RRIFs explained: It comes after an RRSP

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The questions correctly on medical insurance forms can sometimes be hard to interpret..

Canadians are comfortable with the ins and outs of their RRSPs, but still have a lot to learn when it comes to the next step, which is converting them into a stream of cash in the year they turn 71.

We asked Drew Abbott an investment advisor from TD Waterhouse to walk through the basics of converting a Registered Retirement Savings Plan (RRSP) into a Registered Retirement Income Fund (RRIF), a source of retirement income for most Canadians.

When you retire, you have three options for your RRSP.

1. You could close it and withdraw the entire amount. This may be the right choice if there's only a few thousand dollars in it, but because those funds will be fully taxable you'll wind up paying a large percentage of what you pull out to the Canada Revenue Agency to cover a tax bill.

2. You can also use the money to buy an annuity. That's an investment that pays a monthly income, typically for the rest of your life.

3. Your third option is to convert your RRSP to a RRIF. A RRIF is the reverse of an RRSP; it allows you to pull money out, but you can't add money to it.

A RRIF is generally more popular than an annuity.

“It's typically the most advantageous option,” says Abbott. “That way, you maintain the same tax-deferred status and control over the funds. That's lost if you purchase an annuity.”

People often think they need to change over their RRSP at age 65. In fact, you have until Dec. 31 of the year they turn 71 to convert an RRSP to a RRIF.

A common misconception is that you have to sell the investments inside your RRSP when you convert to an RRIF. But any investment from stocks and bonds to GICs and cash that can held in an RRSP can also be held in a RRIF.

You can convert your RRSP to a RRIF at any age.

Canada Revenue Agency has a schedule that dictates the minimum withdrawal each year. It's a small percentage of the total value of your RRIF.

There is no maximum amount that has to be taken out; just remember that this nest egg is supposed to provide a source of income through your retirement.

"If you start age 55, you will deplete it faster," Abbott said. "The goal would be to hold off as long as you can from making withdrawals, because your investments are still sheltered from tax gains from interest, dividends and capital gains."

The income that comes from your RRIF is taxable, but, since you are retired and likelly not earning as much, the income will be taxed at a lower rate.

If your husband, or wife, is younger, you can take your minimum withdrawal based on his or her age instead of yours.

"If I'm 71 and my wife is 69 and I don't need the money. I can wait until my wife turns 71 to start the minimum withdrawals," Abbott said.

If you have to start making the withdrawals, but don't need the money, you can always put it into a Tax-Free Savings Account, Abbott said.

It's still considered taxable income, but stashing the money in a TFSA ensures that any investment gains won't be taxed again.

If you need to make a withdrawal, but you don't have the cash in your account, you can also do it in-kind, meaning that you can take out a stock or another investment, assuming it's the proper dollar amount.

The most difficult part for most people is finding the right mix of investments for their RRIF, Abbott said.

"Your portfolio would be a lot more conservative at 65 than it as at 60, and it's going to be more conservative at 71 than at 65. You're going to move towards income-oriented capital-preservation strategie, because, for most people, this is going to be the major source of retirement income," Abbott said.