Strategies for melting down your RRSP

WELLINGTON FINANCIAL

Executive summary

If you've been a good saver and contributed religiously to your RRSP, you should be rewarded with a sizeable six or seven figure RRSP that would make your retirement that much more enjoyable. The only issue now is – how do you get the money out of the RRSP without paying more tax than you should? One thing is for sure – don't wait until you're near age 71 to do anything. By then, it would be too late.

The whole point of the RRSP is to defer taxes from the time you are in a high tax bracket until you get into a lower tax bracket, thereby saving some tax on your contributions. At some point however, you must take the money out. The government has made the deadline to be age 71, when you must convert your RRSP into a RRIF or an annuity and start withdrawing money at a government prescribed rate. The problem with waiting until then is that you have little flexibility as to what you can withdraw. If your RRSP is large, the mandatory withdrawal amount may push you into higher tax brackets.

What you need to know

Here are some strategies that would help you pay lower taxes on your RRSP withdrawals.

1. Consider deferring your CPP and OAS. Both of these Canadian pensions allow you to defer until age 70 to start receiving them, and you get rewarded for the deferral by receiving higher amounts. If you're retired, you can then use RRSP withdrawals to fill the income gap that the CPP and OAS would have provided, so you can draw down your RRSP at a lower tax bracket.
2. When you stop working, you would normally fall into a lower tax bracket, so top up your income to your existing tax bracket with RRSP withdrawals.
3. Start a RRIF at age 65 to take advantage of $2,000 pension income credit. No matter how much income you have, this pension credit will allow you to withdraw $2,000 tax free from your RRIF, as long as you don't have any other pension income. So, fund the RRIF with your RRSP money to take $2,000 out tax-free each year.
4. If your spouse's RRSP value does not equal yours, you can start to equalize the amounts by withdrawing from yours to put into a spousal RRSP, as long as you have contribution room. The tax on your withdrawal is eliminated by your equivalent contribution into the spousal RRSP.

The bottom line

If you've accumulated a sizeable RRSP, you need to implement a meltdown strategy years before you turn 71 so that you have time to implement the strategy. Otherwise, the mandatory withdrawal rates may bump you into a higher tax bracket, or cause OAS payments to be clawed back, or decrease your Age Amount credit significantly. In all of these occurrences, you will be effectively paying more tax, so do some financial planning to avoid these situations. You may want to consult your financial advisor to explore all your RRSP meltdown options.

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