Intelligence MEMOS

From: Alexandre Laurin

To: Finance Minister Chrystia Freeland

Date: April 5, 2022

Re: **Pension-Related Tax Rule Changes for Budget 2022**

Retirees and workers nearing retirement will be looking to tax-rule changes to improve retirement security in your budget on Thursday.

Policy attention to the decumulation phase of retirement savings can improve Canadians' retirement and tax laws and regulations are key levers.

Many new retirees do not have a pension guaranteed for life. With the decline of private-sector defined-benefit (DB) pension plans, more and more seniors rely on accumulated savings in registered plans to provide for retirement. But no one can know how long they will live. Those whose principal source of retirement income is not guaranteed for life need to protect against outliving their savings, which may **translate** into excess precautionary savings and a lower retirement lifestyle than may have been possible.

Life expectancy in Canada has been rising more than two years per decade since the 1960s, but current age limits related to retirement do not reflect this. Canadians (and their employers) now must stop contributing to tax-deferred retirement saving plans at age 71, which is also the age at which contributors must convert their retirement savings into a Registered Retirement Income Fund (RRIF) or an annuity and begin drawing down their wealth.

Increasing the age from 71 to, say, **age 75** may encourage older Canadians to stay in the workforce longer.

Retirees invested in RRIFs also face a material risk of outliving their tax-deferred savings due to the mandatory minimum withdrawal schedule, notwithstanding **improvements** introduced in 2015. Further **liberalization of the tax rules** to allow for more regular adjustments to minimum withdrawals to keep them aligned with returns and longevity, or eliminating minimum withdrawals entirely, would be worthwhile initiatives toward ensuring retirees enjoy lifelong security.

In recent years, new decumulation options for capital accumulation plans were introduced. Defined-contribution (DC) plans can now offer variable benefits (subject to yearly minimums and maximums) to plan members. And federal tax rules were amended to create Variable Payment Life Annuities (VPLAs) and Advanced Life Deferred Annuities (ALDAs). VPLAs will be offered by large DC plans and will allow members who elect this option to pool their longevity risk and convert their balances into life annuities which payments will vary with the plan's experience. ALDAs will likely be offered by life insurers and will allow the purchase a life annuity which would begin to be paid at a later age. Both are new tools designed to help retirees deal with the risks of outliving their savings.

But tax rules restrict their scope to only a slice of capital accumulation plans' participants, i.e. mainly those invested in the largest DC plans for which there is sufficient scale for these options to make economic sense. It unnecessarily limits retirees' options to purchase longevity insurance at a time when governments are concerned about the increasing cost pressures of providing long-term care to a rapidly aging population.

VPLA providers, in particular, should be allowed to structure VPLAs as a **standalone financial product** in which critical scale could be achieved through pooled investments from the whole of registered retirement saving sources, including smaller DC plans, group RRSPs and TFSAs.

In addition, liquidity rules make it impossible to buy life annuities within a TFSA. More and more employers offer group TFSAs to their employees, as an alternative to group RRSPs. Someone invested in a TFSA wanting to buy an annuity to insure against the risk of living a long life would have to withdraw the funds and purchase an annuity contract in which the interest portion of the payouts is taxable. This additional tax makes the alternative of leaving the funds within the TFSA to self-insure against the risks of longevity – negating the benefits of longevity pooling – more tax effective.

This cost distortion is unwelcome. It is unfair to those who opt to save for retirement in a group TFSA as opposed to a group RRSP. The federal government should amend the rules **to make it possible** to buy life annuities within a TFSA, including VPLAs and ALDAs.

Finally, pension benefits, lifetime annuity income from a registered savings plan, variable benefits from a DC plan, and RRIF withdrawals are eligible for tax breaks: the pension income tax credit and pension income splitting. Taxpayers aged 65 and over are eligible, unless they are pensioners from DB plans for whom an age exception is made: they can claim the tax breaks from age 55.

This age exception is unfair, and perpetuates the growing divide between public-sector workers, almost all of whom receive DB pensions, and those who do not. As long as the eligible retirement income is structured as lifetime periodic payments, either fixed or variable subject to maximums, it should not matter whether they are sourced from DB plans, registered savings plans, or variable pension benefits within a DC plan.

Fairness requires that all should have the same eligibility age.

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