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What to Do with Your RRSP Investment when You Turn 71 or You Retire

With the beginning of the New Year, the RRSP season will be in full swing.

An RRSP contribution can generate a tax refund of 43 percent for high-income earners; it is viewed as a good tax strategy.

But what happens when an individual has already retired and wants to reap the benefit of the hard-saved RRSP dollars contributed over the years?

An individual must terminate RRSPs by December 31 in the year he or she turns 71. The following options are available.

- Withdraw the funds as a lump-sum amount
- Use the proceeds to purchase an annuity
- Transfer the funds to a RRIF (Registered Retirement Income Fund)

In the case of the lump-sum payment, the withdrawal is taxable. That may not be the most effective tax strategy.

Given the current level of interest rates, if the funds are used to purchase an annuity, the annuity will be locked at the low rates. The corresponding monthly payments throughout retirement will remain low.

In the case of the lump-sum payment, the withdrawal is taxable. That may not be the most effective tax strategy.

Most RRSPs are collapsed and transferred to RRIFs.

- If the individual does not collapse the RRSP by December 31 in the year he or she turns turn 71, the tax rules require that the fair market value of the RRSP be included in the individual's taxable income in the following calendar year.
- Arrangements can be made well ahead of time with the financial institution to ***automatically transfer*** the RRSP to a RRIF. That is important for seniors who make their own investment decisions. Although individuals must collapse their RRSPs before the age of 72, there is no minimum age for collapsing the RRSP.

Registered Retirement Income Funds

An RRIF is like an RRSP in that it is a vehicle for growing investments but the individual is not allowed to make contributions. Since the RRIF is the extension of the RRSP, it may be self-directed and can hold the same investments as an RRSP.

Starting the year after the RRIF is established, a minimum amount must be withdrawn each year, calculated on a percentage of the market value—between 7.38 percent at the age of 71 to a maximum of 20 percent after the age of 94.

If a person starts to withdraw funds from the RRIF before age 71, the minimum annual withdrawal is calculated every year using a formula that divides the difference between 90 and the age of the individual at the start of the year over the fair market value of the RRIF at the beginning of the year.

In considering whether to transfer the RRSP to a RRIF, an individual must keep in mind the following points.

1. Although there is a minimum RRIF withdrawal amount every year, the individual can draw funds in excess of the minimum amount.
2. Monies in the RRIF that are not withdrawn continue to grow tax-free.
3. The RRIF can be self-directed. It may be appropriate to use the services of professionals because the ability of the individual to make the right decision may be affected by age.
4. RRIF payments can be structured to include an adjustment for inflation.

5. If an asset is removed from the RRIF at less than market value, a penalty provision requires that an amount equal to twice the difference in value will be included in the individual's income.

Registered Retirement Income Funds at Time of Death

If the individual is married or has a common law spouse, there are a number of planning options available to the owner of the RRIF.

- The general rule: At time of death, the full fair market value of the RRIF is included in the income of the individual.
- The spouse can be named as the successor annuitant and the spouse will continue to receive the monthly RRIF payments.
- If the spouse is not named as the survivor annuitant but is named as the beneficiary, the surviving spouse will receive the funds remaining in the RRIF at time of death. Those funds will be transferred tax-free to the spouse's RRIF.
- If the spouse is under the age of 72, the RRIF funds can be transferred to the surviving spouse's RRSP.
- If there is no spouse, the beneficiary can be a dependent child or grandchild and the funds will be taxable to the child.
- If the child or grandchild is dependent on the deceased because of mental or physical infirmity, the dependent may purchase an annuity and the amounts received will be taxable to the dependents rather than to the deceased.
- If anyone else is named as a beneficiary, the funds in the RRIF are taxable to the deceased's estate.

Individuals can close their RRSP by withdrawing the funds as a lump-sum payment.

Lump Sum Payments

Individuals can close their RRSP by withdrawing the funds as a lump-sum payment. Those payments are included in income and may push the individual into a higher tax bracket, which may not be a favourable option for the retiree. That may not be as important if the individuals are already in the highest tax bracket when they retire or reach 71 but this strategy will eliminate the tax-free deferral if the funds are transferred to the RRIF.

