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Mandatory RRIF withdrawals draw fire

By Jeff Buckstein

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The possibility of seniors outliving the tax deferred savings they have amassed in their registered retirement income plans remains a material risk amid rising life expectancy and a low interest rate savings environment, says a report issued by the Toronto-based C.D. Howe Institute.

At issue are mandatory minimum annual withdrawals which begin at age 71, the age at which holders of registered retirement savings plans must terminate those plans and elect to either roll the proceeds into a RRIF or take out an annuity. The mandatory minimum amounts, which are taxable when removed from the plan, were reduced in the 2015 federal budget, but many would like to see them lowered even further.

“Government impatience for revenue should not force holders of RRIFs and similar tax deferred vehicles to deplete their nest eggs prematurely. While the 2015 budget’s changes are a step in the right direction, retirees need further changes to these rules if they are to enjoy the post-retirement security they are striving to achieve,” said the Howe Institute in its report.

Mandatory minimum RRIF withdrawal rates start at 5.28 per cent of the plan balance at age 71 (down from 7.38 per cent before this year’s federal budget). The rates increase gradually each year thereafter, using a formula that guarantees the proceeds will be fully depleted, and taxed should the plan holder live to 100.

“The essential issue here is a balancing of two different interests,” said Vern Krishna, counsel with TaxChambers LLP in Toronto.

“The RRIF essentially is the product of a long period of tax deferral provided by the tax system to taxpayers to save for their retirement through the RRSP, then convert it into a RRIF. There comes a time, however, when that deferral needs to be concluded, and the withdrawal rules essentially are intended to bring the deferral to a gradual termination.”

Susan Eng, Toronto based vice-president for advocacy with the Canadian Association of Retired Persons, agreed there is a need to tax withdrawals. But she objects to forcing people to withdraw on a rigid schedule, perhaps completely unresponsive to their actual financial needs.

“The point was that a lot of people, in order to manage their affairs, especially earlier on in their retirement, may not have the need for those dollars,” said Eng. “They would rather save and prepare for their later years when they may have higher needs. And indeed, they’re seeing that in their families, in other families and friends where they run into major medical challenges, usually in their 80s.”

Due to unforeseen economic circumstances, the withdrawal rules kick in at a time when taxpayers are earning very little on their investments. In effect, the mandatory rule serves to penalize them, said Krishna.

The Howe Institute report illustrates how low interest rates have shredded seniors’ savings. For example, the real return adjusting for inflation on what would normally be considered safe investments — a portfolio of Canadian government bonds — is now into negative territory.

“Interest rates are so low that it’s very difficult to make anything in these plans if you’re properly invested for your age,” said Clay Hudson a partner with Shibley Righton in Toronto.

The report said low yields, combined with increased longevity — a 71-year-old man and woman now have an average life expectancy of about 85 and 87, respectively — mean that a man has a 75 per cent chance of watching the real value of his tax-deferred savings decline by half over the rest of his life, while for a woman, the risk of that happening is more than 80 per cent.

“Today, with the low interest rate environment, who knows when rates are going to normalize?” said Hudson, who recalled that when savings rates were closer to historical averages, plan holders could invest and earn yields that would replace much of the money withdrawn via mandatory minimum withdrawals.

Furthermore, for people in a high tax bracket, the tax bite off the top can be quite substantial — about 50 per cent, he noted.

Krishna suggested that, in order to take into account increased longevity, the mandatory annual withdrawal period should not start until age 75 or 76. And notwithstanding the decreases in the annual withdrawal rates announced in this year’s budget, which ranged as high as 210 basis points, the government could reduce those rates by another 150 to 200 basis points, he said.

One change suggested by the Howe Institute report is withdrawal rate reviews at frequent intervals, such as every three years, to provide retirees with greater medium-term certainty.

“That sounds good in theory, and it would be difficult to argue against that,” said Krishna. “We do need some element of certainty in the entire process, and a review every three years would accommodate current and changed circumstances.”

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