BMO NESBITT BURNS

Making the Most of Your Retirement Income

After years of saving, it's time to use your accumulated wealth to finance your retirement. Retirement income can come from a variety of sources: registered plans, annuities, employer pension plans, government pensions and part-time employment. If you don't have an employer pension plan you may need to rely solely on your retirement savings and government pensions to provide the income you need.

You can make the most of your retirement income by managing withdrawals from a Registered Retirement Savings Plan (RRSP), Registered Retirement Income Fund (RRIF), Tax-Free Savings Account (TFSA) and any locked-in accounts, while maximizing your entitlement to income from government sources. Your strategy should also include pension income-splitting with your spouse and a plan to help preserve assets and generate income for a surviving spouse upon death.

RRSP income options

For many Canadians today, RRSP contributions form the cornerstone of their retirement income. If you have contributed to an RRSP, you must decide which RRSP maturity option you want and have the money in your RRSP collapsed and transferred by the end of the year in which you turn 71. The good news is that you can choose one, or any combination, of the following RRSP maturity options.

- **Registered Retirement Income Fund –** A RRIF is very much like an RRSP only it works in reverse. Like an RRSP, all of the growth and income generated by the assets in a RRIF are tax sheltered until they are withdrawn from the plan. Unlike an RRSP, where your purpose is to build retirement assets by making contributions, the purpose of a RRIF is to provide retirement income by making regular withdrawals. The Canada Revenue Agency (CRA) requires that you take at least a minimum amount out of your RRIF each year. There is no maximum withdrawal limit, so you may withdraw any amount of money in excess of the minimum. With a RRIF you continue to control how your funds are invested and eligible investments are the same as for RRSPs.
- **Life Annuity –** A life annuity provides a series of periodic payments which you are guaranteed to receive for the rest of your life. Annuity payments are taxed each year as you receive them. The amount of your annuity payments will be determined by the value of your RRSP, your age, current interest rates, how long a period you want your payments guaranteed, and in the event of death, whether you want all or a portion of the payments to continue for as long as your spouse lives.
- **Lump Sum Cash Payment –** A lump sum cash withdrawal will be fully taxed in the year you receive it. Unless the value of your RRSP is quite small, if you withdraw the funds all at once you will probably find yourself being taxed at a higher rate than if you had transferred your RRSP into one of the other maturity options and received smaller payments over several years.

Locked-In Retirement Account options

A Locked-In Retirement Account (LIRA) is an investment that allows your money (locked-in pension benefits) to keep growing and collecting interest until you retire. Funds in a LIRA originate from pension money and are more restrictive in terms of maturity options and permitted withdrawals. You can take advantage of the ability to "unlock" small balances in locked-in plans, as some jurisdictions allow you to close your small accounts. As with an RRSP, you must "mature" the LIRA by the end of the year you turn 71 and select one or more of the following options:

- Purchase a guaranteed life annuity. Your payment will be influenced by factors such as your age, current interest rates, the period you want your payments guaranteed in the event of your death and whether all or a portion of the payment will continue for as long as your spouse lives.
- Roll the funds into a Life Income Fund (LIF), Locked-in Retirement Income Fund (LRIF) or prescribed RRIF, depending on the provincial legislation regulating the original pension plan (not all jurisdictions have the same maturity options). In certain provinces, a transfer to a LIF may allow for unlocking a portion of the LIRA.

Tax-Free Savings Account

The TFSA is a general purpose, tax-efficient savings vehicle that complements other existing registered savings plans for retirement.

Every Canadian individual 18 years of age or older can contribute up to $5,500[1] (in 2014) annually to a TFSA. Unused contribution room can be carried forward for use in future years. Contributions are not deductible for tax purposes; however, all income and capital gains earned in the account grow tax-free.

