

Clientel



*The central message of Clientel is that I value my clients.
I'm as close as your telephone, and available
and delighted to serve you.*

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Welcome to another edition of *Clientel*. In this issue I shall discuss:

- “RRIF RRAF” (A Closer Look at RRIFs)
- U.S. Tax Filing for Registered Accounts
- Thank You for the Referrals
- My Big Fat Greek Vacation

“RRIF RRAF” (A Closer Look at RRIFs)

This item will generally be of interest to those clients who are drawing income from their assets (i.e., retired) or are about to draw income from their assets (i.e., about to retire).

So as not to exclude my younger clients, let me start with a trivia question (the answer to which is most likely to be known by “Baby Boomers”).

Trivia Question #1

What movie (which has played in Vancouver more times than any other movie) features a character named RIFRAF?

A “modest” prize (recognition in my next newsletter) will be awarded to the first several correct respondents (although it is such an obscure question there may not be a correct respondent).

What is a RRIF?

A RRIF (registered retirement income fund) is the continuation of an RRSP (registered retirement savings plan). An RRSP is a vehicle for accumulating retirement savings. A RRIF is one of the vehicles for drawing out those savings as income.

There is no tax payable on the investment earnings within your RRSP. Once you start to draw RRIF income, that income is fully taxable. (I use the expression “fully taxable” to emphasize the point that RRIF income is 100% taxable, regardless of whether you earn interest income, dividend income or capital gains income internally within your RRIF). Each dollar that is withdrawn is treated as ordinary income ... just like pension income or employment income.

As the act of drawing income from one’s RRIF increases the tax one pays (and exacerbates items such as the OAS Clawback or the amount one will pay under income-tested programs such as BC Pharmacare), many would prefer to not draw any income from their RRIF ... and thus to not convert their RRSP into a RRIF.

However, like the Shakespearean character who wants his “pound of flesh” (whose name shall be trivia question number 2 — I expect a lot of people to get this one, so I shall just recognize

the “early respondents”), Her Majesty (which is easier to say than “The Canada Customs and Revenue Agency”) wants to collect some tax dollars.

Trivia Question #2

Which Shakespearean character wants his “pound of flesh”?

Thus, one must convert one’s RRSP to a RRIF no later than December 31 of the year of one’s 69th birthday (by the end of this year if you were born in 1934).

As there are some procedural items to review with respect to the “conversion” process, I send an “age 69” letter (or RRIF letter) each year to all clients who turn 69 that year. (My clients born in 1934 received one this year). Anyone who would like a copy of this letter is welcome to call me (or view it on the Rogers Group website — navigate to David Chalmers and click on “Conversion of RRSPs / RRIF letter”).

As the RRIF letter deals with the additional options for converting your RRSP into income (annuity and LIF), I shall not review those additional options in this newsletter.

When RRIFs were introduced, the conversion deadline was age 71 rather than age 69. Originally, the formula for the amount one had to draw from one’s RRIF caused the RRIF to be completely depleted by age 90.

In 1992, new rules were introduced with respect to the amount that one must withdraw from a RRIF (the “Minimum Income Rules”). For RRIFs already in process under the “old rules,” some transition rules were formulated whereby the RRIFs “in transition” were referred to as “qualifying RRIFs.”

As most qualifying RRIFs are now fully transitioned, I shall skip over those rules and simply state that the amount that must be withdrawn from a RRIF is as shown in the following table.

Note that “age” in this table is your age or, if you are married (according to Her Majesty’s definition) and if your partner is younger than you, the age of the younger partner. Age is further defined as age in “whole years” on January 1.

Example: You were born in September 1930. You turn 73 this year, but your age on January 1 in whole years was 72. Your partner was born in December 1931. His/her age in whole years on January 1 was 71. Thus, you use age 71 to determine the minimum amount of income you must draw (in this case, 7.38% of the January 1, 2003 RRIF balance).

Age	Minimum Percentage of RRIF That Must be Withdrawn
65	4.00
66	4.17
67	4.35
68	4.54
69	4.76
70	5.00
71	7.38
72	7.48
73	7.59
74	7.71
75	7.85
76	7.99
77	8.15
78	8.33
79	8.53
80	8.75
81	8.99
82	9.27
83	9.58
84	9.93
85	10.33
86	10.79
87	11.33
88	11.96
89	12.71
90	13.62
91	14.73
92	16.12
93	17.92
94+	20.00

The above table specifies the minimum amount you must draw. You may draw more than the minimum. When one examines this table, there are two items that bear closer examination:

1. **There is a sudden increase in income at (youngest spouse's) age 71.**
2. **The minimum income level (especially from age 71 onward) exceeds a conservative investment return.** (If you earn 4% interest in your RRIF and you must withdraw 7.38%, then your RRIF balance will diminish by about 3.38% that year.)

