

Tax Expenditure Analysis of Employer-Sponsored Registered Pension Plans

Prepared for
The Ontario Expert Commission on Pensions

By

Jinyan Li

Professor of Law, Osgoode Hall Law School
York University

© 2007

The author thanks David Piccolo for his excellent research assistance and preparation of the tables used in this report. She also thanks Simon Archer and Barbara Austin for their comments on the drafts of this report. She remains solely responsible for any errors that may remain in the report.

Tax Expenditure Analysis of Employer-Sponsored Registered Pension Plans

TABLE OF CONTENTS

Abstract	3
Executive Summary	4
1. Introduction.....	6
2. What Are Tax Expenditures?	7
3. What Is the Cost of RPP Tax Expenditures?	9
3.1 <i>Cash-flow Method Estimates</i>	
3.2 <i>Present-value estimates</i>	
3.3 <i>RPP Tax Expenditure compared to GDP and Federal Income Tax</i>	
3.4 <i>Ontario Pension Tax Expenditure</i>	
4. Who benefits from RPP Tax Expenditures?.....	13
4.1 <i>Individuals covered by RPPs</i>	
4.2 <i>Individuals Not Covered by RPPs</i>	
4.3 <i>Firms sponsoring RPPs</i>	
4.5 <i>Policy implications</i>	
5. Interplay of RPPs and Other Pension Programs	17
5.1 <i>RPPs and Income Replacement Objective</i>	
5.2 <i>RPPs versus RRSPs</i>	
5.3 <i>RPPs and OAS/GIS</i>	
5.4 <i>RPPs and C/QPPs</i>	
5.5 <i>RPP Tax Expenditures and Public Pension Financing</i>	
6. Implications for the viability of the Ontario pension system	24
7. Conclusions	24
Tables	26
References	37

Abstract

This report analyzes tax expenditures associated with employer-sponsored registered pension plans (RPPs) in terms of their cost, the distribution of benefit, and impact on other retirement income programs. The report notes that the amount of RPP tax expenditures as estimated under the cash-flow method ranges from \$7 billion to \$12 billion each year from 1989 to 2006 (with the exception of three “odd” years: over \$15 billion in 1999, less than \$1 billion in 2001 and negative \$1 billion in 2002). It is the largest item of tax expenditure at the federal level, accounting for 0.8 to 1.3 percent of the gross domestic product, as big a share as Old Age Security payments. RPPs provide an important source of “top-up” income to retirees. In fact, as an important part of the “third pillar” of the Canadian/Ontario retirement income system, RPPs play an important role in achieving the “income replacement” objective. However, because the RPP tax expenditures benefit only RPP members and sponsors, the distributional effect is limited by RPP coverage. The decline in RPP coverage in recent years is a cause for concern. Ontario and the Federal government have more or less a common income tax base. RPP tax expenditures that reduce the federal tax base also reduce the Ontario tax base and raise the same policy issues about efficacy and distributional effect. The fundamental design of RPP tax policy has not changed much during the past two decades. Recent changes to RPPs warrant a close re-examination of this policy.

Executive Summary

Employer sponsored registered pension plans (RPPs) receive tax assistance from both the Federal and Ontario governments. From a tax policy perspective, such tax assistance is in the nature of a “tax expenditure”. This report analyzes the amount of the tax expenditures associated with RPPs, who benefits from these expenditures, and the impact of these tax expenditures on other tax-assisted retirement savings plans (such as the RRSPs) and the public pensions (i.e., the Old Age Security and Canada/Quebec Pension Plans). By relying primarily on existing data and secondary literature, the report concludes that the cash-flow estimates of the annual cost of federal RPP tax expenditures ranges from \$7 billion to \$12 billion (with the exception of three “odd” years: over \$15 billion in 1999, less than \$1 billion in 2001 and negative \$1 billion in 2002), accounting for 0.8 to 1.3 percent of the GDP.

RPPs are designed to provide a “top-up” source of retirement income. Therefore, RPP tax expenditures benefits only individuals covered by an RPP. The question of who benefits from these tax expenditures is tied to the membership of RPPs. Generally speaking, RPP members are generally individuals with middle or high-incomes, work for public-sector employers or large companies, or belong to a trade union. Companies that sponsor RPPs also benefit from the tax expenditures as a result of tax deductions for the contributions made to RPPs.

RPPs interact with RRSPs and public pensions. The amounts of tax expenditures associated with the tax deduction for contributions to RPPs and for contributions to RRSPs from 1989 to 2006 show that contributions to RRSPs have increased at a higher rate than those to RPPs. The coverage of RRSPs has expanded during the era of decline in RPP coverage. Because RRSPs can be used as “income smoothing” vehicles as opposed to retirement saving plans, they provide less security in retirement income than RPPs (especially defined benefit plans).

RPPs have a potential impact on the OAS/GIS system through the “claw-back” in the OAS/GIS system and the funding of these programs. OAS payments are clawed back when an individual’s net income (which includes private pension income) is greater

than \$63,511 (as of 2007). RPPs may interplay with OAS/GIS in terms of financing the latter programs. Tax expenditures on RPPs and RRSPs are revenues forgone by the government. OAS/GIS payments are funded by general tax revenue. From 1988 to 1998, the amount of pension tax expenditures was over 80 percent of OAS/GIS payments. In 1999, pension tax expenditures exceeded the OAS/GIS payments. With the exception of the odd years (1999-2002), the percentage has been between 68 to 70 per cent. On the other hand, the RPP and OAS regimes have been designed to assist individuals in different income groups: the former is for middle and high-income groups to ensure a certain level of income replacement, and the latter is for low-income groups to provide old age income security (income replacement may be 100 percent or more for these individuals).

RPPs and C/QPP share a common feature – they are contribution based plans. Only individuals who make contributions to such plans are covered. They are totally different from the OSA/GIS system. The majority of RPPs take into consideration contributions and benefits under the CPP/QPP. For example, DB plans often provide “bridging” benefits to early retirees to ensure that the retirement income remains relatively stable if a worker takes early retirement, and most defined benefit plans’ benefits are integrated with C/QPP

Ontario does not have its own tax policy on RPPs. Because of the shared income tax base and because RPP tax expenditures are provided through deductions or exclusions in computing the tax base, federal tax policy directly affects Ontario. As such, tax expenditures associated with RPPs have revenue costs for the Ontario as well as Federal Government. The increasing RPP tax expenditures and the expansion of RRSPs in the era of a decline in RPP coverage raise significant issues about the efficacy and equity of the tax policy. However, if the dual policy goals of the Canadian and Ontario retirement income system remain to be both income replacement (mostly for middle and high income individuals) and income security, the tax expenditures remain important policy instruments. It is perhaps time to re-examine the design of RPP tax expenditures to make them more effective and viable in a changing business, demographic and social environment.

1. Introduction

Employer-sponsored registered pension plans (RPPs) are tax-assisted private plans. Together with individually-based registered retirement savings plans (RRSPs) and group RRSPs, they form the “third pillar” of the Canadian retirement income system. The other two pillars are public in nature: the Old Age Security, Guaranteed Income Supplement and Allowance for Survivor programs (the “OAS/GIS system”), and the Canada Pension Plan (CPP) and the Quebec Pension Plan (QPP). The OAS/GIS regime is designed primarily to provide old-age income support to individuals in the bottom quintile of income group. The CPP/QPP and private pension plans are designed primarily to replace earnings, and are thus more important to working Canadians, especially those in middle and high income groups. Participation is mandatory in the case of CPP/QPP, but voluntary¹ in the case of private pensions.

The tax subsidies to RPPs are one of the biggest items of “tax expenditures” to the federal government each year.² They raise important policy questions as to: (1) how much do the tax expenditures cost the government each year? (2) who benefits from this tax expenditure? (3) how does the tax expenditure on RPPs affect RRSPs and the two public pillars of the retirement income system?

