

# RRSP withdrawals revisited

Hubert Frenken

For a number of years, Canadians under 65 years of age have cashed in about one dollar of registered retirement savings plan (RRSP) savings for every five contributed. From 1990 to 1994 they took out \$16.6 billion. Between February 1992 and October 1996 they withdrew an additional \$4.4 billion through the Home Buyers' Plan (HBP).

Whereas pension accruals in nearly all employer-sponsored registered pension plans (RPPs) are locked in after two to five years of plan participation and are available only at retirement (see *RPP locking in*), RRSP contributions can be withdrawn any time. It has been suggested that this practice defeats the prime objective of the program, namely, to encourage workers (especially those with no access to RPPs) to save for retirement (William M. Mercer Ltd, 1993 and Cohen, 1993).

This article examines the extent of RRSP withdrawals in recent years, including those made under the HBP. It identifies some characteristics of the taxfilers who dipped into these funds before age 65 and suggests reasons for doing so. It also looks at how withdrawals affect participants' immediate tax obligations and their future retirement savings.

## Considerable amounts and growing

Withdrawals from RRSP savings have always been possible, but no data were available on the extent of this practice until 1988, when the T1 tax return required such amounts to be reported separately.

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## RPP locking in

Under federal-provincial regulatory pension legislation an RPP member leaving the plan after a specified period of time (two years in most provinces) through layoff or voluntary departure has access to his or her pension accruals only at retirement. In most instances the accumulated savings are transferred to a locked-in RRSP or similar vehicle and the financial institution managing these funds ensures that benefits are not paid out until the designated retirement age.<sup>1</sup> These amounts, though part of total RRSP assets under the financial institutions' administration, are not treated as RRSP contributions, but as pension monies still subject to the legislation. For details see Statistics Canada (1996a).

That year, 410,000 taxfilers under age 65 reported some \$2 billion in RRSP income.<sup>2</sup> The amounts withdrawn since then have continued to rise. In 1994, taxfilers under 65 cashed in \$3.9 billion out of assets estimated at well over \$200 billion.

Cashing in of RRSP savings grew dramatically in 1991. This situation was attributed largely to the recession and its accompanying job losses. Nearly 20% of those who made withdrawals had neither

employment income nor unemployment insurance benefits that year; even those with employment income earned on average relatively little. (Frenken and Standish, 1994).

From 1991 to 1994, the number of persons and the amounts withdrawn grew by 16% and 22%, respectively (Table 1). This is rather puzzling, since any who had exhausted their savings in previous years could no longer withdraw. As well, improved economic conditions should, in theory, have reduced the dependency on RRSP withdrawals.

## More older persons

These increases were attributable primarily to older taxfilers. The number of persons under 35 making RRSP withdrawals remained virtually unchanged from 1991 to 1994. But the number between 55 and 64 increased 18% and between 45 and 54, 32% (Table 2). Many may well have been retired, either voluntarily or involuntarily, and drawing from retirement savings before becoming eligible for other types of pension income, such as Canada and Quebec Pension Plan benefits (age 60), Old Age Security payments (age 65) or RPP benefits

Table 1  
RRSP withdrawals \* by taxfilers under 65

	1990	1991	1992	1993	1994
Number of taxfilers ('000)	496	604	635	692	700
Amount (\$ millions)	2,498	3,182	3,403	3,671	3,881
Average (\$)	5,040	5,270	5,360	5,310	5,550

Sources: Small Area and Administrative Data Division and RRSP room file  
\* Excludes withdrawals under the Home Buyers' Plan.

(age varies according to the conditions of the plan).

In fact, more than one-quarter of persons cashing in RRSPs in 1994 were between 55 and 64 and they withdrew over one-third of the total withdrawals. However, a majority (52%) were under 45 and they reported nearly 37% of all withdrawals. These people were not likely ready for retirement and some may have been forced to draw on their RRSP savings for economic reasons.<sup>3</sup> Of this group, 30% had total incomes (including the amount withdrawn) under \$20,000.<sup>4</sup>

Despite this evidence, it appears that many of those who made RRSP withdrawals had high incomes in 1994. While just one in five taxfilers under 65 had a total income greater than \$40,000, nearly one-third in this age group who made withdrawals reported this much.

There have always been fewer women than men contributing to RRSPs and their average contributions have been more modest (Frenken, 1995). In 1994, 45% of all taxfilers under 65 reporting RRSP income were women, scarcely changed from the 44% recorded in 1991. Similarly, women's share of the receipts was 41%, slightly higher than the 39% noted three years earlier.

