Retirement Planning: 2 Things to Understand About RRIFs

Description

An RRSP is a great vehicle for growing your investments tax-deferred until you are 71. After that, you either take the amount out as a lump sum or convert it into an RRIF.

The lump-sum approach can mean a hefty tax bill, depending on how much you have grown your RRSP. Let's say you made good investments and have grown your RRSP to a decent nest egg of about $500,000. If you take that amount out as a lump sum, it would result in a monumental tax bill.

A much better idea is to turn your RRSP into an RRIF, and let that growth continue tax-free. The only difference is that you have to take out a minimum amount from your RRIF account.

RRIF withdrawals

RRIF withdrawals are compulsory. But the amount you have to take out is based on your age. If you are 65, you have to take 4% out of your RRIF funds for the year. The withdrawal amount increases as you age. If you are 71 when your RRIF withdrawals begin, you have to take out 5.28% (as of 2015).

If you only take out the minimum amount from your RRIF, you don't have to pay any withholding tax. However, if you take out more, then you have to pay withholding taxes on the amount that exceeds the minimum, using the same calculation table that is used to calculate RRSP withdrawal tax.

RRIF investments and growth

The other limitation of the RRIF is that you can't make any new contributions to it. So when you transfer your RRSP to an RRIF, you install a one-way valve on your savings. The money can now come out, but not go in. However, the money inside your RRIF can continue to grow.

It's a good idea to invest the money in your RRIF. If you can achieve even 5% growth inside your RRIF, chances are that with taking out the minimum each year, your RRIF will last even if you live to over 100. And just to put things in perspective, with $500,000 and 5% growth, your monthly RRIF withdrawal (at minimum for that age), will be over $2,616. And that is if you start taking your RRIF payments at 65 instead of 71.

Combined with OAS and CPP amounts, you could easily be earning between $3,000 and $4,000 a month in your retirement years. And if you have a well-grown TFSA as well, then it really will be a well-funded retirement.

One dependable investment that can provide you much better returns than 5% is **National Bank of Canada** (TSX:NA). It has been living under the shadow of the big five but enjoys just as much stability and just as many growth prospects. It’s also a dividend aristocrat with nine years of consecutive payout increases. Currently, it offers a juicy yield of 4%.

But a much better number going for this bank is its growth. Its five-year compound annual growth rate is 12.36%. And if it keeps growing the same way, you might still have a little under a million left in your RRIF when you reach a 100.

Foolish takeaway

While an RRIF can pay you a decent sum, even when sticking to the minimum payouts, it’s important to understand that every dollar that comes out of an RRIF is taxable. Substantial RRIF minimum withdrawals can put you in a different tax bracket. So plan your RRSP and TFSA-based growth accordingly, and if possible, defer your OAS and CPP payouts until you are 70, so you have a substantial and fixed retirement income stream.

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