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Personal Investor: Why you need to know about RRIFs before retiring

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You don’t hear a lot about registered retirement income funds and that’s probably because they don’t enter the picture until well into retirement.

Think of RRIFs as inverted registered retirement savings plans. Most of us know money flows into RRSPs during our working lives, is invested, and grows tax-free to our retirement. A RRIF is the same account but money flows out, from contributions to withdrawals.

A RRSP can be converted to a RRIF at any time, but must be done no later than the end of the calendar year that you turn 71. Once a RRIF is established, contributions cannot be made to the plan, and cannot be terminated until death.

By the time the conversion occurs your portfolio should have built up a significant amount of fixed income to provide the option of drawing from the fixed income portion and not feeling pressure to sell equities immediately if the market is in a slump.

But the most pre-planning involves a life-long tax strategy to avoid having forced RRIF withdrawals gobbled up by the Canada Revenue Agency. The year after a RRIF is established you must receive a yearly minimum payout based on the total amount in the fund and your age, or your spouse’s age. The more you withdraw, the higher the tax rate. That’s why it’s important not to contribute too much to an RRSP during your working life.

Also, if that amount hits a certain threshold you could face a claw-back in Old Age Security (OAS) benefits.

So, when withdrawing funds from a RRIF the name of the game is to keep as much as possible in the lowest tax brackets. One way to do that is by splitting income with a lower-income spouse when you turn 65. You can also contribute to a spousal RRSP during your working years and try to keep the amounts in each RRSP as even as possible.

In addition, topping up your tax free savings account (TFSA) during your working years will provide tax-free income in retirement and decrease your reliance on a RRIF.

Finally, money from the sale of a principal residence, a secured line of credit or a reverse mortgage can also provide tax-free income.

Editor's note: An earlier version of this story included incorrect information about the deadline for converting an RRSP to a RRIF. BNN Bloomberg regrets the error.