This paper attempts to answer these questions by relying primarily on existing literature and data. The most important data source for the first question is the report on Tax Expenditures and Evaluations published annually by the Department of Finance, Canada. For the second and third questions, we refer to Statistics Canada’s publications, including Canada’s Retirement Income Programs (2007), as well as secondary literature.

¹ In the case of RPPs, there is no legal obligation for an employer to establish an RPP for its employees. However, once the employer has established an RPP, it is mandatory for all members of the type or class of employees (usually, full-time employees) to be covered.

² Ontario has let the federal system regulate tax policy on pensions so it is not Ontario policy expenditures that are examined in this report.

2. What Are Tax Expenditures?

The Canadian income tax system is used primarily to raise revenues to fund government expenditures that reflect society's priorities. It is also used to achieve public policy objectives through granting special deductions, exemptions and other forms of tax subsidies. These tax subsidies reduce government revenue and have the same effect as the government collecting the revenue from the taxpayer and giving it back. Therefore, they are referred to as "tax expenditures", representing government spending through the tax system (Surrey 1973, Surrey and MacDaniel 1985).

Tax expenditures are "deviations" from a "normal" or "benchmark" tax structure. Because of the different opinions about what should be considered a benchmark tax structure, there are differences in opinion about what should be considered tax expenditures. The Department of Finance takes a broad approach in its report and regards any deviations from the most fundamental structural elements of the tax system as tax expenditures. The most fundamental structural elements of the Canadian income tax system include: (a) Every person (individual or corporation) resident in Canada is liable to tax on the person's taxable income each year; (b) Taxable income includes income from employment, business, property and capital gains; (c) In computing income, expenses incurred in earning the income are deductible, whereas other expenses are not. When an item of income is exempted from tax or an otherwise non-deductible expense is deductible, the special exemptions and deductions are deviations from the benchmark, and thus tax expenditures.

In the context of RPPs, there are two main tax expenditures:³ the current deduction of contributions to these plans and the non-taxation of investment income earned by the funds held within these plans. From the perspective of taxpayers, the value of tax expenditures is the deferral of tax. Contributions to an RPP are tax-deductible if they are made within specified limits;⁴ the earnings of an RPP accumulate tax-free.⁵ Income tax is paid on such contributions and earnings only upon actual distribution to plan

³ There are two personal tax credits – the Age Tax Credit and the Pension Income Credit. Also, pension income splitting has been introduced, which allows retired seniors to file joint returns which potentially allow their income to be subject to a lower tax rate than had they filed individually.

⁴ See s.147.2 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) as amended.

⁵ See, for example, s.149(1)(o) of the *Income Tax Act*.

participants and their beneficiaries, which may occur many years after contributions are made or earnings accrue. If the amount of employer contribution to an RPP were paid as wages, the wages would be taxable to the worker in the current year and there would be no tax deferral. Alternatively, if the same money was put aside to fund a future, deferred compensation to workers, the employer cannot deduct the amount in the absence of specific permissions by the Income Tax Act (e.g., a retirement compensation arrangement or RPP).⁶ The longer the funds stay within the plan, the greater value of the tax deferral.

The characterization of deferred taxation of private pensions as tax expenditures is disputed by scholars.⁷ One argument is that because the tax system is based on the realization of income, the deferred taxation of savings for retirement is not a deviation (Zelinsky 1994; Wooten 1999). The Canadian income tax system has never been a pure “income” tax because it does not tax all forms of annual “accretion to wealth” (which essentially includes consumptions and savings under the classic Haig and Simon’s definition of income).⁸ For various policy reasons (such as difficulties of liquidity and valuation and administrative convenience), only income “realized” during the year is taxable (Hogg, Magee and Li 2005).

Another way of looking at it is to view the retirement savings provisions as a way of converting the income tax system into “a modified form of expenditure tax” or a “consumption tax”. The provisions do this by exempting savings from tax and taxing them only on withdrawal.⁹ In the absence of these provisions, “savings” would be taxed twice, both the initial accumulation of capital and its subsequent yield are

⁶ In the case of RRSPs, tax deferral occurs because the income tax on the contributions and investment income accrued is postponed until the funds are withdrawn by the taxpayer.

⁷ This debate has occurred mostly among US academics. See, Lehman & Kahn (1992), Stein (1991), Wooten (1999), and Zelinsky (1988) and (1994).

⁸ Under the classic definition of “income” by Haig and Simons, income entails an “estimate of consumption and accumulation.” The common-sense notion is that a taxpayer’s material wealth consists only of what she spends and what she saves. By definition, full and accurate implementation of the Haig-Simons ideal would require periodic valuation of the taxpayer’s wealth to get at the accumulation part of the equation. That is, under the Haig-Simons definition, sometimes referred to as the accretion ideal, a taxpayer should periodically pay income tax on appreciation.

⁹ This was how the Carter Commission viewed these provisions: *Report of the Royal Commission on Taxation* (Carter Report) (1966), vol. 3, 411-412. See also McCaffery 1992, noting that “the [US] pension taxation, now one of the largest dollar deviations from a true income tax, corresponds to at least one version of a consumption tax”.

subject to tax. For example, a taxpayer who saves \$100 in an interest-bearing bank account must do so with after-tax funds (e.g., after-tax wages or investment income), yet he/she also will see the interest yield taxed each year. If non-taxation of savings is considered part of the benchmark system, then the deferred taxation of retirement savings is not a deviation.

In spite of the academic debates about whether the current tax treatment of private pensions are tax expenditures, the Department of Finance and the government of other OECD countries routinely list the deferred taxation of private pensions as tax expenditures. (Antolin et al 2004; OECD 1996; Whitehouse 1999)

3. What Is the Cost of RPP Tax Expenditures?

The amount of tax expenditure associated with RPPs is the amount of net tax forgone or deferred.¹⁰ For a given dollar of contribution to an RPP, there is the tax forgone when the contribution is made (because it is deductible from total income) as well as when investment income is earned (because tax would have been collected if the income were earned outside an RPP). The forgone tax is recovered in part by the tax collected in the future when withdrawals are made. Lifetime revenue cost of a contribution is determined as follows:

Tax forgone on	tax forgone on	tax collected
Deduction for contribution	+ investment income -	on withdrawals
← PRESENT →	←----- FUTURE -----→	

There are currently two alternative methods for estimating the value of pension tax expenditures: the cash-flow method and the present value method.

¹⁰ Same methods are used for estimating the tax expenditures associated with RRSPs.

3.1 Cash-flow Method Estimates

The cash-flow method estimates the revenue in the current year if the tax subsidies did not exist (or the contributions were not deductible and the investment earnings were fully taxable). The estimate is arrived at in three steps:

1. The contributions are treated as taxable in the year;
2. The investment income earned in the plan is taxable in the current year and the imputed tax is added to the imputed tax on contributions;
3. The withdrawals from the plan are taxable in the current year and the tax to be paid on the withdrawals is subtracted from the tax that would have been paid on contributions and earnings to get a net tax expenditure estimate.

Table A below shows the cash-flow estimates of net tax expenditures for 1988 to 2008. The amount in Column D is calculated by adding the forgone revenue on current year deductions in A and the foregone revenue on investment income in B and then subtracting the tax collected on withdrawals in C. Alternatively, $D = (A + B) - C$. For example, in 2004, the tax forgone is \$8,270 million on deduction for contributions, \$9,630 million on non-taxation of investment income, and \$7,140 million recovered from taxation of pension benefit payments, resulting in a net tax expenditure of \$10 billion.

Table A shows that the net tax expenditure in 2002 is negative because of the estimated low or negative rate of return on the investment and the amount of withdrawals from RPPs. The figure was over \$10 billion in 1994, 1995, 1999, 2003 and 2004. The projected value of tax expenditures for 2005 to 2008 is over \$10 billion each year. This is the largest item of tax expenditure for the federal government.

