

Retirement Years: Will they be your Golden Years?

Planning for tax efficient retirement




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Is there a different path to retirement?



The Changing Face of Retirement

- ▶ Life Expectancy of Canadians is increasing
 - ▶ Normal Retirement Age – No longer
 - ▶ Saving for Retirement does not rank
 - New data for Gen X – savings is minimal
 - ▶ Economic Factors
 - Demise of Employer sponsored Pension Plan
 - Low interest rate environment
 - Low Inflation
 - Recent changes to Personal Income taxation in Canada
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Retirement Planning Toolkit

Our toolkit is more complex than ever:

- ▶ **Canada Pension Plan Retirement Pension**
 - Early vs Late start ($-0.6\%/month$) vs ($+0.7\%/month$)
 - If collecting CPP, contribute to earn Post-retirement Benefit (PRB)
- ▶ **OAS Pension**
 - Defer starting past age 65 ($+0.6\%/month$)
 - Watch out for OAS Clawback $\sim \$74,000$




Retirement Planning Toolkit


▶ RRSP/RRIF

- Save tax today, pay tax upon withdrawal
- When is optimal time to withdraw?
- New Tax rates change incentives for contribution
- RRSP/RRIF is fully taxable upon withdrawal/death
- Convert to RRIF (age 65) for pension income splitting

▶ Spousal RRSP

- Be proactive with respect to RRSP between spouses
 - Cannot rely on pension income splitting
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Retirement Planning Toolkit

- ▶ Pension Income Splitting
 - Valuable tool to minimize tax liability for retired couples
 - ▶ In general, once the two spouses are in same MTR, may be optimal to leave one slightly higher than other
 - ▶ Can eliminate exposure to OAS clawback
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Retirement Planning Toolkit

TFSA – A Retirement Savings Tool?

- ▶ For retirees, forced withdrawal from RRIF and put monies into TFSA
 - Convert to RRIF earlier?
 - Eliminates tax risk of premature death
- ▶ Useful for low/medium income earners
- ▶ Use TFSA to fund extraordinary retirement needs (new car, weddings etc)
- ▶ Additional “bucket” to draw upon to manage “tax problem” in retirement



Retirement Planning – Don't forget the taxman

- ▶ Tax Planning in retirement must consider the exact sources of retirement income
 - Canada Pension Plan (CPP)
 - Old Age Security (OAS)
 - Registered Pension Plan (RPP)
 - Defined Benefit/Defined Contribution
 - Registered Retirement Savings Plan (RRSP)
 - Tax Free Savings Account (TFSA)
 - Non Registered accounts



Where are we now?

Traditional focus on optimizing “retirement income” sources

- Calculate tax based upon the income sources
- ▶ Need to focus on “after-tax cash flow” required each year in retirement
 - Plan to utilize tools that are not taxable
 - Look at the full income tax calculation
 - What is the right average tax rate to use?



Where are we now?

- ▶ Much emphasis on increased life expectancy
 - Living longer does not mean living better
 - How will expenses change in extra 5-10 years?
 - If spouse dies, how does cost of living change for survivor?
 - Sale of Principal residence?
 - Attendant care
 - Retirement community
 - Long term care



The next step....

Planning for After-tax Cash Flow

- More detailed analysis of cash flow needs in retirement
- Need to plan in 5 – 10 year segments
- Retirement can span 1/3 of one's life
- Clients can face very different spending needs
- Plan for large expenditures (cars, vacation)
- Very different tax positions
- Focus on spending first, income sources second



Mention the words...Income Tax



Planning for after-tax cash flow

- ▶ Step 1: How much cash does the client project to SPEND annually?
 - Spending vs Income replacement approach
 - More specific to client's retirement goals
 - Identify nature of expenses



Planning for after-tax cash flow

- ▶ Step 2: Identify optimal sources of income and/or cash withdrawals from “after-tax” sources that will fund that spending
 - Outline where cash available for spending will come from
 - Not always from an source that is taxable