### Effects on savings and taxes

People who dip into their RRSP savings not only reduce their future income, but also forfeit part of their savings immediately. Amounts withdrawn are subject to a withholding of income tax and may, depending on the taxfiler's marginal rate, result in further tax when the annual return is filed.<sup>5</sup> Persons with low income may actually have a larger portion withheld than the

Table 2  
RRSP withdrawals \* by age of taxfiler

	1991				1994			
	Number		Amount		Number		Amount	
	'000	%	\$ millions	%	'000	%	\$ millions	%
<b>Total</b>	<b>604</b>	<b>100</b>	<b>3,182</b>	<b>100</b>	<b>700</b>	<b>100</b>	<b>3,881</b>	<b>100</b>
Under 35	166	27	508	16	168	24	461	12
35-44	168	28	842	26	197	28	956	25
45-54	116	19	759	24	153	22	1,092	28
55-64	154	26	1,074	34	182	26	1,373	35

Sources: Small Area and Administrative Data Division and RRSP room file

\* Excludes withdrawals under the Home Buyers' Plan.

amount of tax generated by the withdrawal. They receive a refund after their return is assessed.

Currently, the tax is withheld at the following rates:

Amount withdrawn	Proportion withheld <sup>6</sup>	
	Quebec	Other provinces/territories
	%	
Less than \$5,001	21	10
\$5,001 to \$15,000	30	20
Over \$15,000	35	30

Taxfilers making withdrawals may significantly reduce their future retirement income, since all tax-exempt investment income that these savings would have realized is lost. For example, a 65 year-old taxfiler who removed \$5,000 at age 35 will have forfeited more than \$50,000 in RRSP savings, assuming 8% interest compounded annually.

### Home Buyers' Plan

Some taxfilers do have one means of using their RRSP savings without incurring the tax charges,

through the Home Buyers' Plan. This program, in effect since February 1992, has permitted maximum withdrawals of \$20,000 from RRSP savings to finance the purchase or construction of a home. But amounts withdrawn must be fully repaid to the home buyer's RRSP in instalments within 15 years (see *HBP conditions*).

From February 1992 to October 1996, Revenue Canada registered HBP applications for 466,000 individuals who withdrew nearly \$4.4 billion (Table 3). Although the first year was the busiest, participation in the program has continued to be substantial.

At present there are no data on the age, income or sex distribution of the participants. Nor is it known what effect the plan has had on home construction. No doubt, many participants would otherwise have been unable to purchase a home. Others may have had sufficient resources but decided to increase their down payment and reduce their outstanding mortgage.

Much debate has centred on the advantages and disadvantages of the program (Cohen, 1992 and Kinross, 1996). Critics are

**HBP conditions**

The Home Buyers' Plan (HBP), intended to expire in March 1993, was initially extended to March 1994 and subsequently made permanent. In 1995, it was restricted to participants who had not owned a home in the previous five years. The first repayments were due in 1995 for amounts withdrawn in 1992, 1993 and the first two months of 1994.

Amounts withdrawn under this plan are in a sense still part of the person's RRSP assets, but temporarily redirected from traditional investments to a stake in the taxfiler's home.

They are not reported as RRSP withdrawals on the tax return; however, missed payments are treated as cash withdrawals and taxed accordingly. For example, someone who withdrew \$15,000 in 1992 is required each year to repay \$1,000 to an RRSP from 1995 to 2009. Failure to make a payment means that \$1,000 of RRSP income will be added to the filer's tax return. A defaulted payment cannot subsequently be caught up; that is, one may not deposit \$2,000 in the subsequent year and claim all of this as an HBP repayment.

drawals may result in sizeable immediate tax obligations. The reasons for dipping into these savings are varied, but most taxfilers make withdrawals out of financial need. Assuming no changes in legislation, and continued uncertainty in the labour market, this practice will likely grow (Townson, 1995).

