TAX MATTERS

Eight core strategies for creating financial security in retirement in Canada

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I'd like to make one suggestion when it comes to a New Year's resolution for 2020: Make sure your retirement planning is in order. After all, your financial well-being should be a top priority. The U.S. Consumer Financial Protection Bureau defines financial well-being as "a state of being wherein a person can fully meet current and ongoing financial obligations, can feel secure in their financial future, and is able to make choices that allow enjoyment of life." I like that.

I want to guide some thinking on this issue of financial well-being in retirement. Let's start with a review of the eight core strategies, or vehicles, for creating that financial security and enjoyment in life. You may not have the opportunity to use all these strategies, but aim to use a few of them if you can.

OLD AGE SECURITY (OAS)

It was in 1927 that government assistance for seniors first came into existence, with the Old Age Pension Act. Seniors aged 70 or older became eligible for a maximum pension of $240 a year. The benefits were "means-tested" so that only those with incomes below $365 annually could benefit. In 1952, the Old Age Security Act was passed and, today, eligible seniors aged 65 or older receive benefits that currently amount to $613.53 monthly, but these benefits are clawed back starting at an income of $79,054 and disappear entirely at $128,137. In addition to OAS, low-income seniors may be entitled to the Guaranteed Income Supplement (GIS), introduced in 1967, and currently amounting to $916.38 a month. The GIS disappears at an income of $18,600 in 2020.

CANADA PENSION PLAN (CPP)

In 1966, the CPP and Quebec Pension Plan (QPP) were introduced. Unlike the OAS, the CPP and QPP are based on your employment history and contributions to the plan by you and your employer. The maximum benefits under these pensions amount to $1,175.83 monthly. In addition to retirement pensions, the CPP and QPP provide disability, survivor, orphan and death benefits. All these benefits are indexed to the cost of living annually. Visit canada.ca and enter “CPP monthly amounts” in the search field to find the current payment amounts.

REGISTERED PENSION PLAN (RPP)

Count yourself fortunate if your employer provides a pension plan. About 37 per cent of Canadians participate in an employer pension plan (about one half of these folks are public sector employees). Make sure you participate in your employer’s plan so that you can take advantage of your employer’s contributions to the plan and accumulate as much as you can. While some RPPs are “defined benefit” plans (where the level of benefits is defined in advance), an increasing number are “defined contribution” plans (where your benefits depend on the amount of contributions and growth inside the plan over time).

REGISTERED RETIREMENT SAVINGS PLAN (RRSP)

The RRSP was introduced in 1957 and is the retirement plan that most Canadians know best. An RRSP is simply a vehicle, or basket, that can hold a wide variety of investments (stocks, bonds, exchange-traded funds, mutual funds, etc.) to help you accumulate assets for your retirement. Folks like RRSPs because contributions are deductible for tax purposes, which often gives rise to a tax refund. Any earnings inside the RRSP are tax-free, although you’ll face tax on withdrawals from the plan. The maximum contribution to an RRSP is 18 per cent of your prior year’s earned income, or $27,230 for 2020, whichever is less.

TAX-FREE SAVINGS ACCOUNT (TFSA)

TFSAs were introduced in 2009 and are a cousin to the RRSP. TFSAs are a vehicle to hold many types of investments – as with an RRSP. You won’t be entitled to a deduction for contributions to your TFSA, but you’ll enjoy the same tax-free growth inside the plan that an RRSP provides, and you won’t face tax on any withdrawals. Once you’ve made a withdrawal, you can recontribute that amount starting in the following calendar year. You’ve got to be 18 or older to have a TFSA, and you’ll be able to contribute $6,000 for 2020 (and a total of $69,500 if you were 18 in 2009 and haven’t contributed to a TFSA yet).

NON-REGISTERED INVESTMENTS

In addition to the pensions and savings plans above, you can simply accumulate investments outside of those plans in a non-registered investment account. The big difference with a non-registered account is that it’s not tax-sheltered. That is, the growth and income you earn each year will be subject to income tax. For this reason, you’d be wisest to hold your most highly taxed investments (those earning interest) inside your registered plans to the extent possible. Investments in your non-registered accounts should be more tax-efficient, which will generally mean holding all or a portion of any equity investments in your non-registered accounts.

PERMANENT LIFE INSURANCE

You can use a permanent life-insurance policy to accumulate investments for retirement. I realize that term life insurance is the cheapest type to buy, but you may be better off investing in permanent insurance to accumulate investments (called the "cash value") inside the policy. You won't face tax personally on the growth or income inside the policy. You can then make withdrawals of those savings from the policy (which will be taxable), or you can borrow against the policy's cash value to provide cash in retirement. When you die, the life insurance proceeds can repay any borrowings and the remainder goes to your named beneficiaries.

REAL ESTATE

Real estate can help to provide cash in retirement in a few ways. First, you could downsize to a less expensive home to free up some cash to invest, providing additional retirement income. Second, you could buy a rental property, or rent out part of your home, to create income. Next, you could buy a property, fix it up and flip it for a profit, creating additional cash for retirement – but beware, this idea isn't for the faint of heart or the inexperienced; it can backfire if you overpay for the property or spend too much fixing it up. Finally, you might consider using your home or a rental property to take out a reverse mortgage (where you borrow against the value of the property to provide cash in retirement) – although this is my least favourite option.

I'll have more to say about retirement planning next time.

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