PERSONAL Newsletter

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What Happens When Your RRSP Matures?

A registered retirement savings plan ("RRSP") must mature at the end of the year in which an annuitant turns 71. At this point, the annuitant must start to receive payments out of the plan. Unless the annuitant wants to collapse the plan in one shot — a strategy that makes little sense because every dollar received would be taxable — they must choose what financial planners refer to as a "maturity option". There are two of these which are available to all RRSP holders:

- registered retirement income funds ("RRIFs"); and
- annuities.

Taking into account all the changes to them over the years, one way to look at RRIFs is that they can be a continuation of an RRSP, except that minimum annual payouts are required. Annuities, on the other hand, are quite different: an individual uses part or all of the RRSP to buy a stream of payments either for life or over a fixed term.

Registered Retirement Income Funds

An RRIF provides a means of deferring taxes by allowing individuals to roll their RRSPs into another deferred income plan. Typically, this provides a continuing deferral when the taxpayer reaches age 71 and must convert an RRSP into some form of income stream.[1] A taxpayer may invest in more than one RRIF at a time, or transfer RRSP funds to an RRIF at any age up to 71, or contribute a refund of premiums from a deceased spouse's or common-law partner's RRSP (or in the case of disabled children, a parent's RRSP) to an RRIF on a tax-free basis. As well, funds can be withdrawn from an RRIF in excess of scheduled retirement payments and either taxed currently or "rolled over" to a life annuity or annuity to age 90 (either of which may provide payments for a surviving spouse or common-law partner) or, age permitting, to an RRSP.

The RRIF investment rules are essentially identical to the RRSP investment rules, so that you can

[1] Although mandatory in the year you reach 71, this conversion can be made at any earlier time.

usually simply transfer your RRSP assets to an RRIF, and your self-administered RRSP assets to a self-administered RRIF.[2]

The RRIF rules permit RRIFs to accept transfers of funds from registered pension plans as well as RRSPs. If you are over age 72, these transfer amounts are limited by a complex formula determined by the pension provider. For 2020 and later taxation years, RRIFs may also acquire a type of annuity called an "advanced life deferred annuity" ("ALDA"). This is the case if the refund is paid to reduce Part XI taxes payable by the annuitant.

While larger withdrawals may be made, an RRIF basically provides for certain minimum payments that increase over its term. The minimum payments, governed by tax regulations, are calculated by multiplying the amount of the RRIF by a given factor for a person's age, shown below:

Year	*Factor*
under 71	1/(90 - Y)[3]
71	0.0528
72	0.0540
73	0.0553
74	0.0567
75	0.0582
76	0.0598
77	0.0617
78	0.0636
79	0.0658
80	0.0682
81	0.0708
82	0.0738
83	0.0771
84	0.0808
85	0.0851
86	0.0899
87	0.0955
88	0.1021
89	0.1099
90	0.1192
91	0.1306
92	0.1449
93	0.1634
94	0.1879
95 or older	0.2000

Example

If Dagim is 72 years of age at the beginning of the current year, he must withdraw 5.4% of the amount in his plan in the year. Accordingly, if Dagim has $250,000 in his RRIF, he must withdraw at least $13,500 from his plan. This amount will be added to Dagim's taxable income and will qualify for the pension income tax credit.

If an individual dies while there are assets in their RRIF, the individual's beneficiaries will be eligible for payments.

The minimum annual withdrawal can be also based on the age of your spouse or common-law partner. Basing the withdrawal on the age of a spouse/common-law partner who is younger will lower the minimum annual payment. This option is available regardless of a spouse or common-law partner's age and, for that matter, even if your spouse/common-law partner is not designated to continue to receive payments under the RRIF after your death. Bear in mind that designating a spouse/common-law partner as a successor annuitant will generally defer "death tax" on the RRIF.

Annuities

While the traditional annuity has lost ground to RRIFs in recent years, it remains a surprisingly versatile investment. Essentially, an annuity is a con-

[2] As with an RRSP, you may open a self-administered RRIF.

[3] Y = the individual's age at the beginning of that year.

tract with a life insurance company or other financial institution whereby an annuitant uses part or all of the proceeds in their RRSP to purchase a guaranteed series of payments over a term. An annuity typically calls for monthly payments, although the frequency of the payments can be quarterly or semi-annual. Like an RRIF, if you use your RRSP proceeds to purchase an annuity, all annuity payments received will be fully taxable.

