



The RRSP Trap (Part 2)

David Trahair

I'd like to start by saying thanks to all the *MoneySaver* readers who responded to "The RRSP Trap" article published in the July/August issue. I particularly appreciated Norm Abraham's confirmation of my spreadsheet for Jim Bradley to his age of 82. The questions and feedback were very informative and valuable.

I decided to add another column to the original spreadsheet that shows the excess income Jim would have to withdraw each year above what he needs. As I said in the first article in the year he turns 72 it was \$45,919. The total excess from age 70 to 82 is an astounding \$340,286—excess RRIF income Jim will have to take out and pay tax on. Even after that, he still dies at age 82 with \$878,732 in his RRIF. There's got to be a better way. (This new chart is in place in my first article for *MoneySaver* online members and in the *MoneyCharts* section for print members).

How to Avoid the RRSP Trap

Let's take a look at what Jim Bradley could do to avoid the RRSP trap. We'll start by looking at the positive things that Jim has going for him with his current strategy of maximizing his RRSP contributions. First of all, he is getting a tax refund on his RRSP contribution. In 2005 he can contribute the maximum \$16,500, resulting in a tax refund of approximately \$7,200 since

his salary in 2005 will be \$102,000 (a marginal tax rate of about 43% in Ontario).

Since he has already maximized his RRSP contributions, he can't reinvest these tax savings in an RRSP. Good news for Jim—he gets to spend it on whatever he likes. For Jim that's a European vacation each and every year. Obviously there is some value in this situation. He is saving more than enough for retirement and getting a great vacation to boot, right? Well yes, but is there perhaps a better way to do it?

We've seen the negatives of the situation—an RRSP that's so big at the end that Jim ends up having to withdraw more than he needs from his RRIF starting at age 70, clawbacks of the OAS pension and resulting huge tax bill when he (or his spouse if she lives longer) dies. As we have also discussed, he is hoping for a 5% return on his RRSP investments and may get that but there are no guarantees.

Let's look at what Jim could do differently. If he reduces his RRSP contributions to \$8,000 per year, his RRSP refund at 43% would be about \$3,500. So, instead of hand-

RETIREMENT OPTIMIZER RESULTS FOR JIM BRADLEY

Input Summary

Date this analysis was prepared	9/1/04
The age you will be this month is	44
Value of your RRSP on most recent statement	\$276,754.00
Annual RRSP contributions you plan to make from now until retirement	\$8,000.00
Age you plan to retire and stop making RRSP payments	65
Annual rate at which you expect your RRSP to grow until you retire	5.00%
Annual rate at which you expect your RRSP or RRIF to grow after you retire	4.00%
Average annual inflation rate for the remainder of your life	2.00%
Are you eligible for Old Age Security (OAS) pension at age 65?	Yes
Are you eligible for the maximum Canada Pension Plan (CPP) pension at age 65?	Yes
Amount of money from other sources in today's dollars you expect each year after you retire	\$0.00
Age at which you expect this income from other sources to stop	69
Your current total income before taxes is	\$100,000.00
Income (%) before tax in today's dollars you think you will need after you retire	50.00%
Age you think you (or your spouse) will live until	82

Results

1. At retirement your RRSP will be worth	\$1,056,780.31
2. The amount of RRIF income you will be forced to withdraw in your 72nd year that you won't need	\$13,629.92
3. The amount of OAS that will be clawed back in your 72nd year	\$0.00
4. The value of your RRIF that will be taxed on your death (or your spouse if he/she lives longer)	\$557,260.85
5. The approximate amount of income tax that will be lost on the RRIF amount in #4	\$258,624.76

Retirement Optimizer Results for Jim Bradley

DETAILED RESULTS OF YOUR RETIREMENT YEARS

RRSP YEARS

Age During Year**	RRSP Value Beginning of Year	RRSP Withdrawals	Increase in RRSP Value During Year	RRSP Value End of Year	OAS Payments*	CPP Payments*	Other Income*	Total Income	OAS Clawback*	Total Income	Required Income* Death	RRSP on Death
64	\$0	\$0	\$0	\$0			\$0	\$0		\$0	\$0	\$0
65	\$1,056,780	\$0	\$42,271	\$1,099,052	\$7,719	\$13,571	\$0	\$21,291	\$0	\$21,291	\$0	\$0
66	\$1,099,052	\$53,608	\$41,818	\$1,087,261	\$8,589	\$15,101	\$0	\$77,299	\$0	\$77,299	\$77,299	\$0
67	\$1,087,261	\$54,681	\$41,303	\$1,073,884	\$8,761	\$15,403	\$0	\$78,845	\$0	\$78,845	\$78,845	\$0
68	\$1,073,884	\$55,774	\$40,724	\$1,058,834	\$8,936	\$15,711	\$0	\$80,422	\$0	\$80,422	\$80,422	\$0
69	\$1,058,834	\$56,890	\$40,078	\$1,042,022	\$9,115	\$16,025	\$0	\$82,030	\$0	\$82,030	\$82,030	\$0

