

# Tapping unused RRSP room

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In 1997, over 19 million Canadians were eligible to contribute some \$216 billion to registered retirement savings plans (RRSPs), if they had the money and the inclination to do so. Each year nearly all individuals with “earned income” (income qualifying for RRSP purposes) are credited with a specific amount of RRSP contribution opportunity or “RRSP room.” The amount of room is based on their earned income and their pension credits, if any (see *RRSP room*). Room not used in any year is reserved and added to the following year’s new room. The \$216 billion is the sum of unused room from earlier years (\$168 billion) and new 1997 room (\$48 billion).<sup>2</sup>

Some questions have been raised about this large accumulation. First, is this an indication that some segments of the population may be inadequately preparing for retirement by using only a fraction of their RRSP room? Second, will it result in large future losses of government tax revenue as individuals start using up this room (Beauchesne, 1995)?

Are these concerns warranted? This article provides some insight into these issues by looking at how this room has accumulated since 1991 and examining the extent to which taxfilers used this accumulation in 1995.<sup>3</sup>

## Growing and growing

Since 1991, both the number of individuals with RRSP room and the aggregate room have grown consistently (Table 1). However, while the number of taxfilers with room increased by a third from 1991 to 1997, the amount of room grew nearly five-fold to more than \$216 billion. Since



*Stronghold door, Royal Canadian Mint, 1908*

the number of individuals who made contributions increased at about the same rate as the number eligible to do so, the proportion of eligible taxfilers who contributed remained at about one-third throughout the period.<sup>4</sup>

However, the percentage of room used by contributors decreased from 27% in 1991 to 18% in 1992, continued to decline at a slower pace after that, and levelled off at 12% in 1996. The relatively high 1991 percentage is

## RRSP room

The amount of new RRSP room made available each year has a ceiling: the lesser of 18% of the previous year’s earned income or a dollar amount, less any pension credits, or pension adjustment (PA), earned by the taxfiler in the previous year.<sup>1</sup> For example, the 1995 new room was the lower of 18% of 1994 earned income or \$14,500 less the 1994 PA (if any). The dollar limit has been amended a number of times since 1991 and is now frozen at \$13,500 until the year 2004. From 1991 to 1996 it was as follows:

| Year | \$     | Year | \$     |
|------|--------|------|--------|
| 1991 | 11,500 | 1994 | 13,500 |
| 1992 | 12,500 | 1995 | 14,500 |
| 1993 | 12,500 | 1996 | 13,500 |

To determine which RRSP contributors tapped into previously accumulated unused room, a number of factors must be considered. First, only normal contributions are counted; that is, contributions subject to the standard deduction limits and not rollovers of certain types of income. Second, the presence of a PA must be determined. Third, the appropriate contribution ceiling must be identified.

In this analysis it was assumed that taxfilers with no PA used up some of their room from previous years if their 1995 normal contributions exceeded the amount of new room for that year, and that those with a PA did so if the sum of their PA and normal contributions exceeded the new room.

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attributable to the lack of unused room from previous years, because the new legislation came into force only that year. The 1996 levelling off can be partly explained by the reduction in the dollar limits on contributions from \$14,500 in 1995 to \$13,500. As a result, many taxfilers either added less to their RRSP room pool that year or used up a greater amount of previously accumulated room.

### Who has this room?

Men, despite contributing at higher rates than women and using a slightly higher percentage of their available room, still account for the greatest share of available room. For example, they made nearly two-thirds of the 1995 normal contributions and used up 13% of their room that year (versus 11% for women). Yet nearly 62% of the 1996 room belonged to men.

Even though younger persons have been participating in greater numbers in recent years (Aldridge, 1997), they still have more unused room than older taxfilers. Taxfilers under 35 years of age held nearly one-third of the \$163 billion in 1995 room and those between 35 and 44 accounted for an additional one-third. Individuals in these two age groups used up just 8% and 12%, respectively, of the room available to them that year.

