Canaccord Genuity Wealth Management

Financial Focus

Becker Orr Wealth Management

June 2019

Minimizing the Tax on your RRSP

By Clinton Orr

Outside of investments, tax minimization is the most popular topic we discuss with clients. Many retirees have money in a RRSP, which can create a tax burden. Until 2009, when the Tax Free Savings Account was introduced, there were not many other options for saving and investing money. So, it is understandable that many retirees have money in a RRSP. There is a nice tax savings when you contribute to a RRSP, however any withdrawals are fully taxable. Even worse, if you pass away, any money left in your RRSP is treated as income. When you die you are deemed to receive your RRSP assets just before your death. That means the full RRSP value at the time of death is included as taxable income. Similar rules apply to RRIFs. If you have $250,000 left in your RRSP or RRIF when you pass away, it is as if you cashed all of it in at once. You must claim the full value as income. $250,000 of income puts you in the top tax bracket, in Manitoba the combined federal and provincial marginal income tax rate tops out at 50.4%. That is a big tax bill. You do not want to die with a large amount in your RRSP or RRIF.

Fortunately, there are situations were a tax-deferred rollover is permitted. If you have designated a “qualified beneficiary” for your RRSP or RRIF, when you die the funds simply rollover to the beneficiary’s RRSP or RRIF. There is no immediate tax hit, the tax is delayed. When the beneficiary withdraws the funds or passes away, they pay the tax. A qualified beneficiary is a spouse/common-law partner or a financially dependent child or grandchild. Designating a qualified beneficiary does not eliminate the tax, it simply delays the tax. If you pass away, your RRSP will rollover to your spouse, when your spouse passes away, it is all treated as income. However, since the money will now be spread over a longer period, it can be drawn down, so less will remain in the account, resulting in less of a tax liability.

In addition to listing a qualifying beneficiary, I often suggest folks draw down their RRSP, so there is not a large sum remaining when they pass away. The starting point is always your financial plan, the plan will ensure you are getting the income you need in retirement. Once your retirement needs are met, the next step is tax efficiency.

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In some situations, it makes sense to do an extra withdrawal from your RRSP or RRIF, even if you do not require the money. This strategy works especially well if you are in a low tax bracket. I often suggest you withdraw enough from your RRSP to take you to the top of your current tax bracket. For example, let's assume John is retired, has $250,000 in his RRIF and his retirement income is $40,000. The top of John's current tax bracket is $47,630, the marginal tax rate at that level is 27.75%. John is not at the top of his current tax bracket, it makes sense for him to do an extra withdrawal from his RRIF. The extra money can stay invested, he would pay the 27.75% tax and then he could use the after-tax money to reinvest. Contributing to a TFSA would be an ideal way to reinvest those funds. The idea is to draw down his RRIF now, pay the lower tax rate, so there is not a big lump sum remaining when he passes away. If you can draw down your RRSP or RRIF in small bits and pieces over time, you will pay tax at a lower rate and avoid the big tax liability described above. In the long term this could save you a significant amount of tax.

This strategy is not for everyone, it is best suited for a retiree in a low tax bracket. As always, before implementing, it is best to discuss the matter with your financial professionals to ensure it is a fit for your situation.

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