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INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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Registered retirement savings plan (RRSP) maturity options

Understanding the options available when you terminate your RRSP

Although you may wind up your RRSP at any time, you're required to mature your RRSP by December 31 of the year you turn 71. This article discusses the RRSP maturity options available to you, as well as some considerations in determining when to wind up your RRSP.

For the purposes of this article, any reference to a spouse includes a common-law partner.

RRSP maturity options

You must collapse your RRSP by the end of the year you turn age 71, after which you have the following three options:

1. You can directly transfer your RRSP assets to a registered retirement income fund (RRIF).

2. You can use the funds in your RRSP to purchase an eligible annuity.

3. You can withdraw your RRSP funds (less withholding tax) in cash or in-kind.

You can use any one of the options available or you may choose to combine options. You can also wind up your RRSP using these three options before the age of 71.

RRIFs

A RRIF is an arrangement between an individual, the annuitant and a carrier (a financial institution authorized to offer RRSPs/RRIFs) under which payments are made to the annuitant of at least a minimum amount each year. You can have more than one RRIF. Once the RRIF is established, you cannot make contributions to the plan. Usually, you can only directly transfer certain amounts from other registered plans, such as RRSPs, other RRIFs or registered pension plans, into your RRIF. Like an RRSP, earnings in a RRIF are tax-deferred

and amounts paid out of a RRIF are taxable to you at your marginal tax rate when received.

Although there may appear to be many different types of RRIFs, under the tax rules there are only two types—ones that are self-directed and ones that aren't. You may favour a self-directed RRIF if you want to select and manage your own investments. However, RRIFs (whether self-directed or not) are subject to qualified and prohibited investment restrictions. For self-directed RRIFs, you should ensure that it is able to satisfy the minimum payment requirements. While some institutions allow you to receive RRIF payments in-kind (i.e. receive securities rather than cash as a minimum payment), this is not always the case and you may have to sell assets in your RRIF to generate cash to satisfy the minimum payments.

When you convert your RRSP to a RRIF, the investments held in your RRSP should be transferred directly into the RRIF account. You are generally not required to liquidate your RRSP investments prior to transferring your RRSP to a RRIF. If you convert all or part of an RRSP to a RRIF before age 71, you're not committed to the RRIF forever. If you're under age 71, you can transfer the value of your RRIF that exceeds the required minimum payment to your RRSP.

RRIF minimum payments

Your RRIF minimum payment for each year, after the year your RRIF is established, is calculated by multiplying the fair market value (FMV) of your RRIF at the end of the previous year by a prescribed percentage factor. The prescribed percentage depends on your age or your spouse's or common-law partner's age (if applicable) at the end of the previous year (depending on whose age you elected at the time the RRIF was established).

For more detailed information on RRIF minimum payments, ask your RBC advisor for the article, "RRIF payments and withdrawals".

Advanced life deferred annuities (ALDA)

To provide Canadians with greater flexibility in managing their retirement savings, the 2019 federal budget proposed to permit the purchase of a new type of annuity, an ALDA, in certain registered plans. Once the legislation is enacted, you may be able to purchase an ALDA in an RRSP, RRIF, deferred profit sharing plan (DPSP), pooled registered pension plan (PRPP) or defined contribution registered pension plan (RPP).

The portion of the RRIF that's invested in the ALDA is not used to calculate your annual RRIF minimum, and payments from the ALDA can be deferred until the end of the year in which you turn 85. There will be limits on how much of your registered plan can be invested in an ALDA.

A minimum payment must be paid from your RRIF every year. If you need more income, you may take more than the RRIF minimum payment in any year.

Please note that ALDAs were to be available beginning in 2020. However, the needed legislation has not yet been enacted and further details will be required before ALDAs can be made available.

Tax implications of receiving RRIF income

As stated earlier, a minimum payment must be paid from your RRIF every year. If you need more income, you may take more than the RRIF minimum payment in any year. This payment may be requested as a lump-sum at any time during the year or periodically on a monthly, quarterly, semi-annual or annual basis, depending on your preference. If you don't require income, you can elect to receive the annual minimum payment at the end of the year to maximize the tax-deferral benefit of a RRIF.

Withholding tax is not required on minimum RRIF payments but will apply to any RRIF withdrawals in excess of the minimum amount. The withholding tax rates on RRIF withdrawals above the minimum payment amount are identical to the withholding tax rates for RRSP withdrawals.

The withholding tax rates that apply are shown in the table below.

