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Can Genevieve and Sam retire and spend more time travelling?

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A year from now, when her contract ends, Genevieve plans to leave her $85,000-a-year consulting job so she and her husband Sam can spend more time travelling. She is 62. Sam, who is 64, has been winding down his business and is collecting Canada Pension Plan benefits.

Genevieve took early retirement from her career in financial services a couple of years ago and is getting a pension of $42,000 a year. She also gets about $12,000 a year in net rental income. In addition to substantial savings, they have a condo in Ontario and a chalet in Quebec. Together, they have five grown children.

"We would appreciate a review of our finances so that we can efficiently manage our taxes and have a sound plan going forward," Genevieve writes in an e-mail. "Will our funds last until we reach 100 years of age (hopefully)? We are a healthy and active couple." They also wonder whether they should buy disability and critical illness insurance.

Their spending target is $78,000 a year after tax, indexed to inflation.

We asked Ian Calvert, a vice-president and principal at HighView Financial Group in Toronto, to look at Sam and Genevieve's situation. Mr. Calvert holds the certified financial planner (CFP) and chartered investment manager (CIM) designations.

WHAT THE EXPERT SAYS

With Genevieve's contract income of $85,000 a year, their cash flow is extremely healthy today, Mr. Calvert says. "Now that their working years are all but over, they need a withdrawal plan that not only puts the cash in their hands tax-efficiently but organizes their balance sheet for a tax-efficient transfer of wealth to their children," the planner says.

The first place to start is with their registered retirement savings plans. Combined, they have slightly more than $1.1-million in RRSPs. "This is a great accomplishment, a signal that making RRSP contributions during their higher-income working years was a priority."

To fill their cash flow deficiency when Genevieve retires, their RRSPs will play an important role, Mr. Calvert says. The first step should be converting their RRSPs to registered retirement income funds, or RRIFs. "This is not required at their age, but making this transition moves their funds into a much friendlier withdrawal vehicle," he says. They could withdraw directly from their RRSPs, but "for many reasons it doesn't make sense."

A withdrawal from an RRSP (also known as a partial deregistration) is not considered eligible pension income. "This means this income is not eligible for the pension income tax credit and is also not allowed to be split with your spouse at the age of 65," the planner says. As well, most financial institutions will charge a deregistration fee, which is often $50 per withdrawal. "If someone is looking to establish a monthly or quarterly withdrawal plan, these deregistration fees can certainly add up, and are avoidable with proper planning."

Perhaps the only downside with the early conversion is that once the RRSP is converted to a RRIF, there will be a minimum taxable withdrawal each year. "However, you can confidently make the early RRIF conversion if supported by a comprehensive retirement cash flow plan," he says.

If Genevieve and Sam both make the conversion, their combined RRIF minimum withdrawal will be about $44,000 a year. This $44,000, combined with Genevieve's pension of $42,000, Sam's CPP of $10,925, Sam's OAS of $8,020 (he plans to take it when he turns 65) and net rental income of $12,000, would put their total family income at about $123,500 a year after accounting for $6,500 of taxable income in their non-registered portfolio. After making payments of $5,400 a year to their line of credit and family taxes of $25,300, they would have net cash flow of $86,300 a year, surpassing their target of $78,000.

After splitting their eligible pension income, their taxable income would be about $61,750 each. "From a taxable income perspective, this is a great place to be," Mr. Calvert says. Most of their income is being taxed in the two lowest marginal tax brackets (combined federal and Quebec). This also leaves a healthy buffer for when Genevieve decides to take her CPP and OAS benefits, the planner says. In other words, the additional income from her CPP and OAS will not push them into an unfavourable and punishing tax bracket, or risk having their OAS clawed back, which kicks in at income levels exceeding $81,761 a year.

Genevieve asks when the optimal time would be to take her CPP and OAS. "There is no universal answer to this question and a lot of different opinions," Mr. Calvert says. Because Genevieve and Sam can supplement their cash flow from the early conversion of their RRIFs, with the help of Genevieve's pension and Sam's government benefits, there is no need for Genevieve to take CPP and OAS at age 65. She could delay both to age 70 because she and Sam are not dependent on the income, he says. Waiting to age 70 will increase her CPP payment by 42 per cent and her OAS payment by 36 per cent. "This is an attractive increase in a steady and indexed source of retirement income."

If their lifestyle needs remain at $78,000, indexed to inflation, and they can achieve an annualized average rate of return of 5 per cent on their RRIF, tax-free savings accounts and non-registered portfolio, they can confidently spend that much until the age of 100, the planner says. If they direct any surplus cash flow to their TFSAs each year, their balance sheet will become very tax-efficient, he says. "Having the majority of your long-term wealth in your primary residence and your TFSAs, both tax-free assets, will ensure a very tax-efficient transfer of wealth to the next generation."

Sam and Genevieve have about $207,000 in their non-registered portfolio. Any investment income and all capital gains from this account will increase their taxable income each year. They should attempt to own most of their Canadian equities in this non-registered account because dividends from Canadian companies are taxed favourably, he says. They could hold most of their U.S. dividend-paying stocks in their RRIFs. "Eligible Canadian dividends are extremely tax efficient because of the dividend tax credit," Mr. Calvert says.

As for critical illness and long-term care insurance, both come with a cost, one that rises as the insured individual becomes older, the planner says. "Given their level of investable assets, two properties and steady source of retirement income, Genevieve and Sam's retirement plan could absorb the material shock of being diagnosed with a serious health condition or higher health care costs."

<u>CLIENT SITUATION</u>

The people: Sam, 64; Genevieve, 62; and their adult children

The problem: How to draw down their savings and investments in the most tax-efficient way. Gauging whether their funds will last to age 100.

The plan: Once Genevieve retires, convert their RRSPs to RRIFs to make up the income shortfall. Genevieve can postpone government benefits to age 70. Arrange their investments in a tax-efficient manner with a target rate of return of 5 per cent.

The payoff: A comfortable retirement without having to worry about running out of money.

Monthly net income: $8,885

Assets: Cash $42,400; non-registered stocks $207,000; her TFSA $95,000; his TFSA $41,000; her RRSP $585,000; his RRSP $520,000; condo $675,000; chalet $725,000; estimated present value of her DB pension $630,000. Total: $3.5-million

Monthly outlays: Property tax $285; home insurance $150; electricity $250; heating $50; maintenance $300; garden $50; transportation $405; groceries $1,000; clothing $100; line of credit $415; gifts, charity $400; vacation, travel $1,000; other discretionary $100; dining, drinks, entertainment $350; personal care $75; club membership $20; pets $100; sports, hobbies $100; subscriptions $100; doctors, dentists $150; other health care $105; cellphones, internet $165; TFSAs $1,000. Total: $6,670. Surplus goes to savings.

Liabilities: Line of credit for rental $200,000

Ian Calvert is a Vice President & Principal at HighView Financial Group.