The Disability Savings Plan: Contribution Estimates and Policy Issues

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Executive Summary

A Disability Savings Plan has been proposed to accomplish several objectives. These objectives include:

- Providing a savings mechanism for persons with disabilities and their family members to promote self-sufficiency and improve their standard of living
- Developing a new partnership among families and governments
- Ensuring that Canadian families have tools to plan for the time when they cannot care for family members with disabilities.

The Disability Savings Plan would help families provide support to a child: (i) after the child has left home, (ii) following the parent's retirement or (iii) after the parent or grandparent has died.

With the existing RRSP rollover provisions, contributing to an RRSP can achieve the third purpose (except in those situations in which the parent has used the RRSP limit, the parent has no earnings or the parent is over age 70). The first two purposes would require a new savings mechanism to permit use of the contributions in the near term.

A related study by Richard Shillington entitled *The Disability Savings Plan: Policy Milieu and Model Development* has scanned existing programs and mechanisms, reviewed policy precedents and compared the policy implications of three models for reform.

In continuing our examination of the implications of a Disability Savings Plan, this paper seeks to answer three questions:

1. How beneficial are the three possible models to the contributors and beneficiaries?
2. What level of contributions to a Disability Savings Plan should be expected and what would be the revenue cost of the plan to governments?
3. What other policy implications require consideration?

Comparison of Models

Three models for a new savings mechanism to assist families in securing the future for their relatives with disabilities have been proposed (See *The Disability Savings Plan: Policy Milieu and Model Development*):

1. Modified RRSP rules

2. Registered disability savings plan (tax-deferred)

3. Registered disability savings plan (tax-prepaid).

The history of the Registered Education Savings Plan (RESP) demonstrates that the attractiveness of a savings vehicle does affect contribution levels and that changes in rates of return do affect how families allocate resources to different family needs. Prior to the Canada Education Savings Grant (CESG), RRSPs provided a more favourable rate of return than RESPs. Not surprisingly, the uptake on RESPs was small. Once the CESG was implemented, however, it provided a better rate of return which translated into high contribution levels to RESPs and some shift of investment away from RRSPs.

After-tax rates of return under the three possible new savings mechanisms are compared, based on an analysis of the 'effective marginal tax rates' applicable to the plans, including benefit reductions that a beneficiary of the Guaranteed Income Supplement or social assistance might face. In most cases, the tax-deferred model provides a higher return than the tax-prepaid model.

Furthermore, the annual rate of return diminishes under a tax-deferred plan the longer the investment is held. This is because the income-averaging tax advantage obtained from shifting the tax liability from the contributor to the (usually) lower-income beneficiary is averaged over a greater number of years. The rate of return is higher for persons with higher incomes because the deduction is greater for persons with higher incomes.

Estimating Take-up and Cost

The take-up for a Disability Savings Plan will depend to a large extent upon the design of the plan. For example, eligibility rules will play a significant role in determining the size of the contributor population. Modifications to other programs, such as social assistance benefits, will also have a major impact on uptake. (For details on the assumptions used in the calculations, please refer to the full paper.)

The estimates of contributions to a Disability Savings Plan range from $60 million to $230 million per year depending on the design. The estimated cost to the federal government would be $15 million to $47 million per year. Total provincial costs would be approximately half of the federal costs, or from $7.5 million to $23.5 million per year.

Public Policy Discussion

Governments provide assistance to persons with disabilities through expenditure programs, (e.g., disability supports and social assistance) and through tax measures (e.g., the disability tax credit and the RRSP transfer on death). Expenditure programs tend to replace family contributions, and, in the case of social assistance, deter any ongoing family support of social assistance recipients. Tax measures, on the other hand, may reward family support. Apart from the medical expense tax credit and the RRSP rollover, however, the benefits provided by the tax measures do not increase as the level of support rises. Consequently, they provide no incentive for families to increase their level of support of relatives with disabilities.

