



# Planning for Retirement



**Saeed & Company**  
*Chartered Accountant Professional Corporation*

## PLANNING FOR RETIREMENT

Retirement. It's a period of one's life that most people look forward to, anticipating more time to spend with family and friends, and a welcome end to the day-to-day demands of working life. Underlying the anticipation though, is often some degree of anxiety about giving up that regular paycheque. Many would-be retirees worry about whether they will have sufficient income to provide them with a comfortable lifestyle during retirement, whether inflation or unexpected expenses (especially medical expenses) will erode their savings faster than planned, and often, whether they will have amassed sufficient savings to provide for their entire retirement, or whether they will at some point "outlive their money".



No financial or retirement plan can entirely alleviate these worries or provide for every possible contingency. Nevertheless, it is possible for everyone to determine in a general way the level of income that will be needed to fund their desired retirement lifestyle, the income that will be available to them in retirement and the amount of savings that will be needed to meet their retirement goals.

### How much will I need?

Those planning for retirement are often pleasantly surprised to find that the demands on their income can actually diminish after retirement. Retirees are often free, for the first time in decades, from the need to make mortgage payments or from having to pay for their children's education. They will no longer have to put money aside for their own retirement, and also gone now are the "hidden" costs of working and commuting. Consequently, it is usually possible to maintain a pre-retirement lifestyle on a much smaller annual income.

Conventional wisdom has held that retirees will need about 70% of their pre-retirement income in retirement. However, that wisdom has given way to a more individualized approach in which those planning for retirement take the time to calculate in some detail the expenses which their retirement lifestyle will entail. Usually, a ballpark figure can be arrived at by asking the following questions.

#### ***What are my current monthly expenses?***

If you have a written household budget, the information you need should be on it. If not, a bank statement or bank book will summarize the money spent over the course of a month, and often, where it has gone. Failing all else, keep track of your expenditures over a single month by faithfully recording those expenditures in a notebook. It's definitely tedious, but a realistic understanding of just how much your lifestyle costs is critical to successful retirement planning.

#### ***Which of these expenses will be eliminated on retirement?***

If you currently have a mortgage, will that mortgage be eliminated when you downsize to a smaller home or condo on retirement? If you are still financing your children's education, how many more years will that be necessary? If you are making regular contributions to an RRSP, remember that that expenditure will disappear following retirement. Now, deduct those expenses that will be eliminated on retirement from your current monthly cost of living.

#### ***What expenses might arise for the first time in retirement?***

Do you have travel plans that you've been putting off until retirement? If so, consider what the cost of those plans will add to your monthly budget. As well, consider (as few people remember to do) any continuing costs that are currently borne by your employer. Is there a golf club or professional association membership that your employer now pays for and that you want to maintain once you are retired? Do you have costs for prescription medication or eyeglasses that are now paid, in whole or part, through a group medical plan? If so, will that plan continue to cover such costs once you are retired? If not, these costs will need to be factored in to your post-retirement budget. Alternatively, check into the feasibility and cost of private health care insurance for such expenses. Finally, add each of these costs to your projected monthly budget. Once you've worked through this process, you should have at least a rough idea of how much your monthly living costs will be in retirement. Let's move on to the next step.

## Retirement Income Calculation

$$\begin{aligned} &\text{Government source pensions} \\ &\quad \text{(OAS and CPP or QPP)} \\ &+ \\ &\text{Monthly company pension plan payments} \\ &+ \\ &\text{Monthly payments from private savings} \\ &\quad \text{(especially RRSPs)} \\ &= \\ &\text{Monthly Retirement Income} \end{aligned}$$

### Where will the money come from?

Generally, retirement income of Canadians comes from three sources: public or government pensions like the Canada Pension Plan and Old Age Security, income arising from a company pension plan into which the retiree paid during the working years, and income generated by private savings – usually in a registered retirement savings plan (RRSP).

