<u>Can you have “Too Much” in an RRSP?</u>

Why is the Canadian Federal Government so excited about the billions of dollars saved in registered plans?

Over the past several years many of us have enjoyed the handsome tax savings offered by using our RRSP deductions. Many have built up nest eggs in preparation for retirement – whenever that may be. Many felt they would retire sooner, until the significant Market downturn during 2001/2 and 2008/9.

But what about those billions of dollars of registered savings? While the government has foregone collecting taxes at our highest marginal rates over these past several years they are now lying in anxious wait for the conversion to Income Funds as we begin to draw our livings from the investments. We have always been told that tax deductions at our higher marginal rates during our working lives will be replaced with income tax payable at a lower rate once we enter retirement, but is this the complete discussion? Is this in fact, true?

How many of us have heard of the Claw back? It was a system instituted by our then Finance Minister (now Prime Minister) Paul Martin. It has been less than affectionately labelled the “Martin Senior’s Tax”.

The timing to look at the issue is critical now. The first wave of Baby Boomers is 60. They are the beginning of both the most affluent and most numerous economic drivers that do and will influence this country. Again – why does this matter?

If we put all the above together we get a large, wealthy group meeting retirement over the next 25 years with plenty of registered accounts that by law must be converted to Income Funds no later than the year they turn 69. This is what the Senior’s Tax is for - the government wants your money.

Let’s look at the example of a new client, a couple – one over 70 and the other just under 60. Both are retired teachers. His pension is approximately $80,000 per year and hers, commuted to a LIRA (currently at approximately $600,000) has no payouts. In addition he has a Retirement Income Fund and she has a Spousal Retirement Plan. His income, at approximately $100,000, causes him to lose his entire Old Age Security. In the above circumstance his top marginal rate is normally 42% but now, because he is a rich Canadian, is actually 15% higher for a total of 57%. And what about his wife? If something is not done soon she will have the same problem in just over 10 years (when the LIRA must be converted to a LIF).

Is 57% the appropriate tax rate for Senior citizens?

The above is a comparatively well off couple and I know many of our readers might like their problem, but let’s look at the other end of the income spectrum. What happens to modest income earners? There are over 1.2 million poor seniors qualifying for the GIS (Guaranteed Income Supplement). If this senior now earns an additional dollar from either a registered plan withdrawal or a part time job they will pay increased income taxes from 22 to 28 % and they will also lose 50% of the GIS. This translates to a tax rate of 72%!!!

If this causes you to question whether your RRSP's may cause future problems there are some current solutions. You can use Tax Shelters, Universal Life, Leverage, Real Estate partnerships etc, all of which can produce excellent long term returns without causing the same problems as RRSP's. If you have too much money in RRSP's, or too little, (it's hard to believe that savings can hurt you), you can take action.

The term the industry uses frequently is called a "Meltdown". Systematic withdrawals are made from your RRSP to reduce it or to eliminate it. We know what you're thinking - cash the RRSP ($5000 at a time to limit the withholding tax to 10%) and create additional taxable income while one is still working simply raises the marginal tax rate and creates more taxes owing. That is in fact true unless one offsets the income. There are generally 2 broad methods to accomplish this.

Buy Tax Shelters

These work, generally, by either creating losses that can be used to offset the extra income or by the use of tax credits related to charitable giving. Both methods are effective.

Create offsetting expenses through the use of borrowing to invest.

Interest incurred to buy investments is tax deductible. These secondary investments can be placed in a variety of "containers". A particularly useful one that we use is a Corporate Class of Mutual Funds. These funds allow growth to compound within the investment without paying annual taxes. When they are eventually cashed out the growth will be in the form of Capital Gains (taxable at a rate of only 50%) and the return of capital is not taxable.

If you are concerned about your potential retirement situation or feel you may be heading for unfavourable claw backs please see your financial planner or give us a call. It is best to understand the problem early and have sufficient time to deal with the specific circumstances.