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Estimating the Number of Guaranteed Income Supplement Recipients Who Have Mistakenly Saved in Registered Retirement Savings Plans and Registered Pension Plans

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Final Report

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For:
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Executive Summary

The Guaranteed Income Supplement (GIS) has made an important contribution to the drastic reduction of senior poverty in Canada (e.g. Veall, 2008). However, transfer programs by their nature create distortions, and in the case of the GIS, these can be magnified by an interaction with the Registered Retirement Savings Plan (RRSP) program. Indeed Shillington (2003) argues that a large number of seniors are making RRSP contributions in error because they will become GIS recipients in retirement. In that case, retirement RRSP withdrawals will be subject to GIS phaseout of at least 50 per cent, and in a surprisingly large number of cases to personal income tax as well. Hence the effective rate of return will commonly be lower than the rate of return that could have been obtained using the same savings vehicle outside an RRSP. Negative rates of return are easily possible.

Those about to receive GIS would most commonly be made financially better off if they cashed all RRSPs at age 64 to avoid the GIS phaseout. In principle it is possible that a GIS recipient, despite the phaseout, could retain all her/his RRSP saving and withdraw it at the slowest legal rate with a financial result superior to saving outside an RRSP. The study uses a number of scenarios to consider this alternative and shows that an RRSP advantage requires a high enough personal income tax rate at contribution time, a zero or low personal income tax rate at time of withdrawal, a reasonably high rate of return and a long time period. It is an unlikely scenario to apply to many GIS recipients.

Shillington (2003) estimates that 32% of seniors are making an error by saving in RRSPs. His estimate is based on the 1999 *Survey of Financial Security* (Statistics Canada, 2001) where he calculates “retirement savings” as the sum of the value of

RRSPs and the estimated value of Registered Pension Plans (RPPs). He finds that 32% of "near-senior" households (households where the older spouse is age 55 to 64) have retirement savings greater than zero but less than $100,000. He chooses $100,000 because "an annuity purchased with $100,000 will pay roughly $10,000 per year (varying with age, sex, and type of annuity), which is generally not enough to make a senior ineligible for GIS" (Shillington, 2003, footnote 5).

The Shillington estimate is likely high. Most importantly, he considers the estimated value of RPPs when considering saving. Given that for saving to be a mistake it must be discretionary, this is arguable. Most people would not regard RPP saving as discretionary in the same sense that RRSP saving is: RPP contributions are made by employers and employees in an employment context and a single employee cannot opt out, even if it would be in her/his financial interest to take the same contributions and save them in another form. On the other hand, there may be a discretionary element in that defined contribution RPPs typically allow lump sum withdrawal at age 64 (as do group RRSPs). Defined benefit RPPs sometimes have a cashout provision upon retirement, but it is rare.

In any case, in the empirical part of this paper I examine the Shillington estimate by using the Longitudinal Administrative Database, which allows the anonymous use of personal income tax microdata based on a 20% sample (currently over 5 million records per year). I present findings for the years 1992 to 2008. The value of RRSP income in the LAD unfortunately does <u>not</u> include income from Registered Retirement Income Funds (RRIF), which are a common way to arrange RRSP withdrawals. Some key estimates are:

1. In any given year, about 8% of the couples, 3% of the single women and 3% of the single men who receive GIS receive RRSP income (not including RRIF income) and are therefore subject to GIS phaseout. The corresponding numbers for those who *in addition* pay personal income tax on their RRSP income are 5%, 2% and 2% respectively.
2. RRSP income (not including RRIF income) for GIS-receiving couples has fallen to about 6% of GIS income in 2008 from about 9% in 1992. For single men and single women, RRSP income is about 3% of GIS income, with less variation over the 1992 to 2008 period. Personal income taxes of GIS recipients in 2008 were about 2% of GIS income for couples and less than 1% of GIS income for singles.
3. In the LAD, RRIF income is added to income from RPPs as a single variable. Close to 50% of couples, 30% of single women and 30% of single men receiving GIS have RRIF/RPP income and many pay personal income tax. For GIS recipient couples, RRIF + RPP + RRSP income equals about 60% of GIS income for couples and about 30% for each of single women and single men.
4. Using special estimates provided by Statistics Canada, it is possible to estimate RRSP + RRIF income, although it is not possible to separate it by couples, single women and single men. I estimate that about 10 to 12% of all GIS recipients receive such income, approximately twice the number of GIS recipients who received RRSP income but not RRIF income.
5. The RRSP income/GIS receipt histories of all those between 65 and 76 in the year 2008 were examined from age 60 on. About 15% of seniors receive GIS and RRSP income in the same year at least once in their lives and hence experience

the phaseout. Robustness analysis suggests that this number might be approximately halved if we only considered those who received $2000 of GIS and $2000 of RRSP income in the same year. But the numbers would be larger if RRIF income were included and indeed would about double if RRSP, RRIF and RPP income were included. These values approach the Shillington estimate, although to emphasize it is not clear that RPP contributions and incomes in most cases are sufficiently discretionary as to indicate that an individual can have made an error by saving in such form.

Should the system be changed, to mitigate the consequences of RRSP saving in error? Some would argue that it has with the introduction of Tax Free Savings Accounts (TFSAs), income from which does not lead to GIS phaseout. But given there are existing RRSPs, possible policy options include:

1. Sending information to all those approaching age 65 with an explanation about the GIS, its possible adverse interaction with RRSP withdrawals and the alternative of TFSAs.
2. Consideration of an annual exemption of some RRSP income and perhaps RPP income from the GIS calculation. The study provides a very rough estimate that an RRSP/RRIF exemption of $1000 per year could cost the federal treasury $100m, a significant sum although a small fraction of the total annual cost of GIS of roughly $9b. This estimate is not offered for its accuracy but rather as a ballpark magnitude to help determine whether a more accurate calculation is worthwhile using HRSDC administrative data, which are far better suited to this task.