How Do I Get Money Out of My RRSP?

By: Joe the Investor

There is constant blather about contributing money to an RRSP to save for retirement. The lure of doing this is the tax refund that comes with making the contributions. The next most common topic is using your RRSP to buy a house with a homebuyer's plan. The amount is being taken out of the RRSP, but it either has to be repaid back to the RRSP via more contributions, or it becomes taxed each year until the homebuyer's plan is completed. The same rules apply for the lifelong learning plan.

What about strategies for withdrawing the money from your RRSP? The expectation is that RRSP money will sit there until retirement, and then at age 71, the RRSP becomes a RRIF and you are now withdrawing it at that time. Is this the only way to withdraw money from your RRSP? The answer is no.

Did you know that you can withdraw money from your RRSP at any time? Of course, this is discouraged because the money is supposed to be there until you retire and you get taxed on the withdrawal. You can also change your RRSP into a RRIF before age 71 – as early as age 55 - and withdraw more than the minimum RRIF amount at any time once a RRIF has been established.

Why would you want to withdraw RRSP money before retirement? The short answer is that life happens and plans can sometimes change. The best time to contribute money to an RRSP is when your income is highest. The best time to withdraw money is when your income is lowest.

If you are regularly a high earner and get laid off from your job, and you need income in between jobs, an RRSP withdrawal can be useful. If you want to start a business and you need startup capital, an RRSP withdrawal can be useful because start up years typically have low income. The same idea can be utilized if you are going back to school or making a career change. The big picture should be kept in mind in terms of whether the retirement plans are intact and whether RRSP withdrawals will deplete assets. In these situations, money will have to come from somewhere – why not use money in a tax efficient way?

A second group of withdrawal strategies comes just before retirement. Why? Income levels may drop between working years and retirement years. If you have compiled a lot of money in your RRSPs, and face a punishing tax bill past age 71 because your income is certain to reach high tax brackets, an RRSP withdrawal may be a good idea. The assumption is that you can engineer a low income period between working and receiving pensions – and do your RRSP withdrawals within this period. A nuance to this strategy is if you are self-employed and decide to sell or close your business and have a gap between your self-employed income years and your retirement years. Self-employed people typically do not have pensions, but anything is possible these days. Many business owners may have LIRAs from past jobs which can now be turned into LIFs, and the RRSP withdrawals can precede this eventuality.

A third nuance comes with someone who has highly variable income. Business owners can fit this bill, as well as commissioned sales people, companies who pay most of their compensation in bonuses, or professional investors and traders. In those years where your income goes into the tank, you can make RRSP withdrawals to top it up without paying high taxes. If you don't need to spend the money, it can be reinvested in a TFSA or non-registered account. This will depend on whether you have the contribution room, and what your tax situation is.

When making an RRSP withdrawal early or in these special situations, questions should be asked about whether that is the best option in terms of use of the money. If you need the money to pay bills, an RRSP withdrawal is usually a good choice. If you don't need the money, ask what you will do with it once it leaves the RRSP? Is it worthwhile making this withdrawal or will I save money on taxes but take a hit on my investment returns?

The key message is that options should be explored well before retirement age to take advantage of what opportunities may exist concerning RRSP withdrawals.