Should this couple start drawing money from their RRSPs before the age of 71?

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After years of running their own small business, raising three children and paying off the mortgage on their Southwestern Ontario home, Terry and Tom are about ready to hang up their hats. He is 65, she is 61.

Their income comprises dividends from their private corporation – they’re equal shareholders – and Tom’s Canada Pension Plan and Old Age Security benefits. They have $420,000 in corporate investments, on which taxes have been paid by the company, plus substantial savings in their registered retirement savings plans (RRSPs).

Tom has been steadily reducing his hours and would like to retire fully by 2020 at the latest. When he does, they plan to travel extensively – to the tune of $20,000 a year over and above their regular living expenses, for the next 10 years. They also want to renovate their house ($40,000) and buy a new vehicle (another $40,000).

They wonder whether they should start drawing money from their RRSPs before the age of 71, when they must convert them to registered retirement income funds (RRIFs) and begin making mandatory minimum withdrawals. Their retirement spending target is $116,000 a year after tax, which includes $20,000 a year for travel for 10 years.

We asked Barbara Knoblach, a financial planner at Money Coaches Canada in Edmonton, to look at Tom and Terry’s situation.

WHAT THE EXPERT SAYS

Terry and Tom have worked hard to build up a sizable asset base, Ms. Knoblach says. “Their current living expenses are relatively modest and their dividend drawings from the corporation are tax-efficient.” But they have a couple of big expenditures planned – on the renovation and the new vehicle – that will coincide with their planned retirement, forcing them to draw on their assets.

For the most tax-efficient drawdown of assets, Ms. Knoblach recommends the following:

Terry postpones taking her CPP and OAS to the age of 70 to benefit from the increased inflation-adjusted payments for life. Tom has missed a financial-planning opportunity by taking his CPP and OAS at 65. Postponing them would have allowed him to draw down his RRSP in a more tax-efficient manner, the planner says.

Second, Tom draws from his RRSP and splits the income with Terry for tax-savings. As well, Tom converts a portion of his RRSP to a RRIF to take advantage of the federal pension-tax credit.
Dividend payments from the corporation should initially constitute only a small fraction of the couple’s retirement income to take advantage of the company’s refundable dividend tax on hand (RDTOH) account, Ms. Knoblach says. The RDTOH account is used to track a private corporation’s income tax paid on investment income. A portion of this tax is refundable to the corporation when it distributes taxable dividends to shareholders. The company receives a tax refund of $1 for every $3 of dividends paid out, up to the balance of the RDTOH account.

By limiting dividend distributions to the extent in which a tax refund can be obtained by the corporation, Tom and Terry will end up with a bigger nest egg than if they were to pay out all the capital from the company early on in retirement. Once their RRSPs/RRIFs have been depleted, the couple could withdraw the remaining funds from the corporation. They could cover the cost of the renovation and the new vehicle purchase by withdrawing from their tax-free savings accounts or non-registered investments, on which no additional taxes are payable, the planner says.

This will enable Tom and Terry to stay in lower tax brackets throughout retirement than if they were to postpone the drawdown of their RRSPs,” Ms. Knoblach says. “They will also mostly be able to avoid a clawback of their Old Age Security benefits,” she adds.

“The proposed drawdown strategy will provide Tom and Terry with after-tax income of $104,000 in retirement to Terry’s age 95,” Ms. Knoblach says. This falls a bit short of their spending goal. If they were to go ahead and spend $116,000 for the next 10 years and thereafter $90,000 a year in today’s dollars, they would likely deplete their funds by the time Terry was 90, she says. “At that point, they would have to rely on government benefits and the equity in their home.”

They could make some adjustments to avoid the risk of running out of money. For example, Tom could buy a good used vehicle for half the price of buying or leasing a more expensive one. After he has retired, he’ll be spending less time on the road.

Because renovating is important to them, they could use the $20,000 a year travel budget to fix up the house first. Once the job was done, they could spend it on travel as planned.

They are considering downsizing at some point and moving to a smaller town. If they bought a less-expensive property, they could add some money to their long-term investments.

Tom has done well managing their investments, generating returns that range from 5 per cent to 10 per cent a year over the past five years. Their asset allocation now is 63-per-cent equities, 33-per-cent fixed income and 4-per-cent cash. They should shift to a more income-oriented portfolio as they approach retirement, the planner says.

**CLIENT SITUATION**

The people: Tom, 65, and Terry, 61

The problem: Are they on track to meet their retirement spending goal?
The plan: Draw on Tom’s RRSP and take advantage of strategies to split retirement income. Consider buying a less expensive vehicle and finishing renovation before they spend big on travel. Shift to a more conservative investment strategy.

The payoff: The peace of mind that financial freedom brings.

Monthly net income: $7,585

Assets: Cash $8,735; stocks $46,400; corporate investments $418,320; gold bullion $41,000; his TFSA $53,100; her TFSA $53,685; his RRSP $801,830; her RRSP $330,145; residence $575,000. Total: $2.3-million

Monthly outlays: Property tax $515; home insurance $85; utilities $340; maintenance $275; garden $50; vehicle lease $550; car insurance $160; fuel, oil, maintenance $285; parking $10; groceries $900; clothing $170; gifts $75; charity $300; vacation, travel $1,000; dining, drinks, entertainment $600; grooming $45; club membership $65; golf $250; other personal $40; health care $110; phones, TV, internet $250. Total: $6,075

Liabilities: None