Planning for after-tax cash flow

- ▶ Step 3: Based upon results from step 2, Project the required taxable income for retiree/retired couple
- ▶ Not all sources of cash will be taxable
- ▶ Use after-tax resources to optimize tax position



Planning for after-tax cash flow

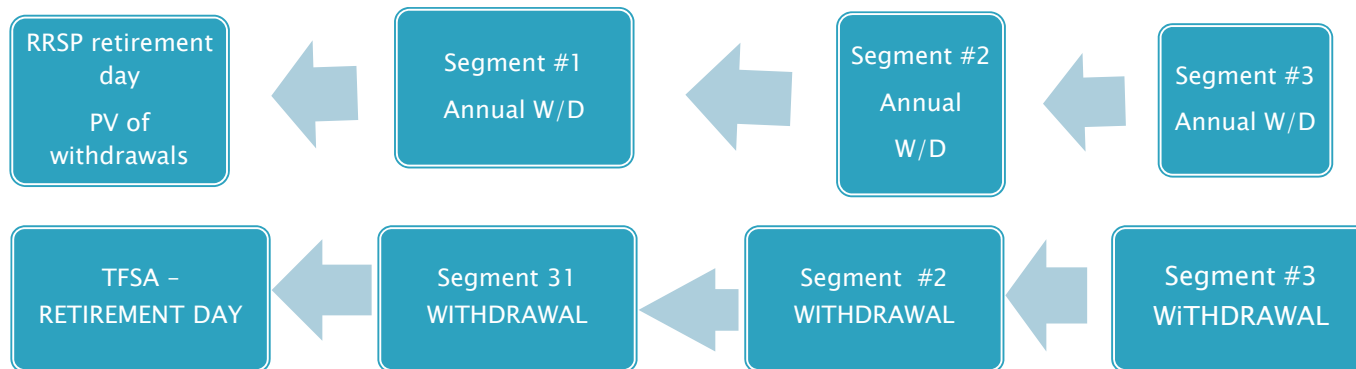
▶ Step 4: Tax Optimization

- Avoid OAS clawback
- Type of investment income will change
- Eligibility for Non-refundable tax credits (NRFTC)
- In different stages of retirement, independence and health of taxpayer will lead to changes their NRFTC




Planning for after-tax cash flow

- ▶ Step 5 : Quantify the total amount required for each retirement income source on retirement day



Planning for after-tax cash flow

- ▶ Detailed process for each retirement planning segment (5 to 10 years)
 - ▶ Plan the amounts required from each retirement income bucket (RRSP, TFSA)
 - ▶ Can track the risks to which one is exposed
 - ▶ Will ensure that there is enough in TFSA and non-registered sources
 - Fund big purchases
 - After-tax cash flow to supplement annual income
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Planning for after tax cash flow

- ▶ Client needs to spend \$75,000 per year in retirement.
- ▶ Income approach would suggest that client needs income of \$100,000

- ▶ After – tax cash flow approach
 - Avoids OAS clawback
 - Detailed planning for RRSP drawdown
 - Preserves some of the Age tax credit
 - Slightly lower threshold for medical expenses



Planning for after-tax cash flow

- ▶ Ensures that client is not “shocked” by tax problems
- ▶ Motivation to use different retirement savings vehicles today
 - Clients may be adverse to using TFSA/non-registered savings tools as no deduction
- ▶ Gives client diversity
- ▶ not all eggs in one basket




Pitfalls with income planning approach


- ▶ Tax rate – be sure it is right?
- ▶ Not all income is taxed equally
- ▶ Last year's tax position may NOT be an indicator of this year
- ▶ Non-refundable tax credits
 - Powerful tax reduction tool in retirement



Tax rate in retirement planning

- ▶ Retirement planning = Average tax rate (ATR)
 - ▶ Traditionally, we would use ATR based upon projected taxable income
 - Income replacement ratio
 - Calculate before-tax income based on spending
 - ▶ Without consideration to entire tax calculation, this ATR could be grossly misstated
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Tax Rate – Pitfall with income approach


