FINANCIAL FACELIFT

Can physician quit hospital job without affecting retirement plans?

DIANNE MALEY
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED MAY 21, 2021

Scott and Lisa.

GLENN LOWSON/THE GLOBE AND MAIL

The long pandemic has been getting to Scott, a physician. "I've been feeling burned out with COVID-19 and am thinking of giving up my hospital responsibilities and focusing on my office practice and long-term care," Scott writes in an e-mail. If he quit the hospital job, he'd be out about $50,000 a year. "I just wonder how this will affect my plan to retire in about five years."

Scott is 52, his wife Lisa is 51. They have two children in university.

Scott's gross income – about $680,000 last year – mainly flows through his professional corporation. "Most of my investing and net worth is inside the corporation," he writes. "My wife works for me part time doing office work, and she also has another part-time contract job" that pays $12,000 a year. Scott draws $144,000 a year in salary and Lisa $38,400. In addition, the corporation pays operating expenses of $132,000 a year and distributes dividends of $120,000 a year to Scott.

Scott and Lisa's goals include travelling ($30,000 a year), renovating their basement ($75,000), spending winters down south and possibly selling their house and buying their dream home (about $1.5-million), or alternatively, staying put and buying a cottage ($500,000 to $750,000) instead. Their retirement spending goal is $120,000 a year after tax.

An unusual aspect in their financial situation is the combined $50,000-a-year gift they get each year from their respective parents, who are passing on their wealth gradually.

We asked Amit Goel, a certified financial planner, portfolio manager and head of private client investment services at Hillsdale Investment Management in Toronto, to look at Scott and Lisa's situation. Mr. Goel also holds the chartered financial analyst designation.

Couple relying heavily on savings wonder if their investments are allotted in a tax-efficient way

How can Justin and Nicole map out their financial future and set aside enough savings to serve as a pension plan?

WHAT THE EXPERT SAYS

"Scott and Lisa should be able to meet all their financial goals even if they endure some extreme market volatility along the way," Mr. Goel says. This is because their investments are forecast to grow more quickly than their withdrawal rate. Their investments are forecast to grow by 4.8 per cent pre-retirement and 3.75 per cent thereafter. Mr. Goel says he stress-tested his forecast across hundreds of possible market outcomes to account for volatility in financial markets.

The planner's forecast assumes Scott gives up the hospital work and grosses $630,000 a year, rising in line with inflation forecast to average 2 per cent a year. The forecast assumes Scott and Lisa retire in five years and live to age 95.

Scott's personal pre-retirement income is well balanced between salary and dividends from the professional corporation, the planner says. "This strategy will allow him to earn just enough income to max out his RRSP." Scott should keep maxing out Lisa's spousal registered retirement savings plan to lower their tax post-retirement, he says. "In the process, this strategy will allow them to minimize [Old Age Security] clawbacks, if any."

Scott and Lisa have an investment portfolio of $2.7-million inside the professional corporation and $1.4-million in their personal accounts, the planner notes. The investments are well-diversified, with 65 per cent equities, 15 per cent real estate investment trusts, 10 per cent fixed income and 10 per cent cash. "With annual savings and expected growth of 4.8 per cent a year, the over-all investment portfolio should grow to $5.5-million by the time they retire," he says.

Because Scott and Lisa aim to retire in five years or so and their investments have increased in value, they could reduce their current allocation to equities, the planner says.

Their investments are allocated across self-directed investing and two advisers. Given the size of their portfolio, "the couple should explore working with a dedicated investment counsellor and financial planner," Mr. Goel says. "This will allow them to cultivate a relationship focused on their risk-return profile and financial goals," he adds. "The consolidated portfolio will also allow them to negotiate a lower fee."

Thanks to the $50,000 gift from their parents, Lisa and Scott will need to withdraw only $100,000 a year pre-tax for the first 10 years of their retirement, Mr. Goel says. The gift from the parents is tax-free. The withdrawal represents less than 2 per cent of the projected financial portfolio. During the later years, the gifts from the parents will cease and be replaced by Canada Pension Plan and OAS benefits, the planner says. "Assuming the portfolio grows by 3.75 per cent in retirement, it will still outpace the withdrawals."

Their strong financial position allows them to create an inheritance pool for their children, perhaps to help them buy their first home, Mr. Goel says. "This can be done in a tax-efficient way by withdrawing more from their RRSPs and corporation," the planner says. "The ideal time period for this strategy is after retirement and before mandatory RRSP/RRIF (registered retirement income fund) withdrawals begin in the year they turn 72, he says. "They could create a $500,000 inheritance pool ($50,000 over 10 years) without impacting their retirement goals."

Their investments and low withdrawal rate give them the flexibility to defer CPP and OAS benefits until age 70, the planner says. "By doing so, they can earn 42 per cent higher CPP and 36 per cent higher OAS than if they started at age 65."

They can afford to buy their dream home for $1.5-million in 2023 after the children have finished university, Mr. Goel says. They'd get $750,000 from the sale of the current house (net of 5 per cent selling costs), take out a $500,000 mortgage (to be paid off on retirement) and take $250,000 from cash savings in their non-registered accounts.

Why the mortgage?

"Pre-retirement, the couple needs to ensure that they grow their investment portfolio as much as possible to fund their post-retirement financial goals," the planner says. Also, the savings from the education costs (after the children have graduated) allow Scott and Lisa to service the mortgage without increasing their monthly outlays. "When they retire, they should pay off the mortgage because servicing it will come at the cost of higher taxes on withdrawals," he says.

Because their professional corporation will continue to have significant investments even after Scott retires, they might want to explore philanthropic opportunities, perhaps by donating securities that have appreciated substantially in value. They should work with a professional estate planner.

CLIENT SITUATION

The people: Scott, 52, Lisa, 51, and their children

The problem: Can Scott quit the hospital work without affecting their retirement plans? Can they afford to buy a better home or a cottage?

The plan: Retire in five years, defer government benefits. Borrow to buy the new home with a view to paying off the mortgage when they retire. Explore estate planning tools.

The payoff: All their financial goals achieved.

Monthly net employment income: $16,665

Assets: His bank deposits $301,155; his non-registered stocks $191,540; joint bank account $49,090; her bank $16,775; his RRSP $308,045; her RRSP $354,465; his TFSA $100,600; her TFSA $98,925; RESP $26,710; corporation $2.71-million; residence $760,000. Total: $4.9-million

Monthly outlays: Property tax $365; home insurance $110; utilities $600; maintenance $250; transportation $385; groceries $1,650; clothing $500; tuition and lodging $5,335; charity $100; vacation, travel $1,500; dining, drinks, entertainment $500; personal care $270; club membership $70; pets $225; sports, hobbies $100; subscriptions $30; health care $105; health, dental insurance $225; disability insurance $640; (life insurance is paid by corporation); cellphones $240; telephone, TV, internet $250. Total: $13,450.Surplus goes to savings.

Liabilities: None

Want a free financial facelift? E-mail finfacelift@gmail.com.

Some details may be changed to protect the privacy of the persons profiled.

Be smart with your money. Get the latest investing insights delivered right to your inbox three times a week, with the Globe Investor newsletter. Sign up today.

351 King Street East, Suite 1600, Toronto, ON Canada, M5A 0N1

Phillip Crawley, Publisher