

Research Project #16: Tax Policy and Occupational Pension Plans

Research Paper: Tax Expenditure Analysis of Employer-Sponsored Registered Pension Plans

Researcher: Jinyan Li

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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 Plan). 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 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. 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 the 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 the common feature – contribution based plans. Only individuals who make contributions to such plans are covered. They are totally different from 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.

Ontario does not have its own tax policy on RPPs. Because of the shared income tax base and 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 cost for the Federal Government as well as Ontario. The increasing RPP tax expenditures and the expansion of RRSPs in the era of 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 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.