For retirees, TFSAs provide a tax-efficient means of investing – particularly beyond the age of 71 when you are no longer eligible to contribute to your own RRSP. In addition, if you are required to take more income than you need from a RRIF, you can contribute the excess amounts to a TFSA to continue to shelter future investment earnings from tax. Furthermore, any withdrawals from a TFSA will not affect the eligibility for federal income-tested benefits and credits (such as the OAS clawback or Guaranteed Income Supplements).

Employer pensions

Roughly one-third of working Canadians belong to an employer sponsored pension plan. There are two types of employer pension plans: defined contribution (DC) and defined benefit (DB).

With a DC pension plan a set amount of money is contributed from each paycheque and the employee decides how the funds are invested. At retirement, the funds that have accumulated are used to purchase an annuity to provide a retirement income stream. With a DB pension plan your retirement pension is based on a formula that considers your salary and length of employment.

For business owners, a registered defined benefit pension, known as an Individual Pension Plan (IPP), can be customized to offer better retirement funding for high-income earners. IPPs provide higher contribution limits than RRSPs, protection from volatile markets and tax savings on contributions for companies.

Government pensions

The Canada Pension Plan/Quebec Pension Plan (CPP/QPP) and Old Age Security (OAS) will provide maximum payments of approximately $19,000 in 2014. To maximize these government benefits, consider applying to receive CPP/QPP as early as age 60, especially if you need other sources of cash flow. However, collecting your CPP/QPP pension early will reduce your monthly entitlement, but you will receive payments over a longer period of time.

You may also consider apreading your income evenly during your retirement years to minimize the impact of the OAS clawback. The clawback on your OAS benefit begins once your income reaches $71,592 (in 2014).

Pension income-splitting for couples

The pension income-splitting rules in Canada provide an effective yet simple strategy to lower family taxes. Being able to split pension income provides an opportunity for couples to reduce their overall family tax bill by taking advantage of a spouse's lower marginal tax rate where retirement incomes of spouses are disproportionate. The rules allow a Canadian-resident individual receiving eligible pension income to allocate up to 50% of this income to his/her spouse.

The definition of eligible pension income is very similar to the definition used for determining eligibility for the pension income tax credit, such that individuals currently eligible for this credit will also be eligible to split pension income with their spouse. It is important to remember that it is the age of the spouse entitled to the pension income that is relevant in determining the eligibility for pension income-splitting, such that it is possible to allocate eligible pension income to a spouse who is under age 65.

Ineligible income includes Old Age Security (OAS), Guaranteed Income Supplement (GIS), Canada/Quebec Pension Plan (CPP/QPP)[2] and RRSP withdrawals.

Since the spouse receiving the transferred income (transferee) is treated for tax purposes as having received the portion of the pension income allocated to them, the transferee spouse may be eligible for the $2,000 pension income tax credit; thereby possibly doubling the use of this credit for a couple. The age of the transferee spouse is relevant in determining the eligibility for this credit, based on the same criteria described in **Figure 1** (except for RCA payments).

The decrease in the higher-income spouse's net income may reduce or eliminate the clawback of OAS benefits and may increase the amount of other income-tested tax credits, since the amount of eligible pension income allocated is deducted from the individual's income.

Figure 1

Definition of eligible pension income
From the perspective of the recipient spouse, eligible pension income will include:

Canadians who are 65 and over and receive

1. Registered pension plan payments;
2. Registered Retirement Income Fund (RRIF) payments (includes Life Income Fund (LIF) and Locked-in Retirement Income Fund (LRIF) payments);
3. Lifetime annuities from registered plans; or
4. Prescribed and non-prescribed annuities (interest component only)

Canadians who are under 65 and receive:

1. Registered pension plan payments; or
2. Items (2) to (4) above only if received as a result of the death of a spouse.

Income planning for the surviving spouse

Even though you've planned for your retirement income needs as a couple, upon the death of one spouse certain factors may impact the surviving spouse's financial well-being. While many expenses for the surviving spouse will remain fixed, certain income sources such as the deceased spouse's CPP/QPP or employer pension plan payments may be reduced. The surviving spouse may also be elevated to a higher tax bracket once the family assets become individual assets and the surviving spouse can no longer benefit from pension income-splitting opportunities. Consider the following strategies to help preserve assets and generate income for a surviving spouse.

