Can Mitch and Michelle help their kids buy homes without jeopardizing their own retirement?

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Mitch and Michelle's retirement spending goal is $120,000 a year after tax.
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Mitch and Michelle are physicians – immigrants to Canada – near the end of their careers. Their work has taken them across different countries and continents. Michelle is 58 and Mitch is 60.

In 2014, they settled in Canada with their three children. Mitch retired from work but Michelle continued, forming a professional medical corporation from which she had been drawing a salary and dividends. She has scaled back her workload and is taking only a dividend this year.

Over time, Mitch bought three condos in the Greater Toronto area, the first of which has risen substantially in value. He and Michelle live in one, two of their children live in another and the third one they rent out. They also have sizable holdings in their self-directed investment accounts.

"We are thrifty people and want to know: After so many years of one hundred hour work weeks, can we finally spend time and money travelling?" Michelle asks in an e-mail. "Can we chip in and help our three children to buy their first homes with prices so high?" They ask whether they can give each child $200,000 without jeopardizing their own retirement plans. The children are 22, 25 and 28.

Michelle hopes to quit working early next year and wonders how best to begin drawing down their various accounts. Their retirement spending goal is $120,000 a year after tax.

We asked Barbara Knoblach, a certified financial planner at Money Coaches Canada in Edmonton, to look at Mitch and Michelle's situation.

What the Expert Says

As self-employed individuals, Michelle and Mitch are not members of any employer-sponsored pension plan, Ms. Knoblach notes. Because they have not lived in Canada all their lives, they will not be eligible for full Canadian government benefits either. "Most of the couple's wealth is stored in their personal non-registered investments."

For 2023, Michelle plans to draw a dividend of $102,000 from her corporation, Ms. Knoblach says. Mitch collects rental income in his name of $36,000 (after deduction of expenses, but before tax) each year. The rental income is artificially low because one of the condos is occupied by two of their children.

The couple also has investment income from their non-registered holdings in the range of $70,000 per year.

Because of a recent health scare, Michelle will exit the work force sooner than initially planned. She had wanted to work to age 65. She wants to be sure they will be okay with their finances if she retires early next year, the planner says.

The first concern is finding $600,000 for down payments for the children. Michelle holds three guaranteed investment certificates of $100,000 jointly with each child, Ms. Knoblach says. “She could transfer these GICs to her children’s names and withdraw another $300,000 from her non-registered cash and GIC holdings,” the planner says. Her analysis assumes the children buy their own homes, allowing Mitch to substantially raise the rent on the condo in which two children live. Like many newcomers to Canada, the couple plan to hold on to their properties for the long term, perhaps passing them on to their heirs.

Even with the down payment gifts, the couple could retire with an after-tax spending power of $239,000 a year, “which vastly exceeds their spending target,” Ms. Knoblach says. “They have attained financial freedom and could retire immediately.”

The planner assumes a rate of return on investments of 5 per cent, a long-term inflation rate of 2.1 per cent and that they live to age 95.

When Michelle retires from active work, it is assumed her professional corporation will be converted into a holding company with minimal business overhead – about $5,000 a year, the planner says. Michelle should continue drawing dividends in the range of $100,000 a year. This dividend income, together with the couple’s rental and investment income from non-registered accounts, means they will not have to dip materially into the principal of their personal investments, she says. Michelle should continue drawing dividends until the funds in the corporation have been depleted, which is projected to be around her age 65. “At this point the corporation should be closed.”

The couple can then begin drawing on the principal in their non-registered accounts. “I recommend establishing a holding account containing one year’s worth of living

expenses from which they should pay themselves regular monthly income as if they were still at work," Ms. Knoblach says. This regular income stream will allow them to budget better than drawing funds randomly from savings and investment accounts, which can lead to a feeling of having a lack of control, she says.

"As prodigious savers, Michelle and Mitch may find it difficult to make the switch from accumulation (saving money) to decumulation (spending money)," the planner says. "Having funds set aside in a separate account that is earmarked for their living expenses will provide them with an indicator that there is money available to be spent." They should also set up a well-funded travel account and make it a goal to use the funds up every year.

Because receiving government benefits is not a priority, and the potential clawback of Old Age Security not a concern, the couple should use their tax-sheltered accounts (registered retirement savings plans and tax-free savings accounts) for maximum tax-free compounding of investment returns, Ms. Knoblach says. "Michelle should keep the funds in her RRSP invested for as long as possible." After she converts her RRSP to a registered retirement income fund (RRIF) at age 71, she should make only minimum withdrawals each year. "Income from a RRIF qualifies as pension income, which she can split with Mitch."

They should continue to contribute to their TFSAs using funds from their non-registered savings. "As holdings in TFSAs are not taxable at death, the funds could eventually be passed down to their children," the planner says. Funds should be invested aggressively all in stocks to take advantage of maximum tax-deferred growth, she adds. "Conversely, funds in their taxable accounts should likely be restructured to a slightly more conservative composition."

Their current asset allocation is 75 per cent equities and 25 per cent cash and fixed-income products.

Michelle and Mitch have diverse holdings in investment accounts, which include Canadian and U.S. blue-chip stocks. They should take advantage of year-end tax-loss harvesting in their non-registered accounts; for example, the timely selling of securities at a loss to offset capital gains obtained from selling other stocks at a profit.

Moreover, Michelle and Mitch should take advantage of "asset location" strategies, Ms. Knoblach says. "In a nutshell, not all investment income is taxed equally." Tax-preferred treatment is given to dividend income obtained from Canadian corporations that are not connected. For this reason, dividend-paying Canadian stocks should be concentrated in personal or corporate non-registered accounts. Dividend income from U.S. and international companies is taxed at a much higher rate, but U.S. dividend income is completely tax sheltered inside RRSPs.

"Michelle should concentrate dividend-paying U.S. stocks in her RRSP to the extent possible." Conversely, TFSAs do not provide tax shelter from a U.S. perspective because these accounts were introduced after the most recent tax treaty was negotiated with the United States, the planner says.

The Internal Revenue Service (the U.S. equivalent of the Canada Revenue Agency) will withhold 15 per cent on dividend income from U.S. sources in TFSAs. Dividend-paying U.S. stocks should for this reason not be held in TFSAs whenever possible, she says.

Client Situation

The People: Michelle, 58, Mitch, 60, and their three children, 22, 25 and 28.

The Problem: Can they gift their children $600,000 for down payments on their first home without jeopardizing their own retirement goals? Which of their various accounts should they draw down first?

The Plan: With their financial goals easily met, Michelle can retire and continue to draw dividends from her corporation until they are exhausted. If the two children move out of their parents' condo and buy homes, Mitch can increase the rent on that unit. They may want to set up special bank accounts from which they can draw monthly like a salary.

The Payoff: The realization that they are far better off financially than they thought.

Monthly pretax income: $17,335.

Assets: Cash and GICs $1,065,000; non-registered stock portfolio $2,606,000; TFSAs $200,000; her RRSP $180,000; corporate investment account $588,000; principal residence $1,200,000; two investment condos $1,350,000. Total: $7.2-million.

Monthly outlays: Condo fees $1,300; property tax $750; water, sewer, garbage $100; property insurance $150; electricity $100; heating $100; security, maintenance $50; garden $200; transportation $580; groceries $1,200; clothing $50; gifts, charity $1,000; vacation, travel $4,000; personal care $100; club memberships $120; dining out, entertainment $450; sports, hobbies $100; subscriptions $100; doctors, dentists $200; drugstore $60; cellphones $150; TV, internet $225; RRSP $1,000; TFSAs $1,000.

Total: $13,085.

Liabilities: None.