**Data sources and acknowledgements**

Most data used in this article and in "RRSP rollovers" are from the RRSP room file of the Pensions Section, Labour Division. For a description of this file see Statistics Canada (1996a). Data for 1995, which will include new figures on the HBP and on excess contributions, will soon be available. For further information contact the Pensions Section at (613) 951-4033. Information on the Home Buyers' Plan is from the Individual Returns and Payments Processing Directorate of Revenue Canada. The author wishes to thank Carl Sarazin and Karen Dorman of the Pensions Section and Daniel Desjardins of Revenue Canada for their assistance.

concerned that the advantage of being able to purchase a home is offset by the disadvantage of losing compound, tax-free interest earned by the RRSP savings, income that cannot be recovered despite the repayment schedule.<sup>7</sup>

**Summary and conclusion**

RRSP withdrawals by Canadians under age 65, which increased dramatically in 1991, continued to grow in the next three years despite improved economic conditions. The greatest growth, both in participation and amounts withdrawn, occurred among individuals aged 45 to 54. However, in 1994, one-quarter of those cashing in RRSPs before the historical retirement age of 65 were between 55 and 64, and they accounted for 35% of the total receipts. They may have needed these savings to tide them over until becoming eligible for pension benefits. More than half were under 45 and they withdrew over a third of the total. Many of these people had low incomes.

A large number of taxfilers used some if not all of their RRSP savings as a down payment to purchase a home under the Home

Buyers' Plan (HBP). The first of the associated repayment instalments were due in 1995. Tax data for that year will permit a more in-depth analysis of the characteristics of the participants in this plan, as well as the extent of their repayments and the degree of success in meeting this obligation (see *Data sources and acknowledgements*).

RRSP withdrawals, even those under the HPB, reduce retirement savings. Moreover, regular with-



Table 3  
**Participation in Home Buyers' Plan \***

	Number of participants	Amounts withdrawn
	'000	\$ millions
<b>All periods</b>	<b>466</b>	<b>4,372</b>
February 26, 1992 to March 1, 1993	158	1,536
March 2, 1993 to March 1, 1994	102	1,008
March 2, 1994 to December 31, 1994	56	453
January 1, 1995 to December 31, 1995	78	713
January 1, 1996 to October 23, 1996	71	663

Source: Revenue Canada, Individual Returns and Payments Processing Directorate  
\* Number and amounts recorded as of October 23, 1996. Some additional applications may have been approved but not yet added to the database.

## ■ Notes

1 Generally, only benefits accrued after the date specified in the legislation (January 1, 1987 in Ontario, for example) are locked in. Benefits accumulated earlier are usually received in cash or transferred tax free to a non-locked-in RRSP. In time, virtually all RPP accruals will be locked in.

2 The amounts reported as RRSP income on the tax return include both RRSP annuity payments and cash withdrawals. However, for persons under 65 annuity income is negligible. For example, in 1991, 1992 and 1993 fewer than 3% of taxfilers under 65 with RRSP income received all or part of that income from annuities and just 2% of the total benefits were paid this way.

Included in the withdrawals are excess contributions for which a comparable deduction was claimed. These contributions were made in previous years and not claimed as deductions at that time. They may now be withdrawn and reported on the tax return as both a withdrawal and a deduction. Under certain circumstances they may have resulted in a penalty tax.

3 Statistics Canada's Survey of Labour and Income Dynamics has revealed that Canada's labour force is in constant transition, resulting in frequent jobless periods for many workers. In 1993, 4.3 million persons lost a job, found a job or moved in or out of the labour force (Statistics Canada, 1996b).

Other uses of RRSP savings may be to support oneself during a period of voluntary absence from work while looking after young children or while attending school, to pay for children's education, to start a business, or to travel.

4 Because the amounts withdrawn are included in total income, they may distort the analysis. Also, total incomes increased dramatically for many taxfilers in 1994, their last opportunity to claim deductions on capital gains accrued on rental and other property. In order to avoid paying tax on these gains in the future, taxfilers were required to report the taxable portion on their 1994 tax returns. As a result, over 1.4 million taxfilers reported \$32.5 billion in deductible capital gains that year.

5 Also, financial institutions impose a significant penalty when certain investments are liquidated before their designated date of maturity.

6 The amount withdrawn would be reduced by this percentage. For example, an Ontario resident withdrawing \$4,000 in 1996 would receive only \$3,600. The remaining \$400 would be sent by the administrator of the RRSP to Revenue Canada. The Quebec rate is different, since, unlike other provinces, whose taxes are collected by Revenue Canada, it collects its own income tax. The Quebec rate includes federal and Quebec tax, as follows: 5% and 16% for less than \$5,001; 10% and 20% for \$5,001 to \$15,000; and 15% and 20% for over \$15,000.

7 Repayments also add to future "shelter costs" of mortgage, property tax and other expenses. Payments may also hamper the taxfiler from continuing to contribute to RRSPs. As well, the volatility of real estate values may serve to make a home purchase a less certain investment than before.

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