There are significant shortcomings with using the cash-flow method to estimate the revenue losses associated with RPPs and RRSPs. Because the method measures the net amount of revenues foregone on contributions, revenues foregone on accrued investment income and revenues collected on withdrawals which are all realized during that same year, the revenues foregone on accrued investment and the revenues collected on withdrawals correspond to contributions made in previous years. The size

of the estimate depends directly on the maturity of the *entire* retirement savings system and the relative sizes of the working and retired populations (Department of Finance 2001, at 42). For example, in the early years of a pension system, contributions tend to be high relative to benefit payouts, whereas the opposite is true with a more mature pension system. Similarly, when more people reach retirement age, withdrawals are high relative to contributions. Therefore, the cash-flow method estimates tend to overstate the cost of tax expenditures when the pension system is new. The estimates may be expected to decline in the near future as the pension system matures and members of the baby boom generation begin to draw down their retirement savings.¹¹

3.2 Present-value estimates

The present value method considers the net revenue forgone in today's dollars because of contributions made in a year.¹² It is calculated as follows:

- (1) Determine the revenue forgone because of the deduction for contributions made this year;
- (2) Add the discounted value of the revenue forgone because of the non-taxation of the accrued investment income earned on those contributions; and
- (3) Subtract the discounted revenue stream received when the contributions and the investment income are withdrawn.

In other words, the net tax expenditure is obtained by taking the difference over the entire length of the investment between the amount of taxes collected in the case where money is saved in a private pension plan and the amount collected when funds are invested in a benchmark non-tax-assisted saving vehicle.

A number of assumptions and pieces of information are necessary in calculating the present-value tax expenditure estimate. In preparing its annual report, the

¹¹ In other words, the cash-flow method is most influenced by demographic changes that change the profile of tax costs and benefits related to tax-assisted private pension plans. It has been used in Antolin, P., A. De Serres and C. De La Maisonneuve, 2004, "Long-Term Budgetary Implications of Tax-Favoured Retirement Plans", OECD Economics Department Working Papers, No.393; Congressional Budget Office, 2003, *Utilization of Tax Incentives for Retirement Savings*, Washington, D.C.

¹² The present value method was first proposed by Samuel Rae, Jr., "Registered Retirement Savings Plans as a Tax Expenditure," *Canadian Tax Journal*, 28(4) (1980), 459-464.

Department of Finance assumes that the benchmark tax system uses nominal income as the tax base rather than real income and there is no behavioural change if the tax subsidies were removed. Assumptions must also be made about the marginal tax rates on contributions and withdrawals, the length of investment in a RPP or RRSP, the investment portfolio of individuals in the absence of the tax subsidies, the rate of return on contributions, and the discount rate (Department of Finance 2001). Suppose that an individual makes a \$100 contribution to an RRSP at age 50 and withdraws the \$100 and any earnings at age 55, the federal marginal tax rate is 25% in each year, the provincial tax is 50% of the federal tax, and the rate of return and the discount rate is 6.4%, the federal tax expenditure on the \$100 contribution is \$4.49 or \$0.04 per dollar.¹³

Unlike the cash-flow method, the present-value method does not take into account the revenue forgone on past contributions. It is not affected by demographic conditions or the maturity of the pension system. The result under these two methods is often different. The Department of Finance provides the present-value estimates as supplementary information only. Because the longitudinal tax return data does not separate RPP income from RRSP income, only one estimate is made for the two programs under the present-value method (see Table C).

3.3. RPP Tax Expenditure compared to GDP and Federal Income Tax

The significance of the RPP tax expenditures can be assessed in terms of its percentage of the national gross domestic product (GDP) and the federal income tax revenue. No matter which method of estimates is used, the amount of RPP tax expenditures is hefty. Table D shows that the amount exceeds one percent of the Canadian gross domestic product (GDP) from 1989 to 1995, and 1998 and 1999.

¹³ Using slightly different assumptions, an OECD study estimates that most OECD countries incur a sizeable positive net tax cost, amounting to at least 10 cents per dollar of pre-tax contribution to tax-assisted private pension plans: Kwang-Yeo Yoo and Alain de Serres, *Tax Treatment of Private Pension Savings in OECD Countries* (OECD Economics Studies No. 39, 2004/2).

3.4 Ontario Pension Tax Expenditure

The tax expenditure estimates for Ontario are not readily available. For the 2006 fiscal year, the Ontario government reported that the cash-flow estimate of the tax expenditure was \$565 million associated with contributions to RPPs and \$1,875 million associated with contributions to RRSPs (Ontario Ministry of Finance 2006). No data are available on tax forgone on investment income and tax recovered from the withdrawals.

The tax base for Ontario income tax and federal income tax is the same for individuals and very close for corporations. In 2006, the total income tax revenue in Ontario is about 39 percent of the federal income tax revenue. It may be possible to assume that Ontario RPP tax expenditure is about 39 percent of the federal tax expenditure.

4. Who benefits from RPP Tax Expenditures?

4.1 Individuals covered by RPPs

By design, the RPP tax expenditures benefit only those individuals who work for employers that sponsor a RPP. Clearly, individuals who are not covered by a RPP derive no benefits from these tax expenditures.

In terms of pension coverage, 39% of paid workers in Canada were members of an RPP in 2003 (Schembari 2007). Close to half of all RPP members were covered by an RPP in the public sector (Schembari 2003). The RPP coverage rate is 78% in the public sector, but only 27% in the private sector. Coverage for women has been increasing in recent years (see Table E). By 2004, women made up 47% of total membership in RPP and 44% of membership in the private sector.

RPP coverage rises strongly with income over the modest/middle income range (\$30,000-60,000). In 2004, 62.5% of employees who had no RPP were in the low-income group (up to \$30,000) (Horner 2007). About half of Canadian households have RPPs, but 31% of family units with \$100,000 or more in private pension savings held

over 90% of the value of these pension assets; the majority of family units with no private pension assets had lower income from employment (less than \$30,000). (Wealth of Canadians 2006).

Among participants of RPPs, contribution rates vary. Higher contribution rates lead to higher value of the tax benefit. Because the value of tax expenditures is determined by the marginal tax rate of the individual, the changes in the level and pattern of tax rates over a worker's lifetime affects the value of the tax expenditure. The income level after retirement also affect the benefits from private pensions because of the OAS/GIS claw-back requirement. Generally speaking, however, the broad pattern of distributional consequences is clear. High-income households are more likely to be covered by RPPs. The share of earnings contributed to RPPs rises with earnings. Tax deferral is worth more to high-bracket than low-bracket taxpayers.

Participants of RPPs may benefit from the tax expenditure differently, depending on the type of the RPP being a defined benefit (DB) plan, or defined contribution (DC) plan. Generally speaking, DB plan participants stand to benefit the most from the current system for at least two reasons. First, DB plans generally provide more security to participants. The employer bears the investment risks and mortality risks of the plan. In Ontario, DB plans are protected by the Pension Benefits Guarantee Fund so that participants receive some benefits if a plan fails (no such protection is available for DC plans). Second, many DB plans provide ancillary benefits, such as early retirement benefits, bridge benefits, survivor benefits, or indexing. The cost of financing these ancillary benefits is not "translated" into the "money purchase limit" for DC plans. As such, more funds can be tax-sheltered through a DB plan than a DC plan.¹⁴

4.2 Individuals Not Covered by RPPs

Canadian workers who lack RPP coverage obviously do not benefit from the RPP tax expenditure. These individuals are generally less educated, earn low incomes, work

¹⁴ For a case study for this, see Gros, Barry and Pat Suzuki (1998) "Pension plan face-lift", *Benefits Canada* (March 1998).

part-time, work for a small company, are relatively young, or are self-employed¹⁵ (Lipsett and Reesor 1997). In addition, recent immigrants were less informed about RPPs (Morissette and Zhang 2004) and less likely to be covered: RPP pension coverage for adult immigrants 65 and over was 21% lower than for the elderly population in total (Baldwin 2006).