- ▶ Kris is planning for her retirement. She is age 63 and looks forward to officially retiring in 2 years. Kris is eligible for DTC and has been on LTD for last two years. She is LTD benefits (2/3 salary tax free) and CPP disability benefits currently . Her DBPP benefits will be slightly less than LTD.
 - ▶ Concern: Will she have enough to fund her current spending levels?
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Tax Rate – Pitfall with income approach

- ▶ Kris' sources of income in retirement

	Income
Registered Pension Plan (DBPP)	\$14,684
Canada Pension Plan (CPP)	10,108
Old Age Security Pension (OAS)	6,978
Net Rental Income	4,186
RRSP contribution	<u>(1,200)</u>
Net Income /Taxable Income	<u>\$34,756</u>


Tax Rate – Be sure it is right!

- ▶ At first glance, use ATR ~ 15% – 20%
 - ▶ RRSP contribution saving tax at MTR = 20%
 - ▶ Plan for tax bill of approx. \$6,000
 - Variable as net rental income fluctuates
 - ▶ Estimated \$30,000 to spend each year in retirement
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Tax Rate – Be sure it is right!

Taxable Income			\$34,756
Taxes Payable before NRFTC			\$6,968
Non-Refundable Tax Credits			
	Basic	\$11,635	
	Age	7,225	
	Pension	2,000	
	Disability	8,113	
	Medical (\$5,980 – 1,042)	<u>4,938</u>	
		<u>33,911</u>	<u>(6,782)</u>
	Donations**	425	<u>(130)</u>
	Net income tax owing		<u>56</u>
**Donations = (\$200 * 20.5%)+ (\$225 x 40.15%)			

Tax Rate – Be sure it is right!

- ▶ Income of \$35,000 but income tax is nil
 - ▶ After-tax cash flow is same as current LTD
 - ▶ Less risk with taxable income sources
 - ▶ RRSP contribution – no tax savings now but taxed later? TFSA instead?
 - ▶ Look at entire tax situation to get right ATR
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Tax Tip – Type of income matters

- ▶ In segment #2 of retirement, client may be “de-registering” their registered investments
- ▶ Amount and Composition of Taxable income will change
- ▶ Detailed tax calculations need to be completed
- ▶ Need to adjust after-tax income in each segment




Tax Tip – Type of of income matters

- ▶ Does the projected retirement income include proceeds from investment that trigger capital gains?
- ▶ Not all income is taxed equally
- ▶ Tax bill is 50% on this income



Tax Tip –Type of income matters

- ▶ Sue, a single retired teacher, has decided to defer the start of her CPP and OAS pension entitlement. In her first year of retirement, she withdrew monies from her non-registered brokerage account to bridge the gap.
 - ▶ Sue's retirement plan is based upon income of \$70,000 per year (after-tax = \$53,500)
 - ▶ Her DBPP gives her \$50,000 per year, so she sells non-reg shares with FMV of \$20,000 (ACB of \$4,000)
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Tax Tip – Type of income matters

	Cash	Taxable	Tax	After-tax cash
	(1)		(3)	(1) – (3)
DBPP	\$50,000	\$50,000	(10,500)*	\$39,500
Sale of shares (non-reg)	<u>20,000</u>	<u>8,000</u>	(2,400)*	<u>17,600</u>
	\$70,000	\$58,000		\$57,100
	After-tax cash required in plan			<u>53,500</u>
		Excess cash		3,600
<ul style="list-style-type: none"> • DBPP = [(45,000x20%) + (5,000 X 30%)] = 9,000+1,500 = 10,500 • Shares = (8,000 x 30%) = 2,400 				


Tax Tip – Type of income matters

► Implications for Sue?