The rules were set (in 1992) when interest rates were considerably higher than today. In those days, one could invest conservatively in one's RRIF and (if the minimum income were withdrawn) earn interest that equaled or exceeded the withdrawal rate, thus keeping one's capital intact. Today, with 5-year interest rates at 4%, a conservatively invested RRIF will start to lose capital even at (youngest spouse's) age 66.

Investment Strategies

Most people who have RRIFs (or who are about to convert their RRSPs to RRIFs) are, by definition, retired, and thus should be conservative with their investment choices. As noted earlier, there is no "tax reward" for taking a risk with RRIF investments. No preferential treatment is given to capital gains or dividend income within a RRIF.

In most cases, I recommend that clients hold a significant portion of their RRIF in guaranteed investment certificates (GICs) or government bonds. You can hold a portion in investment funds to try to earn a higher investment return (with the attendant risk). As always, there is a balance between risk and reward, and each client's specific circumstances must be addressed to determine the most sensible investment mix.

The Structure of a RRIF

A RRIF can be placed "directly" with a financial

institution (such as Coast Capital Savings for guaranteed interest RRIFs or Canada Life for investment fund RRIFs). I often refer to these as "direct" RRIFs.

Since Rogers Group Financial became a member of the Investment Dealers Association in 2001, I have tended to use the "direct" RRIF approach for clients with a relatively small amount of capital in their RRIF.

For most clients, I recommend a "self-administered" RRIF structure. We establish with our trustee a single RRIF, in which multiple investments can be held.

The investments usually consist of a "ladder" of GICs — a GIC (or bond) maturing each calendar year, some investment funds and a money market fund. We make regular withdrawals from the investment funds to provide a portion of the RRIF income (which most clients prefer to receive monthly). The interest from the GICs is paid into the money market fund, from which monthly withdrawals are then made to pay the balance of the desired (or required) income.

There are several advantages to this (self-administered) approach:

1. As you can have many investments within one RRIF rather than many RRIFs, you receive only one RRIF payment each month (simple is usually better).
2. I (or Jana, Mihaela or Nathan) can take verbal instructions for many of the transactions within your RRIF.
3. It is easy to "re-balance" the investments in your RRIF to restore or change your asset allocation.
4. When a GIC matures in a self-administered RRIF, we can immediately re-purchase a new GIC (with a choice of a large number of carriers). By comparison, when a "direct"

RRIF matures, we may need to transfer the balance to a different direct RRIF to get the best interest rate. This causes a “time lag” with a potential loss of interest earnings.

5. If there is a terrible stock market crash, we can stop taking withdrawals from the investment funds and take all of the income from the GICs and money market fund. As long as we have a GIC maturing each year, we can use that GIC to provide the cash for the income payout. It does not matter which investment in your RRIF is used to make the income payout as long as the minimum payment is met.

Withholding Tax

If you draw the minimum income from your RRIF, there is no requirement to have tax withheld at source. If you draw more than the minimum, then tax must be withheld on the “excess amount.”

Notwithstanding this, we often arrange for tax to be withheld on RRIFs based on each client’s projected tax rate (and clawback of Old Age Security). Some clients prefer not to have tax withheld (in which case they may need to make tax installment payments). We can assist with these calculations.

Fees

There is an annual trustee fee of \$125.00 (plus GST) for a self-administered RRIF. The benefits of this approach far outweigh the fee. I also note that for most of my clients I am absorbing either all or part of the annual trustee fee for self-administered accounts (although I may need to revisit this practice at some point).

Personal and Spousal RRIFs

A personal RRSP is converted to a personal RRIF. A spousal RRSP is converted to a spousal RRIF. Many couples end up with three RRIFs (a personal RRIF for one partner, and personal and spousal RRIFs for the other).

When you withdraw funds from a spousal RRIF,

you are treated exactly the same as when you withdraw from a personal RRIF, unless you make a withdrawal that exceeds the minimum formula AND your partner has made a spousal RRSP contribution in the past three years. If both of these conditions apply, then the “excess withdrawal” (the amount which exceeds the minimum) is taxable to your spouse.

If you are over 72 and have a spousal RRIF, your partner cannot have made a spousal contribution in the past three years. (He or she cannot contribute to your RRSP after your age 69 as you have converted it to a RRIF). Thus, we should be able to remove the “spousal” label when it doesn’t matter anymore. However, we cannot “remove the label,” but there is a mechanism for combining personal and spousal RRIFs together. I am starting to do this for my clients (it makes things simpler and eliminates one trustee fee). If you have a spousal RRIF and your partner has not made a spousal RRSP contribution in the past three years, we can address this in our next meeting.

