RRIF WITHDRAWALS - WHAT TO DO?

The recent shocks to the economy have created extremely volatile markets that raise the fears of all investors and particularly retired Canadians relying on their portfolios for regular income.

Most of you are well aware that Canadians are required to convert their Registered Retirement Savings Plans (RRSPs) into Registered Retirement Income Funds (RRIFs) by age 71 and are then mandated to withdraw at least a minimum amount each year. The minimum required withdrawal rate increases at each age – from 5.28 per cent at age 71, up to 20 per cent for those age 95 and older.

It is entirely understandable that retirees wish to carefully preserve their nest egg, often withdrawing the minimum required payment to make their plans last as long as possible. This also better ensures the sustainability of income, helps them avoid or reduce OAS Clawbacks, and to keep the resulting income taxes as low as possible. A significant market drop, like the one experienced early this year can have serious implications to those who must sell their investments to meet the RRIF minimum payment. Obviously, being forced to sell low in negative markets is a wealth-destroying process.

Thankfully on March 25th the government responded to the COVID-19 crisis by allowing a temporary reduction in the required minimum withdrawals by 25 per cent for 2020. This also applies to Life Income Funds and locked-in RRIFs. They are once again using the tactics employed after the market correction in 2008.

But should you make the election or not?

First of all, if you have already taken the original minimum payment for 2020, you already have received your annual minimum payment and cannot put it back. You need not read further.

If one considers the reduced call on invested reserves and the accompanying tax savings, a reduced withdrawal may make a lot of sense. Consider Bruce*, who has $100,000 in his RRIF on Jan 1, 2020, and turns 72 later in 2020. Normally, his 5.4% minimum withdrawal would be $5,400, but with the change in legislation, he can choose to take out just 4.05%, or $4,050.

If Bruce has a spouse and he dies early, this reduction in his current withdrawal will increase the future payments to his spouse at a time when they would lose the ability to income split for tax purposes – further increasing their taxes.

Finally, this temporary measure is not really costing the government a lot and it may cost you more. If you take less money out of your RRIF it will continue to grow. If you die earlier than expected, there will be a larger tax bill to pay at death. The Government will still get all their money when the larger RRIF is included on your terminal tax return.

Considering the ballooning federal debt, income taxes are more likely to rise than remain the same. Allowing your non-tax paid RRIF pool to grow may turn out to be less tax efficient.

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** Names have been changed.*