

# RRSPs - not just for retirement

*Hubert Frenken*

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Registered retirement savings plans (RRSPs) have existed for 35 years. And every year, their tax-assistance and retirement savings opportunities are at the centre of much publicity. The response to these opportunities has been dramatic, especially in recent years. Contributions for the 1987 to 1990 period amounted to a staggering \$49 billion. It would seem logical then that, after such a long time and with so much money deposited, these plans would be generating sizeable retirement benefits.

At first glance, income tax data seem to support this theory. In 1990, nearly 800,000 Canadians reported \$4 billion in RRSP income on their tax returns, up 29% from 1988 (the earliest year these data are available). What is surprising, however, is that almost two-thirds of this \$4 billion was received by persons under age 65. It seems obvious then, that a large share of RRSP holdings are paid out long before the beneficiaries have reached - what traditionally is regarded as - the normal retirement age.

## Extensive cash withdrawals

RRSP savings can be either received in cash, converted to an annuity or transferred to a registered retirement income fund (RRIF). This study examines the first two types of benefits. RRIF payments are not identifiable from the Revenue Canada data, but were comparatively small in 1990 (see [\*How RRSP income is reported\*](#)). The relative freedom to cash in RRSP deposits any time <sup>(1)</sup> is reflected in the proportion of payments that are cash withdrawals, rather than annuity benefits. According to 1990 Revenue Canada taxation statistics, three out of every four dollars paid from RRSP savings that year were cash withdrawals. Almost all taxfilers under 65 years of age with RRSP benefits (97%) received their RRSP income in this form, while one-third of those aged 65 and older received all or part of their benefits in this manner.



## Chart A **Three out of every four dollars in RRSP benefits were cash withdrawals in 1990.**

Source: *Revenue Canada, Taxation*

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It must be remembered that cash withdrawals are reported on income tax returns in the year they are made, while the conversions of RRSP deposits into annuity benefits are not reported in this immediate manner. (Only the income received from such annuities is reported in the year it is received.) [\(2\)](#) Nevertheless, it is obvious that the practice of cashing in RRSP savings is widespread, even among those approaching retirement.

In 1990, \$1.6 billion or 40% of total RRSP income was reported by taxfilers under 55 years of age - virtually all as cash withdrawals. An additional 22% was paid to individuals aged 55 to 64 ([Table 1](#)). Their \$6,650 average benefit was higher than that of any other age group and more than 90% represented cash withdrawals.

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## Table 1 **RRSP beneficiaries and benefits by age, 1990.**

Source: *Small Area and Administrative Data Division*

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Why are such large withdrawals made? An earlier study has shown that it is usually high-income persons who report RRSP contributions on their income tax returns (Frenken, [1990](#) and [1991](#)). These contributors may liquidate their savings either from necessity (such as job loss), to meet an unusual financial obligation (to assist in purchasing a home or to pay off a mortgage, for example) or simply for enjoyment (possibly travel or early retirement).

Those in the 55 to 64 age group would, in general, have been able to accumulate greater savings than younger individuals. While some may have been forced into early retirement for a number of reasons, others may have elected to draw on RRSP funds before becoming entitled to Old Age Security (payable at age 65).

The rate of growth in total RRSP income from 1989 to 1990 was comparable to that from 1988 to 1989 (approximately 14%). However, there may be greater growth from 1990 to 1991 as a result of job losses and other financial difficulties encountered during the recent recession. [\(3\)](#) As well, withdrawals may have increased further in 1992, as a consequence of the Home Buyers' Plan, introduced by the Minister of Finance in the February 25, 1992 budget. This plan permits individuals to withdraw up to \$20,000 from RRSP savings before March 2, 1993 without withholding of tax. The funds must be used to finance

the purchase or construction of a home and amounts withdrawn must be repaid to the home buyer's RRSP in instalments within 15 years. (Data for 1991 and 1992 were not yet available at the time this article was prepared.)