- After-tax cash flow > Required cash flow
- Sold too many shares from non-reg. portfolio
- Is there another alternative?
 - Withdrawal from RRSP to fund shortfall?
 - Better to keep unrealized CG than RRSP amount
 - Tax on \$20,000 of shares < tax on \$20,000 of RRSP



Tax Tip – Type of income matters

- ▶ In his retirement plan, Jim, age 75, requires an income stream from his non-registered portfolio of \$10,000 per year. Concerned with capital preservation, low interest rates and income tax, Jim has \$250,000 invested in 4% preferred shares of a stable taxable Canadian Corporation
 - ▶ Jim receives \$10,000 in dividend income
 - ▶ Tax efficient due to Dividend tax credit
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Tax Tip – Type of income matters

- ▶ Gradually de-registering investments in retirement
 - Interest income vs dividend income (preferred shares)
 - ▶ Dividend Gross up is part of the net income for tax calculation
 - ▶ Can impact income tested benefits
 - OAS clawback
 - Age Tax Credit
 - Inefficient income splitting
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Tax Tip – Type of income matters

	Income sources	Net Income for tax
DBPP	\$40,000	\$40,000
CPP	13,000	13,000
OAS	7,000	7,000
RRIF	4,500	4,500
Dividends – TCC	<u>10,000</u>	<u>13,800</u>
	\$74,500	78,300
	OAS Threshold	<u>(74,788)</u>
	Amount subject to OAS	3,512
		<u>15%</u>
	OAS clawback	<u>527</u>

Tax Tip – Type of income matters

Dee, age 76, is in segment #2 of retirement. She draws minimum amount of income from RRIF, collects CPP (survivor amount) and full OAS. She has net capital loss carryover of \$14,000 for many years. She has medical expenses of \$2,000.

- ▶ Unrealized capital gain of \$30,000 in portfolio
- ▶ Strategy employed:
 - Realize capital gain of \$28,000



Tax Tip – Type of income matters


	Income sources	Net Income for tax	Taxable Income
CPP	13,000	13,000	
OAS	7,000	7,000	
RRIF	40,000	40,000	
Interest income	3,000	3000	
Taxable Capital gain	<u>28,000</u>	<u>14,000</u>	
Net income		77,000	\$77,000
		Less: Net capital loss forward	<u>(14,000)</u>
		Taxable Income	\$63,000

Tax Tip – Type of income matters


- ▶ No impact on taxable income
- ▶ BUT huge impact on taxes payable because NET INCOME FOR TAX increased
 - No longer eligible for any medical expense tax credit
 - OAS clawback applied
 - Age amount tax credit lost
 - Ontario Trillium Benefit reduced

Tax Tip – Type of income matters

Alternatives for Dee:

- ▶ Effort to minimize tax upon death
 - ▶ TCG could be realized in smaller annual amounts (over a few years)
 - ▶ Keep in mind – net capital loss c/f can be used against any type of income in year of death (one year prior)
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Tax position – Always Changing

- ▶ As clients transition between segments, be cognizant of the changes to their tax position
 - ▶ Sale of family home – Principal residence exemption on capital gain
 - ▶ Sale price could be after-tax proceeds
 - ▶ Huge impact on annual taxable income
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Tax position – Always Changing

- ▶ Dianne is a widow, age 80, but in good health. In 2016, her net income ~\$55,000
- ▶ In Fall 2016, she sold her family home for \$650,000. She gave a gift to her 4 children and invested remaining \$550,000 in her non-registered portfolio (low risk)
- ▶ TFSA is maxxed out
 - RRIF withdrawals

TFSA



Tax Position – Always Changing


	2016	2017
Pension Income (Incl OAS/ CPP)	55,000	58,000
Excess W/D from RRSP		20,000
Income on Proceeds of house (3.5%)		<u>19,250</u>
Net income for tax purposes		<u>97,250</u>
1) Unintended consequences – significant OAS clawback ~ \$3,335		
2) Net income enters 3 rd federal tax bracket (provincial too)		

Tax position – Always changing


- ▶ In segment #3 of retirement, dealing with new medical and caregiving issues
- ▶ Significant shift in the nature of client's expenses
 - Travel and entertainment decline
 - Vehicle costs decline
 - Caregiving/medical issues increase