The main policy objectives underlying expenditure programs and tax measures are to support those with special needs who do not have resources of their own and to make the tax system fairer. We suggest that governments should explicitly pursue a third objective: that of encouraging family support of relatives with disabilities. Family support could be encouraged by:

- Reducing the benefit reduction rate faced by persons on social assistance who receive assistance, and

- Providing a tax advantage for income transfers.

The advantages of reducing the deterrents to family support, which arise as a result of the preoccupation with benefit targeting, warrant further consideration. By modelling the trade-off between benefit targeting and encouraging family support, we find that a lower benefit reduction rate could accomplish two goals:

- Increase financial support to persons with disabilities, and

- Decrease costs to government.

Finally, the model suggests that reducing the benefit reduction rate faced by those on social assistance, which is often 100 percent, to 50 percent or lower actually could reduce social assistance costs while at the same time increasing support to persons with disabilities. The analysis suggests that policy changes could generate significant additional income support for persons with disabilities without increasing social assistance costs.

Conclusion

A registered Disability Savings Plan, when coupled with improvements to social assistance, would be an effective method for encouraging family contributions, promoting additional savings

and benefiting persons with disabilities. The analysis demonstrates that the tax deferred disability savings plan provides an attractive 'after-tax' rate of return for contributions that are exempted by social assistance and a modest but positive rate of return even when payouts are subject to a benefit reduction rate of 50 percent.

The amount of savings and government costs are dependent on the plan's design. However, anticipated contributions between $60 million and $230 million per year would cost the federal government between $15 million and $47 million annually, respectively.

Introduction and Summary of Findings

This paper provides commentary and analysis on some issues relating to options such as the registered disability savings plan (RDSP) proposed by the Planned Lifetime Advocacy Network (PLAN) to help households provide financial support to family members with disabilities. The typical situation is that of parents seeking the best means to support an adult child both currently and in the future, and the analysis here focuses on that case. However, siblings, grandparents and other relatives may also provide such support.

The analysis expands on that put forward in the report, *The Disability Savings Plan: Policy Milieu and Model Development*, prepared by Richard Shillington of Tristat Resources with input and advice from Professor Jonathan Kesselman of Simon Fraser University and Sherri Torjman of the Caledon Institute of Social Policy.

The paper is organized in three sections. Section 1 examines the attractiveness of vehicles such as Registered Retirement Savings Plans (RRSPs) and variants of the proposed RDSP that could be used to channel support to family members with disabilities. In particular, we calculate after-tax rates of return on saving in such vehicles under various assumptions regarding the effective tax rates facing the contributor and beneficiary. Section 2 presents estimates of the likely level of contributions under an RDSP and the corresponding revenue cost of the plan to government. These estimates are based on the rate of return analysis of Section 1 and on a profile of the retirement savings behaviour of families, particularly those providing support to family members with disabilities. Section 3 explores, from a public policy perspective, on the treatment of various support options under the tax and transfer systems. In particular, it comments on the trade-off between two conflicting goals – that of encouraging family support of persons with disabilities and that of targeting government financial assistance to those 'who need it most.' It should be noted that this paper considers only broad policy issues; it does not attempt to address the myriad detailed design questions involved in the development of any tax measure like the RDSP.

The main findings are set out below under the three section headings.

Rate of Return Analysis. An RRSP-style RDSP could provide supporting family members with attractive rates of return on their RDSP contributions, particularly where the benefits do not give rise to offsetting reductions in social assistance (SA) benefits.

In most cases, an RRSP-style RDSP would provide a higher after-tax rate of return than a Tax Prepaid Savings Plan-style (TPSP) plan, in which contributions are not deductible but benefits are tax-free. For this reason, the analysis in Sections 2 and 3 focuses on the RRSP-style plan. However, there are circumstances in which the rate of return would be higher under a TPSP-style plan.