Pension coverage is generally high among full-time workers at large and medium-sized firms, and in certain industries, such as manufacturing, construction and trade (Table F). RPP coverage rises dramatically with employer size, from 2.7% of employees in firms with fewer than 50 employees to 81.6% in firms with over 500 employees (Horner 2007; Frenken and Maser 1992; Morissette and Drolet 2001). Union membership is a key factor in deciding coverage: overall 80 percent of union members belong to an RPP compared to 27 percent of non-union members (Baldwin 2004; Akeyampong 2002; Lipsett and Reesor 1997).

The RPP coverage rate for the private sector has been gradually decreasing, from 35.4% in 1977 to 26.8% in 2003 of the paid workforce. Table G shows the decline in RPP coverage in Canada and Ontario as a percentage of the labour force and population.

4.3 Firms sponsoring RPPs

Employers in the private sector that sponsor an RPP also benefit from the tax expenditures. These firms are generally large companies in manufacturing, construction, trade, transportation and warehousing, finance, insurance and real estate, and services (Maser and Anderson 2007). Under the general scheme of the Income Tax Act, while current wages paid to workers are deductible, the projected value of promised pensions or monies put aside to pre-fund a deferred wage promise are not deductible in the absence of specific permissions (such as s.147.2 in respect of

¹⁵ Lipsett and Reesor (1997) found the major determinants of RPP coverage to be: unionization and firm size, seniority (as proxied by job tenure), permanent/non permanent job status, part/full-time hours and wages. Secondary determinants include class of workers (public/private sector), industry, occupation, age, education, province of residence, marital status and presence of dependents.

RPP contributions). The special deduction for RPP contributions is thus a tax advantage to deferring pay in the form of a pension promise.

Why do companies offer pensions? One explanation is that companies want to use deferred compensation or pensions to enhance workers' effort and their productivity (Gustman, Mitchell and Steinmeier 1994). Empirical studies found that high pay and pensions were more prevalent in jobs that were difficult to supervise than in jobs that involved repetitive tasks (Hutchens 1986), and that companies were more likely to offer pensions in jobs that paid above-average wages toward the end of the worklife (Lazear 1979). Another explanation is retention of employees. Studies found that worker turnover is only about half as high for workers covered by pension plans as for workers without pensions. (Allen, Clark, and McDermed 1993; Gustman and Steinmeier 1993) A third motivation for companies is to control retirement flows. When a company wishes to reduce labour costs, it can use pensions to induce workers to retire early instead of the outright laying off of workers or reduction of wages. In addition, studies have found that workers with generous pensions under DB plans tend to retire earlier than those with lower pensions or no pensions. (Gustman, Mitchell and Steinmeier 1994)

Against these potential benefits are some drawbacks, such as the financial cost of maintaining the RPP and the lack of financial incentive for "unproductive workers" to leave. Other drawbacks include the uncertainty in cost for employer's funding defined benefits, mortality risks, fiduciary risks, and the high cost of compliance with pension and tax regulations. Finally, changes in labour force demographics may mean that employers may not want to encourage early retirement any more.

4.5 Policy implications

Since the RPP tax expenditure policy was primarily intended to encourage employers to sponsor RPPs, the recent decline in the RPP coverage calls into question the effectiveness of this policy. As illustrated in a separate report,¹⁶ the exact role of tax policy in causing the decline of DB coverage is not very clear.

¹⁶ Li (2007), "Tax Policy on the Coverage and Funding of RPPs".

Individuals who are unemployed, self-employed, temporarily employed, and are employed by companies without RPPs do not benefit from this tax subsidy. As a public policy, the distribution of the RPP tax expenditure clearly violates the notion of equity and fairness (Austin 1996; Yonge 1997). It provides a greater amount of tax subsidy to individuals with higher income and to workers employed by public sector employers or large companies.

5. Interplay of RPPs and Other Pension Programs

This section analyzes the impact of RPPs by looking at RPPs as a “top-up” source of retirement income, their interaction with public pensions and potential implications for financing other pension programs.

5.1 RPPs and Income Replacement Objective

RPPs and RRSPs are part of the “third pillar” of the Canadian pension system. They are designed to “top up” public pensions in order to prevent a significant drop in living standards after retirement.

When the Canada and Quebec Pension Plans were established, they were not designed to guarantee, in combination with OAS, that every Canadian would be able to maintain his or her pre-retirement living standard upon retirement. A gap was left to be filled by employer-sponsored pension plans and individual savings (Lalonde, 1984).

This “top-up” function is particularly important to individuals with middle or high income because the public pension system is geared to replacing only about 40 percent of gross income (at the average industrial wage) (Li 2006; Canadian Institute of Actuaries, 2006). RPPs and RRSPs are designed to top-up the income replacement to 70 percent of the target income level (currently \$100,000). According to some surveys, the median income replacement rates are above 70 percent for individuals in the middle and top quintile, and that the vast majority of individuals with lesser

earnings enjoyed full or nearly full income replacements rates, largely because of the importance of public pensions to low-income seniors (LaRochelle-Côte, Myles and Picot 2007).

As a source of retirement income, the existing data do not separate RPPs from RRSPs. On average, private pension income is the single largest component of retirement income to Canadians. In 2003, it accounted for 43 percent of income from all retirement programs (Schembari 2007). The importance of private pensions has been rising in recent years. It grew from 18% of total retirement income in 1990 to 29% in 1999, and to 34% in 2003 (Canada's Retirement Income Programs 2003, 2007). Over half of those 65 and older received private pension income in 1999, up from 38% in 1990 (Canada's Retirement Income Programs 2003). Private pensions provide larger proportions of retirement income to individuals with higher income: 2.9% for seniors in the bottom deciles, 9.9% in the middle deciles and 46.4% in the top decile (Baldwin 2006). To put it differently, private pensions constituted about half of the income of seniors with incomes of \$40,000 to \$79,999. Those with incomes under \$20,000 were less likely to have been members of RPPs or to have saved through RRSPs and, not surprisingly, less than 10% of their income came from private pensions. Instead, they rely heavily on public pensions (Maser 2005).

Overall, the assessment of the private pension system is positive. Baldwin states that “the decision to create a pension system that relies heavily on the third pillar [private pensions] as a source of income appears to have worked reasonably well” (Baldwin 2006). Similarly, LaRochelle-Côte, Myles and Picot, 2007 conclude that “the Canadian pension system appears to be doing relatively well in ensuring basic standards of well-being among seniors, at least for individuals near the median.”

5.2 RPPs versus RRSPs

Since 1990, there has been an integrated tax policy in treating contributions to RPPs and RRSPs. In essence, the tax-sheltered RPP contributions reduce the RRSP contribution room. RRSPs are mostly individual-based, although group RRSPs have experienced growth in recent years (Luchak and Fang 2005). Group RRSPs have some features similar to DC plans in that they are funded by monthly payroll deductions.

RRSPs have expanded in an era of decline of RPPs as measured by the amount of tax expenditures. Table H shows that the projected RRSP tax expenditure in 2006 (\$8.445 billion) almost doubles the amount in 1989 (\$4.345 billion). On the other hand, the RPP tax expenditure did not grow as much: it was \$8.165 billion in 1989 and projected to be \$11.810 billion in 2006. Overall, however, the annual net tax expenditure on RRSPs is smaller than that associated with RPPs.