The strategy to withdraw funds may be useful when the individual wants to withdraw funds from the RRSP between the date of retirement and when the funds are transferred to the RRIF. That strategy is used when the individual requires funds to finance his or her lifestyle if other income is not sufficient.

When the funds are withdrawn from the RRSP, they are subject to withholding tax as follows.

Less than $5000	10% withholding
$5000 to $15,000	20% withholding
More than $15,000	30% withholding

Annuity

The funds of an RRSP can be used to purchase an annuity, usually from an insurance company. With an annuity, the individual will receive a monthly income for the remainder of his or her life. The amount of the monthly income will be based on various factors.

- The amount in the RRSP
- The interest rate at the time the annuity is purchased
- The age of the individual
- The type of annuity purchased and its guaranteed payment options
- The insurance company

With the annuity, an individual receives a fixed stream of payments for the remainder of life. A younger individual likely will live longer than an older individual and thus will receive annuity payments for a longer period—so the younger the individual, the lower the payments. Higher interest rates at the time of purchase result in higher monthly payments, as well.

The annuity payments stop when the individual dies. Some annuities offer options where payments are guaranteed for a determined period to offset the risk of an early death, but those options will reduce the amount of monthly income streams.

A disadvantage of purchasing an annuity—other than when the interest rates are low—is that it does not offer inflation protection and flexibility. Once the annuity is purchased and the payments established, the annuity does not provide for additional funding in case the individual requires more income. On the other hand, the RRIF option provides for additional funds to be withdrawn if necessary, over and above the minimum annual withdrawal.

Annuity payments are usually fixed for the life of the annuitant, therefore inflation is an issue. The individual can purchase an inflation-protection option but of course that option will lower the monthly payments.

Generally, annuity payments stop when the individual dies. There are, however, various options available to individuals to receive annuity benefits after the death of the annuitant.

- Life annuity: The annuity stops when the annuitant dies.
- Life annuity with a joint-survivor option: The annuity will continue until the death of both the individual and the spouse.
- Life annuity with a guaranteed period: The payments are guaranteed for a specific period. If the annuitant dies during the guaranteed period, the value of the annuity will transfer to the beneficiaries.
- Joint life annuity with a guaranteed period: The annuitant will receive payments until the death of the individual and the spouse. If he or she dies during the guaranteed period, the beneficiaries of the last spouse to die will receive the value of the annuity. *Example: I am 71 and I buy a joint life annuity with a guaranteed period of 15 years. If I die before I reach age 86, my wife will receive the payments. If my wife dies before the end of the 15th year, her beneficiaries will receive the value of the annuity.*
- Term certain age 90: The individual will receive payments until the age of 90 and if he or she dies earlier, the annuity will be transferred to the beneficiaries.

To conclude, any individual must consider various circumstances while deciding if the RRSP should be transferred to a RRIF or should be used to purchase an annuity—or a combination of both.

The issues to consider include the following.

Guaranteed Payments

- An annuity will provide a stream of payment as long as the annuitant is alive.
- The RRIF is affected by the return on the investments and the withdrawal of lump-sum payments.

Change in Needs

- Once an annuity is purchased, the retiree is locked in.
- The RRIF can be converted to an annuity at a later date.

Flexibility

- Annuities are locked in until death.
- The RRIF provides only for minimum annual withdrawals. Therefore, the individual can draw more from the RRIF, if needed.

Age

- There are no age restrictions to purchase an annuity.
- The RRIF must be purchased by December 31 (or earlier) of the year the individual turns 71.

Tax sheltering

- Annuity payments are taxed in the year they are received, as are RRIF payments.
- The investment income earned by the remaining RRIF funds grow tax-free, however.

Life Expectancy

- Retirees will achieve the greatest benefit from annuities if they outlive their estimated date of death (tabulated by insurance companies) when calculating the payments. With an annuity, the payments cease with the death of the annuitant.
- At time of death, the remaining funds of the RRIF are transferred to the spouse, a child, or whomever is the beneficiary.

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