Registered retirement income funds

The *Income Tax Act* (Canada) requires that a registered retirement savings plan (RRSP) matures by December 31 of the year in which the planholder (annuitant) reaches age 71.

At the time an RRSP matures, planholders must choose what they want to do with the retirement savings they've been deferring from taxes. Three options – or a combination of them – are possible:

- Cashing in the RRSP
- Purchasing an annuity
- Converting the RRSP to a registered retirement income fund (RRIF)

Here's a look at the options.

Cashing in the RRSP

When an RRSP is cashed in, the entire fair market value of the plan will be included in the planholder's income for the year of withdrawal – and taxed at his or her marginal income tax rate. This could entail a tax bite exceeding 45% for many Canadians. So, withdrawing all RRSP savings is probably not the best way to start retirement.

Purchasing an annuity

Annuities pay a predetermined amount of annual income over a specified period. The amount paid will be based primarily on interest rates prevailing at the time the annuity is purchased. Unlike cashing in an RRSP, when an annuity is purchased, the value of the RRSP is not included in income all at once. Rather, the amount received annually will be taxed as income each year.

Converting to a RRIF

RRIF payouts are essentially the opposite of annual RRSP-deductible contributions. There are maximum annual amounts that may be contributed to an RRSP, and there are minimum RRIF withdrawals each year. The amount withdrawn from a RRIF will be taxable each year.

And, as in an RRSP, growth within a RRIF is tax-deferred, and annuitants may continue to manage their own investments if a self-directed plan is used.

General RRIF rules

A RRIF can be opened at any age, but new contributions can never be made to a RRIF. The most common way money gets into a RRIF is through a rollover from an RRSP. When an RRSP is rolled into a RRIF, no taxes are payable on the transferred funds. As in an RRSP, tax is generally only payable on amounts actually withdrawn from a RRIF, allowing the remaining assets to continue to grow on a tax-deferred basis.

Many planholders find the tax rate on RRIF withdrawals much lower than the tax rate they faced while employed because their income in retirement is not as high. This is one of the benefits of the RRSP/RRIF system: RRSP contributions are often made and deducted from income that is taxed at high marginal rates, while RRIF withdrawals are often included in income and taxed at much lower rates.

The RRIF assets can be transferred to an RRSP provided the annuitant is age 71 or younger. The RRIF minimum, if applicable, will still be paid out for that year unless the annuitant is 70 or 71 in 2007 or 71 in 2008.

Minimum annual withdrawals

Once a RRIF is established, the annuitant is required under the *Income Tax Act* (Canada) to withdraw a minimum amount each year with the exception under certain conditions due to 2007 and 2008 transitional provisions (see next section). That amount is based on the age of the annuitant or the annuitant's spouse or common-law partner (see "Calculation using spouse or common-law partner's age" on page 4) as outlined in the accompanying "Minimum payment schedule." The minimum annual withdrawals are calculated by multiplying the fair market value of the RRIF at the beginning of the year by the corresponding age factor in the table.

In the year a RRIF is established, no minimum withdrawal is required. In each subsequent year, only the minimum withdrawal amount is required (with certain exceptions as noted in the next section). To maximize tax-deferred growth (beyond electing not to receive a first-year payment), some annuitants subsequently choose to withdraw only their minimum amount at the end of each year.

Example

John converted his RRSP to a RRIF in September 2007 when he turned 71. His minimum withdrawal for 2007 is zero. Assuming that the value of the RRIF at the beginning of 2008 was $200,000, John must withdraw $14,760 (0.0738 x $200,000) in 2008.

Minimum payment schedule

Age[1]	General (%)	Qualifying RRIFs[2] (%)
70[3]	5.00	5.00
71	7.38	5.26
72	7.48	5.56
73	7.59	5.88
74	7.71	6.25
75	7.85	6.67
76	7.99	7.14
77	8.15	7.69
78	8.33	8.33
79	8.53	8.53
80	8.75	8.75
81	8.99	8.99
82	9.27	9.27
83	9.58	9.58
84	9.93	9.93
85	10.33	10.33
86	10.79	10.79
87	11.33	11.33
88	11.96	11.96
89	12.71	12.71
90	13.62	13.62
91	14.73	14.73
92	16.12	16.12
93	17.92	17.92
94 or older	20.00	20.00

[1] Age as of December 31 of previous year.
[2] A qualifying RRIF is generally a registered retirement income fund entered into before 1993.
[3] For ages below 71, the formula is 1/ (90 – age).

Minimum withdrawal where annuitant turns 70 or 71 in tax year 2007 and 71 in tax year 2008

Due to the legislative increase to the age limit, an annuitant must convert their RRSP to a RRIF from 69 to 71 years of age, transitional provisions have been made to the requirements to pay the RRIF minimum amount. Particularly, there has been a transitional amendment to the RRIF minimum for RRIF annuitants who turn 70 or 71 for the 2007 tax year and 71 in the 2008 tax year. For these RRIF annuitants, the requirement to pay the RRIF minimum is waived. If, however, the RRIF annuitant chooses to withdraw an amount(s) from his or her RRIF, there would be no withholding tax on the amount up to the RRIF minimum that would otherwise have applied if not for this transitional provision. Only amounts in excess of the otherwise calculated RRIF minimum would be subjected to withholding taxes.

Example

Paul converted his RRSP to a RRIF in September 2006 when he turned 69. His minimum withdrawal for 2006 is zero. Due to the new amendments, Paul did not need to convert to a RRIF until the end of the year he turns 71 years of age in 2008. Based on the changes, his RRIF minimum payment for the 2007 tax year, the year in which John turns 70 years of age, is zero. His RRIF minimum for 2008, the year in which Paul turns 71 years of age, is also zero. Assuming Paul decides to withdraw an amount out of his RRIF in 2007 or 2008, there would be no withholding taxes on amounts up to the otherwise calculated RRIF minimum amount.