Income has always been the primary factor in people's decisions on whether and how much to contribute to RRSPs (Frenken and Maser, 1993; Frenken, 1995b). Those with low incomes, who seem to be contributing in greater numbers of late (Frenken, 1997), still account for the bulk of unused room. Taxfilers with less than \$30,000 total income in 1995 held nearly one-half of the room that year. In fact, 30% of the room belonged to persons with incomes under \$20,000. They used up less than 3% of their room that year, while those with incomes between \$20,000 and \$29,999 contributed only 8% of the amount available to them.

**Table 1**  
**Total RRSP room 1991 to 1997 \***

|      | Taxfilers        |                            | Amount      |         |
|------|------------------|----------------------------|-------------|---------|
|      | Number with room | Percentage contributing ** | Available   | Used ** |
|      | '000             | %                          | \$ millions | %       |
| 1991 | 14,364           | 32                         | 45,345      | 27      |
| 1992 | 15,531           | 31                         | 77,094      | 18      |
| 1993 | 16,264           | 30                         | 106,904     | 15      |
| 1994 | 16,928           | 31                         | 136,537     | 13      |
| 1995 | 17,525           | 32                         | 162,715     | 12      |
| 1996 | 18,039           | 33                         | 189,653     | 12      |
| 1997 | 19,115           | ..                         | 216,367     | ..      |

Source: RRSP room file

\* Includes each year's new room and unused room from previous years. Since 1991 was the implementation year of the new legislation, there was no unused room that year.

\*\* The number of contributors and the amount used relate only to normal contributions and exclude rollovers. See note 4.

This low usage rate and extensive accumulation of RRSP room by Canadian workers with low incomes might lead to the conclusion that this segment of the population is inadequately preparing for retirement. Some of these individuals may have other assets to draw on in retirement, but most will have little need for extensive savings to replace pre-retirement earnings. Pensions from the Old Age Security/Guaranteed Income Supplement (OAS/GIS) program and the Canada and Quebec Pension Plan (C/QPP) will fully replace earnings for most people with low incomes over their careers (Department of Finance, 1995).<sup>5</sup>

### Who uses it?

Not all taxfilers accumulate large amounts of unused room. Some take full advantage of their contribution opportunities on a regular basis, while others may allow some unused room to accumulate, but periodically contribute more than their new room to use up some of that accumulation.

In 1995, nearly 5.7 million taxfilers, 32% of the 17.5 million with RRSP room, contributed. More than 1.6 million, 29% of contributors, used at

least some of their previously accumulated room. More than 240,000 (4% of all contributors) reported either an RRSP contribution alone or a combination of PA and contribution that exceeded \$14,500. Moreover, almost 1.4 million or nearly 25% had a contribution or a combination of PA and contribution that was less than \$14,501 but greater than 18% of their previous year's earned income (Table 2). Only those persons with earned income over \$80,556 would have been limited by the \$14,500 ceiling. Relatively few people have that much income; therefore, by far the greatest number who contributed more than their new room that year surpassed the 18% limit.

The 1.6 million contributors who tapped their unused room in 1995 deposited nearly \$9.4 billion – 47% of the \$20 billion normal RRSP contributions that year. This \$9.4 billion was applied to both 1995 new room and unused room from previous years. In summary, even though 68% of taxfilers eligible to contribute to RRSPs in 1995 made no deposits, 32% (nearly 5.7 million) did, and of these, 29% used up some, but not necessarily all, of their room from previous years.

**Table 2**  
**Taxfilers who used previously accumulated RRSP room in 1995**

|  | Contributors |            | Contributions * |            |
|--|--------------|------------|-----------------|------------|
|  | '000         | %          | \$ millions     | %          |
| <b>Total</b>                               | <b>1,636</b> | <b>100</b> | <b>9,386</b>    | <b>100</b> |
| Contributions alone                        | 766          | 47         | 5,312           | 57         |
| Greater than \$14,500                      | 70           | 4          | 1,390           | 15         |
| Less than \$14,501, but greater than 18%** | 695          | 43         | 3,922           | 42         |
| Combinations of PA and contribution        | 870          | 53         | 4,074           | 43         |
| Greater than \$14,500                      | 174          | 11         | 1,335           | 14         |
| Less than \$14,501, but greater than 18%** | 696          | 43         | 2,739           | 29         |

Source: RRSP room file

\* Includes contributions covering both new and unused room.

