THE GLOBE AND MAIL

With $4.4-million, how should Omar and Tanya withdraw funds in retirement to pay less tax?

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Special to The Globe and Mail

Published Friday, July 25, 2025

Omar and Tanya are both 56 years old with two children in their 20s and a mortgage-free house in the Niagara region of Ontario. Omar earns $160,000 a year in finance while Tanya has retired.

"We are interested in knowing if I can retire in the next couple of years and also help one of our children with the purchase of a house," Omar writes in an e-mail. They have already helped the other child financially.

Tanya has no work pension but she does have substantial savings in her RRSP and locked-in retirement account, or LIRA. Omar has a defined benefit pension that he will not draw until he is 65 because the penalty for taking it early is steep. He also has substantial savings.

The more you earn, the higher your retirement savings rate needs to be

"Retirement before 65 will mean using our own savings" in the early years, Omar writes. "We are interested in knowing which accounts to tap first, registered or non-registered."

So their question is not whether they can afford for Omar to retire in a couple of years; they certainly can. It is whether they can afford for Omar to retire early, give one of their children $250,000 for a down payment and still maintain after-tax spending of $100,000 a year, adjusted for inflation, for the duration of their lives.

We asked Ian Calvert, a certified financial planner and principal at HighView Financial Group, to look at Omar and Tanya's situation.

WHAT THE EXPERT SAYS

Omar and Tanya have a house worth $1-million, a combined $300,000 in their tax-free savings accounts, $1,710,000 in RRSPs, $1,400,000 in a joint non-registered investment account and $30,000 in cash, for a net worth of $4,440,000, Mr. Calvert says.

Omar has a pension that will pay about $46,390 a year starting in 2034. He needs a tax-efficient withdrawal plan to bridge the gap between when he retires at 59 and when he starts drawing his work pension and government benefits at age 65.

"They have a great balance sheet with a lot of flexibility to control their desired taxable income once retirement starts," the planner says. "Having $1,400,000 in joint non-registered funds is a great accomplishment and adds a tremendous amount of flexibility."

In their mid-60s and no longer enjoying their work, what's the best way for Tyrese and Miranda to retire?

The calculations assume a 5 per cent rate of return on their investments – interest, dividends and capital gain – an inflation rate of 2.5 per cent and that Omar retires at the end of 2028.

Starting in 2029, when they are both 60, they should begin an RRSP exit strategy, Mr. Calvert says. This will be more than a decade earlier than their forced minimum withdrawals.

Once Omar stops working, his taxable income will be quite low. The only income appearing on their tax returns would be the annual investment income in their joint account. With a 3 per cent yield from interest and dividends on $1,500,000 – assuming the $1,400,000 has grown in value – they would each be reporting about $22,500 a year.

"Taxable income at this level creates an opportunity to voluntarily start their RRSP, or registered retirement income fund, withdrawals early while still maintaining a low and favourable rate of tax," Mr. Calvert says.

Omar and Tanya should aim to withdraw $30,000 each from their RRSPs, he says. This $30,000, plus the $22,500 from their non-registered portfolio, would bring their taxable income to $52,250 a year each. "This is an optimal place to be, right at the top of the lowest combined tax bracket of 19.55 per cent," the planner says.

The years from 2029 to 2034 will be their lowest taxable income years throughout all of retirement, he notes. "Taking advantage of this low tax bracket should be a top priority." Furthermore, with Tanya already retired, she could start RRSP withdrawals prior to 2029 if there was a need for additional cash flow.

Converting the RRSPs to RRIFs is advisable if they establish monthly withdrawals from the accounts because most financial institutions charge a deregistration fee on RRSP withdrawals.

[Laid off with $2.5-million in savings, should Jake and Wanda retire permanently?]

In 2029, their cash flow plan would be $60,000 from their RRSP accounts and $59,000 from their non-registered portfolio. The total income of $119,000 a year less $10,300 in taxes will provide an after-tax amount to satisfy their stated lifestyle needs of $100,000 indexed in inflation, Mr. Calvert says. They should also transfer $7,000 every year from their non-registered portfolio to each of their TFSAs.

The withdrawal demands on their non-registered portfolio will be the highest during the years of 2029 to 2034 at around $60,000 a year. "If they can earn on average 4 per cent per year, they shouldn't experience much of a decline in the portfolio's value even during their highest withdrawal years," the planner says. Then at age 65, they will have five new sources of income: two CPP benefits, two OAS benefits and Omar's pension of $3,866 per month.

Once the pension and government benefits commence, this will add about $91,000 of taxable income. "This will create two major changes in their retirement plan," Mr. Calvert says. First, they should not need any more funds from their non-registered account.

"Their RRSP/RRIFs, Omar's private pension and their combined government benefits will be enough to satisfy their cash flow needs, even with a small buffer," the planner says.

"Second, this puts them in a position to materially increase their lifestyle spending without encroaching on any capital." The downside is their tax rates will change significantly. After income splitting, their taxable income is expected to be about $115,000 a year each, he says. "At this level, they should expect a small amount of OAS claw back."

[He refinanced his mortgage to settle high-interest debts. CIBC and CMHC repaid an interest-free loan instead]

Their asset location strategy could use a readjustment, Mr. Calvert says. It would be advantageous to hold more of their Canadian stocks in their joint account, as opposed to their registered accounts. "Currently, by holding more fixed income in their non-registered account, they are reporting more interest than dividends, which is likely resulting in a higher total taxes payable."

They also have inquired about helping their younger child with the down payment on a home. "With Canada's housing affordability levels, parents helping adult children has become a common financial planning obstacle," Mr. Calvert says. "To complete this effectively, the ideal gift shouldn't disrupt the parents' retirement plan or come with a large tax bill for them."

Omar and Tanya are aiming for $250,000 for their daughter. After age 65, with the introduction of Omar's pension and their government benefits, their non-registered assets ideally won't be needed for annual cash flow, the planner says. "The removal of $250,000 shouldn't cause a disruption to their retirement plan at their current expense level."

They have two options to consider, he says. "Depending on the unrealized capital gains in their joint account, they could certainly use these funds." Taking away $250,000 is not going to jeopardize the longevity of their assets. If capital gains are an issue, they could always use the funds in their TFSAs. The following calendar year, they would have the opportunity to begin replenishing the funds over time.

<u>CLIENT SITUATION</u>

The person: Omar and Tanya, both 56, and their two children, 23 and 26

The problem: Can they afford for Omar to retire in a couple of years, give one of their children a substantial sum for a down payment and still be able to meet their retirement spending goals without ever running out of money? In what order should they draw down their savings?

The plan: In the early years, before Omar draws his pension and they start getting government benefits, they should draw substantially from their RRSPs or RRIFs. They can take the down payment money from their non-registered account.

The payoff: A roadmap to achieving all of their financial goals.

Monthly net income, all sources: $8,685.

Assets: Cash $30,000; non-registered $1,400,000; his TFSA $150,000; her TFSA $150,000; his RRSP $875,000; her RRSP $835,000; residence $1,000,000. Total: $4.4-million.

Monthly outlays: Property tax $465; water, sewer, garbage $85; home insurance $150; electricity $130; heating $115; maintenance $100; transportation $935; groceries $600; charity $50; vacation, travel $1,000; dining out $500; subscriptions $100; life insurance $175; phones, TV, internet $335; RRSPs $1,500; TFSAs $1,250; pension plan contributions $300. Total: $7,790.

Liabilities: None.

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