Estimated Level of Saving in an RDSP. If an RDSP were introduced, the level of contributions would depend on several factors including the detailed eligibility rules of the plan, the

contribution limits, restrictions on when transfers could be made to beneficiaries and, most important, the treatment of plan benefits under SA regimes and other social programs. The estimates in the paper are based on the admittedly strong assumption that payments out of RDSPs would not be offset by reductions in SA benefits.

Three groups of eligible beneficiaries are considered: minor children (those under age 18 at the time the contributions are made), working age adults and seniors. To be eligible, beneficiaries are assumed to qualify for the federal disability tax credit and to meet a test of financial dependency on the contributor.

Three options are considered which vary according to when transfers to beneficiaries are permitted. Under option A, transfers are permitted only after the death of the contributor. Under option B, for contributions made in respect of a minor child, transfers may be made at any time after the child attains age 18. Under option C, transfers to adult beneficiaries may be made at any time upon completion of a five-year holding period. The estimated contribution levels under these options are $60 million, $100 million and $230 million, respectively.

These contribution levels would give rise to annual federal revenue costs of $15 million, $23 million and $47 million, and provincial costs of about one-half these amounts.

Public Policy Issues. Government programs and tax measures provide considerable support to persons with disabilities. They also deliver assistance to caregivers and recognition of financial support given by taxpayers to family members. However, there are no government measures that explicitly encourage increased levels of family support in the way that the charitable donations credit encourages the funding of charities.

Encouraging increased private support of persons with disabilities could advance two public policy objectives: improving the lives of disadvantaged Canadians and limiting pressure on government programs. Two complementary approaches deserve consideration: (1) a tax-preferred vehicle such as an RDSP, and (2) reducing the current penalty imposed on family income transfers by the high benefit reduction rates under SA programs.

In examining the structure of SA benefits, governments must weigh the benefits of encouraging family support against the need to limit program costs by targeting benefits to those who need them most. The paper begins an exploration of this trade-off by using an economic ‘consumer choice’ model to simulate levels of financial support under different SA benefit reduction rates. The results suggest that reducing these rates could generate additional income support for beneficiaries without adding to SA costs.

Rate of Return Analysis

Introduction: The Case of RESPs

The recent history of registered educational savings plans (RESPs) provides a convenient introduction to this analysis. The RESP is a tax vehicle that parents may use to set aside funds for their children's postsecondary education. Contributions to an RESP, unlike those to a registered pension plan (RPP) or registered retirement savings plan (RRSP), are not deductible. However, RESPs provide two sorts of tax benefits to savers. First, the investment income earned in an RESP accrues tax-free. Second, when funds are paid out of the plan, the accumulated investment income is taxable but generally only at a low or zero rate because it is taxed in the hands of the student who typically has little other income and whose tax liabilities are reduced by the education and tuition tax credits. Thus the RESP provides both a deferral of tax on the investment income and an 'income-averaging' benefit through the shift in the tax liability on that investment income from the contributing parent to the (lower-income) student.[1]

Despite these tax advantages, RESPs were not very popular until 1998 when the federal government enriched the plan by adding the Canada Education Savings Grant (CESG). Through the CESG, the federal government matched RESP contributions at a 20 percent rate to a maximum grant of $400 per year. The results were striking. From a low level, RESP contributions jumped to more than $1.7 billion by fiscal year 2000-01. Moreover, the proportion of children with RESPs grew from under 5 percent in 1997-98 to 26 percent by 2002-03.[2] But that is not all that happened. The level of RRSP contributions, which had been growing by about $2.5 billion per year, dropped by about $570 million in 1998.

Other factors than the introduction of the CESG likely explain much of the decline in the RRSP contribution level. Nevertheless, this history is instructive. It shows that contribution levels do respond to the attractiveness of the savings vehicles. It also suggests that changes in rates of return can affect how resources are allocated to different family needs – children's education vs. parent's retirement income in this case.

