RRSPs and Drawdown Considerations

Ross McShane

Many of our clients nearing or in retirement ask us if they should consider withdrawing funds from their RRSPs before the mandatory age of 72. An individual or couple may have a retirement portfolio that includes different "pots" of money – RRSPs, non-registered, Tax-Free Savings Accounts (TFSAs), possibly a Locked-in Retirement Account (LIRA) and/or a corporate portfolio. Investment income and withdrawals could be taxed differently for each "pot". Proper financial planning is therefore required to ensure the most tax-efficient cash generation strategy.

Usually it is best to leave RRSPs intact until it is mandatory to convert them to a Registered Retirement Income Fund (RRIF) at the age of 71. This article will explore the reasons why it might make sense to withdraw funds before the mandatory age.

First, let's do a quick refresher of RRIF basics.

- Investments held within an RRSP can be transferred to a RRIF.
- You must convert to a RRIF by the end of the calendar year in which you turn 71.
- Payments that must start in the year you turn 72 are treated as ordinary income, i.e. a dollar withdrawn is treated as a dollar of income for tax purposes. (Contributions to RRSPs over the years allowed you to defer the taxation of this income to future years.)
- Withdrawals can be monthly, quarterly or as an annual lump sum.
- The minimum RRIF payment is based on a prescribed factor. If the annuitant (owner) is under age 71, it is 1/ (90-age) x value of the RRIF. At age 71 it is 7.38% of the value of the RRIF and the factor increases each year. (There is no maximum amount that must be withdrawn annually.)
- The minimum payment can be based on the spouse's (or common-law partner's) younger age to lower the amount withdrawn and hence taxable income. In this case the formula is: 1/ (90-spouse's age) x value of the RRIF. If the spouse is 65 then the payout ratio in year 1 is 1/90-65) = 4%.
- Starting at age 65, the annuitant (owner) may split up to 50% of the RRIF withdrawal with his/her spouse or common-law partner.
- The taxation of investment income earned within the RRSP and RRIF is deferred until withdrawn.
- Investment income loses its identity within RRSPs and RRIFs in that interest, dividends and capital gains are treated the same – fully taxable upon withdrawal. As a result, asset

Minimum Annual Withdrawals

To determine the minimum amount that must be withdrawn from a RRIF in a given year for a specific annuitant, multiply the January 1 fair market value of the RRIF by the factor associated with the annuitant's age on January 1. Clients can opt to use the age of their spouse or common-law partner if this election is made before the first withdrawal. No minimum withdrawal is required in the year a RRIF is established. To maximize tax-deferred growth in the RRIF, set up withdrawals to occur on December 31. While RRIFs have a minimum that must be withdrawn in a year, there is no maximum.

Age	General (%)	Qualifying RRIFs* (%)	Age	General (%)	Qualifying RRIFs* (%)
71**	7.38	5.26	83	9.58	9.58
72	7.48	5.56	84	9.93	9.93
73	7.59	5.88	85	10.33	10.33
74	7.71	6.25	86	10.79	10.79
75	7.85	6.67	87	11.33	11.33
76	7.99	7.14	88	11.96	11.96
77	8.15	7.69	89	12.71	12.71
78	8.33	8.33	90	13.62	13.62
79	8.53	8.53	91	14.73	14.73
80	8.75	8.75	92	16.12	16.12
81	8.99	8.99	93	17.92	17.92
82	9.27	9.27	94 +	20.00	20.00

*A qualifying RRIF is generally a RRIF established before 1993.
**To calculate minimum annual withdrawals for below age 71, use the formula 1/(90-age).

Source: Canada Revenue Agency

location (holding the investments in the appropriate part of the overall portfolio) becomes important, but this is the subject of another article.

So, in what situations would someone want to draw from an RRSP before the mandatory RRIF age?

- Cash flow is required and the investor does not have more tax-efficient portfolios to draw from, e.g. non-registered, corporate or TFSAs.
- If a private pension is not available, consider an early RRIF at age 65 to take advantage of the pension credit. To accomplish this you would transfer enough investments from an RRSP to a RRIF so that $2,000 can be withdrawn from the RRIF each year until the entire RRSP is converted at age 71.
- Withdraw income if your tax bracket is lower today than it may be in later years.
- Withdraw funds to invest in a TFSA. Although tax is paid this year on the withdrawal, investment income earned within the RRSP that would eventually be taxed upon withdrawal is turned into tax-free investment income within the TFSA. This is beneficial if the tax bracket this year is the same as in later years.
- Health issues – estates are taxed at the top marginal rate of 46.41%. If your tax bracket is lower than that, you may want to accelerate the withdrawal of funds.
- Death of spouse – withdraw in the year of death to take advantage of available credits. The alternative is to roll investment funds to the surviving spouse and eventually withdraw at the surviving spouse's tax rate.

Every situation is different, so you are encouraged to seek advice from your integrated team (accountant, financial planner and investment specialist) to determine the strategy that is appropriate for you.

Ross McShane, CGA, CFP, RFP, Director, Financial Planning, McLarty & Co Professional Corporation, Ottawa, Ontario (613) 726-1010, www.mclartyco.ca