Withholding tax at the time of RRIF withdrawal

Amount in excess of RRIF minimum payment	Residents of all provinces/territories except Quebec	Quebec residents
$5,000 or less	10%	20%
Over $5,000 to $15,000	20%	25%
Over $15,000	30%	30%

Your RRIF payments must be included in your income and taxed in the year received. RRIF income is taxed at your marginal tax rate. If you are at least age 65 and you receive RRIF payments, you may be eligible for the pension income tax credit. In addition, you may be able to split your RRIF income with your spouse. For more information on these topics, ask your RBC advisor for our articles on pension income splitting and the pension income tax credit.

Tax considerations at death

On passing, you are considered to have received, immediately before death, an amount equal to the FMV of all property held in your RRIF at that time. This amount and all other amounts you received from your RRIF in the year have to be reported on your terminal income tax return. There are two exceptions to this general rule:

1. If your spouse is "successor annuitant" of your RRIF, you're not considered to have received an amount from your RRIF at the time of death. Your RRIF continues and your spouse becomes the annuitant under the fund. This allows RRIF payments to continue to go to your surviving spouse without interruption and minimizes administration. Future RRIF payments will be taxable in your spouse's hands.

2. If your spouse is beneficiary of your RRIF, you're not considered to have received an amount from your RRIF at the time of death if your spouse directly transfers the entire eligible part of the RRIF property to their RRSP or RRIF or to an issuer to buy an eligible annuity by December 31 of the year following the year of your death. Your spouse will be responsible for any future tax liability arising from the property from your RRIF.

In the case of naming your spouse as beneficiary of your RRIF, where they do not transfer the entire eligible part of the RRIF property to their RRSP or RRIF or to an issuer to buy an eligible annuity, your legal representative can choose to have the FMV of your RRIF at the time of your death taxed in your spouse's hands instead of on your terminal tax return.

If you name a financially dependent child or grandchild as a beneficiary, the value of your RRIF at death that they receive can be taxed in their hands instead of yours. This allows for a redistribution of some or all of your income to your beneficiary who receives the funds.

If your financially dependent child or grandchild is a minor, the eligible proceeds from the RRIF can be used to acquire an annuity for the beneficiary. The annuity must have a term to age 18. This may allow the beneficiary to spread the income inclusion from your RRIF proceeds over a period of years.

Generally, a child or grandchild is considered financially dependent on you if their income is less than the basic personal tax exemption and they ordinarily live with you.

If your financially dependent child or grandchild is mentally or physically infirm, the RRIF proceeds may be transferred to that child's or grandchild's RRSP, RRIF, RDSP or to a life annuity on a tax-deferred basis.

> If you purchase a life annuity, you will not have to make ongoing investment decisions and it will provide a guaranteed income for as long as you live.

For more information on estate planning or tax consequences related to your RRSP/RRIF, ask an RBC advisor for a copy of the article, "Estate planning for your RRSP/RRIF".

Annuities

An annuity is a contract that binds a life insurance company to deliver an income for your entire life or for a specified period of time in return for a lump-sum amount.

If you purchase a life annuity, you will not have to make ongoing investment decisions and it will provide a guaranteed income for as long as you live. Your future income is guaranteed by the annuity provider. Generally speaking, the decision to annuitize is a permanent decision which cannot be reversed and must be considered carefully.

The monthly income from an annuity is based on many factors. Three of the major factors are your age, your sex and the current rate of interest at the time of purchase. Other factors include the guarantee period, the time between the annuity being purchased and the first payment being made, and the frequency of payments. There are also many different features that can be added to an annuity that can affect the income amount payable, for example, joint life or inflation protection. A description of the various types of annuities and options available are beyond the scope of this article. For more information about annuities, you should seek the assistance of an advisor licensed to sell annuities.

Receiving income from an annuity and tax considerations

All payments received in a calendar year from an annuity purchased with registered funds (registered annuity) must be reported as income and are fully taxable. The payments from a registered annuity are generally not subject to withholding tax at the time they're paid to you.

If you're at least age 65, you may be eligible for the pension income tax credit if you're receiving annuity payments from a registered annuity. In addition, you may be able to split your annuity income with your spouse. For more information on these topics, ask your RBC advisor for articles on pension income splitting and the pension income tax credit.

Tax considerations at death

On passing, all payments you received during the year, up to the time of death, must be included as income on your final tax return.

If you named a spouse as the beneficiary of a single life annuity, and the guarantee period has not expired, or the annuity is a joint life annuity, subsequent payments will be made to the surviving spouse and taxed in the spouse's hands.

