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After years of saving, couple on the verge of retirement prepare for the spending phase

DIANNE MALEY
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As they approach full retirement, Jill and George are well fixed thanks to George's long career as a self-employed consultant.

"I have been self-employed for almost 20 years but work in my field appears to be drying up," George writes in an e-mail. His income has dropped to about $30,000 a year.

Recently, George took a part-time job paying $32,000 a year. Jill is drawing a salary of $20,000 a year from George's corporation. Both are 61 and have two children in their 20s, the younger of whom is in his final year of university. Neither has a company pension.

George and Jill are confident they can live comfortably on their investments and government benefits to the age of 95, he writes. Their retirement spending target decreases over time, starting with $100,000 a year from the age of 62 to 75, falling to $90,000 a year to age 85 and to $70,000 a year thereafter.

"My question is, what is the most tax-efficient way to fund our desired cash flow?" George writes. "Should we use the non-registered savings and delay taking Canada Pension Plan benefits? Should we start withdrawing RRSP funds at age 62 or hold off until 71?"

Jill and George want to draw on their hard-earned savings in the most tax-efficient way possible.

We asked Ian Calvert, a financial planner and portfolio manager at HighView Financial Group in Toronto, to look at Jill and George's situation.

WHAT THE EXPERT SAYS

George and Jill have done a great job positioning themselves for retirement, Mr. Calvert says. They have no debt and total assets of about $3-million, of which of $1.2-million is the value of their Toronto-area residence.

"George is not overly worried about the longevity of his assets but is very concerned about tax efficiency during their decumulation (or spending) phase," the planner says. "People who spend their whole lives working and saving can find it challenging to switch to the spending phase of life."

To start, George and Jill need a comprehensive financial plan detailing their future cash flow, Mr. Calvert says. Mapping out their future expenses will help them understand how much they will have to withdraw from their portfolio over time. "They can and should be spending confidently." For their financial plan to be effective over the long run, the couple should revisit it at least once a year to ensure they are still on track and to account for any changes, the planner says.

Their decumulation tax planning will take effect the first year neither has any salary, Mr. Calvert says. "They need to stop earning employment income before they consider taking taxable income from their portfolio. Essentially, they need to be in full retirement with no part-time income."

The first step is to have a solid estimate of the income generated by their non-registered investments, he says. They have $1.1-million of non-registered savings, of which they are keeping $100,000 in cash to cover one year's expenses. Assuming a yield of 3 per cent, they are generating and reporting about $30,000 of investment income annually, the planner says. Their combined Canada Pension Plan and Old Age Security benefits will be about $18,700 a year and $16,800 a year, respectively, bringing George and Jill's combined income to about $65,500.

Because this level of taxable income is still quite low, they should consider adding some taxable withdrawals from their registered retirement savings plans, which they should convert to registered retirement income funds (RRIFs) before making the withdrawals, Mr. Calvert says. They should aim for taxable income of $49,020 each to bring them to the top of the 24.15 per cent combined federal and provincial tax bracket.

"To accomplish this, they should aim for total combined RRIF withdrawals of $32,500 – plus a withdrawal of $41,500 from their non-registered portfolio, $30,000 of which will be the investment income," the planner says. This, combined with their CPP and OAS benefits, would allow them to fund $100,000 of lifestyle expenses and $9,500 of income taxes, he notes.

"This would not only be a favourable rate of tax, but they would not need to worry about losing their Old Age Security benefit." OAS benefits are clawed back gradually, starting at income of $79,845 each a year for 2021. He suggests they leave a buffer for any capital gains that may be triggered in their non-registered portfolio.

Another option to consider would be delaying their CPP until the age of 70. This would add 42 per cent to this guaranteed, inflation-protected source of income throughout their lifetimes, Mr. Calvert says. "Keeping their CPP off of their tax returns between age 65 and 70 would allow them to get additional funds out of their RRIF at a very low rate of tax."

George and Jill are planning to spend more in their early retirement years, Mr. Calvert says. "This is a great strategy" because they are likely to travel more and be more active during this period. "Without a proper financial plan, George and Jill could be too conservative during this stage," he adds. "The hard stop into retirement and the loss of employment income can make people afraid of depleting their assets too early."

George and Jill are heading into retirement with a portfolio of 100 per cent equities and an emergency fund of cash. In this low-rate environment, they are opting for blue-chip stocks with dividend yields between 3 per cent and 4 per cent, rather than holding any fixed-income securities. "Holding equities with a strong and growing dividend is certainly a good strategy, especially heading into retirement where the income will be used to pay for lifestyle expenses rather than being reinvested," Mr. Calvert says.

"However, it's important to remember that fixed income investments have more than one purpose (income) when building an investment portfolio," the planner says. Bond prices tend to move in the opposite direction to stock prices, lowering the portfolio's volatility. They also offer flexibility.

"Having an uncorrelated asset class such as bonds allows investors to sell some bonds to purchase equities when – not if – they experience the next bear market," Mr. Calvert says. Investors positioned this way had the opportunity to take advantage of the stock market pullback in March and April of 2020, he says. "A portfolio of 100 per cent equities did not have the same flexibility to capitalize on the sell-off."

CLIENT SITUATION

The people: George and Jill, both 61, and their children

The problem: How to draw on their hard-earned savings in the most tax-efficient way possible.

The plan: Draw down RRSP/RRIF savings first, possibly deferring CPP benefits to age 70.

The payoff: The satisfaction of knowing they are paying the right amount of tax but no more.

Monthly net income: $6,000

Assets: Cash in bank $100,000; non-registered stocks $1-million; his TFSA $105,000; her TFSA $95,000; his RRSP $354,000; her RRSP $279,000; residence $1.2-million. Total: $3.1-million

Monthly outlays: Property tax $600; water, garbage $150; home insurance $125; electricity, heat $215; maintenance, garden $225; transportation $645; groceries $655; clothing $235; gifts, charity $150; vacation, travel $475; dining, drinks, entertainment $350; personal care $75; golf $85; pets $60; subscriptions $20; other personal $70; health care $85; phones, TV, internet $400; TFSAs $1,000. Total: $5,620

Liabilities: None

Ian Calvert is a Wealth Planner & Portfolio Manager at HighView Financial Group.