RRIF YEARS

Age During Year**	RRIF Value Beginning of Year	Minimum RRIF Withdrawals	Additional RRIF Withdrawal to meet Required Income	Increase in RRIF Value During Year	RRIF Value End of year	OAS Payments*	CPP Payments*	Other Income*	Total Income Before Add. RRIF	Total Income After Add. RRIF	OAS Clawback*	Total Income	Required Income	Excess Income
70	1,042,022	49,020	8,407	39,360	1,023,354	9,298	16,346	0	75,264	83,671	0	83,671	83,671	0
71	1,023,354	51,168	8,020	38,567	1,002,733	9,483	16,673	0	77,324	85,344	0	85,344	85,344	0
72	1,002,733	74,002	0	37,149	965,880	9,673	17,006	0	100,681	100,681	0	100,681	87,051	13,630
73	965,880	72,248	0	35,745	929,378	9,867	17,346	0	99,461	99,461	0	99,461	88,792	10,669
74	929,378	70,540	0	34,354	893,192	10,064	17,693	0	98,297	98,297	0	98,297	90,568	7,729
75	893,192	68,865	0	32,973	857,300	10,265	18,047	0	97,178	97,178	0	97,178	92,379	4,798
76	857,300	67,298	0	31,600	821,602	10,471	18,408	0	96,177	96,177	0	96,177	94,227	1,950
77	821,602	65,646	1,009	30,198	785,144	10,680	18,776	0	95,102	96,112	0	96,112	96,112	0
78	785,144	63,989	3,999	28,686	745,842	10,894	19,152	0	94,035	98,034	0	98,034	98,034	0
79	745,842	62,129	7,220	27,060	703,554	11,111	19,535	0	92,775	99,994	0	99,994	99,994	0
80	703,554	60,013	10,722	25,313	658,131	11,334	19,926	0	91,272	101,994	0	101,994	101,994	0
81	658,131	57,586	14,563	23,439	609,421	11,560	20,324	0	89,471	104,034	0	104,034	104,034	0
82	609,421	54,787	18,806	21,433	557,261	11,791	20,731	0	87,309	106,115	0	106,115	106,115	0
83	557,261	51,658	23,407	19,288	501,484	12,027	21,145	0	84,831	108,237	0	108,237	108,237	0
84	501,484	48,042	28,524	16,997	441,915	12,268	21,568	0	81,878	110,402	0	110,402	110,402	0
85	441,915	43,882	34,215	14,553	378,370	12,513	21,999	0	78,395	112,610	0	112,610	112,610	0
86	378,370	39,086	40,574	11,948	310,659	12,763	22,439	0	74,289	114,862	0	114,862	114,862	0
87	310,659	33,520	47,732	9,176	238,583	13,019	22,888	0	69,427	117,159	0	117,159	117,159	0
88	238,583	27,031	55,846	6,228	161,934	13,279	23,346	0	63,657	119,503	0	119,503	119,503	0
89	161,934	19,367	65,168	3,096	80,495	13,545	23,813	0	56,725	121,893	0	121,893	121,893	0

* Amounts adjusted for inflation

** You must convert your RRSP to a RRIF in the year you turn 69. The next year you must make your first RRIF withdrawal before December 31st.

ing over \$16,500 to his mutual fund salesperson and getting \$7,200 back from the government (a net cash outflow of \$9,300), he hands \$8,000 over and gets \$3,500 back for a net outflow of \$4,500.

Assuming he started with \$16,500 available, the reduced RRSP option would leave him with \$12,000. That's the extra \$8,500 that he didn't hand over plus the \$3,500 tax refund. With a \$16,500 RRSP contribution, all he has left is the tax refund of \$7,200. He is, therefore, left with \$4,800 more in hand than the maximum RRSP option. He can do whatever he likes with it. He could invest it in something other than an RRSP or choose to purchase something like a vacation property.

I can hear the mutual fund salespeople screaming already. But he's got an extra \$8,500 working in his RRSP for him! What about the value of compound earnings? And what about the fact that the money is growing tax-sheltered?

The result of all those "positives" is that he ends up with a huge RRSP that penalizes him because he has his finances under control and doesn't need all that money after retirement. Furthermore, he doesn't feel inclined to hand over half of what's left in his RRIF after he dies to the taxpayer.