If the beneficiary is anyone other than a spouse and the guarantee period has not expired, the death benefit will be paid to the beneficiary as a cash lump-sum payment. The death benefit is equal to the present value of the remaining payments in the guarantee period from the date of death. The death benefit will be taxable to you in the year of death.

Cash-in or deregister your RRSP

The simplest, but usually the least tax-efficient, maturity option is to cash-in or deregister your RRSP. When you cash-in your RRSP, the full value of the RRSP is included in your taxable income in the year of withdrawal. Given the fact that Canada has a progressive tax system, if you have a large RRSP, you may be taxed at the highest marginal tax rate on at least a portion of the amount withdrawn.

If you don't convert your RRSP to an annuity or RRIF by the end of the year you turn age 71, your RRSP may be deregistered in the following year and you will have to include the full FMV of the RRSP as taxable income in the year of deregistration.

You will be subject to withholding tax at the time of withdrawal or deregistration. The withholding tax is not an additional tax on your RRSP funds. Rather, it represents a prepayment of the tax owing on the RRSP funds, similar to the way income tax is withheld on employment income. When you file your tax return, the withholding tax is used as a credit towards any taxes due.

Before choosing to withdraw or deregister all or a portion of your RRSP, you should consider the following:

- It's a one-time decision that cannot be reversed;
- You forgo the opportunity to grow your investments in a tax-deferred environment;
- Payments from your RRSP do not qualify for the pension income tax credit;
- There may be substantial income taxes owing;
- You lose access to certain estate planning opportunities such as leaving your RRSP to a spouse or financially dependent child or grandchild, which may be done on a tax-deferred basis; and
- The resulting increase in income can potentially impact government benefits such as Old Age Security (OAS) and other income-tested benefits.

Considerations when selecting an RRSP maturity option

You do not have to choose one option exclusively over another. It's quite possible—and often preferable—to mix and match different options to create a retirement income plan that meets your individual needs. For example, you may wish to put part of your RRSP funds into an annuity and part into a RRIF. This will provide you with a guaranteed income stream but also allow you to have flexibility with a portion of your retirement funds. The exact proportion would depend upon your specific needs. Additionally, it's important to keep in mind that it is possible to move from a RRIF to an annuity but not the reverse.

You can also spread your annuity purchases out over many years. For example, you might decide at age 71 that you'll put $50,000 of your RRSP into an annuity and the balance into a RRIF. At ages 74 and 77, you might then move another $50,000 from the RRIF to the annuity. At age 80, you could move the balance remaining in your RRIF to an annuity.

To select the RRSP maturity options that are best for you, you should consider a variety of personal and financial criteria and match these criteria with the maturity options available. We discuss some of the criteria you should consider in the following sections.

Your personal income needs

The first aspect you should consider is whether your other sources of retirement income (e.g. employer pension, Canada Pension Plan (CPP)/Quebec Pension Plan (QPP), Old Age Security (OAS), and other investment income) will be sufficient to maintain your lifestyle in retirement. If you will require little or no additional income from your RRSPs, at least in the near future, then the RRIF option may provide you with the maximum amount of tax deferral.

Your family's income needs

You must also consider how long you want the income stream to continue, for yourself and for your spouse. Generally, individuals are living longer. If there's a possibility that you may outlive your retirement income, then an annuity can provide for an ongoing source of income for as long as you live.

Your estate objectives

How important is it to you to leave an estate for your heirs? If this is important, then a RRIF is likely the best option for you to preserve your registered retirement assets for your estate. A RRIF allows you to continue to accumulate your

registered retirement assets on a tax-deferred basis while you enjoy the benefits of a retirement income.

At your death, the assets remaining in your RRIF can be transferred to a beneficiary named on the plan or may form part of your estate. There are also opportunities to transfer your RRIF to certain beneficiaries on a tax-deferred basis as discussed earlier. While, an annuity may not pay a death benefit if there is not a surviving spouse or a guarantee period.

Current rate of return and inflation

By purchasing an annuity, you're locking in a fixed interest rate for life. This has generally worked well for people who purchased annuities in the 1980s, when interest rates were high. However, given today's low interest rate environment, you may want to consider the various investment alternatives that are available to a RRIF holder to achieve a higher rate of return. This is especially important when considering the effect of inflation on your purchasing power. Further, RRIFs can always be used to purchase annuities at a later date when conditions may be more favourable for the annuity option.