### What will the government provide?

The two main government sources of retirement income are the Canada Pension Plan (CPP) or Quebec Pension Plan (QPP) in Quebec, and Old Age Security (OAS). Many Canadian retirees receive both, but the rules respecting eligibility and the amounts paid by each are quite different.

During their working life, virtually all Canadians will have made contributions to the CPP, and equivalent contributions will also have been made on their behalf by an employer. Those contributions create eligibility for CPP benefits, which usually commence one month after a contributor's 65th birthday, but which can be applied for and received as early as age

60, or as late as age 70 (in some circumstances). The CPP benefit is indexed to increases (but not to decreases) in the cost of living.

The amount of CPP retirement benefits that a person may receive depends on how long he or she was in the workforce (and making contributions), the amount of contributions made (the annual contribution is calculated as a fixed percentage of one's earnings), and the age at which a person decides to start collecting CPP. Since the amount of a CPP monthly retirement benefit can vary a great deal, when planning for retirement it is helpful to know just how much you can expect to receive. A Statement of Contributions lists the amount of contributions made each year during one's working life to date, together with the amount of retirement benefit the person could expect to receive based on their contributions to the Plan to date. If you haven't received a recent statement from the government, you can request one once a year. The request can be made online, through the Service Canada Web site, or at any Canada Pension Plan office.

The OAS program also provides retirement income for Canadians, but operates on a much different basis than the CPP. OAS entitlement is based on one's residence in Canada and the full monthly benefit amount is the same for every person who has met the complete eligibility requirements. Essentially, every legal resident or citizen of Canada, who has lived in Canada for at least 10 years after the age of 18 and is 65 years of age or older, may receive at least partial OAS. Someone who has lived in Canada for 40 years or more since they were 18, will qualify for the full benefit. Partial benefits are available on a pro rata basis for those whose period of Canadian residency after age 18 was less than 40 years. However, an OAS recipient whose income is more than about \$73,000 a year will have to repay some of that benefit to the federal government. Specifically, the repayment is equal to 15% of the recipient's income over \$73,000 per year. Once an OAS recipient's income exceeds about \$118,000 per year, he or she will effectively no longer be receiving OAS – meaning the repayment will be 100% of the benefit received.

### 2016 Maximum Payments

**Canada Pension Plan:**  
\$1,093/month or \$13,116/year

**Old Age Security:**  
\$570/month or \$6,840/year





## Company pension plans

At one time, it seemed that the proverbial gold watch and the company pension plan were the cornerstone of most retirement plans. However, today's workplace is very different than it was 40 or 50 years ago, and fewer than half of Canadian workers are now members of company pension plans. Therefore, while the company pension plan remains an important source of retirement income for those able to enjoy its benefits, they are now much fewer in number.

Essentially, a private pension plan operates in a similar fashion to the CPP, in that contributions are made throughout an employee's working life by either the employer alone or by both the employee and the employer. Such pension plans fall into two broad groups: the defined contribution plan and the defined benefit plan. The former provides for a specified or defined level of contributions (usually a set percentage of earnings) throughout one's working life. On retirement, the funds accumulated in the plan, through contributions and amounts generated by the investment of those contributions, is used to purchase a pension in the form of an annuity. The amount of monthly income that annuity will produce depends on the amount available to purchase the annuity, the prevailing interest rates at the time the annuity is purchased, and the terms of the annuity.

The other broad group of pension plans are the defined benefit plans. Again, the name is descriptive: a defined plan guarantees the employee a specified, defined level of benefit on retirement. Whenever the amount in the plan is insufficient to provide that benefit, it is up to the employer to make up any shortfall.

Projecting a private pension income in retirement is obviously easier for a person who is a member of a defined benefit plan, as the magic number can be calculated well in advance. On the other hand, members of defined contribution plans face a more difficult task. However, even they can estimate the amount of contributions which they and their employer will have made by the time their retirement date arrives. The unknown variables are: how much those contributions will have increased through investment over the years, and the economic conditions that will prevail at the time of retirement, when those funds are converted into retirement income. Probably the best advice in these circumstances is to be conservative, both in projections of investment returns and the estimation of the level of income the invested funds will produce when an annuity is purchased.