## Seniors with RRSPs have higher incomes

High-income individuals are generally in a better position to contribute to RRSPs and to make other types of investments. Also, members of employer-sponsored pension plans are much more likely to contribute to RRSPs than those who are not members ([Frenken](#), 1990). These facts are reflected in the tax returns of filers aged 65 and older.

In 1990, the 296,000 in this age group who reported RRSP income (12% of them) had an average aggregate income of \$36,200, while their counterparts without RRSP benefits showed an average total income of just \$20,400 (a difference of \$15,800).

This difference was only partially accounted for by RRSP benefits, however, since the average income reported from RRSPs was only \$5,000. RRSP beneficiaries, in general, also received higher income from other investments and from employer-sponsored pension plans than non-beneficiaries ([Chart B](#)). Their investment income (including interest, dividends and rental income, but excluding capital gains) averaged \$11,000, while those without RRSP benefits received on average only \$6,100 from these sources. Similarly, average pension income amounted to \$7,500 for RRSP recipients versus \$3,300 for those without RRSP income.



### Chart B In 1990, taxfilers aged 65 and over with RRSP Income depended less on OAS and various supplements.

Source: *Small Area and Administrative Data Division*

Non-beneficiaries had to depend more on universal Old Age Security (OAS) benefits and various miscellaneous income sources in 1990. OAS benefits represented 19% of their total income, but only 11% of the income of RRSP beneficiaries. Also, miscellaneous income, which includes various tax credits, grants and non-taxable support payments such as Guaranteed Income Supplement benefits, represented 10% of the total income of taxfilers without RRSP benefits, but only 3% of that of RRSP beneficiaries. [\(4\)](#)

## Summary

In 1990, nearly 800,000 taxfilers reported \$4 billion in income from RRSPs. Even though the prime objective of these tax-assisted savings is to provide retirement income, large amounts are cashed in each year by persons under age 65. In 1990, \$1.6 billion (40%) was paid to persons under 55 years of age and another \$900,000 (22%) to those aged 55 to 64. Almost all of these benefits were cash withdrawals.

About \$1.5 billion in RRSP benefits was reported by 300,000 taxfilers aged 65 and older in 1990. These individuals had an average total income of \$36,200, compared with just \$20,400 for those without RRSP benefits. Not only were they able to draw on their RRSP savings, but they also had a higher average income from other investments and from employer-sponsored pension plans.

It is uncertain what impact the introduction of the Home Buyers' Plan in February 1992 will have on RRSPs. Any large-scale response to this opportunity to make tax-exempted withdrawals of up to \$20,000 per person may affect future RRSP benefits, even if repayments are made when required.

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## How RRSP income is reported

Since 1988, taxfilers have been reporting RRSP income (either cash withdrawals or annuity payments) as a separate item on their tax returns. This permits such income to be identified on the T1 tax file of the Small Area and Administrative Data Division of Statistics Canada. These data are supplemented with information from Revenue Canada's taxation statistics sample file, which separates this income into two categories: cash withdrawals and annuity payments.

RRIF benefits are excluded from this analysis, because they cannot be identified. They must be reported as "other pensions or superannuation" or "other income," depending on the age of the taxfiler. It would appear, however, that in 1990 these payments were much smaller than annuity benefits. Until recently, RRIFs were considerably less popular than annuities. They had a rigid payout schedule and had to be exhausted during the year the beneficiary turned 90. With annuities, however, various payment schedules were available and beneficiaries were not required to receive full payout by age 90.

Data obtained from Canadian life and health insurance companies seem to support this hypothesis. As recently as 1988, these companies reported having issued fewer than 16,000 RRIF certificates to clients ([CLHIA](#), 1991). That number grew dramatically in 1989 and 1990, partially as a result of some relaxation of payment rules. Since RRIFs have only recently started to challenge annuities as a form of RRSP benefit payment, it can be assumed that 1990 RRIF benefits were still only a fraction of the payments generated by RRSP annuities.

