Can Katarina, 64, afford to quit work? If she keeps working, will it affect her OAS?

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At age 64, Katarina is on her own again, semi-retired after a long career and doing some casual work in a high-demand field. She has two grown children, a house and a small amount of debt.

Katarina wonders whether she can retire fully in a year or so with a spending budget of $70,000 a year after tax. She'd like to do some travelling. She also worries about the Old Age Security clawback.

"If I continue working, will my Old Age Security be affected?" Katarina asks in an e-mail. She wonders, too, if she should seek professional financial advice. "Should I consider hiring a financial planner?" she asks. "I have been doing my own investing since my husband passed away a few years ago." In addition to her house, Katarina has a total of $616,240 in her tax-free savings account and registered retirement savings plan. Is she on track?

WHAT THE EXPERT SAYS

Katarina has a number of different income sources that will need to be co-ordinated when she retires from work, Ms. Knoblach says. Katarina is collecting $4,200 a month before tax from two defined benefit pensions, her own and her late husband's. Both are partly indexed to inflation. "This will provide for the majority of her income needs in retirement," the planner says.

She is also collecting Canada Pension Plan benefits and the CPP survivor benefit. Katarina is thinking of starting Old Age Security benefits when she turns 65.

She is facing a cash crunch because she is making high debt repayments that may keep her stuck working in her casual position, the planner says. Katarina is paying $1,105 a month on a car loan and line of credit balance totalling more than $22,000. Making such high payments could put her deeper in debt "if she is not prepared to use some of her savings to pay off those two small debts in full," the planner says.

Katarina's investments total almost $623,000, about 90 per cent of which is in stocks.

Will Katarina's OAS be clawed back if she continues to work past the age of 65?

"Yes," Ms. Knoblach says, and the clawback will be twofold. The calculations assume Katarina takes OAS at age 65. If she continues to work, earning employment income of $14,400 a year in addition to her pensions and government benefits, Katarina will have $86,000 in pre-tax income ($66,000 after tax) and not have to draw funds from her RRSP. "While active in the work force, she could withdraw $5,000 to $7,000 a year from her TFSA to arrive at $70,000 a year after tax."

But her income would be above the threshold for the OAS clawback, which is triggered at net income of $79,054 in 2020. In Katarina's case, between 10 and 12 per cent of her OAS benefits would be clawed back.

A second, bigger clawback would come once Katarina has to start drawing down her RRSP. She will have to convert her RRSP to a registered retirement income fund by the end of the year in which she turns 71 and begin making mandatory withdrawals the year after. Her RRSP is projected to grow to about $950,000 if she does not withdraw funds before the age of 72. She would have to withdraw 5.4 per cent of the RRIF value and so would have taxable income from the RRIF withdrawal in the range of $50,000 a year. Withdrawal minimums increase progressively to 20 per cent of the value of the RRIF at 95. "For this reason, Katarina will likely never have less than $50,000 in taxable income per year from RRIF withdrawals for the rest of her life if she adheres to her $70,000 per year retirement income target."

"From a tax perspective, an RRIF drawdown starting at age 72 would therefore have a much more adverse effect on Katarina's OAS benefits than would her casual employment income in her early retirement years," Ms. Knoblach says. Assuming Katarina is in good health, she could mitigate this effect by deferring OAS benefits to age 70.

"She could quit her job by the end of this year, convert at least a portion of her RRSP to a RRIF and start a structured drawdown of the RRIF next year."

A financial planner could help her determine how much money to take out every year to optimize the tax impact, Ms. Knoblach says. "In essence, Katarina should avoid getting bumped into an unfavourable tax bracket early in retirement, but by the same token, she should take out sufficient funds from her RRIF every year to minimize the OAS clawback later on." The clawback would be lower because the amount of savings in her RRIF would be lower, resulting in a smaller mandatory withdrawal from the RRIF.

Katarina could use the money from her RRIF to pay off her debts and contribute as much as possible to her TFSA each year, with any remaining money going to her non-registered account, the planner says.

The planner's calculations show Katarina could retire at year end with inflation-adjusted, after-tax spending power of $77,500 a year, surpassing her target. This can be achieved without fine-tuning her RRIF drawdown using the above tax optimization strategy.

If, conversely, she keeps working in her current job to the age of 69 to avoid having to draw down on her RRSP, she would end up with a marginally higher after-tax spending power of $79,800 a year, Ms. Knoblach says.

"In either case, her target is immediately met. Katarina is therefore free to quit her job at any time if she desires to do so."

Should Katarina seek the help of a fee-only financial planner?

As well as helping with tax strategies, a financial planner could help Katarina compare her financial “as-is” status with the forecasts presented here, Ms. Knoblach says. “This will allow her to identify any discrepancies and implement corrections, if need be, to ensure that her retirement unfolds as planned.”

A planner could also help with asset allocation. Because Katarina is so close to retirement and the outlook for the stock market so uncertain, “it may be neither necessary nor prudent for her to have such a high percentage of equities in her investment portfolio,” Ms. Knoblach says.

Before Katarina begins drawing on her savings, she should convert a portion of her investments into cash to provide her with a buffer against market volatility.

CLIENT SITUATION

The person: Katarina, 64

The problem: Can she afford to quit work? If she keeps working, will it affect her OAS?

The plan: She can quit any time if she wants to. To mitigate OAS clawback at age 72, defer OAS to age 70. In the meantime, convert at least a part of her RRSP to a RRIF and begin withdrawing money to supplement her pensions. Review risk tolerance.

The payoff: A better understanding of the complexities of asset “de-accumulation,” which can have tax consequences.

Monthly net income: $4,885

Assets: TFSA $51,985; RRSP $564,255; non-registered $6,600; estimated present value of DB pensions $880,000; residence $380,000. Total: $1.9-million

Monthly outlays: Property tax $270; home insurance $105; heat, hydro $250; maintenance, garden $50; transportation $345; groceries $400; clothing $125; line of credit $500; vehicle loan $605; gifts $40; vacation, travel $100; dining, drinks, entertainment $350; personal care $50; club memberships $240; golf $400; subscriptions $65; health care $250; health, life insurance $230; phone, TV, internet $255; other discretionary $500; TFSA $100. Total: $5,230

Liabilities: Line of credit $11,170; car loan $11,670. Total: $22,840

Some details may be changed to protect the privacy of the persons profiled.