Let us look at the rates of return that underlie the history of this tax measure: the rates of return on saving outside an RESP or RRSP, in a pre-1998 RESP, in an RESP with the CESG and in an RRSP. In these cases, we consider a particular example and set of economic assumptions, the details of which are set out in the box below.

To begin with, note that every parent of a student has the option of providing direct financial support while the child is studying. In this case, a transfer of $1,000 out of the parent's after-tax income results in assistance of $1,000 to the child. There is no tax event – no tax deduction to the parent, no taxation of the amount in the hands of the child, and no loss of tax credits or program benefits by the child. This result – $1,000 of net benefit to the child for $1,000 of cost to the parent – provides a benchmark for assessing the attractiveness of options involving the pre-funding of financial support.

Assumptions for Illustrative Examples

The parent providing the support is a BC resident with income in 2005 in the range, $74,575-$90,555 and faces a combined federal provincial marginal tax rate (MTR of 39.7 percent).[3]

The student's expected MTR is 0 percent. The student's annual income while studying is not expected to exceed the total of the amounts of the basic personal credit, the education credit and the tuition credit.

The holding period of the investment is 10 years. We simplify the example by looking at one contribution and one withdrawal, but this could represent an average of differing holding periods without materially affecting the results.

The expected rate of inflation over the 10-year period is 2 percent per annum.

The expected pre-tax rate of return on investment is 5.57 percent per annum. Removing the inflation premium embodied in the return leaves a 'real' or 'constant dollar' return of 3.5 percent.

When invested outside an RESP or RRSP, the investment income is subject to an MTR of 29.6 percent. This is based on an investment portfolio that includes a balance of debt and equity investments, and reflects the effect of the dividend tax credit and the 50 percent inclusion rate for capital gains.[4]

Now consider the option of setting aside funds today, outside an RESP or RRSP, to finance the child's education in the future. Consider the proceeds of $1,000 invested today for use in 10 years. With an MTR of 29.6 percent, the investment yields an after-tax rate of return of 3.92 percent [= (1 - 0.296)*5.57 percent]. In 10 years, the $1,000 grows to $1,469. This is the net amount of support to the student as there is no tax event associated with the transfer of after-tax income. However, because of inflation, this amount should not be compared to the simple transfer of $1,000 in 10 years time; $1,000 available in 10 years is not worth as much as $1,000 today. Discounting the net proceeds of $1,469 to reflect 2 percent inflation over the 10 years leaves a constant dollar amount of $1,205. The real after-tax rate of return on the investment is 1.88 percent per annum [= 100 percent*(1.0392/1.02 - 1) or = 100 percent*($1,205/$1,000)$^{0.1}$ – 1)].

The next option is saving in an RESP. Here, the $1,000 investment grows at the tax-free rate of 5.57 percent to $1,780 after 10 years. The $780 in accumulated investment income is taxable to the child, but, given our assumption that the student has a sufficiently low total income as to be non-taxable, the tax liability is zero. Thus the amount of support provided to the student is $1,780 or, in constant dollars, $1,411. The real after-tax rate of return on investment is 3.50 percent *per annum* (p.a.), the same as the pre-tax real rate of return.

Under an RESP with CESG, the $1,000 investment is matched by a 20 percent grant. In 10 years, the total investment of $1,200 grows to $2,063. Again assuming non-taxability of the student, the amount of support is $2,063 or $1,693 in constant dollars. The real after-tax rate of return on the

parent's $1,000 investment is 5.40 percent, substantially greater than the pre-tax real rate of return on the parent's investment.