The T1 tax file and the accompanying T1 family file permit more extensive analysis than this article

presents. These files have been described in earlier issues of *Perspectives on labour and income* ([Frenken](#), 1991 and [Galarneau](#), 1992). For further information and more current data, contact the Small Area and Administrative Data Division, Statistics Canada, 14th Floor R.H. Coats Building, Tunney's Pasture, Ottawa, Ontario, K1A 0T6; telephone (613) 951-9720.

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## Legislation

The Income Tax Act and its accompanying regulations spell out how RRSP benefits can be paid. Total savings must be converted into annuity income or registered retirement income funds (RRIFs) before the end of the year in which the beneficiary reaches age 71.

The most common form of annuity purchased with RRSP funds is "a straight life annuity" (Coward 1991), which provides the beneficiary with a monthly benefit for life. Payments depend on the life expectancy of the beneficiary and the interest rate offered at the time of purchase. The issuer of the annuity assumes the risk and guarantees the benefits promised. RRIFs provide monthly payments that depend to some extent on the rate of return on the investments held in the fund. The beneficiary controls the investments and assumes the risk associated with this.

While the conversion to annuity and RRIF benefit provides opportunities for tax-deferral, lump-sum withdrawal require that federal tax be withheld immediately, at the following rates (Revenue Canada, Taxation, 1983):



Table

*\* The Quebec government requires the withholding of additional taxes.*

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The author wishes to thank Mahmood Mohiuddin, Director, Pensions and Life Insurance Benefits, Canadian Life and Health Insurance Association Inc., and Diane Coates and John O'Meara, Registered Plans Division, Revenue Canada, Taxation, for their valuable comments and suggestions in reviewing this article.

# Notes

## *Note 1*

With few exceptions, RRSP contributions are not locked in, as is the case with a growing share of employer-sponsored pension plan accruals. Under the regulatory legislation implemented by the governments of Canada and of most provinces, members of pension plans, when terminating employment after two years of membership (five years of service in some provinces), cannot cash in benefits accrued after the effective date of the applicable legislation (January 1, 1988 in Ontario, for example). These benefits are locked-in and accessible only at retirement. They may be transferred to a locked-in RRSP or similar non-accessible fund, in which case the financial institution or "issuer" is obligated to hold the deposits until the designated retirement age.

Some employers who sponsor group RRSPs may require that employees leave contributions in the plan for a certain period of time before withdrawing them. In general, however, RRSPs have no restrictions on withdrawals and cashing in prior to retirement.

## *Note 2*

The total annuity values are amortized over a period of years, resulting in comparatively low monthly or annual disbursements. For example, converting \$30,000 of RRSP savings into an annuity might yield an annual benefit of \$3,000 (depending on the age of the beneficiary and rate of interest) and this would result in the reporting of only \$3,000 in RRSP income annually. However, receiving the \$30,000 as one cash sum would require reporting the full amount in the year received.

## *Note 3*

Contributions to RRSPs declined dramatically during the first two months of 1991 from the amounts deposited in January and February 1990, resulting in a drop of 16% in total contributions from 1989 to 1990. (The bulk of each year's contributions is made in the first two months of the subsequent year.) The economic uncertainty in early 1991 may not only have curbed the volume of contributions, but it may also have increased cash withdrawals that year.

## *Note 4*

These differences would be even more pronounced if the analysis included non-taxfilers. In 1990, 16% of the population aged 65 and older did not file a tax return, presumably because they did not have a tax liability. However, nearly all would have received Old Age Security benefits and many full or partial Guaranteed Income Supplement and provincial Guaranteed Annual Income payments.

