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# Registered Retirement Income Funds

As is the case with many Canadians, a large proportion of your wealth is probably contained in a registered retirement savings plan (RRSP) or a registered retirement income fund (RRIF), depending on your age. Since a RRIF represents such a large part of your nest egg and future retirement income, it never hurts to be familiar with how RRIFs work.

Both RRSPs and RRIFs are government-sanctioned tax-deferred plans. If it hasn't happened already, your RRSP will mature the end of the year in which you turn 71. At this point, you must begin receiving payments out of the plan. Cashing out the entire plan is out of the question, since the entire proceeds would be taxable income and would create a massive tax liability for you. Instead, you can choose to convert your RRSP into either a RRIF or an annuity. A RRIF can simply be thought of as an RRSP, except you cannot make contributions to it and you are obligated to annually withdraw a specified amount. Annuities, on the other hand, are quite different: you use part or all of your RRSP to buy a product that pays stream of payments either for life or over a fixed term. In both cases, one must pay tax on the full amount received from these maturity options.

Like with RRSPs, you can invest in multiple RRIFs at once. Your RRSPs will automatically roll into RRIFs at the end of the year in which you turn 71, but you can technically convert an RRSP into a RRIF at any age. You can open a RRIF at most financial institutions. Your RRIF's investments can either be self-administered or managed professionally. The RRIF investment rules are identical to the RRSP investment rules, so that you can simply transfer your RRSP assets to a RRIF.

## RRIF Withdrawals

After converting an RRSP to a RIFF, the RRIF continues the taxed-deferred nature. The requirement to gradually withdraw the funds is intended to spread out your receipt of the funds over the duration of your retirement. A minimum amount must be withdrawn annually following the year the plan is created. The federal government legislated specific factors that your financial institution will use to calculate your RRIF minimum payment for the year; you don't need to determine this yourself. The income from your RRIF is subject to income tax, but the payments are not subject to withholding tax at source unless you withdraw in excess of the minimum amount.

There is no minimum payment for the year in which the RRIF is established. For subsequent years, if you are under the age of 71 at the beginning of the year, your minimum payment is determined by the following formula:

Minimum payment = fair market value of the RRIF at the beginning of the year ÷ (90 – your age at the beginning of the year)

If you are 71 or older at the beginning of the year, your minimum payment is equal to the fair market value of the plan at the beginning of the year multiplied by the relevant percentage below. For example, if on January 1st you are 75 years old and your RRIF's value is $200,000, your minimum payment for the year is $11,640 ($200,000 x 5.82%).

| Age at Beginning of Year | Percentage Factor |
|---|---|
| Under 71 | 1/(90 – age) |
| 71 | 5.28 |
| 72 | 5.4 |
| 73 | 5.53 |
| 74 | 5.67 |
| 75 | 5.82 |
| 76 | 5.98 |
| 77 | 6.17 |
| 78 | 6.36 |
| 79 | 6.58 |
| 80 | 6.82 |
| 81 | 7.08 |
| 82 | 7.38 |
| 83 | 7.71 |
| 84 | 8.08 |
| 85 | 8.51 |
| 86 | 8.99 |
| 87 | 9.55 |
| 88 | 10.21 |
| 89 | 10.99 |
| 90 | 11.92 |
| 91 | 13.06 |
| 92 | 14.49 |
| 93 | 16.34 |
| 94 | 18.79 |
| 95 or older | 20 |

You can use the age of your spouse or common-law partner at the beginning of a year rather than your own to calculate the minimum amount. You usually make this choice at the time the RRIF is established; in any event, it can only be made before the first payment is made out of the RRIF. If your spouse is younger than you are, using the spouse's age results in a lower minimum amount and is therefore usually the more sensible choice (since you can always take out more than the minimum if you desire).

Although you can use your spouse's age to fix the minimum amount schedule, you must still convert your RRSPs to a RRIF by the end of the year in which you reach age 71. That is, you can only use your spouse's age for the minimum amount and not the conversion requirement itself. Even though the minimum is calculated using your spouse's age, the payment is still taxed in your hands and not that of your spouse.

## Pension Income Splitting

Income splitting with your spouse or common-law partner is generally not allowed for tax purposes. However, the government allows seniors to split their pension income. You and your spouse (or common-law partner) can agree to split up to 50% of the eligible pension income of you or your spouse. Generally, you will want to split the income of the higher earner since they are more likely to be in a higher tax bracket. If a taxpayer is 65 years or older at the end of the taxation year, all of their pension income is "eligible", and up to 50% of it can be transferred to the spouse/partner. If they are not 65 at the end of the year, only certain types of income can be split. Specifically for RRIF payments, you or your spouse/partner must be 65 or older at the end of the year in order to split that income.

Pension income splitting is beneficial where you are in a lower tax bracket than your spouse/partner and your combined tax liability will be lower as a result. That is, the higher earning spouse/partner's income that is otherwise taxed at a higher rate will be reduced, and the lower earning spouse/partner will have more income that is taxed at a lower rate. The actual tax savings will depend on which federal and provincial tax brackets you and your spouse/partner are currently in.

## Pension Income Tax Credit

If you are 65 or over at the end of the year, you can claim a pension income tax credit for up to $2,000 of your pension income (including your RRIF income). You can also claim RRIF income that is transferred via pension income splitting. The credit will translate into up to $300 in annual federal tax savings (15% x $2,000), and there are provincial pension income tax credits too.