Parents must weigh their desire to support their children's higher education against their own need for income security in retirement. The relative effectiveness of saving to meet these competing goals will affect how parents balance them. Assume that, with expected levels of income from OAS, the CPP (or QPP) and based on saving to date in private pension plans and RRSPs, the parent expects to have retirement income in the range, $35,595-$64,954. The marginal tax rate in BC on taxable income in this range is 31.15 percent. Consider the allocation of $1,000 of after-tax income to finance an RRSP contribution that will be withdrawn in retirement in 10 years. Given the tax deductibility of RRSP contributions, and the 39.7 percent MTR facing the parent today, an RRSP contribution of $1,658 has a net cost to the parent of $1,000.[5] This investment grows at the tax-free rate of 5.57 percent to $2,852 in 10 years, and, with the MTR of 31.15 percent, the after-tax proceeds are $1,963 ($1,611 in constant dollars). The annual after-tax rate of return on the net saving (i.e., amount of foregone consumption) of $1,000 is 6.98 percent; after allowance for inflation, the real after-tax rate of return is 4.88 percent. This rate exceeds the pre-tax real rate of return because of an income-averaging benefit associated with the shifting of taxable income from the contribution year, with an MTR of 39.7 percent, to the withdrawal year, where the MTR is 31.15 percent.

A final option to consider is that of contributing to an RRSP but withdrawing the proceeds before retirement and using them to support the child's education. Here the gross proceeds of $2,852 are taxable at the parent's MTR while working which we assume to be 39.7 percent – the same as when the contribution was made. The after-tax proceeds here are $1,780 ($1,411 in constant dollars) for a real, after-tax rate of return of 3.50 percent. The results of these options are summarized in Table 1.

Table 1
Rates of return on RESP and retirement saving options

Option	After-tax proceeds* ($)	Real rate of return (%)
Saving outside an RESP or RRSP	1,205	1.88
RESP without CESG	1,411	3.50
RESP with CESG	1,693	5.40
RRSP (cash out in retirement)	1,611	4.88
RRSP (cash out before retirement)	1,411	3.50

* In 10 years, but expressed in constant dollars.

Several observations are worth noting from this comparison:

- First, the direct transfer finances the same expenditure by the student as it would by the parent; there is no tax incentive to favour one choice over the other.

- Second, setting aside funds before the child needs them, even outside an RESP or RRSP, provides a positive real, after-tax rate of return, albeit of modest proportion.

- Third, where the student is non-taxable, an RESP (without CESG) provides a full tax exemption on the investment income. As we can see from the final option, this is the same rate of return as provided by RRSP saving where the taxpayer remains in the same tax bracket in the year the funds are withdrawn as when they were contributed. This is an important point that may help to explain the limited take-up of RESPs prior to the introduction of the CESG. If the rates of return on RESP and RRSP saving are similar, then RRSP saving offers the substantial advantage that the decision regarding the allocation of the proceeds can be deferred until later. There are many uncertainties connected with saving: Will my child actually enrol in postsecondary education? How long will my spouse and I continue working? How long will each of us survive? Will our current retirement savings prove adequate? Given these uncertainties, the advantage of being able to defer the decision of how much educational support to provide is a real one.

- Fourth, the comparison shows that the RESP with CESG offers a considerably higher rate of return than RRSP saving for retirement. This should help to explain both its strong take-up and the evidence of some shift in the allocation of saving between retirement and the child's education objectives.

As a final point here, it is worth noting how this comparison is affected if we assume that the student has enough income to be taxable. This change does not affect the options of saving in an RRSP or saving outside an RRSP or RESP since none of these options involves the taxation of income in the hands of the student. However, since the accumulated investment income and CESG amounts in an RESP are taxable in the student's hands, the change does reduce the return available on RESP saving. With an assumed first-bracket MTR of 22.05 percent (the federal-provincial rate in BC in 2005), the real after-tax rates of return on RESP saving drop from:

- 3.50 percent to 2.05 percent, for an RESP with no CESG; and

- 5.40 percent to 4.14 percent for an RESP with the CESG.

Thus, where children are expected to have taxable income of their own while studying, the reduced rates of return on RESP saving will encourage parents to devote more of their resources to retirement saving and less to supporting their children's education.

