



## Make the most of your RRIF withdrawal

If you're like many retired Canadians, you probably spent many years building your RRSP savings through regular contributions and investments advice from your financial advisor. Now that you've converted your RRSP to an income-producing RRIF, it's important not to let all of that hard work go to waste by failing to maximize the benefit you receive from your RRIF withdrawals.

This article presents three strategies to help you ensure you're making the most of your RRIF withdrawals.

### **1 ENSURE YOUR WITHDRAWALS CONTINUE TO GROW UNTIL THEY'RE NEEDED**

When you're relying on your RRIF withdrawals to help you meet day-to-day expenses, it's important to keep the money easily accessible.

Unfortunately, for many Canadians, this means their money sits in a traditional chequing account that pays little or no interest. With rates typically hovering around 0.25 per cent, you'd be nearly as well off keeping your money under the mattress.

Luckily, there are alternatives for Canadians who want both accessibility and growth. Many non-traditional banks now offer high interest savings accounts that allow investors full accessibility to their money. A few of these accounts offer chequing services, bank machine withdrawals, debit purchases, online bill payments and electronic transfers (online or over the phone). Depositing your RRIF withdrawal in a high-interest chequing account allows your money to continue to grow until it's needed, and makes it easy to access at any time.

### **EXAMPLE**

Tony normally makes a withdrawal from his RRIF at the start of each year. He deposits it into his chequing account at a major bank, which pays 0.25 per cent interest. This year, his withdrawal is \$24,000, which



leaves him with \$13,200 after he pays tax on the withdrawal at his marginal tax rate of 45 per cent. He plans to spend \$1,100 per month. By the end of the year, his account will have earned about \$15 in interest.

Alternatively, on the advice of his financial advisor, Tony opens up a high-interest savings account paying 3.75 per cent<sup>1</sup> per year. By the end of the year, his account has earned \$225 in interest. By moving to a high-interest account, Tony has earned an additional \$210 while retaining easy access to his cash at all times.

1 As of September 30, 2006 a rate of 3.75 per cent is applied to all funds in the account. Interest is calculated on the total daily closing balance and paid monthly. Rate is subject to change.

## **2 DELAY YOUR ANNUAL REQUIRED WITHDRAWAL**

One of the primary advantages of a RRIF is that it allows your retirement savings to continue to grow tax-free. While you're required to make a minimum specified withdrawal each year, there are no rules about when the withdrawal must be made. If your situation allows it, make a single lump-sum withdrawal at the end of the calendar year. This will give the investment additional time to grow tax-free, and will ultimately put more money in your pocket.

## **EXAMPLE**

Tony's RRIF portfolio is currently earning a return that averages 7 per cent per year. Following the advice outlined above, he now deposits his RRIF withdrawals into a high-interest savings account, currently paying 3.75 per cent interest.

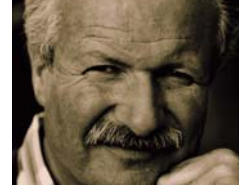
Assuming that his required RRIF withdrawal is \$24,000 (\$13,200 after tax), Tony now wants to determine the best time to make the withdrawal. If he makes the withdrawal at the start of the year (and this time leaves it intact for the full year) his \$13,200 will grow by \$495 – which compares favorably to the \$33 he would have earned had he deposited the money in a traditional chequing account paying 0.25 per cent interest.

However, if he delays his withdrawal until the end of the year, the money will continue to grow tax-free in his RRIF at the average rate of return of 7 per cent. The result is his \$24,000 will grow by \$1,680. By delaying his withdrawal until the end of the year, he has generated an additional \$1,185 of income.

## **3 CREATE A TAX DEDUCTION ON RRIF INCOME THAT ISN'T NEEDED FOR DAY-TO-DAY EXPENSES**

Even if you are someone who has additional sources of income, such as a pension or substantial non-registered





investments, you are still required to withdraw a minimum amount from your RRIF each year and pay the applicable tax.

If you would normally reinvest the money from your RRIF payments, there is a strategy available that allows you to create a tax deduction to offset this discretionary RRIF income and, at the same time, potentially increase the value of your non-registered investments. By taking out an investment loan and using the RRIF withdrawals to pay the interest, you can create an interest deduction equal to the amount of the RRIF income. You will also enjoy the benefit of investing a large lump-sum amount that gets working right away.

You've worked hard to achieve a comfortable retirement. Taking advantage of these few simple strategies can help ensure that your money continues to work hard in retirement.

### **EXAMPLE**

Upon reviewing his financial situation, Tony realized that \$10,000 of his annual RRIF withdrawal is not needed to pay for his retirement expenses. He would like to invest this money in a tax efficient manner and increase the value of his non-registered investments. His advisor suggests that rather than simply investing his RRIF withdrawal, he should consider using the \$10,000 to fund a \$142,857 interest-only investment loan.<sup>2</sup>

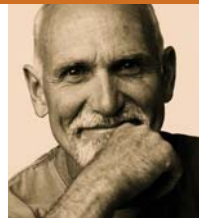
Which option would put him further ahead in the long run? The table on the next page shows the results.

With a leverage strategy his interest payments are tax deductible, meaning the net annual cost of his interest payments after his tax-deduction is \$5,500 for a total of \$55,000 over 10 years. This matches the value of his \$10,000 RRIF withdrawal after he pays income tax at a 45 per cent tax rate. Under the non-leverage strategy, he contributes the same \$55,000 directly to his investment plan.

At the end of 10 years, after the loan is repaid and all taxes are accounted for, the leverage strategy puts Tony ahead by \$49,487, for a return of 12.2 per cent. If he uses a non-leverage strategy, Tony will be ahead by \$18,197 after all taxes have been paid, for a rate of return of 5.4 per cent.

By using his discretionary RRIF income to pay the interest on an investment loan, Tony could increase the value of his non-registered investments by more than \$30,000.

2. Assumptions: Interest-only loan, 7% investment return, 7% interest rate, 25% taxable portion of return, 30% tax rate on investment income, 100% tax deductibility, 45% marginal tax rate. Results reflect a non-Quebec scenario. Results in Quebec will differ slightly due to differences in interest-deductibility rules.



|  | Leverage Strategy | Non-Leverage Strategy |
|--|-------------------|-----------------------|
| <b>Cost of Investing</b>                         |                   |                       |
| Total cash contributions over 10 years           | –                 | \$63,558              |
| Income tax paid on fund's income over 10 years   | \$10,362          | \$1,804               |
| Total after tax loan interest paid over 10 years | \$55,000          |                       |
| <b>Total cost of investing</b>                   | <b>\$65,362</b>   | <b>\$65,362</b>       |
| <b>Investment Results</b>                        |                   |                       |
| Investment value at end of 10 years              | \$281,021         | \$87,620              |
| Less repayment of loan                           | \$142,857         | -                     |
| Less capital-gain tax on sale of investment      | \$23,315          | \$4,061               |
| <b>Tony's equity at end of 10 years</b>          | <b>\$114,849</b>  | <b>\$83,559</b>       |
| <b>Total net gain on investments</b>             | <b>\$49,487</b>   | <b>\$18,197</b>       |
| <b>After tax rate of return</b>                  | <b>12.2%</b>      | <b>5.4%</b>           |

Borrowing to invest is suitable only for investors with higher risk tolerance. You should be fully aware of the risks and benefits associated with investment loans since losses as well as gains may be magnified. The value of your investment will vary and is not guaranteed, however, you must meet your loan and income tax obligations and repay your loan in full.

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