But let's not stop there. We need to know if Jim has enough to retire on with the reduced RRSP contributions. I have punched in Jim's reduced RRSP contribution to the spreadsheet and guess what? He's fine. His RRSP will still grow to \$1,056,780 at age 65 using a 5% annual rate of return, he will always meet his required income levels and when he dies at age 82, his RRIF will still be worth \$557,261.

The RRSP Optimizer Key Variables

There are some variables relating to retirement over which you have little control: inflation, the age that you will pass to the great beyond and income tax rates to name a few. There are others, however, that you have a great deal of control over, such as the percentage of your current income that you will need after you retire.

I illustrate in my book that if you retire debt-free with self-sufficient children and are in reasonably good physical shape that percentage could be 50% or even lower. On the other hand, if you retire in debt up to your ears, lease cars and have live-at-home kids, you could need even more than you make now! The choice is not easy but it's yours to make.

There is also another variable that you control. It's whether you can or need to earn income after you "retire". Unfortunately for some, it will be a requirement—they simply won't have enough money put aside to survive. For others, it's worth giving some thought to.

What Are You Doing After Work?

No, I don't mean at five o'clock (or seven or eight if you are a workaholic), I mean after you stop working for good. What are your hobbies? You'll need to do something to keep

yourself busy and that something you definitely have control over. It can also have a huge impact on how much money you'll need.

Think about your hobby—is it a cash generator, a cash drainer or cash neutral? Many hobbies are cash drainers, including such things as traveling the world, becoming a wine connoisseur or perhaps collecting fine art. There is absolutely nothing wrong with those hobbies, they'll just cost you more. Cash neutral (more or less) hobbies could include gardening (which is torture for me!), woodworking, automobile restoration, volunteering on non-profit boards etc.

Cash-generating hobbies could include consulting in your area of expertise, lecturing, perhaps writing or handyman activities. Personally sitting around the house all day would drive me nuts. I love dealing with money issues and hope to continue writing about it and helping clients and friends handle their money even after I stop working. That will be a source of funds for me. What about you?

Let's go back to Jim Bradley and plug in some numbers to see what happens. We'll assume that Jim feels he'll be able to earn \$5,000 per year (in today's dollars) from age 66 to 69. That will reduce the amount he will need to withdraw from his RRSP during those years before he has to convert his RRSP to a RRIF. Let's say because of this he figures he can afford to reduce his RRSP contributions from \$8,000 to \$5,000 per year. The results?

His RRSP will be worth \$949,623 at age 65, he will always meet his required income estimate and his RRIF will still be worth \$440,826 when he dies at age 82.

How to Optimize Your Own RRSP

Jim Bradley's case showed us that if we get our finances under control, we may not need to maximize our RRSP contributions. Your case probably won't be like Jim Bradley since you and your family are unique and your situation will change sooner or later.

Good news. The spreadsheet that I used for Jim Bradley will soon be available to everyone. The program will calculate all your numbers each year from age 55 to 95.

Drop me a line about your own experiences. I'd love to hear from more of you like B.H. who has "been there, done that"!

David Trahair, CA, Author of "Smoke and Mirrors: Financial Myths That Will Ruin Your Retirement Dreams", 15 Coldwater Road, Suite 101, Toronto, Ontario, M3B 1Y8, (416) 385-3804 ext 228, david@MyWebCA.com.

Retirement Optimizer Results for:

Jim Bradley

INPUT SUMMARY

Date this analysis was prepared:	01/09/2004
The age you will be this month is:	44
Value of your RRSP on most recent statement:	\$276,754.00
Annual RRSP contributions you plan to make from now until retirement:	\$8,000.00
Age you plan to retire and stop making RRSP payments:	65
Annual rate at which you expect your RRSP to grow until you retire:	5.00%
Annual rate at which you expect your RRSP or RRIF to grow after you retire:	4.00%
Average annual inflation rate for the remainder of your life:	2.00%
Are you eligible for Old Age Security (OAS) pension at age 65?	Yes
Are you eligible for the maximum Canada Pension Plan (CPP) pension at age 65?	Yes
Amount of money from other sources in today's dollars you expect each year after you retire	\$0.00
Age at which you expect this income from other sources to stop:	69
Your current total income before taxes is:	\$100,000.00
Income before tax in today's dollars you think you will need after you retire:	50.00%
Age you think you (or your spouse) will live until:	82

RESULTS

1 At retirement your RRSP will be worth:	\$1,056,780.31
2 The amount of RRIF income you will be forced to withdraw in your 72nd year that you won't need:	\$13,629.92
3 The amount of OAS that will be clawed back in your 72nd year:	\$0.00
4 The value of your RRIF that will be taxed on your death (or your spouse if he/she lives longer):	\$557,260.85
5 The approximate amount of income tax that will be lost on the RRIF amount in #4:	\$258,624.76
6 If you (or your spouse if he/she lives longer) live to age 94 your RRIF will still be worth:	-\$406,809.53