Providing Support for Children with Disabilities

With the rates of return on saving in RESPs and RRSPs as comparison points, we now consider the attractiveness of options for providing financial support to adult children with disabilities. In this analysis, we use most of the same assumptions (parent's income and MTR, pre-tax rate of return on investment, 10-year holding period for savings) as in the RESP analysis. However, it is important to look at different cases defined by the effective marginal tax rate (EMTR) facing the child who receives the support.

An EMTR is a modification of the MTR that takes into account the effect of the additional income on income-tested tax credits or benefits provided under transfer programs, such as social assistance or the Guaranteed Income Supplement (GIS) for seniors. For example, a senior who has income taxable at a 22.05 percent MTR but who is also eligible for GIS faces an EMTR of 72.05 percent. Since each $1.00 of additional income reduces GIS payments by $0.50, the net gain from a $1,000 income increase is $279.50 [= $1,000 - $220.50 - $500].

We consider three cases:

(1) EMTR = 0 percent [MTR = 0 and benefit reduction rate (BRR) = 0];

(2) EMTR = 22.05 percent [MTR = 22.05 percent, BRR = 0]; and

(3) EMTR = 50 percent [MTR = 0, BRR = 50 percent].[6]

An example of the first case is an individual who has a modest amount of employment income but, due to the personal and disability tax credits, is not taxable. Another example might be an individual receiving SA where the amount of financial support provided by the parent is low enough (under the province's SA rules) to be disregarded in determining the level of the SA benefit. In the second case, the individual has taxable income (e.g., earnings or pension income) but does not receive SA or GIS benefits. In the third case, the individual could be a senior who does not have taxable income but who qualifies for GIS. The third case also indicates the attractiveness of different support options in the hypothetical case of a reduction in the social assistance benefit reduction rate from 100 percent to 50 percent. There is an obvious fourth case – that of a social assistance recipient subject to a benefit reduction rate of 100 percent on other income. However, since the net proceeds of financial support in this case are always zero, and the rate of return always equal to 100 percent, we have ignored it.

Before examining savings options, we should again consider the effect of a direct transfer made out of after-tax income. As in the case of educational support, such a transfer creates no tax event – no deduction for the parent or increase in taxable income for the child. Where the recipient is a senior, there is also no effect on the level of GIS benefits. These benefits depend on the level of

'net income' as determined for income tax purposes, and net income does not include non-contractual transfer payments from other individuals.[7] However, financial support from family members is taken into account in determining eligibility for SA benefits. Where such support is subject to a 100 percent benefit reduction rate (BRR), there is, of course, no advantage in providing it. Any family support in such a situation is likely to be provided covertly or in ways – such as the direct provision of care or other goods and services – that escape the BRR.

Two options are compared: an RDSP/RRSP and a TPSP-style RDSP. Under an RDSP, in the form generally proposed, contributions up to an annual limit are tax-deductible, investment income in the plan is tax-exempt and benefits paid out of the plan are included in the taxable income of the recipient. This differs from regular RRSP tax treatment in that the benefits are taxed in the hands of a specified beneficiary who is generally an adult child with a severe disability. Thus, the benefits will often be more lightly taxed than if they were received by the contributor as in the case of an RRSP. However, the tax treatment is the same as that available when the proceeds of an RRSP are transferred tax-free to a financially dependent infirm child upon the death of the annuitant. (For this reason, we refer to the option as RDSP/RRSP.) In examining the attractiveness of an RDSP here, we ignore one aspect of the proposal – the idea that some specified fraction of the annual investment return be taken from the account and used for a social purpose.