## Estate Planning

You can designate anyone (or multiple people) as the beneficiary of your RRIF; if you should pass away, the RRIF's property will pass to that beneficiary.

You can also designate your spouse or common-law partner as a "successor annuitant" of the RRIF, so they become the RRIF's new holder after your passing. If a RRIF passes to a successor annuitant, then entire transfer occurs on a tax-deferred basis. There are no immediate tax consequences. The successor annuitant will continue to receive payments from the RRIF.

If a RRIF passes to a person other than a spouse/partner or a qualified child or grandchild, the fair market value of the plan at the time of death is included in the RRIF holder's income. Since people can often accumulate very large sums of wealth in their RRIF, this event can trigger an enormous tax liability for the estate.

If the RRIF holder's surviving spouse or partner was not the successor annuitant, but still inherits the RRIF by being directly named as a beneficiary of the RRIF or inherits the plan via the deceased's will, there is still an opportunity to roll over the RRIF proceeds on a tax-deferred basis. The terminology and paperwork can seem convoluted, but the spouse/partner simply needs to transfer the RRIF proceeds to their own RRSP, RRIF, annuity, or pooled registered pension plan (PRPP). The deceased's RRIF income is instead taxed in the survivor's hands, but the survivor can claim an offsetting tax deduction for the contribution to their own plan.

If the beneficiary is the child or the grandchild of the deceased who was financially dependent on the deceased, amounts received by the child or grandchild will be included in the income of the beneficiary. The beneficiary can contribute the proceeds to an RRSP, RRIF, annuity, PRPP, or registered disability savings plan (RDSP).

## RRIF or Annuity?

Although annuities were once a popular choice, RRIFs are more common today because they are more flexible. However, the choice should be based on personal preference and needs and not on popularity. When deciding between a RRIF and an annuity, the following factors should be considered:

- Guaranteed payments. One of the biggest advantages of an annuity is that a person can buy a life annuity that guarantees payments for life. Obviously, the protection offered by a life annuity can be important, especially if one's financial resources are limited.
- Flexibility of Investments. A RRIF can hold many different types of investments. You can even create a self-administered RRIF and pick your own investments. Consequently, a RRIF may be used to invest in such items as Canadian and qualifying foreign public companies, qualifying bonds and mutual funds, Canadian mortgages, exchange-traded funds (ETFs), Treasury Bills, Canada Savings Bonds, to name a few. However, an annuity can free an individual from worrying about investment decisions and performance.
- • Inflation. Although the guarantee of a monthly annuity payment may seem beneficial, the protection may not be as great as it seems. One reason is that inflation could diminish the value of the annuity. A RRIF may offer better protection from inflation since one can control the investments which are made. The most important protection of a life annuity is to make sure one continues to receive payments no matter how long they live. But if one has other financial resources or is confident in their ability to invest wisely, this "insurance may not be necessary. And like other types of insurance, one may have to "pay for it" in the form of a lower return than might have been received on equivalent investments.
- • Withdrawal Flexibility. RRIFs offer the ability to withdraw assets from the plan whenever you want. While some annuities may be collapsible, doing so may result in penalties. The terms of the particular RRIF should be reviewed to determine what withdrawal privileges will be available and whether there will be penalties attached. Similarly, the characteristics for particular underlying investments should also be reviewed to determine whether there will be sufficient flexibility, e.g., in terms of liquidity, the size of the particular investment, etc.
- Tax Considerations. A RRIF may offer a degree of tax deferral relative to an annuity; assets may remain in the plan until an individual is at an advanced age. In the meantime, investment income accumulates in the plan tax-free.
- Death Tax. If a plan holder designates someone other than a spouse/common-law partner as a beneficiary, the balance remaining in either option is usually included as taxable income in the plan holder's final income tax return. If an option is chosen that maximizes deferral, this may mean that there will be more value in the plan when the plan holder passes away, and therefore more tax to pay (this, of course, is the "flip side" of the tax deferral advantage mentioned above). This effect can be minimized by withdrawing greater amounts from a RRIF while one is still alive. Inherently, therefore, the death tax problem does not detract from RRIFs themselves.

In summary, there are pros and cons to both RRIFs and annuities. While the choice must be based on one's personal situation, the following are some general guidelines on which maturity option may be best:

- If one has considerable financial resources available and does not need the protection of a life annuity, one should seriously consider a RRIF.
- If, for any reason, an individual might need emergency money during retirement, they should probably choose a RRIF because it allows for flexible withdrawals (unless they can acquire a collapsible annuity that does not have significant withdrawal penalty). A compromise for those who want the protection of an annuity and the flexibility of a RRIF is to use RRSP proceeds to purchase both types of plans. Whatever is required for emergency purposes could be placed in a RRIF and the remainder invested in an annuity.
- If an individual feels that a particular investment eligible for an RRIF will yield a better return than an ordinary annuity, a RRIF may be preferable. This must be balanced against the protection provided by a life annuity.

For many people, the key to the RRIF/annuity decision is one of control. If one wants to control their retirement capital and enjoys the freedom to invest, make withdrawals, and so on, a RRIF may be preferable. If on the other hand, one wants protection, as well as freedom from investment worry, an annuity may be the better choice.