It is possible to use part or all of your RRSP proceeds to purchase an annuity which would terminate when you turn 90 (or when your spouse/common-law partner reaches 90, if your spouse/common-law partner is younger). However, the most popular type of annuity as an RRSP maturity option is a life annuity—an annuity that provides for payments for the rest of your life. The obvious attraction is that it assures an annuitant of an income stream as long as they live. This is particularly advantageous in the case where the individual lives beyond the age under which RRIF funds would have been exhausted.

The return received on an annuity is based on the following factors:

- Life expectancy;
- The issuer's administration and other costs; and
- Long term interest rates.[4]

There are some variations on the life annuity:

- Joint life annuities (payments until the death of the surviving spouse/common-law partner); and
- Guaranteed periods (guaranteed minimum payout period — typically 5, 10, or 15 years; if an annuitant dies in the meantime, their beneficiaries will receive an inheritance from the annuity).

Advanced Life Deferred Annuity

Effective January 1, 2020, an ALDA may be a qualifying annuity purchase for certain plans. An ALDA is a contract for a life annuity that must be issued by a licensed annuities provider. An ALDA is payable for as long as you live, or if it is a joint-lives annuity, for as long as you or your spouse or common-law partner lives. Contrary to annuities that must commence by the end of the year in which the RRSP, RRIF, DPSP, PRPP, or RPP annuitant or member turns 71, the commencement of an ALDA may be deferred until the end of the year in which the annuitant or member turns 85.

Up to 25% of the value of your RRSP, RRIF, DPSP, PRPP, or RPP (including ALDA payments) can be transferred tax-free into an ALDA, up to a prescribed limit of $170,000 (this amount is indexed periodically). The ALDA annuity payments made to a surviving spouse or common-law partner are taxable in the year of receipt. The ALDA lump-sum payments made to a surviving spouse or common-law partner (or a child or grandchild who was, immediately before the death, financially dependent on the deceased for support due to a mental or physical infirmity) qualify for a tax-deferred transfer to an eligible vehicle of the annuitant or member.

RRIFs or Annuities?

Although annuities were once the most popular maturity option pertaining to RRSPs, in view of the changes to the flexibility of RRIFs, only a minority choose annuities over RRIFs as a maturity option.

There are pros and cons to both RRIFs and annuities. In making the decision between an RRIF and an annuity, the following factors should be considered:

- **Guaranteed Payments.** One of the biggest advantages of an annuity is that a person

[4] Life insurance companies and other financial institutions match the return they give an annuitant with what they earn in corresponding long-term interest-bearing investments.

may buy a "life annuity" that "guarantees" payments until they die. Obviously, the protection offered by a life annuity can be important, especially if your financial resources are limited.

- **Flexibility of Investments.** As stated earlier, like RRSPs, there are a wide range of RRIF investment alternatives.
- **Inflation.** Although the guarantee of a monthly annuity payment may seem beneficial at first, the protection may not be as great as it seems. One reason is that inflation could "eat away" at the value of the annuity. In fact, when it comes to coping with inflation, an RRIF may offer better protection since you can control which investments are made.
- **Withdrawal Flexibility.** RRIFs offer the ability to withdraw assets from the plan whenever you please. While some annuities may be collapsible, there will be economic penalties built into annuities with this option.
- **Tax Considerations.** An RRIF may offer a material degree of tax deferral relative to other maturity options; assets can remain in the plan until an individual is at an advanced age. In the meantime, investment income accumulates in the plan tax-free, as is the case with an RRSP. However, ALDAs could also be a suitable choice for those looking to use RRIF funds for non-essential expenses only to defer the tax burden to a later age, assuming a further decrease in income is expected.
- **Death Tax.** If a plan holder designates someone other than a spouse/common-law partner as a beneficiary, the balance remaining in the maturity option (be it an RRIF or annuity) is usually included as taxable income in the plan holder's final income tax return. If a maturity option is chosen that maximizes deferral, this could mean there will be more value in the plan when the plan holder passes away, and therefore more tax to pay. This effect can be minimized by withdrawing greater amounts from an RRIF while the holder is still alive.