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TAX MATTERS

## Drawing income in retirement takes proper planning for savings to last

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A number of years ago, my father-in-law retired. That change came as a shock to my mother-in-law because he was suddenly home all day. I remember her joking that she was now getting twice the husband and half the income. I'm not sure she liked that trade-off.

At that time, I helped them think through a common issue many retirees, or those close to retirement, face: how to draw income in retirement in the most tax-effective way.

### The story

Let's talk about William. He lives in Ontario, is in his mid-sixties, and is on the verge of retiring. Over the years, he saved for retirement using a few types of accounts, including a registered retirement savings plan (RRSP), a tax-free savings account (TFSA) and non-registered investment accounts.

William is concerned about making his retirement savings last. He wants to make sure he doesn't run out of money before running out of retirement. One

way to extend the life of his savings is to reduce the tax paid on withdrawals.

The key to success here is choosing the right order in which to draw from his accounts. Doing this can reduce taxes, preserve more government benefits and smooth the pace of withdrawals over time.

So you want to retire. How do you tell everyone at work?

Financial Facelift: Darren and Merella want to spend \$180,000 a year in retirement. Should they sell their properties?

### The withdrawals

Not all withdrawals are taxed the same way. Withdrawals from an RRSP, registered retirement income fund (RRIF), registered pension plan (RPP) or similar registered accounts are fully taxable.

TFSA withdrawals, on the other hand, are completely tax-free. And withdrawals from non-registered

investment accounts may be partly taxable if investments have grown, because tax applies only to realized capital gains when you sell investments.

If you own a corporation and withdraw funds, the amount is generally taxed as salary or dividends. In some cases, you can make withdrawals tax-free if the company owes you money or has a capital dividend account (CDA) balance available (the CDA is increased by the tax-free portion of realized capital gains or by life insurance proceeds after someone's death).

Withdrawing from accounts without a plan can push you into a higher tax bracket, trigger Old Age Security (OAS) clawbacks, create unexpectedly large capital gains, slow the growth of certain accounts – or all of the above. Let's solve these problems with the right approach.

Tax credit could help millions of small business employees without workplace retirement plans, report says

Estate plan for your parrot? It's not as far-feathered as you might think

## **The approach**

Back to William. He receives \$8,900 annually in OAS and expects to collect \$18,000 a year from the Canada Pension Plan, for total government benefits of \$26,900.

He'll also convert his RRSP to a RRIF by the end of the year when he turns 71. After this, he'll have to withdraw a minimum amount each year, with that required percentage increasing annually.

In his first year of RRIF withdrawals the minimum withdrawal rate will be 5.28 per cent of the RRIF value as of Jan. 1.

Assuming a projected RRIF balance of \$520,000, he'll be required to withdraw \$27,456 that year.

I'll call these amounts William's "mandatory income," meaning income he'll receive no matter what. In total, this is \$54,356 (\$26,900 in government benefits plus \$27,456 from his RRIF).

William has also taken on consulting work to keep busy and supplement his income. He expects to earn \$60,000 annually for the next few years. If he earned this personally, his total income would rise to \$114,356 (\$60,000 plus \$54,356). Because OAS clawbacks begin when net income exceeds \$93,454 (in 2026), he'll lose \$3,135 of OAS benefits.

Here's the plan: William will instead earn his consulting income through a corporation. This allows him to control his personal net income by choosing how much salary or dividends to pay himself. Ideally, he should bring his income up to – but not above – the OAS clawback threshold of \$93,454. This strategy also avoids jumping into the next federal tax bracket, where his marginal tax rate increases from 29.7 per cent to 31.5 per cent, beginning at \$94,907.

The balancing act of preparing for emergencies in retirement

## **The steps**

To determine how to draw income in retirement, consider the following steps:

Step 1: Calculate mandatory income. For William, this includes CPP, OAS and required RRIF withdrawals, totalling \$54,356.

Step 2: Determine your "tax bracket gap." This is the additional income you

can earn before triggering a higher tax bracket or benefit clawbacks. William's gap is \$39,098 (\$93,454 minus \$54,356). Check out [taxtips.ca](http://taxtips.ca) for tax brackets.

Step 3: Partition additional withdrawals. William leaves some income in his corporation to avoid higher personal taxes and OAS clawbacks, but still needs extra cash. So, he'll draw from his TFSA next, since withdrawals are tax-free, and may also use non-registered accounts, where capital gains on dispositions are taxed at lower rates.

Step 4: Plan for bigger expenses. For major costs like a vehicle, renovations or medical expenses, consider TFSA or non-registered withdrawals first. Dividends or shareholder loan repayments from a corporation may also be tax-efficient. Highly taxed RRSP or RRIF withdrawals should generally be the last resort.

*Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at [tim@ourfamilyoffice.ca](mailto:tim@ourfamilyoffice.ca)*