‘Un-Tax’ Retirement, Use RRSP Meltdown

What is the RRSP Meltdown Strategy?

This strategy will enable you to withdraw income from your RRSP’s tax free. Typically, when you withdraw from your RRSP you are required to pay tax on the withdrawal at your marginal tax rate. With the RRSP meltdown strategy however, there will be no taxes owing.

The strategy is quite simple really, and works by first of all setting up a personal investment loan. The loan is then structured in such a way as to make the interest payments equal to the tax you would pay on your RRSP withdrawals.

Since the interest on the investment loan is tax deductible, the income tax payable on the RRSP withdrawal is canceled out. This will result in zero taxes owing on the money you withdraw from your RRSP. The investment loan could be used to purchase a segregated fund contract or perhaps guaranteed income funds which in and of themselves are also highly tax efficient.

Let’s Look at an Example:

Mr. Jones is 50 years old and is planning to retire at the age of 65. His RRSP currently holds $400,000 in GIC’s earning a rate of 3% annually. By the time he is ready for retirement his account balance will have grown to $623,187.00.

To maintain his current lifestyle Mr. Jones calculates that he will need to withdraw $50,000 a year from his RRSP after age 65. Assuming a 30% marginal tax rate, he would realize a net net income of only $35,000, and his entire RRSP savings would be depleted by the time he reached the age of 80.

But just prior to his retirement, Mr. Jones decides to borrow $400,000 to purchase a segregated fund contract. It is an interest only loan at a rate of 3.75%, which creates for him an annual loan payment of $15,000. ($400,000 x 3.75% = $15,000)

In the same year Mr. Jones withdraws $50,000 from his RRSP’s at a marginal tax rate of 30%, so his tax liability is $15,000. ($50,000 x 30% = $15,000)

However, because the $15,000 loan payment is fully tax deductible the income tax payable on his RRSP withdrawal is entirely offset resulting in $0 tax owing!

In the Meantime…

The $400,000 that Mr. Jones borrowed was used to purchase a guaranteed income fund that has been compounding annually at a rate of 6%. By his 80th birthday his RRSP balance will be zero but the guaranteed income fund will have more than doubled to $958,623.

Mr. Jones now decides to pay back the investment loan leaving him with an account balance of $558,623 but still earning 6% a year. As he begins to draw money from the account he soon realizes that he no longer needs $50,000 per year.

Because his investment is no longer in a registered account the withdrawals are considered capital gains which are taxed at 1/2 the marginal tax rate. (30% ÷ 2 = 15%) He now need only to withdraw $41,200 a year to realize the same $35,000 net income as before. ($41,200 – 15% = $35,020)

Mr. Jones will have extended his retirement lifestyle an additional 20 years and will surpass the age of 100 before his guaranteed investment fund is depleted. If Mr. Jones were to pass away before that time, the entire balance of his investment portfolio could be passed on to his beneficiaries tax free!

Conclusion:

An RRSP Meltdown Strategy can be very beneficial to those who are closing in on retirement and need to begin strategizing their RRSP withdrawals. It is a great way to convert your existing RRSP into a more tax efficient non-registered income producing portfolio tax free.

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