A level income arrangement may seem ideal for some, but an average inflationary trend could easily erode that income. It's important to keep this in mind when deciding whether to purchase an annuity.

Flexibility versus guarantees

The flexibility provided by the various RRSP maturity options discussed vary greatly. This is an important consideration, as you may need to maintain flexibility in case your circumstances change.

You generally cannot cash in a life annuity once it has been purchased. It's essentially a one-time decision. In that sense, annuities are relatively inflexible. However, it provides a guarantee to you and you know the amount you'll receive for the rest of your lifetime.

RRIFs, on the other hand, provide you with the ability to vary the annual payments you receive, as long as the minimum payment requirements are met. You may choose from a wide range of investments for your RRIF. In addition, a RRIF can be transferred between financial institutions after payments have commenced. This allows you to maintain control of the assets in your RRIF. You also have the ability to convert your RRIF to a life annuity at any time in the future. This option is advantageous if interest rates increase in the future and you no longer wish to manage your own RRIF assets.

A main factor you will want to determine is how you'll use the RRSP funds. Is it for extras, such as trips or home improvements? Will it be your primary source of income, or do you intend to leave a large estate to your children?

Your answer to these questions will dictate the degree of flexibility you'll need from your RRSP funds.

> Regardless of the option you select, any income you receive during the year is taxable in the year received.

Tax implications

Regardless of the option you select, any income you receive during the year is taxable in the year received. However, you are eligible for a pension income tax credit (a federal credit on the first $2,000 of pension income and potentially a provincial credit) if you're at least age 65 at the end of the year and you're receiving income from a RRIF or an annuity. Thus, choosing to convert your RRSP into a RRIF or an annuity may help you minimize your personal income tax if you're at least age 65.

In addition, up to 50% of the type of income that qualifies for the pension tax credit may be split with a lower-income spouse to take advantage of their lower marginal tax rates.

A single individual or widow/widower with no financial dependents, little income and a large RRIF may be concerned about paying tax on a substantial portion of their RRIF at the highest marginal tax rate on death. You may try to avoid this by accelerating the depletion of the RRIF through higher annual RRIF payments to take advantage of your lower marginal tax rates during your lifetime. However, this strategy results in a prepayment of tax and you lose the ability to grow your investments in a tax-deferred environment. It's important to seek the assistance of a qualified tax advisor in assessing this strategy before implementation.

Another advantage of the RRIF is that that the amount paid out of a RRIF can be changed from year to year, subject to minimum payment requirements. This means you can further adjust your RRIF income to complement your other sources of income, giving you the potential to minimize tax and avoid the clawback of income-tested benefits such as OAS.

Timing the maturity of your RRSP

You must wind up your RRSP by the end of the year you turn 71. However, it may make sense to mature your RRSP at an earlier time. When you should close your RRSP depends on many factors; the following discusses two of the major factors in more detail.

Your income needs

If you have adequate income from investments, pensions or other sources to fund your retirement, consider leaving your savings in your RRSP until you must wind it up by the end of the year you turn age 71. This allows you to defer your taxes for as long as possible and allows your RRSP to benefit from tax-deferred growth.

Should you require additional income to support your lifestyle, you have the flexibility to receive income from your RRSP by:

- Withdrawing lump-sum amounts from your RRSP as needed;
- Converting a portion of your RRSP to a RRIF; and/or
- Using a portion of your RRSP funds to purchase an annuity.

Lump-sum RRSP withdrawals can be timed to when you need the cash for a one-time expense, like fixing your roof or going on a vacation. Converting a portion of your RRSP to a RRIF or using a portion to purchase an annuity and thus creating an income stream can provide you with an annual top-up to help support your lifestyle. You can have an RRSP and any of the maturity options open simultaneously until the end of the year you turn age 71.

Your age

If you're age 65 or older and not receiving an employer pension, you may want to convert a portion of your RRSP to a RRIF or annuity in order to create an income stream and take advantage of the pension income tax credit or to take advantage of pension income splitting with a lower-income spouse. This may allow you to take funds out of your RRSP with little or no tax liability now rather than waiting until after age 71 when you're forced to receive payments from your registered plan.

Conclusion

Determining the relative importance you place on the criteria discussed in this article will help you select the maturity option that's right for you. Remember, choosing the timing and the right option for you involves considering a variety of factors. Speak with a qualified tax advisor to ensure you have fully considered your circumstances and evaluated all options available before deciding on an RRSP maturity option.

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Wealth Management

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