Intelligence MEMOS

From: William B.P. Robson, Don Drummond and Alexandre Laurin

To: Finance Minister Chrystia Freeland

Date: March 24, 2023

Re: **Let's Ditch Our Obsolete Retirement Tax Rules**

With the worst of COVID-19 behind us, the federal government needs to re-focus on long-standing stresses, including tax rules that limit many Canadians from saving as much for retirement as they would like and may need, and that force them to draw down their retirement saving faster than is prudent.

MPs and federal public servants have tax-backed plans that guarantee them indexed payments for life. Most Canadians cannot look forward to retirement incomes that are anything like as generous or secure. The C.D. Howe Institute's **Shadow Budget** contains measures to reduce this unfair gap – measures your budget could bring out of the shadows on Tuesday.

1. Let Canadians save more for retirement. The current limit on saving in defined-contribution pension plans and RRSPs – 18 percent of a person's earned income – dates from 1992. Given assumptions both about how long people lived after retiring and about how much their savings typically earned, it was thought that ratio would produce retirement income roughly equivalent to what the typical defined-benefit pension plan did. It's arguable that 18 percent was too low even then. But now, with people living longer and with yields on safe investments having fallen, it is badly out of line with reality. To reduce the disadvantage this limit on tax-deferred saving creates for people in defined-contribution plans or saving in RRSPs, we would raise the contribution limit by three percentage points of income per year – from the current 18 percent to 30 percent of earned income – over four years.
2. Let Canadians save longer for retirement. The rules require Canadians to stop contributing to, and start drawing down, tax-deferred saving in the year they turn 71. Again, this might have been reasonable in 1992 but not now, when many people can and probably should work and save longer. Forcing people to draw down their assets discourages them from doing so and increases the likelihood they will exhaust their savings in these accounts. We would increase the age at which contributions to tax-deferred retirement saving schemes must cease to 72, beginning next January. We would increase a further month every six months after that until it reaches at least 74, approximating the increase in life expectancy that has occurred since 1992.
3. Reduce mandatory RRIF withdrawals. Another problem with the regime established in the early 1990s is the requirement for older Canadians who do not buy annuities with their tax-deferred savings to draw them down according to a schedule of minimum withdrawals, starting in the year the saver turns 71. As returns on safe assets fell and longevity increased, these minimum withdrawals exposed ever more Canadians to a risk of outliving their savings. In 2015, Ottawa reduced the minimums, but those changes still left the risk of depleting tax-deferred savings far higher than it was in 1992, and longevity has increased further since then. We would reduce all minimum withdrawals by one percentage point beginning with the 2023 taxation year, and further reduce them in future years until the risk of the average retiree depleting tax-deferred savings is negligible.
4. Promote annuities from TFSAs. A valuable additional tool for retirement saving that has appeared since 1992 is the Tax-free Savings Account (TFSA). Although TFSAs have become very popular, tax rules undermine their ability to provide a secure income in retirement. When an RRSP-holder buys an annuity with savings in an RRSP, the investment-income portion of the annuity continues to benefit from the tax-deferred accumulation that applied to the RRSP. But TFSA-holders cannot buy annuities inside their TFSAs, which means they end up paying tax on money that is intended to be tax-free. This difference disadvantages people who would be better off saving in TFSAs and **discourages** a much-needed expansion of the market for annuities in Canada. We would allow purchases of annuities within a TFSA and we would let annuity providers structure them as a stand-alone product, suitable for savings from other vehicles, such as defined-contribution plans and group RRSPs.

The 2023 federal budget presents an opportunity to narrow the gap between the retirement security available to federal employees and the comparative insecurity of other Canadians. We hope the government seizes that opportunity.

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