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How to Wind Up Your RRSP

The Registered Retirement Savings Plan (RRSP) continues to be one of the best savings tools for Canadians when it comes to retirement planning. If you have been making contributions but are not near retirement age, you probably haven't considered the options for when the RRSP eventually needs to be wound up. Of course, the funds in your RRSP can be accessed at any time prior to and during retirement, but we continue to support the practice of maintaining your RRSP for as long as possible for its tax-deferral benefits.

Your RRSP must be wound up in the calendar year in which you reach 71 years of age. What happens at that time?

There are currently three maturity options available, which can be used exclusively or in combination:

1. Distribute funds as income. The RRSP is closed and RRSP assets are distributed to you and included in your taxable income in the year you receive the assets. This may create a significant tax liability. In addition, any investment income earned on the after-tax value of the assets withdrawn from the RRSP in the future is also subject to tax. As such, this is likely not the most effective alternative for most investors.

2. Purchase an annuity. A lump sum amount is transferred from an RRSP to an insurance company, entering into an annuity contract. The annuity provides annual payments for the rest of your life. There are many different types of annuities, including annuities with guaranteed payout periods or those indexed to inflation.

While the benefit of this option is that an income stream is guaranteed for the remainder of the holder's life, there are also potential disadvantages. Generally, once the lump-sum payment is made to purchase the annuity, the contract cannot be reversed and access to the original capital is lost. As well, purchasing an annuity may reduce the size of your estate available for beneficiaries. Finally, the annual payments associated with an annuity may be lower if it is acquired during a period of low interest rates compared to an annuity purchased during a period of higher interest rates.

3. Transfer to a Registered Retirement Income Fund (RRIF). The RRIF acts as an extension of your RRSP because capital continues to be invested on a tax-deferred basis and assets can transfer "in kind" (as is) from the RRSP. The main difference is that an RRIF is subject to an annual minimum withdrawal requirement, which creates taxable income for the holder.

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The first withdrawal from the plan is required in the year following the year of conversion and the amount is determined by the holder’s age and the amount of assets in the plan on Dec. 31st. However, for holders with a younger spouse, the minimum withdrawal calculation may be based on the spouse’s age to lower the annual taxable payments.

Although the minimum withdrawal has no tax withheld, it is included in income and may result in tax payable. Amounts above the minimum can be withdrawn, but tax will be withheld. Finally, the full amount of the RRIF will generally be subject to tax in the terminal tax return of the holder at death, unless a spouse has been named as the plan’s beneficiary or successor annuitant, or a qualifying financially dependent child or grandchild is named as the beneficiary.* As a plan beneficiary, a spouse can transfer funds on a tax-deferred basis to an RRSP or RRIF in their own name. As a successor annuitant, the surviving spouse can continue the plan under their name.

As you near the age where the RRSP needs to be wound up, proper planning can help to ensure that the best decision is made. Many factors will impact which maturity option is most beneficial, including the income needs of you and your family, future capital requirements, current interest rates, level of inflation and size of the estate that you wish to leave for your beneficiaries.

*Note: In Quebec, a beneficiary cannot be designated in certain RRSP/RRIF contracts. The designation has to be made in the will for these types of contracts.