



Maximize your retirement income – Get more!

Many Canadians will be relying on their personal savings to generate the majority of their income in retirement. Those personal savings include employer-sponsored pension plans, registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), and other investments such as guaranteed interest contracts (GICs), bonds, mutual and segregated funds, equities, and annuities.

While all of these investment vehicles can generate income, each is treated differently in the way the income is reported for tax purposes. For example, income from your registered investments is “included” at 100 per cent (i.e. it is fully taxable). However, non-registered income is included at different rates depending on the investment source. That is an

important consideration when planning how your retirement income will be structured.

PRESERVE YOUR GOVERNMENT BENEFITS

In addition to personal savings, when you reach age 65 there are also valuable federal and/or provincial benefits such as Old Age Security (OAS), an Age Credit and Medical Expenses Credit that can supplement your income. Understanding how these government benefits work is important because improper planning can cause the benefits to be clawed back.

For example, OAS is a federal tax benefit that generates almost \$492/month, or approximately \$5,900/year. OAS is an income-tested benefit, which means that the amount of OAS paid to you is determined by the amount of income you report on line 234 of your federal income tax form. If line 234 exceeds a certain amount (currently \$62,144), the benefit starts being reduced and, in some cases, it can disappear altogether.



SOLUTION #1 - PORTFOLIO REVIEW

To preserve and maximize OAS and other income-tested benefits, consider realigning your personal savings portfolio to generate retirement income in the most tax-efficient way. Speak with your advisor to make sure you understand the whole tax equation and how it affects you.

Consider Catherine Potter, a 65-year-old stay-at-home mother. Catherine has no registered investments of her own. Years ago, when her husband Bill passed away, she received the \$500,000 proceeds of his life insurance

policy. Catherine used the insurance money to buy a 10-year, 7 per cent government bond. She also receives her full OAS benefit of approximately \$5,900 and a survivors benefit from Canada Pension Plan of \$4,800. She has no tax deductions available to her.

Catherine's combined annual gross income is \$45,700 (\$35,000 from the bond, \$5,900 from OAS and \$4,800 from the CPP survivors benefit). The income from the bond, OAS and CPP are all reported at 100 per cent on line 234 of her tax return making her income fully taxable and leaving her with \$36,835 in after-tax income (see chart below).

Investments	Amount	Income	Inclusion Rate	Line 234	After-tax (ETR 19.4%)
10 yr., 7% bond	\$500,000	\$35,000	100%	\$35,000	\$28,210
OAS		\$5,900	100%	\$5,900	\$4,755
CPP		\$4,800	100%	\$4,800	\$3,870
Total		\$45,700			\$36,835



Catherine's 7 per cent bond is maturing next month and she wants to maintain the same level of after tax income. With low interest rates, Catherine needs to find a way to make up for the loss of income she is faced with when the bond matures.

After consulting an advisor, Catherine developed a tax-managed portfolio that diversified her investments, took advantage of the tax efficiency of systematic withdrawal payments (SWPs) and gave her the balance and stability she needed to maintain her retirement income. The following chart shows the results¹:

Investments	Amount	Income	Inclusion Rate	Line 234	After-tax (ETR 8.0%)
OAS		\$5,900	100%	\$5,900	\$5,430
CPP		\$4,800	100%	\$4,800	\$4,415
GIC	\$50,000	\$2,000	100%	\$2,000	\$2,000 ²
Prescribed Life Annuity ³	\$50,000	\$3,350	26%	\$870	\$3,280
SWP of mutual/segregated fund @ 5% ⁴	\$400,000	\$20,000	2.4%	\$475	\$19,962
Total		\$36,050		\$14,045	\$35,087
GIS ⁵		\$3,167			\$3,167
					\$38,254

By diversifying her investments with products like Guaranteed Interest Contracts, life annuities and mutual funds or segregated funds, Catherine's advisor was able to maintain her income, despite the drop in interest rates, by lowering her line 234 reported income and consequently, her effective tax rate (ETR).

