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Bridging Retirement Income Gaps

What happens if you retire before you're officially "supposed" to? Whether you've decided to "hang up your boots" early or life "threw you a curveball", retiring before age 60 or 65 could leave a bit of an income gap. That's because you can't fully tap into the Canada Pension Plan (CPP) until you're at least 60, and Old Age Security (OAS) doesn't kick in until 65.

So, how do you pay the bills during those bridge years without surrendering a fortune to the taxman?

It all boils down to looking at the big picture. Instead of stressing about a single year, your goal should be to manage your taxes over your entire lifetime. Think of these "gap years" as a special transition window where you get to creatively design your own income stream.

Here's a game plan that may work for most people:

Lean on Your RRSPs First - If you don't have much employment income coming in right now, your RRSPs can be your best friend. Yes, any money you pull out of an RRSP is taxable. However, since your overall income has dropped, withdrawing the money now means you'll be taxed at a much lower rate.

There's a highly strategic reason to do this, too. If you leave your RRSP completely untouched, letting it grow into a massive nest egg by the time you turn 71, it legally has to be converted into a Registered Retirement Income Fund (RRIF). Once that happens, the government forces you to make minimum withdrawals every single year.

If your account has grown too large, those mandatory withdrawals will be massive, and they'll be heavily taxed. By proactively "melting down" your RRSP during your low-income gap years, you effectively flatten out your lifetime tax bill. You might even want to make a calculated withdrawal at the end of the year just to take full advantage of your basic personal tax exemption.

Leave Your TFSA Alone - While it might be tempting to pull money from your Tax-Free Savings Account (TFSA) because it won't trigger an immediate tax bill, try to hold off. It's usually much better to keep your TFSA intact to use as an emergency fund for sudden, unexpected expenses. Furthermore, TFSAs are fantastic vehicles for transferring wealth to your family, because they can be passed down to the next generation completely tax-free.

The Power of Patience with CPP and OAS - Just because you retired early doesn't mean you should immediately claim your government pensions. In fact, there can be significant benefits to waiting until you're 65, or even 70, to take your CPP. Delaying these benefits guarantees you a significantly higher, inflation-protected payout for the rest of your life.

Ultimately, it's all about pacing yourself and orchestrating your streams of income mindfully. While you wait for your government pensions to reach their maximum value, use your RRSPs to bridge the gap. Then, once your CPP and OAS cheques finally start rolling in, you can slow down your RRSP withdrawals—keeping your retirement comfortable and your taxes firmly in check.

Questions about retirement income planning? Contact our office!

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