

Tax workers, not retirees

Those who depend on interest income hit with highest tax rates

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Despite the alarming fall in corporate pension coverage, Canadians haven't compensated by increasing retirement saving. Half of us are still not saving in RRSPs or Registered Pension Plans, Statistics Canada reported Tuesday. Cumulative unused RRSP contribution room quadrupled between 1992 and 2004.

Meanwhile, financial planners see more retirees carrying large debt loads, and an AXA Retirement Scope survey finds 58% of Canadians expect to work past 65.

An AXA survey released this week found 75% of us believe the solution to these problems is to lower the tax burden on retirees. "Many people expect pension reform to occur and feel the retired should be taxed at a lower rate than the working," says AXA Canada's Lise Allard.

That's a view I've long harboured privately. It may be something the new Conservative government might consider putting on its agenda.

AXA found Canadians far-sighted in preparing for retirement: 78% of workers have started to save, up 8% from a year ago. For most of us, it takes almost a third of a century to save enough out of incomes that are among the mostly highly taxed in the western world.

Ottawa-based certified financial planner Marc Lamontagne says Statistics Canada doesn't include non-registered savings or rental properties in its figures "so in theory people are

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saving more than reported." Recent gains in house prices and the stock market have made people feel richer, lulling them into saving less, Lamontagne says. This is called the Ricardian theory.

But there is also a shift in how Canadians approach retirement planning.

"We are no longer saving a fixed percentage of our income throughout our life time," Lamontagne says.

"Instead we are putting off saving till later in life." That means waiting until mortgages are paid off and major consumer items acquired. Then we "save like crazy in the last 15 years before retirement. It is amazing how many clients hire me around the age of 45."

Rather than target some giant future number, (like \$1-million or \$2-million), the Bank of Montreal finds Canadians think more in terms of a monthly target income: \$3,500 on average.

Winnipeg-based CFP Valerie Chatain-White says the range is \$3,000 to \$6,000, depending how lavish a lifestyle is desired. But more seniors resort to debt to reach that number.

"Years ago Canadians were excellent savers and had very little debt in retirement," Chatain-White says. "Last year I noticed that due to low interest rates more people are entering the retirement phase in debt."


That's counter to the traditional planning pillar that all debt should be eliminated before ending work. That included mortgages, but today seniors view homes as one more source of emergency cash, whether via home equity lines of credit or reverse mortgages. The cash generated by the latter is tax-free but at the expense of home equity ultimately denied your heirs.

Working longer and saving more is one remedy. But even if we succeed in the late push to save, in retirement we'll encounter the same merciless tax levels as when working. When I filed taxes for my now deceased mother I was amazed at the tax drubbing she was subject to on a modest half teacher pension, the usual government pensions and modest amounts of investment income. The latter was mostly from bank GICs, which attracted the same high level of tax as the pension income.

Tax rates are lower for dividends or capital gains but most retirees don't want stock-market risk. They shouldn't be punished by higher tax on interest income than on stocks.

Under the Liberals, the hope of cutting taxes on interest or pension income would have been dim. From my initial chats with Conservative MPs like Monte Solberg and Garth Turner, it's clear the new government may be more receptive to these issues as the Baby Boom generation starts retiring.

The new government is of course constrained by election promises. Lower capital gains taxes may help some but not retirees with interest income. What would help would be the

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registered lifetime savings plan (RLSP) the Tories floated in the 2004 campaign. Similar to America's Roth plans or the C.D. Howe Institute's proposal for tax prepaid savings plans, RLSPs would generate tax-free income in retirement: ideal for interest-bearing investments.

That's a far cry from the RRIFs most RRSPs become after age 69: the tax savings RRSP investors enjoyed while working come back to bite retirees as they withdraw highly taxed RRIF income. Nor would RLSPs trigger Old Age Security clawbacks, which is also a concern for retirees with non-registered dividend income. Under the new dividend tax regime, higher "gross-ups" on dividends mean retirees are subject to higher levels of OAS clawbacks than before.

Memo to new federal Finance Minister Jim Flaherty: if you want ageing urban Baby Boomers to vote Tory, tax them less in retirement. The RLSP is a great place to start.

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