- Reduce the value of your estate subject to probate taxes by naming a beneficiary for your RRSP, RRIF and insurance policies.
- Defer payment of any capital gains tax by taking advantage of the spousal rollover available for distribution to your spouse or to a spousal trust.

- Insurance can be an effective way to provide for the financial needs of a surviving spouse. To ensure there is sufficient money available to pay expenses, consider including a direction in your Will to allocate a portion of your estate to purchase a life annuity to generate a guaranteed lifetime income stream for your surviving spouse. Alternatively, life insurance can be used to create or increase the value of your estate. The tax-free lump sum death benefit can be used by the surviving spouse for income replacement, debt elimination, tax payment and/or estate equalization purposes.

In situations where there is a second marriage, setting up a spousal trust in your Will can ensure that your surviving spouse is able to maintain his or her standard of living and lifestyle after you are gone, while preserving the capital for the benefit of your own children from a previous marriage. The spousal trust benefits your surviving spouse during his or her lifetime by way of mandatory income distributions and discretionary capital distributions. Upon your surviving spouse's death, your children would receive the property – originally your wealth – remaining in the spousal trust. If you want to ensure that your wealth remains within your family if your spouse remarries, establishing a spousal trust in your Will also allows you to control who will receive the residual inheritance upon the death of your surviving spouse and may protect your spouse from a family law claim in the event of remarriage.

Getting the advice you need

To determine how much income you'll need during retirement, how to maximize sources of income and to ensure income generation for a surviving spouse, your BMO Nesbitt Burns Investment Advisor can help. He or she can provide you with the information, tools and assistance you need to reach your goals.

[1] TFSAs indexed to inflation in $500 increments. Individuals must be the age of majority in their province of residence to open a TFSA with BMO Nesbitt Burns. In BC, NS, NB, Newfoundland, Yukon, Northwest Territories and Nunavut, the age of majority is 19.

[2] A form of income-splitting already exists for CPP/QPP recipients through the CPP sharing provisions which operate independently of the pension income splitting provisions described herein. If you are receiving your CPP/QPP retirement pension, or are eligible to receive it, you can elect to share your CPP/QPP pension benefits with your spouse. You must apply to the government requesting an equal share of the retirement benefits you both earned during the years you were together. The amount of CPP/QPP that is split depends on how long you and your spouse have lived together and your contributions made to CPP/QPP during that time. If only one spouse is a CPP/QPP contributor, you may share that one pension.

All insurance products are offered through BMO Nesbitt Burns Financial Services Inc. by licensed life insurance agents, and, in Quebec, by financial security advisors.

The comments included in this publication are not intended to be a definitive analysis of tax applicability or trust and estates law. The comments contained herein are general in nature and professional advice regarding an individual's particular tax position should be obtained in respect of any person's specific circumstances. BMO Nesbitt Burns Inc. ("BMO NBI") provides this commentary to clients for informational purposes only. The information contained herein is based on sources that we believe to be reliable, but is not guaranteed by us, may be incomplete or may change without notice. The comments included in this document are general in nature, and professional advice regarding an individual's particular position should be obtained.

®"BMO (M-bar roundel symbol)"and "Making Money Make Sense" are registered trade-marks of Bank of Montreal, used under licence. ® "Nesbitt Burns" is a registered trade-mark of BMO Nesbitt Burns Inc. BMO Nesbitt Burns Inc. is a wholly-owned subsidiary of Bank of Montreal. If you are already a client of BMO Nesbitt Burns, please contact your Investment Advisor for more information.

BMO Nesbitt Burns®

Making money make sense®

Member-Canadian Investor Protection Fund. Member of the Investment Industry Regulatory Organization of Canada.

WG-14-026 | August 2014