“Tax Effective Withdrawal Strategies For Your RRSP or RRIF”

Mark Huber
CFP, Author, Speaker, Coach, Attraction Marketer
Hello and Welcome!

For most Canadians, about the only legitimate tax shelter left of any significance is the registered retirement savings plan (RRSP), which allows you to deduct plan contributions.

Also, earnings accumulate on a tax-deferred basis. But for some investors, success in building healthy RRSPs is giving them headaches and tax headaches.

You get a tax break on contributions and earnings, but when money comes out of a tax-deferred plan it is fully taxable as regular income at your marginal rate. Even though you may have earned capital gains or dividends inside your plan, these do not attract the favorable tax treatment afforded them outside.

Having more money inside your RRSP than you require to live comfortably doesn't make sense because every dollar coming out of your RRSP is fully taxable!

Once an RRSP becomes a Registered Retirement Income Fund (RIFF) at age 71, the government mandates larger minimum withdrawals every year -- whether you need the money or not.

Beyond a certain point, RRIF withdrawals will be taxed at the top marginal rates of 45 to 48%, depending on the province [but just 39% in flat-tax Alberta.] (at time of writing)

Why has there been so little written about melting down RRSPs?

One big change that makes the strategy more attractive is the new 50% inclusion rate for capital gains, down from 67% and 75%.

That means capital gains in investments held in non-registered portfolios will draw tax at about 23% in most provinces, and then only if you decide to crystallize a profit in a given year. If you don't need the money you can defer the capital gains tax liability of a non-registered investment until you really need the cash, or at your death if you don't.

By contrast, the part of a RRIF subject to the minimum withdrawal is taxed fully as income, with the minimum withdrawal amount rising higher with age.
Apart from straight income taxes -- often at or near the top marginal rate -- there are clawbacks of Old Age Security and other government benefits to consider.

Once an RRSP reaches $700,000 and beyond it begins to be subject to claw backs of OAS benefits.

**Result:** Potentially hefty taxes for you when you withdraw money, or for your estate.

What’s left in your RRSP or registered retirement income fund (RRIF) when you pass on will eventually become taxable, the bills having to be paid by your estate or your heirs.

It’s “legitimized extortion,” is one lament I have heard. (And frankly, I agree!)

To sidestep this getting into this problem in the first place more and more Canadians have turned to a strategy called an “RRSP meltdown,” which has been around since the mid-1990s. Its main purpose is to get money out of an RRSP without being drowned in tax.

It can also be an estate planning tool, among other things.

**The strategy in detail**

In general, meltdown works like this: You borrow money to invest in capital-gains-earning securities. To pay the interest, you withdraw cash from a tax-deferred account.

That withdrawal becomes, in effect, tax-deductible, because in this example the rules allow you to deduct interest on loans used to make income-producing investments.

Your investment earnings are now in the form of capital gains, and will be taxed at a more favorable rate when you dispose of them. And by slimming your RRSP, you may also lower the odds that your heirs will face a punishing tax bill.
Speaking against the merits of RRSP’s is taboo for many advisors. So most people don’t discuss it. For wealthy seniors, however, RRSP’s can be a tax trap.

Most people buy RRSP’s because of the lure of the tax deduction. But is this a real tax deduction?

Consider the following real life examples.

A young man age 25 contributes $1000 to his RRSP and receives a $420 tax credit because he is at the 42% tax bracket. He invests at 12% and forgets about it until age 65, 40 years later. At retirement he withdraws all the money, which has now grown to over $93,000 and is taxed at 42% again. Revenue Canada gets $39,000 back on their $420 “investment” in the man’s RRSP. Revenue Canada also made 12% on their $420 “investment”, compounded over 40 years!

A 70-year old retired teacher (now widowed) collects her pension of $36,000 plus the reduced pension of her late husband’s pension of $25,000. She also collects CPP and OAS totalling $18,000. Her RRSP is worth $300,000 (a combination of her RRSP and her late husbands RRSP). Next year, at age 71, she will have to begin withdrawals of about $22,000 that will be added to her income. Her total taxable income next year will be over $100,000 and she will pay about $40,000 in taxes. This would certainly push her to the highest tax bracket and many, if not all, government entitlements would be clawed back.

A husband and wife have combined RRSP/RRIF assets of $400,000 ($200,000) each. They both collect company pensions, CPP and OAS. They are killed in a car accident. Upon settling the estates, the executor must take into income all the existing income for the year plus the entire $200,000 in the RRSP or RRIF. Each spouse’s final tax return shows income totaling $250,000.

Each estate is facing a tax bill of $120,000 for each spouse and without a large insurance policy payoff; this will reduce the size of the inheritance to the children by $240,000!

(Ask us about an estate protection strategy that would eliminate this type of situation from happening to you!)