Participation in RRSPs has been rising. According to Schembari (2007), from 1992 to 2004, there was a 25% increase in the number of taxfilers contributing to RRSPs and a 12% increase in the average contribution in dollars. The greatest increase in the number of contributors was seen in the older age groups (45 to 64) and the average contribution was the highest for those 55 to 64. Since 1994, contributions to RRSPs have exceeded those to RPPs (Maser and Anderson 2007). The gender gap has been narrowing. For example, women aged 25-64 accounted for 46% of contributors in 2004, up from 43% in 1992. There are now more Canadians participating in RRSPs than RPPs: 37% of the labour force had RRSPs whereas 33% had RPP coverage (Maser and Anderson 2007). As in the case of RPPs, higher income taxfilers were more likely to contribute to RRSPs: individuals with incomes of \$80,000 and over had the highest average contribution in 2004 (Schembari 2007). This could mean that RRSPs are becoming a more important source of retirement income for individuals with middle- and high-earnings.

Compared to RPPs, RRSPs are more “equitable” to all individuals with earned income, whether or not they are employed or self-employed, or employed by an employer with a RPP. They help “correct” the inequity in the coverage of the RPPs. They are particularly

attractive to younger workers and mobile workers as they value portability of their pensions and are more savvy in managing the investment. On the other hand, RRSPs provide less retirement income security for participants, especially when compared with DB RPPs. Participation is generally automatic for workers eligible to be covered under an RPP, especially a DB plan, but optional in the case of RRSPs. Unlike DB plans, RRSPs are not locked-in. Therefore, RRSPs are used not just for retirement saving purposes. Withdrawals from RRSPs are often motivated by the need to smooth consumption to override “income shocks” sustained as a result of unexpected events (unemployment, death of a spouse, disability or divorce), to buy a home or invest in further education, or to obtain better rate of returns on investment (Mawani and Paguette 2007).¹⁷

The “liquidity” feature of RRSPs is a double-edged sword. As mentioned above, while it reduces the security of the plan as a source of retirement, it may encourage more individuals to save through RRSPs. The ability to withdraw from RRSPs is particularly important to individuals who retire before age 65. In 2004, over 1.4 million Canadians withdrew money from their RRSPs; about one-quarter of individuals aged 55 to 64, but they received 40% of all RRSP income. Some of them may be retired and using money from their RRSPs as a source of retirement income or to tide them over until they become eligible for the CPP/QPP or RPP benefits (Schembari 2007).

Like RPPs, RRSPs provide more tax subsidy to individuals in higher tax brackets, because the tax subsidy takes the form of a deduction in computing taxable income. The tax incentives for RRSPs are meagre for low-income individuals because tax deferral means little to people whose tax rate is low or zero. In reality, individuals with low earnings have not taken advantage of the tax subsidy. The bulk of the unused room is held by low-income taxfilers (Schembari 2007). While 3.1% of taxfilers with income less than \$10,000 contributed to RRSPs, 76.3% of taxfilers with income of \$80,000 and over contributed (Schembari 2007). Low-income individuals may not have enough disposable income to permit saving through an RRSP. They may not

¹⁷ Other than withdrawals under the qualified “Home Buyers Plans” or “Lifelong Learning Plans,” withdrawals are fully taxable. If the marginal tax rate is at the same or lower than the time of contributions, there is still the benefit of tax deferral because the investment earnings accumulated within an RRSP are tax-free. However, if the marginal tax rate is higher, there may be a “tax penalty”. See Mawani and Paguette, 2007.

want to save because of the full income replacement by the public pensions or because of the OAS/GIS claw-back (see below).

In spite of the low participation rates for low-income individuals, the government has increased the contribution room since 1957 (see Table I). The more generous tax subsidy has not induced taxfilers to save more. While the RRSP contribution room has been increasing, the unused RRSP contribution room has also been increasing. In 2004, the total RRSP room available to taxfilers aged 25 to 64 reached \$367.3 billion, 4.5 times higher than it was in 1992. The share of room used has continued to drop, to 7% in 2004 from 20% in 1992 (Schembari 2007).

It seems clear that the RRSP tax expenditure benefits individuals who actually use the RRSP tax subsidy and these individuals are generally in the middle and high income groups. Like RPPs, RRSPs are intended to assist individuals to replace about 70 per cent of pre-retirement income. Individuals in low-income groups receive full or more than 100 percent income replacement under the public pension programs. Therefore, it is not surprising that individuals in the middle and high-income groups actually save more through RRSPs and RPPs. To this extent, the RRSP tax expenditure cannot be criticized as totally ineffective in achieving the policy goal or being unfair to individuals with low income.¹⁸ On the other hand, as public policy, it is questionable whether this tax policy has led to “additional” savings or RRSPs savings at the expense of non-RRSP savings (Austin 1996).

5.3 RPPs and OAS/GIS

RPPs have a potential impact on the OAS/GIS system through the “claw-back” in the OAS/GIS system and the funding of these programs. OAS payments are clawed back when an individual’s net income (which includes private pension income) is greater than \$63,511 (as of 2007).¹⁹ Pensioners with an individual net income above \$63,511 must repay part or all of the maximum OAS pension amount. The full OAS pension is eliminated when a pensioner's net income is \$103,191 or above. The GIS is paid to

¹⁸ It is beyond the scope of this report to debate about whether the tax policy itself is justifiable.

¹⁹ See “Old Age Security (OAS) Payment Rates” at <http://www1.servicecanada.gc.ca/en/isp/oas/oasrates.shtml>.

individuals who generally have little or no other income beyond their OAS and perhaps a very small pension. GIS benefits stop at a specified annual income amount (\$36,528 as of 2007). As a result, the clawback rate is 50 cents for each dollar, or 50%.

Because private pension income is fully taxable, the combined effect of paying tax on the pension income and the reduction of GIS benefits may result in an effective marginal tax rate of 75 per cent (the 50% clawback noted above and 25% rate of taxation) on those RRSP benefits and a reduction of living standard. Therefore, for those at the lowest end of the income spectrum, RRSPs are a "terrible investment" (Shillington 2003). The individuals who have low and modest savings in their RRSPs are worse off than those without any private retirement savings.²⁰

RPPs may interplay with OAS/GIS in terms of financing the latter programs. Tax expenditures on RPPs and RRSPs are revenues foregone by the government. OAS/GIS payments are funded by general tax revenue. From 1988 to 1998, pension tax expenditures account for over 80 percent of OAS/GIS payments. In 1999, pension tax expenditures exceeded the OAS/GIS payments. Table J shows that other than the two "abnormal" years during which pension tax expenditures were extremely low, the percentage has been between 68 to 70 per cent.

The comparison of pension tax expenditures and OAS/GIS payments shows the extent of public support to the retirement income security of Canadians with different levels of income, albeit through different means. Individuals in the middle and high quintiles receive tax subsidies and those in the bottom and low quintiles receive periodical pensions directly from the OAS/GIS system.

5.4 RPPs and C/QPPs

The majority of RPPs take into consideration contributions and benefits under the CPP/QPP (Schembari 2003). An integrated benefit formula generally means that participants who retire before becoming eligible for CPP/QPP will receive an additional

²⁰ "Although the amounts saved may have required significant sacrifices, they will have little impact on the households' standard of living at retirement" (Shillington 2003).

amount from their RPP. The RPP benefit component of the integrated benefit is reduced when the participants start to receive CPP/QPP. The integration ensures that the retirement income remains relatively stable if a worker takes early retirement.