By making the right investments, Catherine is now on the right track. Her after-tax income is a little lower but she has reduced her line 234 reported income from \$45,700 to \$14,045 and her effective tax rate from 19.4 per cent to 8 per cent. Because Catherine's income is so low she can now receive some Guaranteed Income Supplement (GIS) because for GIS purposes the government looks at line 234 less any OAS payments, so her income for GIS purposes is \$8,145. In addition, Catherine now maximizes her

income-tested benefits. For example, she is now eligible for the maximum age credit of \$1,020, an increased savings of approximately \$600. Not only did she accomplish her goal of maintaining the same level of income, Catherine has actually increased her after tax income by approximately \$1,420 and that doesn't include the increased savings from the age credit and any other income tested benefits.

1 For illustration purposes only. Actual results will vary by province.

2 Assumes a GIC rate of return of 4% purchased from an insurance company so that the interest income will qualify for the pension income credit

3 Quote based on a 65 year old female with a 3 year guarantee at time of publication. Non-registered annuity income also qualifies for the pension income credit.

4 Assumes a 5% rate of return and a 5% withdrawal rate. The numbers reflect the first year results.

5 The GIS income threshold at the time of publication is \$14,472 but doesn't include OAS so her income for GIS purposes is \$14,045 - \$5,900 or \$8,145 making her entitled to \$264 per month at time of publication. GIS income is not taxable.

SOLUTION #2 - CREATE DOLLAR-FOR-DOLLAR DEDUCTIONS

The equation to calculate line 234 is essentially: $\text{Income} - \text{Deductions} = \text{Line 234}$. The previous example describes how changes to the income portion of this equation reduced Catherine Potter's reported income on line 234. The complementary strategy to reducing line 234 would be to increase the dollar-for-dollar deductions available. There are two ways in which this can be done:

1. A deduction can be created using RRSP contributions. Any unused RRSP room at age 69 should be used up with a lump-sum final contribution. The resulting deduction can be spread over a few years.

While organizing his retirement affairs, Spencer, a 69-year old retired steelworker from Hamilton, realized he still had RRSP top-up room. His advisor told him that any unused RRSP room at age 69 should be used up with a lump-sum final contribution which, in turn, would create a tax deduction for Spencer.

Spencer made a lump-sum final contribution of \$50,000 to his RRSP. He decided to then spread the contribution over 10 years (\$5,000/year) to stretch and maximize his tax deduction over time.

The tax managed benefits of his decision are numerous: Since Spencer is 69, his RRSP converts to a RRIF and his new after-tax RRIF income grows by \$2,509; the RRSP deduction of \$5,000 created a tax savings of \$1,600/year; and, at the same time, he was able to lower his line 234 reported income, which reduced the OAS clawback by \$134 a year.

Simply by maximizing his RRSP contribution Spencer was able to increase his after-tax income and tax benefits by \$4,243 – that's equivalent to a 10-year GIC that returns 12.5 per cent! Now Spencer's mind is at ease knowing that he has a comfortable retirement income to live off of and he can go back to enjoying his hobbies of gardening and model train building without worrying about his income.

2. A deduction can be created using discretionary income (e.g. from a RRIF). Income not needed for living expenses is considered discretionary, and can be used to pay the interest on funds borrowed to invest, creating a tax deduction.

Margaret is 72 years old and has been retired from her job as a librarian since she turned 65. The income from her RRIF more than covers her living expenses; in fact, she has \$10,000 in annual discretionary RRIF income.

After tax, Margaret's net income on that \$10,000 would be \$5,500 a year. If she chose to invest that money, assuming an eight per cent return, the value of her investment after 10 years would be \$87,285.



A tax-managed alternative would be for Margaret to take an interest-only loan for \$125,000 at the start of year one. The annual loan interest is eight per cent or \$10,000 a year – the same as her discretionary RRIF income. The interest payments become a tax deduction for her, which reduces her line 234 reported income by \$10,000. Assuming the same return, in 10 years, after paying off the principal on the loan, Margaret's investment would be worth \$120,420.

Simply by using her income that was not needed for living expenses to pay the interest on funds borrowed to invest, Margaret was able to create a tax deduction that reduced her reported income and increased her overall wealth by more than \$33,000.

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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