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The total tax liability that Canadians face on RRSP/RRIF withdrawals could easily wipe out the entire federal deficit! Put another way, the government now owns about 40% of your RRSP or RRIF and it seems that from the rumbling coming from Ottawa, they may want their portion sooner, rather than later!

The Problem with RRSPs for Wealthy Canadians

1. The plan is registered with Revenue Canada so they can find you. All RRSP plan trustees are collection agents for the government.

2. Contributions are capped so many people cannot contribute what they need to live the retirement lifestyle they desire.

The RRSP/RRIF Meltdown Strategy

Here is how the strategy could work:

This idea is for those individuals with a large RRSP or RRIF and who are concerned about taxes now and in the future and want to look at alternatives to their wealth creation process.

We’ll assume an RRSP of $300,000 that is earning 8.45% in Canada annually. (This is a historical average and not a guarantee of future return.) and a 12-year time horizon.

We’ll also assume that we arrange an investment loan of $750,000 costing 6% interest annually and investing the loan proceeds to earn 8.45% annually. (This is a historical average and not a guarantee of future return.) with a 12-year time horizon.

Loan payments can be structured as “interest only” (or as amortized) but for simplicity, we have shown the “interest only” loan.

The following steps are recommended:

1. Borrow $750,000 and invest it. As the purpose of the loan was
investment, the interest on the loan is tax deductible.

2. Withdraw $45,000 from the RRSP each year. (Some tax will be withheld on the withdrawal. This will be refunded when your return is filed.)

3. Use the $45,000 from the RRSP withdrawal to pay the interest cost on the loan.

The result:

**Essentially, investors are changing the location of their invested capital. It’s gone from a place where it’s fully taxed to a place where it’s half-taxed!**

Essentially, taking advantage of capital gains being taxed on only 50% of the gain and as well, when applicable, the dividend tax credit.

The yearly RRSP withdrawals are tax free as they are offset by the interest expense deduction.

Investing outside an RRSP removes the constraints of investing inside your RRSP.

In the end of 12 years, you have a $750,000 loan outstanding that can be paid off by liquidating a portion of the portfolio built up on the borrowed funds.

What you have left is the after-tax growth of the portfolio from the original $750,000 invested.

**Tailor-made solutions are achievable for those who take the time to study this technique and apply it sensibly.**

(See the chart below for the math behind the strategy...)

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To recap:

Rationale: Transfer 100% taxable dollars from RRSP to 50% taxable (capital gains) dollars in non RRSP acct. (40% marginal tax rate)

The Canadian Way RRSP-1  Net after taxes in the 25th year = $1,303,485.22

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The UnCanadian Way RRSP-2  Net after taxes in the 25th year = $24,071.98

Open  After $750K loan repaid in year 12 AND  Net after taxes in the 25th year = $2,867,787.46

The UnCanadian Way
Summary: RRSP-2 and Open-1 in the 25th year = $2,891,859.41 OR $1,588,374.19 MORE!
( 55% BETTER) than RRSP-1 Strategy alone!

Strategy is tax neutral: Taxable RRSP withdrawals are offset by tax deductible loan interest only payments.

Note: Assuming 100% of non RRSP gains are capital gains with 50% inclusion at 40% marginal tax rate

"Interest deductibility" from "borrowing to invest" is NOT age restrictive NOR is it based on eligibility and is NOT "means tested"

Tax deductible RRSP contributions must end by age 71 - NOT SO with a "borrowing to invest" program

What are the Risks?

Borrowing to invest has inherent risks to it and is not for everyone. You must have the emotional fortitude to make a long-term investment commitment and sufficient RRSP or RRIF assets to allow for the interest costs to be funded for many years as well as address the need for current income to you if you need it.

Of course, interest rates could rise, which could affect overall performance.

The real crux in leveraged investing is making sure the money is invested prudently.

Investors should break the strategy into its two components and look carefully at each.

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First, assess your suitability for leveraging.

Then look at the wisdom of pulling money out of your RRSP early. It could make sense, especially if you are in a lower tax bracket now and anticipate that in retirement—perhaps with a company pension being paid—you will be in a higher one.

While most situations work, I found some combinations of loan size to RRSP/RRIF size that do not work, especially if income is needed from the RRSP/RRIF annually, Caution is recommended.

I trust that you enjoyed this report and that it will serve as a beacon to light your path on the journey to your financial success...!

Cheers!

Mark Huber

The choice of what to do next is now all yours to make.

**Your next step** Contact us!

For your very own **FREE Estate Creation & Preservation Investigation** contact me, Mark Huber, CFP here at:  604-207-9970

Or

Toll Free Phone: 1-888-923-9133

Email:  mhuber@HowToBeSetForLife.com
About the Author

Mark Huber  
CFP, Author, Speaker, Coach, Attraction Marketer

I am a proud Canadian living in scenic Vancouver, British Columbia, Canada.