For members of both defined benefit and defined contribution plans, the best source of information about their plans – contribution requirements, investment returns and any other information needed to formulate retirement plans – is the human resources department of their company and the company's pension administrator.

## On your own—registered retirement savings plans

For most working Canadians, who are not members of company pension plans, the registered retirement savings plan (RRSP) is the foundation of their retirement planning.

By now, most Canadians are aware of the fact that the benefits of RRSPs are three-fold. First, a deduction from income is available for amounts contributed to the plan. Second, once inside the RRSP, contributions are invested and grow free of current tax. Finally, when amounts are eventually withdrawn from the plan by the contributor, the now-retired contributor's tax rate is usually lower than it was during his or her earning and contributing years, meaning that a permanent tax savings is achieved.

### Contribution Limit

18% of the previous year's earned income, to a specified maximum

#### Example:

2015 earned income of **\$60,000**  
Available 2016 contribution room = **\$10,800**

## How much can I contribute?

While the details of the RRSP rules can be complex, the basics are straightforward. A taxpayer who has earned income (for most Canadian taxpayers, this will be income from employment or self-employment) can contribute up to 18% of the income in the next year (known in RRSP parlance as "contribution room") and deduct that contribution from income on his or her tax return. If a taxpayer does not make a contribution, or makes less than the maximum allowable contribution, a contribution up to the amount of the unused contribution room can be made (and a deduction claimed on the individual's tax return) in any subsequent tax year. The computation is somewhat more complex for members of company pension plans, as any benefit entitlement which arises under that plan will reduce

the employee's RRSP contribution room through a mechanism known as a "pension adjustment". Once again, a company's human resources department should be the place the employee turns first for information on any pension adjustment amount.

### Maximum RRSP Contribution Amounts

2015: \$24,930

2016: \$25,370

### When you retire

No matter how long you continue to work, when you reach the age of 71 the funds in an RRSP must be converted into retirement income, with the payments from that income beginning in the following year.

There are two options available to taxpayers who must convert their RRSPs. The first is a registered retirement income fund (RRIF), and the second is an annuity. Each has its advantages and disadvantages, and the choice is a personal one.

If the RRIF option is chosen, the funds in the RRSP are transferred in their entirety to the RRIF and the existing investments may be left undisturbed. There are really only two differences between an RRIF and an RRSP. It is not possible to make any contributions to an RRIF and a certain percentage of the funds in the RRIF must be withdrawn (and taxed as income) each year. The amount of the required withdrawal is based on the age of the RRIF annuitant at the beginning of the year the withdrawal is made, and is set by law. In other words, even if you don't need the money and would prefer to leave it in the RRIF to grow, you are required to withdraw the statutory minimum each year.

### RRIF Withdrawal Example

RRIF balance:  
**\$100,000**

Age of RRIF annuitant on January 1, 2016:  
**74**

Required 2016 withdrawal:  
**\$7,710 or \$642.50 per month**

The other option open to RRSP holders is the conversion of their RRSP to an annuity. This option has several advantages. An annuity offers a level of security that an RRIF cannot provide. In essence, the issuer of the annuity guarantees a fixed payment to the annuity holder for the remainder of his or her life (or, in some annuities, for the life of the annuitant and his or her spouse). The annuity

issuer then takes on the risk that the funds available for that monthly payment may run out during the annuitant's lifetime. The issuer takes control of the investment of the funds used to purchase the annuity and any investment returns above and beyond that required to fund the annuity payments accrue to the issuer. In essence, a purchaser of an annuity gives up control of the investment of his or her savings, as well as the right to participate in any future growth of those funds through investment, in exchange for a guaranteed monthly payment. The annuity option is attractive to those who are no longer interested in making investment decisions for their savings and prefer the simplicity and security of a guaranteed monthly payment.