Assuming that Paul withdraws $21,550 out of his RRIF in 2007, $10,000[4] would come out of the RRIF plan free of withholding taxes. The remaining RRIF payment of $11,550 ($21,550 – $10,000) would be subjected to withholding taxes.

[4] Assumes the value of the RRIF at the beginning of 2007 was $200,000; the otherwise calculated RRIF minimum for the year is $10,000 (1/(90 – 70) x $200,000) in 2007.

Calculation using spouse or common-law partner's age

When setting up a RRIF, an annuitant can base the annual minimum withdrawal calculations on either his or her own age, or on the age of his or her spouse or common-law partner. To maximize the amount that can continue to grow tax-deferred in the RRIF, many annuitants choose to base the calculations on the younger spouse or common-law partner's age as the minimum payment factors increase with age. The election to use a spouse or common-law partner's age must be made before the first RRIF withdrawal.

Attribution on spousal or common-law partner RRIFs

A RRIF will be a spousal or common-law partner plan if it receives funds from a spousal or common-law partner RRSP. Amounts withdrawn from a spousal RRIF will be attributed to the contributing spouse, up to the amount that was contributed to any spousal RRSP in the year of withdrawal or the previous two calendar years. The minimum withdrawal is not subject to attribution (including the amount up to the otherwise calculated minimum in the transitional provisions).

For more information, please refer to our Tax & Estate InfoPage *Income-Splitting Opportunities*.

Taxes on RRIF withdrawals

Though all RRIF withdrawals are fully taxable, only amounts withdrawn from a RRIF in excess of each year's minimum amount are subject to withholding taxes at source.

The withholding taxes are the same as for RRSP withdrawals:

Amount	All provinces except Quebec	Quebec
Up to $5,000	10%	21%
$5,000.01 to $15,000	20%	26%
Over $15,000	30%	31%

The table represents only the withholding tax on the excess RRIF withdrawals. This withholding tax is essentially an estimated prepayment of the taxes that may actually be owing. RRIF withdrawals must be reported on the annuitant's income tax return for the year of withdrawal, and tax will be payable at the annuitant's marginal rate on these withdrawals. The annuitant will then claim the amounts withheld, if any, as a credit against the taxes owing.

Systematic withdrawal plans

Systematic withdrawal plans (SWPs) are often used in conjunction with RRIFs. SWPs enable mutual fund investors to automatically receive payments from their RRIF accounts on the dates they desire. Investors can choose to receive only the minimum amount for each year so that no withholding taxes will be applied. SWP payments can be sent to planholders by cheque or as a direct deposit to a bank account.

Installment tax payments

Depending on the overall tax situation of the RRIF annuitant, the Canada Revenue Agency (CRA) may require quarterly income tax instalments. This circumstance is generally triggered if the difference between an annuitant's income tax payable and amounts withheld at source exceeds $2,000 in the current year and either of the two preceding years. A RRIF annuitant who withdraws only the minimum amount without any withholding tax may be required to remit income tax quarterly. The CRA will send out Installment Notices that set out the amounts due quarterly, if instalments are required.

Pension income-splitting/Pension credit

Beginning in 2007, RRIF annuitants are entitled to split up to 50% of their RRIF income with a spouse or common-law partner. Additionally, annuitants may take advantage of the federal pension tax credit of 15% on up to $2,000 of eligible pension income, plus a corresponding provincial tax credit. Individuals who are under 65 may also be entitled to the pension credit on RRIF income if the amount is received as a result of the death of his or her spouse or common-law partner.

For more information, please refer to our Tax & Estate InfoPage *Pension income-splitting*.

Death of a RRIF annuitant

When a RRIF is established, careful consideration should be given to naming a beneficiary of the plan's assets. The annuitant may also wish to name a successor annuitant.

Note: Invesco Trimark currently does not accept beneficiary designations on RRSPs/RRIFs if the annuitant is a resident of Quebec.

A beneficiary is a person who, on the annuitant's death, will receive the assets in the RRIF. A successor annuitant is a spouse or common-law partner who, if named on the account, will continue to receive the annual minimum payments from the RRIF following the annuitant's death.

On the annuitant's death, if the surviving spouse or common-law partner is the beneficiary of the RRIF, the RRIF assets may be transferred on a tax-deferred basis to the spouse's or common-law partner's RRIF. If the surviving spouse or common-law partner is age 71 or under, the RRIF assets may alternatively be transferred to an RRSP.

If a child or grandchild was financially dependent on the deceased annuitant and was the beneficiary of a RRIF, the funds in the RRIF may be used to purchase an annuity that must end by the time the child or grandchild reaches the age of 18. However, if a financially dependent child or grandchild of any age was also dependent on the deceased annuitant by reason of mental or physical infirmity, the child or grandchild may transfer the value of the deceased annuitant's RRIF into his or her own RRIF or RRSP.

Financial dependence is determined by looking at the (grand)child's income in the year prior to the year of the annuitant's death. For a death in 2008, the (grand)child's income cannot exceed the 2007 basic personal amount of $9,600. If the (grand)child is infirm, the maximum is 2007 income of the $16,490.

If anyone else is named as the RRIF beneficiary, the entire value of the RRIF will be included in income and taxed in the deceased's terminal return.

For more information see the Tax & Estate InfoPage *Death and taxes* for a more detailed discussion of RRIFs and death, along with numerical examples.

The last word

As is usual in tax matters, the rules covering RRIFs are complex, and specific cases need to be addressed individually. Professional legal and tax advice should be sought when necessary.

For more information about this topic, contact your advisor, call us at 1.800.874.6275 or visit our website at www.invescotrimark.com.

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