I enjoy sharing cutting edge marketing ideas and practices with those who also share a passionate vision for creating true wealth and living their dream lives.

“It’s Your Life! Plan For It! Then Live Like You Mean It!”

My successful 28 (and counting) year career in the highly competitive financial services industry has been due in large part to the Direct Marketing and Internet Marketing skills I acquired over years of study and implementation.

This marketing knowledge made me uniquely qualified for success both in the financial services industry as well as the marketing and advertising industry...

Because no matter the industry, product or service offered - it all comes down to creating and promoting an effective and action based message.

This formula makes for increased visibility, awareness and sales...

Now, my #1 passion is (and always has been) helping people to accomplish their personal and financial goals.

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But one of my long time frustrations as a financial planner was that I felt I was only addressing one part of my clients “formula for success”...

While advising on their investments, insurance, estate and financial needs and financial plans was important and rewarding enough – I often felt limited and “impotent” because of a families lack of financial resources to really make more of a meaningful impact on their life as collectively they planned and saved for their futures and personal and financial goals in life...

The bottom line was that I had no way of showing them how bring more money into their lives!

Until now that is!

I’ve long recognized that my role is not only to partner with individuals to assist them in creating prosperity and financial peace of mind for themselves and for their family but also to work proactively to bring the most innovative planning tools, strategies, ideas, products and people to the attention of my clients on an ongoing basis.

Now, while I still can’t give individuals or families a salary increase I CAN show how to get “online” and to make money with the tools and resources and ideas that they have.

This has been a very enriching and rewarding experience!

I am now really and truly making a real and meaningful impact in the lives of many individuals today!

Furthermore, I subscribe to the ideal that when we discover something of great value it is our obligation and pleasure to share it with others....
Who wants financial freedom? Do you know what that is?

It’s the financial ability to do whatever you want, whenever you want, with whomever you want without being concerned about what it costs!

Who doesn’t want that?

What you probably don’t know is how easily and quickly you can have it.

It’s not about working for a company for 30 years, and then finding out they lay you off before you get any kind of retirement.
Times have changed – even big companies can do nothing to guarantee your financial future.

Investment advisors talk about “safe” investments, cutting back and spending less, and talking about how many years do you expect to live and planning your spending of capital based on that!

How depressing!

There is another way – and your investment counsellors will actually approve.

Why not take some time, energy and money to run an online business? Don’t worry about the “How” right now, we’ll get to that.

Then, take the profits you make from that business to pay for additional lifestyle benefits? That’s a nice conservative plan and investment advisor can approve and then you can live like you want to without running out of money.

How much money coming in each month would you need to forget about going to a job and just enjoy yourself? Do you want to travel, buy a vacation home, splurge on things you love to do? You can!

Think about an actual number. A number that if you had that coming in every month, it would make your life awesome! Especially if it didn’t take more than one or two hours per day to maintain and you could do it from a computer/laptop anywhere in the world?

Do you have your number?

Don’t read ahead if you don’t.

Stop.

Get that number in your head before you read on!

Do you have it?
OK, you can continue reading, but if not, go back and really think about this. This is important, it’s your life!

Did you know that, according to a traditional plan, if you want $5,000/month to spend, that means you need $2 Million invested at a 3.0% AFTER TAX yield to bring you $5,000/month?

Bank GICs and certificates of deposit only pay .5% (if your lucky) and that’s BEFORE TAX!

So, to have $10,000 to spend each month, that takes $4 Million.

Remember that the $2 Million or $4 Million is “after tax” money you have to invest. How close are you to that?

Here’s another plan . . .

**That can get you there yet this year.** That’s right - this year, right now. . . even if you have no investments or portfolio now. *(If you do, good for you, you have a head-start!)*

**Here’s how:**

You focus on the monthly cash flow. We can show you how to get the $5 – 10K MONTHLY cash flow in less than one year. So which do you prefer?

Investing a little time, money and effort to get you there before the end of this year, or, continuing on the grind you are on without any hope of kicking back and taking it easy – for decades?

**The Good News/Bad News**

Let me give you the bad news first. This plan involves you learning stuff you don’t know and are probably afraid of – Internet Marketing. . .

but here’s the good news . . .

with less than the effort of one year of college – and yes, that includes the partying – you can learn what you need to know to have a $5 – $10K monthly income for the rest of your life – yes, you’ll have to work and learn new things –

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but what a return!

I only wish I knew this 40 years ago . . .

but I guess it doesn’t apply since back then there were no computers and us geeks had “slide rules” on our belts along with the pocket protectors for pens . . .

(extra time with me for free for consulting if you know what a “slide rule” is and can name one of the companies that made them . . .)

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(Header: Hello from *Your Name* - Lets Talk)
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The End