### Other deferred compensation plans

In addition to the above registered plans you may consider negotiating with your employer for other benefits which effectively defer the compensation you receive currently. These other deferred compensation techniques include death benefits, retiring allowances, and employee benefit plans.

### Death benefits

You may wish to negotiate a provision in your employment contract for the payment of a death benefit to your spouse or common-law partner or beneficiaries in the event of your death. (A death benefit is defined as an amount received upon or after the death of an employee in recognition of the employee's service.) The first \$10,000 of all death benefits paid by all your employer(s) can be received by your spouse or common-law partner or another beneficiary free of tax. If you do not provide for all your death benefits to be left to one spouse or common-law partner, the \$10,000 exemption must then be allocated among all recipients pro rata to the amounts they receive. If you allocate death benefits to one surviving spouse or common-law partner and other non-spouse beneficiaries, the surviving spouse or common-law partner gets first claim on the \$10,000 exemption, with the others sharing the remaining exemption (if any) pro rata. If the death benefit must be shared among two or more surviving spouses or common-law partners, whether or not there are also other beneficiaries, everyone takes a pro rata share of the \$10,000 exemption.

### Retiring allowances

A retiring allowance is an amount payable by your employer to you in recognition of long service or in respect of loss of employment. Retiring allowances are deductible to your company and are taxable

to you upon receipt. However, where the retiring allowance relates to employment that commenced before 1996, taxes on the retiring allowance may be partially deferred through contributions to a registered retirement savings plan. The permitted special RRSP contribution (which is over and above normal contributions) will be \$2,000 per year of service with the employer before 1996, plus another \$1,500 per year of service before 1989 for which there was no pension or DPSP vesting. This benefit is being gradually phased out by denying recognition to years of service after 1995 in the contribution formula.

That portion of a retiring allowance eligible for RRSP contribution will, if paid directly by the employer to your RRSP, escape the withholding of tax normally required on compensation paid by the employer. This can prevent financing problems that might otherwise arise on your contribution of the maximum allowance to your RRSP. If the employer transfers more than your contribution limits permit, of course, there can be penalty tax until the excess is withdrawn and becomes subject to tax.

If you die prior to receiving the retiring allowance, the payment made to your surviving spouse or common-law partner will be considered a death benefit, as described above.

### Deferred compensation arrangements

Many deferred compensation plans will now be subject to one set or another of special rules. The most commonly applicable rules will be the salary deferral rules. It is worth noting that certain bonus plans and sabbatical plans are specifically sanctioned by these rules. As well, certain “phantom” income

plans may continue to permit deferral opportunities. These plans typically provide for future compensation tied to movements in company stock price.

In some cases, executives (most often owner-managers) will want to stake out entitlements to remuneration when the employer’s future cash flow permits. This can normally be accomplished in part. A bonus or contract payment can be awarded to be paid at such future time as the directors consider the company’s position to permit it. This is known as a contingency. So long as the employee has no right to enforce payment at any particular time, it appears that one of the main purposes for the transaction is not to defer tax, and the company does not endeavour to deduct the compensation on a current basis, there should be no current tax to the employee. Where the agreement creates an enforceable right either now or, less clearly, on the occurrence of some specific future event, problems will arise and professional advice is essential.

### Conclusion

Planning for one’s retirement can often seem like a daunting task, requiring the combined skills of an actuary, an investment wizard, and a fortune teller. In fact, the basics of the process are well within the grasp of virtually anyone prepared to take the time to do it. In addition, as the population ages and retirement looms for more and more Canadians, there has been a huge increase in the number of information sources available to Canadians on the subject of retirement planning. The web sites of most major financial institutions offer retirement savings calculators, and in the financial planning section of most bookstores, publications specifically on retirement planning proliferate. So, there’s really no reason not to get started. After all, it’s your money – and your future!