\*\* Greater than 18% of 1994 earned income.

While 38% of all 1995 RRSP contributors were between 45 and 64 years of age, more than 47% of those who tapped their unused room that year were in that age group. Some 22% of contributors who used up some of their accumulated room had an income of \$60,000 or more, and an additional 26% reported between \$40,000 and \$59,999. Moreover, the two groups combined accounted for 62% of the \$9.4 billion contributed.

## Conclusion

As a whole, Canadian taxfilers have traditionally contributed only a relatively small proportion of the maximum allowable amount to RRSPs. The amount not used has been accumulating since 1991 and by 1997 the total RRSP room (both unused room from previous years and 1997 new room) was more than \$216 billion. There are indications that at least some of this accumulated room is being used up by a growing number of taxfilers. The proportion of total room used decreased annually from 1991 to 1995, but held at 12% in 1996. One reason for this levelling off was the reduction

of the maximum dollar amount of new room credited to taxfilers that year, from \$14,500 to \$13,500. Since this amount is now frozen at \$13,500 until the year 2004, perhaps a growing number of RRSP contributors will make deposits that exceed their annual new room in the coming years.

A large proportion of unused RRSP room is held by workers with low incomes, many of whom may never be in a financial position to contribute to RRSPs. They may also have little need to do so; according to the Department of Finance, government pensions from the OAS/GIS and C/QPP may provide disposable income as great as, or greater than, that before their retirement. Persons with higher incomes who have not made full use of their RRSP opportunities may have had more pressing financial obligations. This may change with time, however.

Traditionally, taxfilers in their late forties and fifties have had both the highest RRSP participation rates and highest average contributions (Frenken, 1995b). They are also more likely than others to use some of their

previously accumulated room, which for some may be quite substantial. At those ages, individuals are generally in a better financial position than before to make RRSP contributions. They are very likely in their peak earning period and, with paid-off mortgages and children no longer dependent on them, they may have greater discretionary income than they did when they were younger. Also, because of their age, they may have a greater sense of urgency to save for their retirement.

The first members of the baby boom generation have recently entered the ages of greatest RRSP participation and will be followed by many more for some time. Whether this will result in a massive depletion of accumulated RRSP room with consequent tax implications remains to be seen. □

## Notes

1 The PA is a calculated value of the pension credits earned by the taxfiler who participates in an employer-sponsored pension plan or deferred profit sharing plan. The inclusion of the PA in calculating RRSP room is intended to provide similar tax breaks to workers with or without such coverage (Frenken, 1995a).

2 These data differ slightly from those published by the Small Area and Administrative Data Division (SAADD) of Statistics Canada, because SAADD has removed some records from the file and because this article is based on a 2% sample. New room for 1997 is based on 1996 tax information.

3 Although preliminary summary information on 1996 contributions and 1996 and 1997 room was available at the time of analysis, the most recent detailed data for study were for 1995.

4 The 1991 RRSP participation rate of 32% is identical to the figure noted in the accompanying article, "RRSP contributions and withdrawals: An update." That year marked the beginning of RRSP room. For subsequent years, the rates contained in this study are slightly lower. Whereas the other article considers only taxfilers with RRSP room assessed in the particular

year examined, this analysis includes all individuals with room assessed at least once since 1991, making the denominators used here a bit larger.

5 A proposal to replace the OAS/GIS with a new Seniors Benefit is now being considered. This change would have little effect on the need for retirement savings for people with low incomes. In fact, many may see an increase in their government pensions from previous levels.

### ■ References

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