Your Retirement Plan

Maximizing Retirement Income

THIS PUBLICATION IS PART OF A SERIES THAT FOCUSES ON THE UNIQUE NEEDS OF INDIVIDUALS NEARING OR IN RETIREMENT

After years of saving, you're ready to use your accumulated wealth to finance your retirement. Income can come from a variety of sources: employer pension plans, government pensions, registered plans, annuities and part-time employment. If you don't have an employer pension plan you may rely solely on your savings and government pensions to provide the income you need. Maximizing retirement income involves maximizing your entitlement to income from government sources and managing withdrawals from RRSPs, RRIFs, TFSA and locked-in funds, while minimizing income tax.

Government pensions

The Canada Pension Plan/Quebec Pension Plan (CPP/QPP) and Old Age Security (OAS) form the basis of the Canadian retirement income plan and for 2012 together they provide a maximum payment of just over $18,000 per year.

To maximize these government benefits:

- If you need other sources of cash flow, consider applying to receive CPP/QPP as early as age 60. Collecting the Canadian pension early will reduce your monthly entitlement, but you will receive payments over a longer period of time. Furthermore, the lower CPP payment may result in a lower annual income and minimize the risk of OAS payment reduction. However, be aware that recent changes to the CPP have resulted in greater disincentives to receiving CPP early. Speak to your BMO Nesbitt Burns Investment Advisor for more information on how these changes may affect you.
- Consider sharing CPP entitlements with your spouse if he/she is in a lower tax bracket. Sharing benefits between two people who are in different tax brackets can reduce the total tax paid by the family and may also help to preserve some of the OAS benefits, which may be reduced based on the level of income.
- Apply for OAS 6 months before you turn 65. If you are already over 65 and not currently receiving OAS, you should apply to determine if you qualify for a full or partial pension.

  Please note: the 2012 Federal Budget included a tax measure that will see the eligibly for OAS increase from age 65 to 67. However this increase is being phased in and will not impact current recipients or those who turn age 65 prior to 2023.
- Spread the receipt of income evenly during retirement years. OAS may be clawed back if retirement income is above a certain threshold. It is important to structure income from an investment and RRIF portfolio to minimize the 'clawback' of OAS.

Employer pensions

Roughly one-third of working Canadians belong to an employer sponsored pension plan, and for those who participate in a Defined Benefit plan, they are often unclear about their pension benefit entitlement at retirement.

To understand your entitlement under a Defined Benefit Pension Plan:

- Ask your employer to confirm your monthly entitlement and when you can start receiving pension benefits. Does the entitlement increase if you begin receiving it later or, conversely, is it reduced if you start drawing benefits early? Is the employer pension plan tied to CPP benefits? If so, your pension entitlement may decline at age 65.
- Confirm how much of your pension plan your survivors are entitled to receive (i.e., if you pass away, what is your surviving spouse entitled to get? Is it a continuing monthly benefit or lump sum?).
- Ask about inflation protection. Annual inflation as low as three per cent can significantly erode the value of your pension income over a 20- to 30-year period.

RRSP income options

You have saved and invested wisely over the years in a Registered Retirement Savings Plan (RRSP). You will need to convert your RRSP and your government benefits to create the lifestyle you've been planning. So now the question becomes, what are your best options?

Selecting the right retirement income option is one of the most important financial and estate planning decisions you'll make.

You must decide which RRSP maturity option you want and have the money in your RRSP transferred into it 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 supplement your retirement income by making regular withdrawals. 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. Eligible investments for RRIFs are the same as for RRSPs.
- **Life Annuity** - A life annuity is a product that 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 in the event of death, and whether you want all or a portion of the payments to continue for as long as your spouse lives.

  A life annuity offers you the security of knowing that for as long as you live, you will receive a fixed income.

  However, many people are uncomfortable with the thought that all of their RRSP savings would be gone if they lived for only a short period of time after retirement. The solution is to buy an annuity that will make payments for a guaranteed period of time; however in general, the longer the guaranteed period, the lower the payments.
- **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.

LIRA and locked-in RRSP income options

A LIRA is a locked-in RRSP. Funds in a LIRA originate from pension money and are more restrictive in terms of maturity options and permitted withdrawals. In some cases, the restrictions could hinder you from maintaining your desired lifestyle. 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 in to a LIF, 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 of a portion of the LIRA.
- Take advantage of the ability to "unlock" small balances in locked-in plans – some jurisdictions allow you to close your small accounts.

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.

Pension Income Splitting

The introduction of pension income splitting legislation in 2007 allows a transfer of up to 50 percent of eligible pension income to a spouse, which provides a significant opportunity to split income where retirement incomes are disproportionate. The allocation of this income is done by each spouse making a joint election annually in their respective tax returns. For income tax purposes, the amount allocated will be deducted from the income of the person who actually received the *eligible pension income* and this amount will be reported by the other (lower income) spouse.

The definition of eligible pension income is the same definition used for determining eligibility for the $2,000 pension income tax credit, such that individuals currently eligible for this credit will also be eligible to split pension income with their spouse. (Note 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 under age 65).

Tax-Free Savings Account

The Tax-Free Savings Account (TFSA) is a general-purpose, tax-efficient savings vehicle that has been hailed as the most important individual savings vehicle since the introduction of the RRSP. Because of its flexibility, it complements other existing registered savings plans for retirement.

Beginning in 2009, every Canadian individual 18 years of age or older can contribute up to $5,000 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).

Asset re-positioning

Many of the assets you've earmarked for retirement are now needed to provide income for retirement. Asset re-positioning is one of the most important issues a retiree faces. For example, investments may be increasingly relied upon to provide cash flow or may be liquidated to supplement retirement income.

Reverse mortgages

In some cases, our home is our largest or only asset; however, the family home does not provide annual cash flow to supplement income during retirement. In fact, it could be a significant income draw due to maintenance, property tax and other costs. And yet, many of us are not willing to part with the many happy memories associated with our homes. In those instances where selling is not an option, a reverse mortgage may be a suitable alternative. It allows you to continue living in your family home, while providing access to the equity that can be used to fund retirement income.

However, reverse mortgages may not be appropriate for everyone so be sure to fully understand the advantages and disadvantages before proceeding.

What's next?

Your BMO Nesbitt Burns Investment Advisor is familiar with your financial circumstances and will help you identify how much income you will need during retirement and how to supplement your government and employer pension with income from your registered and non-registered portfolios.

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