Any increase in the CPP contribution rate may have a negative impact on participation in RPPs. Most RPP plans have integrated benefits and in addition some rely on a mix of employer and employee contributions. If CPP contribution rates rise, then employees with average and below-average wages may have difficulties making contributions to RPPs (Morrissette and Drolet 2001). This may shift more of the cost of sponsoring RPPs to employers, causing employers to rethink their plan. This problem is relevant to RPPs (especially DC RPPs) that require employees to make contributions. In theory and assuming that the nominal wage remains the same, an increased CPP contribution reduces the amount of "take-home" wage that can be used to make RPP contributions. If employee contributions to RPPs are mandatory and deducted at source by the employer, an increased CPP contribution simply reduces the take-home wage. If employee contributions to RPPs are voluntary, low-wage employees may not have enough money to contribute to RPPs. For employers, increased CPP contributions increase their cost as well.²¹

5.5 RPP Tax Expenditures and Public Pension Financing

Abolishing tax expenditures on RPPs and RRSPs would raise additional tax revenue in the current year, which could be used to fund public pensions. Assuming that Canada retains the dual policy goals of the Canadian retirement income system (i.e., prevention of old age poverty and maintenance of living standard by replacing 60-70% of pre-retirement income up to a ceiling), the absence of private pension income would require a dramatic increase in public pensions, creating pressures on public spending (Policy Research Initiative 2005, at 17).

Any significant increases in either OAS or CPP/QPP benefits may be difficult politically and financially. Politically speaking, it is hard to imagine that Canadian voters would support the use of public revenue to pay more pensions to individuals with high pre-

²¹ Note, however, there is no clear empirical evidence on this issue.

retirement income (in order to maintain their standard of living). Negotiations between the federal and provincial government on changes to the C/QPP may be extremely difficult. Such an ostensibly regressive system that redistributes income from the working-age population to the retirees has no precedent in any OECD country. It would be against the recent global trend in reducing public pensions (Borsh-Supan 2004). Even if the political support is there, financing the increased public pensions would be extremely costly. It would require a big increase in the contribution rate to the CPP/QPP. It would also require more general revenue be allocated to the OAS system, which will inevitably reduce other public spending programs or require raising taxes.

6. Implications for the viability of the Ontario pension system

There are no available studies suggesting that the forgoing analysis of the national private pension system does not apply to Ontario. Because the Ontario personal income tax shares the same base as the federal income tax, the deduction for contributions and non-taxation of investment income reduce the Ontario tax base and tax revenue. But, Ontario currently has no direct policy role in the design of pension tax expenditures, as they are provided in the federal Income Tax Act. If Ontario is concerned about the lack of retirement income security for individuals who are not in the position to benefit from the current pension tax expenditures, it should consider working with the Federal Government to explore reform options.

7. Conclusions

Tax expenditures associated with RPPs cost the federal and provincial governments money each year. The benefit of this expenditure is distributed according to the coverage of the RPPs and an individual's income level. Individuals who are not covered by RPPs receive no benefit from this tax expenditure. Individuals in the middle and higher quintiles receive more benefit as the value of the benefit is tied to the marginal tax rate.

The amount of tax expenditures associated with RPPs has generally been increasing while the coverage of RPPs has been slowly declining. This phenomenon raises questions about the efficacy of the tax expenditure policy. In contrast, the increase in tax expenditures associated with RRSPs have been accompanied by an increase in participation in RRSPs, most notably by individuals in higher income groups. RRSPs are generally more equitable and flexible than RPPs, but provide less security in retirement income. It is thus important to re-evaluate tax policy in order to encourage RPP coverage expansion by making RPPs more flexible to both sponsors and members.

Table A:**Cash-Flow Estimates of Net RPP Tax Expenditure (1989-2008)**

Year	(A) Deduction for contributions (\$millions)	(B) Non-taxation of investment income* (\$millions)	(C) Taxation of withdrawals (\$millions)	(D) Net Tax Expenditure (\$millions)
1989	3615	7440	2890	8165
1990	4050	9000	3635	9415
1991	4460	8950	4030	9380
1992	4990	7865	4580	8275
1993	5205	8610	4930	8885
1994	4890	9540	4010	10420
1995	4925	10040	4520	10445
1996	4930	8015	4905	8040
1997	5170	8305	5540	7935
1998	4490	11445	5985	9950
1999	5030	17285	6695	15620
2000	4895	9390	6695	7590
2001	4575	2785	6415	945
2002	5325	335	6670	(1010)
2003	6615	11465	6905	11175
2004	8270	9630	7140	10760
2005	8395 (Projected)	10215 (Projected)	7235 (Projected)	11375 (Projected)
2006	8700 (Projected)	10670 (Projected)	7560 (Projected)	11810 (Projected)
2007	9015 (Projected)	11405 (Projected)	8055 (Projected)	12365 (Projected)
2008	9325 (Projected)	12165 (Projected)	8495 (Projected)	12995 (Projected)

* This amount is calculated by using the changes in actual asset levels—after accounting for contributions and withdrawals— to derive the amount of investment income for the year: Department of Finance, *Notes to the Estimates/Projections 2004*. Therefore, all increases in the market value of the assets will be considered foregone income in that year. The asset levels are measured by using their market value. This explains the volatility in the figures. It also raises questions as to whether this accurately reflects the tax that was foregone considering that: (a) there is a different tax treatment of interest, dividends and capital gains – how is this accounted for in this treatment; (b) behavioral differences – how is the portfolio constructed in a registered account vs. a non-registered account and how much tax is actually being foregone?

Source: *Personal and Corporate Income tax Expenditures*, Department of Finance 1993 and Department of Finance's *Tax Expenditures and Evaluations Reports 1997-2006*.

Table B:
Sample Calculation of present-value cost of tax expenditures

		Amounts (\$)						
		Contribution (beginning of year 1)	Year					Withdrawal (end of year 5)
			1	2	3	4	5	
Tax Assisted Retirement Savings Investment	Gross Balance	62.50	106.40	113.21	120.46	128.16	136.37	136.37
	Federal tax paid (A)	-25.00						34.09
	Provincial tax paid (C)	-12.50						17.05
	Net Balance	100	106.40	113.21	120.46	128.16	136.37	85.23
Non-Tax Assisted Retirement Savings Investment	Gross Balance	62.50	66.50	69.16	71.93	74.80	77.80	
	Federal tax paid (B)		1.00	1.04	1.08	1.12	1.17	
	Provincial tax paid (D)		.50	.52	.54	.56	.58	
	Net Balance	62.50	65.00	67.60	70.30	73.12	76.04	
Federal tax loss (Tax paid B – Tax paid A)	25.00	1.00	1.04	1.08	1.12	1.17	-34.09	Total present value cost
Federal present- value tax cost	25.00	.94	.92	.90	.88	.86	-25.00	4.49
Provincial tax loss (Tax paid D – Tax paid C)	12.50	.50	.52	.54	.56	.58	-17.05	
Provincial present- value tax cost	12.50							.47
Total federal and provincial present-value cost								6.74

Source: Department of Finance, *Tax Expenditures and Evaluations* (2001).

Table C:**Present-value estimates of tax expenditures associated with RPPs and RRSPs (2001-2008) (\$ millions)**

	2001	2002	2003	2004	2005 projected	2006 projected	2007 projected	2008 projected
PV method (RPPs and RRSPs)	5670	5850	6820	8040	8490	8990	9380	9850
Cash-flow method	945	-1010	11175	10760	11375	11801	12363	12995
- RPP	4040	2425	8630	7600	8110	8445	8870	9310
- RRSP	4985	1415	19805	18360	19485	20246	21233	22305
- Total								

Source: Department of Finance, *Tax Expenditures and Evaluations 2006*.