Sustaining Your RRIF Capital

A conservative investor will see their RRIF balance diminish over time (as the withdrawal rate exceeds the investment income that is earned). If we have healthy stock market returns in the future, then a more aggressive investor may do better. Ironically, as the minimum income rate gets higher as one gets older, one would need to be increasingly aggressive with advancing age to sustain one’s RRIF capital. Of course, the opposite approach is more appropriate. One should become more conservative with advancing age. As such, the RRIF rules by their very nature can compromise the security of many seniors.

At this point David climbs on his soapbox. Suffice it to say that (in my opinion) the RRIF rules are poorly conceived, with a greater emphasis on sending tax dollars to Ottawa than helping people who have saved hard to have a secure retirement income. The tax dollars are then used to provide indexed pensions to politicians so they

will not have their retirement security compromised. *David steps down from soapbox.*

Retirement Security

A fall-back position as one's RRIF capital diminishes is to convert some or all of your RRIF capital to a life annuity (if your RRIF balance depletes to a level which causes concern). You can make a tax-free transfer of your RRIF to an annuity.

While the annuity option does work well, there are a number of considerations to make before playing that (irrevocable) card. We need to look at estate planning considerations, the level of interest rates, and the relative health of each client and partner before making an annuity conversion. (Annuities that provide an income for life are priced on the principle that sick people subsidize healthy people.)

Having received income from your RRIF, you can also turn around and reinvest that income on a "non-registered basis" in order to keep a pool of capital for your long-term security. There is, of course, a "catch." If you were allowed to withdraw less from your RRIF, you could invest money inside your RRIF for your future security. If you are forced to draw more than you need from your RRIF, you have to pay tax on the all of the income you (are forced to) withdraw. We can reinvest the after-tax portion of the money you have withdrawn in a "non-registered" investment account. Of course, there is less capital in your hands (and more in Her Majesty's hands) as a result of the tax that has been paid on those large RRIF withdrawals.

When we do reinvest the excess, we then have to pay taxes each year on the investment income we earn. (With these non-registered investments, it might be more appropriate to take some modest investment risk, as we pay less tax on dividends and capital gains than on interest income).

Summary

RRIFs are the foundation of the retirement income of many of my clients. There are some complex (and not particularly fair) rules to follow. However, by strategizing carefully, structuring a RRIF effectively, making appropriate investment choices, and continually monitoring each client's capital as it relates to their specific goals, we can organize RRIFs to provide the best chance for long-term financial success.

Please don't hesitate to call me or any member of my support team if we can provide additional information.

U.S. Tax Filing for Registered Accounts

This is a reminder that you must file a special tax election form if you hold a Canadian registered account (RRSP, RRIF, LIF) and you file a U.S. tax return. Full details are on page 5 of the July 2003 issue of *The Financialist*. Contact me if you would like another copy of this article (or you can view it on our website). Please note the August 15, 2003 deadline.

Thank You for the Referrals

Thank you to those clients who have referred friends or family members to me. As those who have recently referred prospective clients to me will know, I make a charitable donation to the charity of the referrer's choice as a way of expressing my gratitude.

My Big Fat Greek Vacation

My wife Barbara and I are going to spend the month of September in Greece. (Big Fat refers to the vacation ... not to Barbara). Having not taken a holiday longer than two weeks for over

30 years, I have decided to take at least a full month each year from this point onward. There are a number of clients who have transactions that fall due in September (GIC renewals, etc). We are bringing forward many of our follow-up dates so that these can be addressed in August. I am also reviewing those files with my support team.

If you would like to chat with me in the next little while, please note that I shall be away in September (but will be reachable in an emergency situation).

My new Associate Nathan is now familiar with many client files and is available to assist you. I also have arranged for my former Associate (and now a full Advisor with the firm) Cory Hill to be available to assist during my absence.

Clientel

Thank you for reading this issue of *Clientel*. Please don't hesitate to call me (or Nathan or Mihaela, Jana, or Jeanette) if we can be of any assistance. As always, the central message of this newsletter is that my support team and I are delighted to serve you in any way we can.

This issue was a touch technical as I examined some RRIF strategies but, hopefully, was lightened somewhat by the trivia questions. Please phone or e-mail me with your responses if you can answer either (or both) of the questions.

Sincerely,

ROGERS GROUP FINANCIAL



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*David N. Chalmers is a Financial Advisor with Rogers Group Financial.
The views expressed are those of the author and not necessarily those of Rogers Group
Financial, which makes no representations as to their completeness or accuracy.*

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