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TAX MATTERS

Tune up your RRSPs with a few helpful tweaks

Control the type of income you earn to save tax dollars

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I'm never going to retire. I might find other purposes in life one day, but that's not retirement. I think about a man whom I met in high school. He was a senior citizen who came to our school to finish his high-school diploma. "Why did you wait so long to finish?" I asked him once. "Well, if I cut classes, no one is going to call my parents," he replied.

When it comes to saving for retirement, don't wait too long to get it done. It's never too late, but time is your ally. And while you're at it, consider the registered retirement savings plan advice I provided last week. Today, let's look at three more RRSP tips to improve the outlook for your financial future.

Name the right beneficiary

If you have a spouse (if you're married or living common-law), it makes sense in most cases to name your spouse as beneficiary of your RRSP (or registered retirement income fund) because your plan assets can transfer to your spouse on a tax-deferred basis. No tax will be owing until your spouse makes withdrawals or dies and leaves the plan assets to other heirs.

It may also be possible to defer tax by naming a child or grandchild as the beneficiary of your plan. If the child is a minor, or has a mental or physical infirmity, and is financially dependent on you at the time of your death, you can leave your plan assets to that child and defer tax. How to set this up is a topic for another day.

You can also name your estate as beneficiary, which will expose your plan to probate fees in provinces that levy those taxes, but could make sense if you want to leave your plan to different beneficiaries in different proportions.

Finally, you could name a charity as beneficiary of your plan. This will provide a donation tax credit in the year of death which will offset taxes owing on the assets donated.

Create a proper withdrawal strategy

When it comes to making withdrawals from different investment accounts in retirement, have you given thought to which accounts you'll access first? You'll want to pay the least amount of tax on your income. There are lots of things to consider, such as when you choose to start collecting Canada Pension Plan and Old Age Security benefits. If you delay receipt of these amounts you'll increase your benefits, but you may need to withdraw more from your RRSP in the meantime. This can also reduce the amount in your RRSP by the end of the year you reach the age of 71 when you'll likely convert your RRSP to a RRIF. A lower amount in your RRSP at that time will mean lower required withdrawals and less taxes each year.

If you don't need all of the money you withdraw from your RRIF, consider contributing the excess to your tax-free savings account, or gift the funds to your spouse for TFSA contributions. Funds in a TFSA will earn income and grow on a tax-sheltered basis and will provide more tax-free cash flow in retirement when withdrawals are made later.

Also, remember that you can split eligible pension income with your spouse, so that up to half of RRSP and RRIF withdrawals at 65 or older can be reported on your spouse's tax return. This could reduce taxes owing on income in retirement.

Finally, it could make sense to withdraw funds from nonregistered accounts before your RRSP since you'll face tax on capital gains on the liquidation of these assets. Capital gains are taxed at half the rate of RRSP withdrawals.

Recognize underdiversification and invest for growth

Investing in mutual funds? You may think that owning a few mutual funds means diversification. But if all of the funds are, for example, Canadian equity funds, you may have a lot of overlap among those funds in your RRSP. Make sure you're diversifying by asset class, not solely by money manager or mutual fund company.

In addition, as Canadians, we typically have a home bias when it comes to investing. That is, a disproportionate part of a typical Canadian's portfolio is often invested in Canadian securities. This ignores that Canada represents just 3.5 per cent of the MSCI World Index, which means you'll be missing out on over 96 per cent of investment opportunities across the 23 developed markets if you only focus on Canada.

Finally, inflation is an issue. It's important to have long-term growth assets in your portfolio. You might reduce the weighting in stocks and other growth assets as you get closer to the year when you'll be withdrawing the funds you've accumulated, but you always need to ensure you have some growth assets in your portfolio.

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