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## Source

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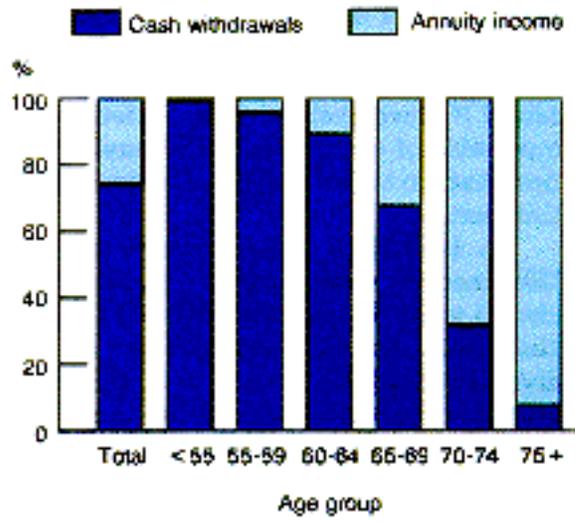
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Chart A

**Three out of every four dollars in RRSP benefits were cash withdrawals in 1990.**



Source: Revenue Canada, Taxation

Table 1

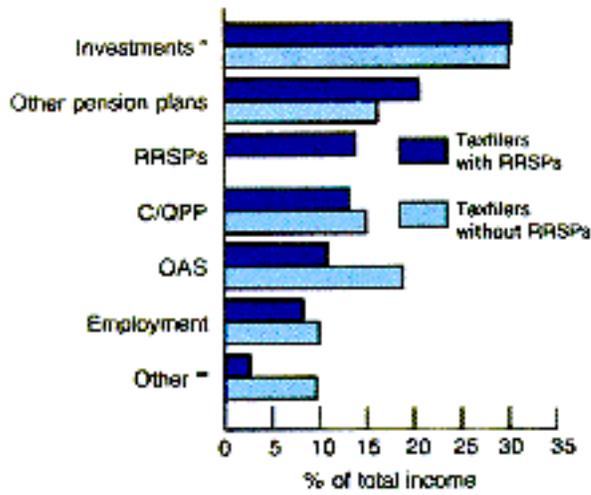
**RRSP beneficiaries and benefits by age, 1990**

|                   | Beneficiaries |              |                         | Benefits     |              |              |
|-------------------|---------------|--------------|-------------------------|--------------|--------------|--------------|
|                   | Number        | Distribution | Proportion of taxfilers | Amount       | Distribution | Average      |
|                   | '000          | %            |                         | \$ millions  | %            | \$           |
| <b>Total</b>      | <b>792</b>    | <b>100</b>   | <b>4</b>                | <b>3,976</b> | <b>100</b>   | <b>5,020</b> |
| Under 65 years    | 496           | 63           | 3                       | 2,498        | 63           | 5,040        |
| Under 35 years    | 137           | 17           | 2                       | 413          | 10           | 3,010        |
| 35-44 years       | 135           | 17           | 3                       | 644          | 16           | 4,780        |
| 45-54 years       | 89            | 11           | 3                       | 546          | 14           | 6,130        |
| 55-64 years       | 134           | 17           | 7                       | 894          | 22           | 6,650        |
| 65 years and over | 296           | 37           | 12                      | 1,478        | 37           | 4,990        |
| 65-69 years       | 119           | 15           | 13                      | 669          | 17           | 5,600        |
| 70-74 years       | 98            | 12           | 15                      | 478          | 12           | 4,900        |
| 75 years and over | 79            | 10           | 8                       | 331          | 8            | 4,180        |

*Source: Small Area and Administrative Data Division*

Chart B

**In 1990, taxfilers aged 65 and over with RRSP income depended less on OAS and various supplements.**



Source: Small Area and Administrative Data Division

\* Includes interest, dividends and rental income, but excludes capital gains.

\*\* Includes various tax credits, most non-taxable transfer payments, and miscellaneous income.

| <b>Amount withdrawn</b>      | <b>Proportion withheld</b> |                     |
|------------------------------|----------------------------|---------------------|
|                              | Quebec*                    | Elsewhere in Canada |
|                              | %                          |                     |
| Less than \$5,000            | 5                          | 10                  |
| Between \$5,000 and \$15,000 | 10                         | 20                  |
| More than \$15,000           | 15                         | 30                  |

\* *The Quebec government requires the withholding of additional taxes.*