Winding up your RRSP: Don't get hit by deadlines, penalties

Options and tips for winding up your retirement savings plan

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More than 15 million Canadians have set up RRSPs – millions of plans that, at some point in the future, will need to make an abrupt transition from accumulating money for retirement to paying out money in retirement. It's a basic rule of RRSPs, but it can catch soon-to-be retirees by surprise if they don't plan properly.

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The surprise can turn nasty, too, with the tax man taking an unexpected bite out of a retirement fund.

Canadians face three broad choices when they mature their RRSPs – something that must happen at the latest by the end of the year in which they turn 71.

RRIF

First, they can convert their RRSP to a Registered Retirement Income Fund (RRIF). This is the most common choice at maturity.

In fact, converting an RRSP to a RRIF can seem like little more than a name change, in that the RRIF can hold most of the same investments the RRSP did. You can even hang on to your old financial adviser.

The difference is that once the RRIF is in place, deposits stop and minimum withdrawals start. Those minimum annual withdrawals start at low levels and rise steadily with age.

Annuities

Second, people can use the proceeds of the RRSP to buy an annuity.

Annuities come in various varieties — single life, joint and last survivor, term certain, and so on. The more bells and whistles the annuity has, the more it will cost, meaning that the monthly payout will be less.

Minimum RRIF withdrawal amounts

Age at start of year	RRIFs set up after the end of 1992
65	4 %

66	4.17 %
67	4.35 %
68	4.55 %
69	4.76 %
70	5 %
71	7.38 %
72	7.48 %
73	7.59 %
74	7.71 %
75	7.85 %
76	7.99 %
77	8.15 %
78	8.33 %
79	8.53 %
80	8.75 %
81	8.99 %
82	9.27 %
83	9.58 %
84	9.93 %
85	10.33 %
86	10.79 %
87	1.33 %
88	11.96 %
89	12.71 %
90	13.62 %
91	14.73 %
92	16.12 %
93	17.92 %
94+	20.00 %

Life annuities guarantee their payouts for the life of the holder, so they are attractive for people worried they might run out of money.

Quotes provided by insurance companies show that $100,000 of RRSP money can buy a non-indexed annuity for a 65-year old man of about $600 a month for the rest of his life. Payouts for women are lower, as they tend to live longer.

Collapse it

The third option is to collapse your RRSP and pay tax on the whole amount.

This is the least attractive option, on several counts. For one thing, people with a good chunk of change in the plans could wind up losing more than 40 per cent of it to taxes.

They'd also have no retirement income with this approach, and wouldn't qualify for the pension income tax credit.

It's also possible to choose a mix of options — a RRIF and an annuity, or a RRIF then an annuity.

Conversion tips

We asked several retirement experts for tips to make the most of the RRSP maturing process. Here are some they came up with.

Annuities: Now is not the best time to buy an annuity. Annuity payouts depend on a number of factors – with one of the most important being current interest rates. And as anyone who's recently checked rates knows, they're pretty darned low at the moment.

"Annuities were much more popular in the 1970s and 80s when interest rates were higher," says Jason Heath, a Certified Financial Planner at E.E.S. Financial Services Ltd., a fee-only financial planning firm in Markham, Ont.

While acknowledging that some kinds of annuities can be a good fit for some people, he suggests holding off on any annuity purchase until rate rise.

"I wouldn't do it in the next couple of years," he says, noting the widespread expectation that interest rates – and therefore annuity payouts – will remain low.

Cherith Cayford, a principal at CMG Financial Education in Victoria, B.C., adds that annuities generally don't offer an inflation hedge, "unless one is built into the benefit received, in which case it would be significantly lower."

RRIF drawdown: If you don't need the money, base the RRIF drawdown on the age of the younger spouse.

RRIF rules require minimum withdrawals that steadily rise with age. But our experts all pointed out that those same RRIF rules also allow you the option of electing to use your younger spouse's age to arrive at the minimum withdrawal amount, rather than your own.

See whether it makes sense to draw down your RRSP before converting it to a RRIF.

Have patience: The conventional wisdom is that people should always wait as long as possible (i.e. age 71) to convert to a RRIF. Not necessarily, our experts say.

"I think there are a lot of circumstances where early [RRSP] withdrawals … can be beneficial in the long run," Heath says. "If someone retires early, for example, they may have a period of time before government or company pensions start to pay out when their income is quite low."

Heath advises clients to "run the numbers" to determine what the most efficient source of capital is to fund their retirement.

Pension considerations: RRIF withdrawals at age 65 and beyond also qualify as pension income, and so they fall within the boundaries of the pension income tax credit. That's a federal tax credit on the first $2,000 of qualifying pension income each year.

Each spouse can claim that credit, so the experts say each spouse should try to arrange at least $2,000 in qualifying pension income.

Flexibility: Converting to a RRIF offers more flexibility than buying an annuity. Our experts all pointed out that the decision to purchase an annuity is irreversible.

"With the annuity, you hand over your money; you've lost control," says Marcy Ages, a senior consultant at T.E. Wealth in Toronto. "But with a RRIF, you can choose and grow the investments inside the plan."

She also points to the estate-planning benefits. When a RRIF holder dies, the remaining money in the RRIF can go to someone. With an annuity, there is usually nothing to pass on, unless some kind of guarantee option is purchased.

Cash on hand: Have some cash in the RRSP/RRIF portfolio.

"When people are close to retirement, I recommend raising the cash component of their portfolio so it could cover two to three years of [RRIF] withdrawals," says Marc Lamontagne, a Certified Financial Planner at Ottawa-based Ryan Lamontagne Inc.

"Markets are volatile. You never want to be forced to sell an investment when it's down."

That is exactly what some seniors found themselves having to do after the 2008 stock market meltdown when the TSX lost half its value. The federal government brought in a special provision to allow people to take less than the prescribed minimum for the 2008 tax year. But that was a one-off event.

Withdrawals in kind: Failing that cash cushion, withdrawals can also be made "in kind." You can ask your financial institution to transfer an investment from your RRIF to a non-registered account.

You will still have to pay tax on the value of the withdrawal – all RRIF withdrawals are fully taxable – but an in-kind transfer could spare you from having to sell an equity investment when the market is in the tank.