Table D:
Cash-flow Estimates of RPP Tax Expenditure as a percentage of GDP and Federal Income Tax

Year	RPP T.E. (\$millions)	GDP (\$millions)	RPP TE as % of GDP	Federal income tax*	RPP TE as % Of federal income tax
1989	8165	657 728	1.24	84354	9.6
1990	9415	679 921	1.38	92920	10.1
1991	9380	685 367	1.37	93185	10.0
1992	8275	700 480	1.18	97471	8.4
1993	8885	727 184	1.22	93388	9.5
1994	10420	770 873	1.35	92744	11.2
1995	10445	810 426	1.29	100774	10.3
1996	8040	836 864	.96	108554	7.4
1997	7935	882 733	.90	115906	6.8
1998	9950	914 973	1.09	129273	7.6
1999	15620	982 441	1.59	133032	11.7
2000	7590	1 076 577	.71	143129	5.3
2001	945	1 108 048	.09	159706	0.5
2002	(1010)	1 152 905	-.09	151272	-0.6
2003	11175	1 213 175	.92	156400	7.1
2004	10760	1 290 828	.83	164895	6.5
2005	11375*	1 375 080	.83	174894	6.5
2006	11810*	1 446 307	.82	186100	6.3

* Sources: Fiscal Reference Table produces data for 2005-2006 fiscal year and this data is assigned to 2006 in table; and Statistics Canada, *Canada's Retirement Income Programs*, CD-ROM: (Ottawa: Income Statistics Division, 2005) CANSIM Tables 051-0001 and 282-0002.

Table E: DB Plan Participation of Ontario Employees* by Gender

Year	Male	Female
1974	942359	386425
1976	1004023	443648
1978	1067636	473698
1980	1124917	515189
1982	1136304	548041
1984	1104021	563647
1986	1114751	589420
1988	1175715	582944
1990	1146553	692646
1992	1118818	756957
1993	1050156	766481
1994	1007632	769160
1995	985619	764357
1996	969319	760625
1997	954425	756432
1998	936104	746895
1999	936104	758105
2000	962374	783265
2001	998403	821763
2002	968192	833165
2003	967979	862858
2004	943161	859494

Source: CD-ROM and CANSIM tables 051-0001 and 282-0002.

*These data are from published CANSIM tables and only approximate coverage in the Ontario jurisdiction. Here, "Ontario employee" a resident of Ontario who participates in a defined benefit pension plan, which itself may be registered in any jurisdiction. These include Ontario residents who are employed in federally-regulated industries.

Table F: Members of RPPs in Canada by Industry*

Industry	1999	2000	2001	2002	2003	2004
Agriculture, forestry, fishing and hunting	9187	9218	9305	8574	8549	8694
Mining, oil and gas extraction	55216	48916	48483	45355	44950	42984
Utilities	65645	65143	64923	43861	47450	49090
Manufacturing	628892	680793	681315	660557	642242	603250
Construction	230631	250329	271034	271035	279921	290519
All trade industries	313197	363751	399066	369076	366364	349156
Transportation & warehousing	172231	173137	229764	217954	218018	213304
Information and cultural industries	148921	149987	146955	140688	136387	133959
Finance, insurance and real estate	221082	484096	482419	469768	482722	483188
Community business and personal service	53823	76408	84001	88682	94374	87374
Educational services, health care and social assistance	267781	342341	347967	370370	389800	400056
Public administration	1543879	1592134	1577863	1613822	1631942	1656863
Other services (except public administration)	636323	219781	226713	235199	203607	238971

Source: CD-ROM and CANSIM tables 051-0001 and 282-0002.

*Figures are for Canada, not Ontario.

Table G: DB RPP Coverage Rate for the Private Sector

Year	% of Canada's Labour Force	% of Ontario's Labour force*
1988	19.4%	22.5%
1989	n/a	n/a
1990	20.0%	23.4%
1991	n/a	n/a
1992	19.3%	22.5%
1993	18.7%	21.3%
1994	18.2%	20.6%
1995	18.0%	20.3%
1996	18.0%	20.0%
1997	17.9%	20.0%
1998	17.6%	19.7%
1999	17.5%	19.8%
2000	17.9%	20.0%
2001	18.3%	20.6%
2002	17.8%	19.9%
2003	17.5%	19.8%
2004	17.4%	19.3%
2005	n/a	n/a
2006	n/a	n/a

Source: CD-ROM and CANSIM tables 051-0001 and 282-0002.

*Ontario labour force is defined using "Ontario workers", which includes workers in the federally-regulated industries who are resident in Ontario or who are employed in Ontario. Coverage rates for the Ontario labour force excluding federally-regulated workers are not available from CANSIM.

Table H: Cash-flow Estimates of RPP and RRSP Tax Expenditures (1989-2008)

Year	RPP TE (\$millions)	RRSP TE (\$millions)	RRSPs TE as % of GDP	RPP TE as % of GDP	Total TE as % of GDP
1989	8165	4345	.66	1.24	1.90
1990	9415	4595	.68	1.38	2.06
1991	9380	5535	.81	1.37	2.18
1992	8275	5445	.78	1.18	1.96
1993	8885	6885	.95	1.22	2.17
1994	10420	6730	.87	1.35	2.22
1995	10445	7390	.91	1.29	2.20
1996	8040	6845	.82	.96	1.78
1997	7935	9170	1.04	.90	1.94
1998	9950	9910	1.08	1.09	2.17
1999	15620	13120	1.34	1.59	2.93
2000	7590	8240	.77	.71	1.48
2001	945	4040	.36	.09	0.45
2002	(1010)	2422	.21	-.09	0.12
2003	11175	8630	.71	.92	1.63
2004	10760	7600	.59	.83	1.42
2005	11375*	8105*	.59	.83	1.42
2006	11810*	8445*	.58	.82	1.40

Source: Department of Finance's *Tax Expenditures and Evaluations Reports, 1997-2006*.

Table I: RRSP Contribution Room

<u>Year</u>	<u>\$ amount</u>
1957	\$2,500
1972	\$4,000
1976	\$5,500
1986	\$7,500
1991-95	\$11,500
1996-2002	\$13,500
2003	\$14,500
2004	\$15,500
2005	\$16,500
2006	\$18,000
2007	\$19,000
2008	\$20,000
2009	\$21,000
2010	\$22,000 (indexed after 2010)

Source: *Practitioners Income Tax Act*, 2007, notes to “RRSP deduction limit” under s.146(1); and Maser (2003).

Table J: Tax Expenditure on RPPs and RRSPs (cash-flow estimates) Compared with OAS and Federal Income Tax Revenue

Year	Total T.E. on RPPs and RRSPs	Total OAS Payments (\$ millions)*	Total T.E. as % of OAS
1989	12510	15202	82.3
1990	14010	16154	86.7
1991	14915	17039	87.5
1992	13720	18168	75.5
1993	15770	18758	84
1994	17160	19578	87.6
1995	17835	20143	88.6
1996	14885	20430	72.8
1997	17105	21207	80.8
1998	19860	21758	91.2
1999	28740	22285	128.9
2000	15830	22856	69.2
2001	4985	23668	21
2002	1412	24641	5.7
2003	19805	25692	77
2004	18360	26902	68.2
2005	19480 (projected)	27871	69.9
2006	20255 (projected)	28992	70

* Source: Statistics Canada, *Canada's Retirement Income Programs*, CD-ROM: (Ottawa: Income Statistics Division, 2005) CANSIM Tables 051-0001 and 282-0002.