Non- Refundable tax credits – Powerful tool in tax toolkit

- ▶ In segment #3 of retirement, new tools in the tax toolkit may become available
 - ▶ After-tax cost of caregiving/medical costs needs to be considered
 - ▶ Becoming the norm – need to contemplate segment #3 in retirement = caregiving costs
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Disability Tax Credit (DTC)

- Eligible when taxpayer has a severe and prolonged disability regarding the functions of daily living
 - Vision
 - Speaking
 - Hearing
 - Walking
 - Eliminating
 - Feeding
 - Dressing
 - Mental Impairment
 - Life sustaining therapy (Dialysis)
 - Once eligible for DTC, taxpayer can claim a base amount for DTC of ~ \$8200
 - Not income tested
 - Often retroactive application
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Disability tax credit (DTC)

- To claim DTC, must have relevant medical practitioner complete T2201
- Will impact the tax position of client – need to look at full tax calculation

	2018 Base Amount
Basic Personal	\$11,809
Age amount *	7,333
Pension Income	2,000
Disability	<u>8,235</u>
* Threshold is 36,976	\$29,377

Disability tax credit (DTC)

- ▶ If taxpayer does not have sufficient taxes payable, DTC may remain unused

Net Income	25,000	
	X 15%	
Federal Taxes Payable before NRTFC	4,200	
Basic Personal	11,809	
Age	7,333	
Pension	2,000	
DTC	<u>3,858</u>	(of possible \$8,235)
	25,000	x 15% = 4,200
Federal Taxes Payable	nil	

- ▶ Can transfer all of DTC to the taxpayer /taxpayer spouse's child, grandchild, parent, grandparent, brother, sister
- ▶ Demonstrate the taxpayer was dependent on that person for all or some basic necessities of life (food, shelter, clothing)

Medical Expenses – After-tax cost

- ▶ Can claim medical tax credit for wide range of medical expenses
 - Prescriptions
 - Paramedical practitioners (Chiropractor, RMT)
 - Attendant care
 - Retirement communities
 - Long Term care
- ▶ Unusual items that are often overlooked
- ▶ See IT bulletin



Medical Expense Tax Credit

Can claim NRFTC for amount of medical expenses that exceed (in total) :

The lesser of:

- ▶ 3% of net income for tax purposes


OR

- ▶ \$2,302 (2018)



- ▶ Incentive to put entire family medical expenses on lower income spouse tax return
- ▶ Impacts pension income splitting

Medical Expenses – Segment #3

- ▶ Attendant care (claimed as Medical expense)
 - If one is eligible for DTC, and paying for an attendant to assist in daily functions, can claim attendant cost as medical expense
 - Attendant care cost claimed is amount paid for attendant care (up to limit) to \$10,000
 - In this case, can claim DTC and Medical expense
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Medical Expenses – Segment #3

- ▶ Attendant care provided in retirement home
- ▶ Full time attendant outside the home
- ▶ Full time attendant inside the home
 - Can claim DTC and up to \$10,000 of actual expenses paid
 - Or can claim medical expenses on own (No DTC)

Attendant Care – Retirement home?


Resident #: 00032602

Residence: The Beechwood (9003)


Total paid	Total for 2017
Rent portion	\$11,600.00
Service expense portion	\$40,250.71
Total	\$51,850.71

Eligible Service Expenses	Allocation %	Eligible Service
Nursing Wages (Nursing Services)	35.10%	\$14,128.00
Food Wages (Meal Preparation)	30.70%	\$12,356.97
Housekeeping Wages & Benefits	8.30%	\$3,340.81
Activities Wages and Benefits	4.90%	\$1,972.28
Laundry Wages & Benefits	1.80%	\$724.51
Total Eligible Service Expenses	80.80%	\$32,522.57
Nursing Supplies	0.20%	
Activities Supplies	0.70%	
Food Supplies	17.40%	
Housekeeping Supplies	0.70%	
Laundry Supplies	0.20%	
Total Ineligible Service Expenses	19.20%	
Total Eligible and Ineligible Services	100.00%	

