Also, it is important not to underestimate real estate commissions, land transfer taxes, and other moving costs. At an older age, renting may be a better option than owning.

8) Insurance Policies

An unlikely, yet effective source of retirement income can be insurance policies. If you are nearing retirement already, there are some strategies to use insurance policies as retirement income. Policy holders can often access cash by withdrawing assets from the cash surrender value of the policy, without impairing the coverage terms. Some policies also have a contractual provision that allows you to borrow funds against the value of the insurance policy. This loan is payable after you pass away and is subtracted from the benefit paid by the insurance policy.

In a different approach, investors in their mid-30s to early-50s can take out a policy on their parents. They pay the premiums and when the parents pass away, the payout becomes a core part of their retirement income. When seeking out retirement income, revisit your existing insurance to see if you are able to use any of these strategies. We can help you to explain your insurance policies – and to better understand your options.

9) Your Kids (or other family)

While not the first choice of most parents, sometimes their children are in very good financial position, and willing and able to 'gift' to their parents. It worked the other way around for many years. Sometimes turnaround is fair play.

Conclusions

As one moves to a new stage where the steady paycheque comes to an end, it shouldn't be a time of financial worry. The key is to truly understand your needs or wants in retirement, review your current net worth picture, and put the plan together that will allow for steady and tax smart cash flow to allow you to achieve your goals.

About TriDelta Private Wealth

TRIDELTA
Private Wealth

TriDelta Private Wealth is an independent, comprehensive financial planning firm. We start with developing a complete financial plan so that your entire financial health is considered when offering advice and recommending solutions. We offer the very best investment, insurance, retirement, debt and mortgage solutions in the market with complete independence.

If you liked this guide, please let us know. If you think we can help you with your retirement income or other financial planning needs, please contact us to have an introductory conversation.

To learn more, contact Ted Rechtshaffen by phone at (416) 733-3292 ext. 221 or 1-888-816-8927, or by email at tedr@tridelta.ca

www.tridelta.ca

Toronto
2 Sheppard Ave. East
Suite 205
Toronto, Ontario
M2N 5Y7
(416) 733-3292 x 221

Oakville
156 Lakeshore Rd East
Suite 203
Oakville, Ontario
L6J 1H4
(905) 901-3429

Georgian Bay
143 Mill Street
Unit B
Creemore, Ontario
L0M 1G0
(705) 520-0093