Selected Bibliography

- Akeyampong, E. (2002), "Unionization and Fringe Benefits" in *Perspectives on Labour and Income* (Ottawa: Statistics Canada).
- Allen, Steven G., Robert L. Clark, and Ann A. McDermed (1993), "Pension Bonding and Lifetime Jobs" *Journal of Human Resources*, vol.28, No.3, 463-81.
- Antolin, Pablo, Alain De Serres and Christine De La Maisonneuve, (2004), "Long-Term Budgetary Implications of Tax-Favoured Retirement Saving Plans" *OECD Economic Studies* No.39, 2004/2.
- Austin, Barbara (1996), "Policies, Preferences and Perversions in the Tax-Assisted Retirement Savings System," *McGill L.J.* 41: 571.
- Baldwin, B. (2007), "Determinants of the Evolution of Workplace Pension Plans in Canada" *Caledon Institute of Social Policy* (March, 2007).
- , (2006), "A Shaky Third Pillar: The Vulnerability of Retirement Incomes," in *New Frontiers of Research on Retirement*. Leroy Stone, ed. Ottawa: Statistic Canada.
- , (2004), "Pension Reform in Canada in the 1990s: What Was Accomplished, What Lies Ahead?" *Canadian Labour Congress*.
- Borsh-Supan, Axel (2004), *Mind the Gap: The Effectiveness of Incentives to Boost Retirement Saving in Europe* *OECD Economic Studies* No.39, 2004/2.
- Bruce, Neil (1988) (ed.), *Tax Expenditures and Government Policy: Seventh John Deutsch Roundtable on Economic Policy*. Kingston: Queen's University Press.
- Bryden, Kenneth (1974), *Old Age Pensions and Policy Making in Canada*. Montreal and London: McGill-Queen's University Press.
- Canadian Institute of Actuaries (2007), *Planning for Retirement: Are Canadians Saving Enough?* Online: [CITE?]
- Deaton, Richard Lee (1989), *The Political Economy of Pensions: Power, Politics and Social Change in Canada, Britain and the United States*. Vancouver: University of British Columbia Press.
- Department of Finance, *Tax Expenditures and Evaluations*, 1996, 2001, 2006.

- Dilnot, A. and P. Johnson (1992), *The Taxation of Private Pensions*, The Institute of Fiscal Studies.
- Franco, D. (1996), "The Taxation of Funded Pension Schemes and Budgetary Policy", European Commission Economic Papers, No.117.
- General Accounting Office (2000), "Private Pensions: Implications of Conversions to Cash Balance Plans" GAS/HEHS-00/185.
- Gros, Barry and Pat Suzuki (1998), "Pension plan face-lift", *Benefits Canada* (March 1998), online:
<http://www.benefitscanada.com/content/legacy/Content/1998/03-98/ben227.html>.
- Gustman, Alan L., Olibia S. Mitchell and Thomas L. Steinmeier (1994), "The Role of Pensions in the Labour Market: A Survey of the Literature," *Industrial and Labour Relations Review* vol.47, No.3, 417-438.
- Gustman, Alan L. and Thomas L. Steinmeier (1993), "Pension Portability and Labour Mobility: Evidence from the Survey of Income and Program Participation" *Journal of Public Economics* Vol.50, 299-323.
- Hutchens, Robert (1986), "Delayed Payment Contracts and a Firm's Propensity to Hire Older Workders" *Journal of Labour Economics* vol.4, No.4, 439-57.
- LaRochelle-Cote, Sebastien, John F. Myles and Garnett Picot (2007) "Income Security During Retirement in Ontario", prepared for OECF.
- Lazear, Edward P. (1979), "Why is There Mandatory Retirement?" *Journal of Political Economy* vol.87, No.6, 1261-84.
- Lehman, Jefferey S. and Douglas A. Kahn (1992), "Tax Expenditure Budgets: A Critical View," 54 *Tax Notes* 1661.
- Lipsett, B. and M. Reesor (1997), "Employer-sponsored Pension Plans. Who Benefits?" Applied Research Branch, Human Resources Development Canada, Working Paper W-97-2E. Ottawa, December 1997.
- Li, Jinyan (2006), "Separation, Linkage and Blurring in the Public and Private Pillars of Canada's Retirement Income System." In *New Frontiers of Research on Retirement*. Leroy Stone, ed. Ottawa: Statistic Canada.
- Luchak, A. and T. Fang. (2005), "Pensions or Group RRSPs: Patterns of New Plan Adoptions, Establishing Secondary Plans, Terminations and Plan

- Substitutions”. Paper presented at the conference on the Evolving Workplace of the Canadian Employment Research Forum, Ottawa, September 28-29.
[Http://www.cerforum.org/conferences/200509/papers/luckakFang.pdf](http://www.cerforum.org/conferences/200509/papers/luckakFang.pdf).
- Maser, Karen, (2003), “An Introduction to Canada’s Retirement Income Programs” in *Canada’s Retirement Income Programs: A Statistical Overview (1990-2000)* (eds.) Karen Maser and Josee Begin, Income Statistics Division, Catalogue No. 74-507, Ottawa: Statistics Canada.
- , and Robert Anderson (2007), “Introduction to Canada’s Retirement Income Programs” in *Canada’s Retirement Income Programs*. Statistics Canada Ct. no.74-507-XCB, Ottawa: Statistics Canada.
- Milligan, Kevin (2002), “Tax-Preferred Savings Accounts and Marginal Tax Rates: Evidence on RRSP Participation,” *The Canadian J. of Economics*, Vol.35, No.3, 436-56.
- Mintz, Jack M. and T.A. Wilson (1997), “Private Provision of Retirement Income: Tax Policy Issues,” in K.G. Banting and R. Boadway, eds. *Reform of Retirement Income Policy: International and Canadian Perspectives*. Kingston: School of Policy Studies, Queen’s University.
- Morissette, R. and M. Drolet (2001), “Pension Coverage and Retirement Savings”, *Perspectives on Labour and Income*, Statistics Canada, Catalogue No.75-001-XPE, Vol.13, No.2: 39-46.
- Morissette, R. and X. Zhang (2004), “Retirement Plan Awareness”. *Perspective on Labour and Income*. Vol.16, No.1, Ottawa: Statistics Canada.
- Morissette, R. and Y. Ostrovsky. (2006) *Pension Coverage and Retirement Savings of Canadian Families, 1986 to 2003*, Ottawa: Statistics Canada.
- Myles, J. (2002), *The Maturation of Canada’s Retirement Income System: Income Levels, Income Inequality and Low Income Among the Elderly*, Ottawa: Statistics Canada.
- Nielson, Norma and David K. W. Chan (2007), “Private Pensions and Government Guarantees: Clues from Canada,” *PEF*, 6(1): 45-66.
- OECD (1996), *Tax Expenditure: Recent Experiences*, Paris.
- Ontario Ministry of Finance (2006), *Ontario Economic Outlook and Fiscal Review* (Descriptions of each tax provision were provided in the government's first Transparency in Taxation report, presented in [Annex V](#) of the report).

Ontario Economic Council (1983) *Pensions Today and Tomorrow: An Ontario Economic Council Position Paper*

Palameta, B. (2003), "Profiling RRSP Contributors." *Perspectives on Labour and Income*, 4, 1. Ottawa: Statistics Canada.

Schembari, Patricia (2007), "Retirement Savings through Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs): A Decade of Change," in *Canada's Retirement Income Programs*, Statistics Canada Ct. no.74-507-XCB, Ottawa: Statistics Canada.

Stein, Norman P. (1991), "Qualified Plans and Tax Expenditures: A Reply to Professor Zelinsky," *9 Am. J. of Tax Pol'y* 225.

Townson, Monica (1995), *Reforming the Canada Pension Plan: The Implications for Women*. Ottawa: Status of Women, Canada

Whitehouse, E. (2002), "Tax Treatment of Funded Pensions," Social Protection Discussion Paper No. 9910, World Bank, Washington DC.

Young, Claire F.L. (1997a), "Public Taxes, Privatizing Effects, and Gender Inequality" in S. Boyd (ed.) *Challenging the Public/Private Divide: Feminism, Law and Public Policy*. Toronto: University of Toronto Press.

____ (1997b), "Taxing Times for Women: Feminism Confronts Tax Policy, in R. Krever ed. *Tax Conversations*. The Netherlands: Kluwer Law International.

____ (2000), *Women, Tax and Social Programs: The Gendered Impact of Funding Social Programs Through the Tax System*. Ottawa: Status of Women Canada.

Zelinsky, Edward A. (1988), "The Tax Treatment of Qualified Plans: A Classic Defense of the Status Quo," *66 N.C.L. Rev.* 315.

----, (1994), "Tax Policy, Revenue Policy: Qualified Plans, Tax Expenditures, and the Flat, Plan Level Tax," *13 Va. Tax Rev.* 591.