Medical Expenses – Attendant Care

- ▶ When considering the cost of retirement home living, want to check the rate of eligible expenses
 - ▶ This client anticipated that only “care” was included for medical expenses
 - ▶ Total fees paid: \$51,850
 - ▶ Eligible medical expenses: \$32,522
 - ▶ Tax savings of $\$30,000 \times 20\% = \$6,000$
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Medical expense – Long Term Care

- ▶ Long term care (subsidized by government)
 - ▶ Can be further subsidized for low income earners – watch income sources
 - ▶ Dividend income or increased income after sale of PR impacts income
 - ▶ Even if subsidized, taxpayer gets the invoice for full amount
- 

Medical Expenses –

Fees for full time care in Nursing Home

- Full cost of nursing home can be claimed as a medical expense
- HOWEVER, if claim as medical expense, cannot claim DTC as well
- Retiree can choose which one they will claim
- Despite fact that tax credit only applies to eligible medical expenses in excess of 3% of net income, usually advantageous to claim medical expenses
- Excess medical expenses can be claimed by supporting relative, by claiming retiree as dependent



Medical Expense – Transfer excess to supporting Child

	Taxable Income	Taxes Payable
OAS	\$6,786	
CPP	7,504	
GIS	<u>4,036</u>	
Net Income	18,326	
GIS deducted	<u>(4,036)</u>	
Taxable Income	14,290	
Taxes owing		\$2,929
Basic Personal Age amount	11,327 <u>7,023</u> <u>18,350 x 20.5%</u>	<u>(3,762)</u>
Taxes Payable		nil


Medical Expense – Transfer excess to supporting Child

Mary had the following medical expenses that year:
Mary is approved for the DTC

Long Term care	\$16,870	
Prescriptions	<u>210</u>	
	\$17,080	
Less 3% of Mary net income (3% x 18,328)	<u>(550)</u>	
Medical expenses claimed on daughter	16,530	

* Better to claim LTC (16,870 – 550) than DTC ~\$8,000

Medical Expense – Transfer excess to supporting Child

- ▶ Must be able to show that they “support” the retiree
 - Transportation to all medical appointments
 - Personal hygiene
 - All new clothing
 - Shoes
 - Additional food and snacks
 - Audio books
 - ▶ Often overlooked – not intuitive because child did not pay the medical expenses
 - ▶ Government subsidized
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Summary – Tax position changes

- ▶ Calculate the taxes payable for each retirement segment, realizing that variables will change
 - Be sure you use the right tax rate
 - Constant income retirement does not mean that ATR will be the same
 - Switch of capital from registered to non-registered
 - Eligibility for non-refundable tax credits



Why focus on After-tax cash flow?

- ▶ Calculating income required in retirement is not enough
 - Integrate after-tax cash flow to minimize tax and provide cash when needed
 - Need to identify that now so that retiree has saved in the various buckets
 - Identify sources of after-tax cash flow now and work backwards to ensure that retiree has monies in all the buckets



Will this work in practice?

Benefits	Limitations
Detailed planning ensures that client has savings in all the right retirement buckets	Need to assume spending patterns such as “retirement home” or “attendant care”
Overall tax efficiency	More detailed analysis = more work
Average tax rate is more accurate if one considers entire tax position	Clients may be hesitant to abandon traditional retirement planning tools
No tax surprises in retirement	

Impact on Retirement Planning

The shift to after-tax assets

- ▶ New high income tax rate impacts tax liability upon death (33% federal plus provincial)
- ▶ New focus is to die with assets in “after-tax” position
- ▶ Not possible for all assets so must assess if worthwhile for client
 - Real property (house /cottage)
 - Investment holdings



Thank you.....



"Now, if we stick to our financial plan,
I can retire at 55 and you at 87."