DETAILED RESULTS OF YOUR RETIREMENT YEARS

RRSP YEARS

Age During Year**	RRSP Value Beginning of Year	RRSP Withdrawals	Increase in RRSP Value During Year	RRSP Value End of Year	OAS Payments*	CPP Payments*	Other Income*	Total Income	OAS Clawback*	Total Income	Required Income*	RRSP on Death
55	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
56	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
57	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
58	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
59	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
60	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
61	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
62	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
63	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
64	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
65	\$1,056,780	\$0	\$42,271	\$1,099,052	\$7,719	\$13,571	\$0	\$21,291	\$0	\$21,291	\$0	\$0
66	\$1,099,052	\$53,608	\$41,818	\$1,087,261	\$8,589	\$15,101	\$0	\$77,299	\$0	\$77,299	\$77,299	\$0
67	\$1,087,261	\$54,681	\$41,303	\$1,073,884	\$8,761	\$15,403	\$0	\$78,845	\$0	\$78,845	\$78,845	\$0
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69	\$1,058,834	\$56,890	\$40,078	\$1,042,022	\$9,115	\$16,025	\$0	\$82,030	\$0	\$82,030	\$82,030	\$0

RRIF YEARS

Age During Year**	RRIF Value Beginning of Year	Minimum RRIF Withdrawals	Additional RRIF Withdrawal to meet Required Income	Increase in RRIF Value During Year	RRIF Value End of Year	OAS Payments*	CPP Payments*	Other Income*	Total Income Before Add. RRIF	Total Income After Add. RRIF	OAS Clawback*	Total Income	Required Income*	Excess Income
70	1,042,022	49,620	8,407	39,360	1,023,354	9,298	16,346	0	75,264	83,671	0	83,671	83,671	0
71	1,023,354	51,168	8,020	38,567	1,002,733	9,483	16,673	0	77,324	85,344	0	85,344	85,344	0
72	1,002,733	74,002	0	37,149	965,880	9,673	17,006	0	100,681	100,681	0	100,681	87,051	13,630
73	965,880	72,248	0	35,745	929,378	9,867	17,346	0	99,461	99,461	0	99,461	88,792	10,669
74	929,378	70,540	0	34,354	893,192	10,064	17,693	0	98,297	98,297	0	98,297	90,568	7,729
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76	857,300	67,298	0	31,600	821,602	10,471	18,408	0	96,177	96,177	0	96,177	94,227	1,950
77	821,602	65,646	1,009	30,198	785,144	10,680	18,776	0	95,102	96,112	0	96,112	96,112	0
78	785,144	63,989	3,999	28,686	745,842	10,894	19,152	0	94,035	98,034	0	98,034	98,034	0
79	745,842	62,129	7,220	27,060	703,554	11,111	19,535	0	92,775	99,994	0	99,994	99,994	0
80	703,554	60,013	10,722	25,313	658,131	11,334	19,926	0	91,272	101,994	0	101,994	101,994	0
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87	310,659	33,520	47,732	9,176	238,583	13,019	22,888	0	69,427	117,159	0	117,159	117,159	0
88	238,583	27,031	55,846	6,228	161,934	13,279	23,346	0	63,657	119,503	0	119,503	119,503	0
89	161,934	19,367	65,168	3,096	80,495	13,545	23,813	0	56,725	121,893	0	121,893	121,893	0
90	80,495	10,231	75,995	-229	-5,960	13,816	24,289	0	48,336	124,331	0	124,331	124,331	0
91	-5,960	-812	88,762	-3,756	-97,667	14,092	24,775	0	38,055	126,817	0	126,817	126,817	0
92	-97,667	-14,386	104,096	-7,495	-194,871	14,374	25,271	0	25,258	129,354	0	129,354	129,354	0
93	-194,871	-31,413	122,917	-11,455	-297,830	14,661	25,776	0	9,024	131,941	0	131,941	131,941	0
94	-297,830	-53,371	146,705	-15,647	-406,810	14,954	26,291	0	-12,125	134,579	0	134,579	134,579	0
95	-406,810	-81,362	176,562	-20,080	-522,090	15,254	26,817	0	-39,291	137,271	0	137,271	137,271	0

* Amounts adjusted for inflation

** You must convert your RRSP to a RRIF in the year you turn 69. The next year you must make your first RRIF withdrawal before December 31st. During this next year you are 69 at the beginning of the year and you turn 70 during the year.

38,775