It has also been suggested that an RDSP could be designed in the form of a tax-prepaid savings plan (TPSP).[8] Contributions to a TPSP are not tax deductible, but investment income accruing in the plan, and benefits paid out of it, are tax-exempt. An unresolved issue regarding TPSPs is whether benefits should be included in the beneficiary's income for the purpose of determining eligibility for income-tested tax credits and program benefits. In the case of RRSPs, the full amount of any benefit payment is included in the beneficiary's income. This reflects the fact that the amounts contributed to the plan, and the associated investment income, have never been included in the RRSP holder's income. Parallel treatment for TPSPs would recognize that the amounts contributed have been included in the contributor's income, but the accrued investment income has not.[9] The investment income portion of a benefit payment, even though excluded from taxable income, would be included in income for the purpose of determining income-tested benefits. Although arguments have been made for more generous treatment of TPSP benefits, we assume parallel treatment with RRSP benefits for the purpose of this rate-of-return analysis.

Under the RDSP/RRSP option, net savings of $1,000 by the parent are enough to finance a contribution of $1,658. At a pre-tax rate of return of 5.57 percent, this amount grows in 10 years to $2,852 ($2,339 in constant dollars). Under the different assumptions regarding the EMTR of the child, the net proceeds and real after-tax rates of return are set out in Table 2.

Under the TPSP-type RDSP option, the savings amount of $1,000 grows in 10 years, at 5.57 percent p.a., to $1,720 ($1,411 in constant dollars). Again, the net proceeds and real after-tax rates of return are shown in Table 2.

Table 2
Rates of return on RDSP options

	Effective marginal tax rates*		
Marginal tax rate (%)	0	22.05	0
Benefit reduction rate (%)	0	0	50
RDSP/RRSP			
- Net proceeds** ($)	2,339	1,823	1,170
- After-tax real rate of return (%)	8.87	6.19	1.58
TPSP-type RDSP			
- Net proceeds** ($)	1,411	1,411	1,046
- After-tax real rate of return (%)	3.50	3.50	1.10

* Facing the child.
** In 10 years, but expressed in constant dollars.

Again, several points are worth noting from the Table 2 results:

- In the cases shown in the first two columns, where the benefit reduction rate is zero, a TPSP-style RDSP provides an attractive real rate of return on investment of 3.5 percent p.a. This after-tax rate of return equals the pre-tax rate of return, reflecting the fact that the investment income earned in the plan is permanently exempt from tax.

- However, in these cases, an RRSP-style RDSP, or an RRSP where the proceeds are transferable tax-free to a child with a disability, provides a rate of return that is considerably higher than that of the TPSP-style plan. It also provides a better rate of return than that available to a parent contributing to an RESP with the CESG – 8.87 percent vs. 5.40 percent where the EMTR is zero, and 6.19 percent vs. 4.14 percent where the child has an EMTR of 22.05 percent. This results from the fact that the deductibility of the RDSP or RRSP contribution is more valuable than the matching contribution of 20 percent under the RESP-CESG.

- Because of the income-averaging benefit provided, the rate of return on RDSP/RRSP saving is particularly high – well above the pre-tax rate of return on saving of 3.5 percent – when the child's EMTR is low (zero or 22.05 percent). However, even with a relatively high EMTR of 50 percent, saving in an RDSP/RRSP provides a positive real, after-tax rate of return of 1.58 percent. This is not too different from the rate of return

available to the parent on saving in financial assets held outside an RRSP or RESP (1.88 percent, as shown in Table 1). Thus, we would expect some take-up of an RDSP/RRSP option even where the child faces such an EMTR.

- Where the EMTR is 50 percent, a TPSP-style RDSP also provides a positive real after-tax rate of return, in this case of 1.10 percent.

Because it includes an income-averaging benefit, the real after-tax rate of return on RDSP saving (in an RRSP-type plan) depends on the difference between the contributor's MTR and the child's EMTR. In addition, the effect of the income-averaging advantage on the annual rate of return is greater the shorter the holding period. To illustrate the extent of this variation, Table 3 reports the net proceeds and real after-tax rates of return for net contributions of $1,000 by parents in the four main tax brackets in BC (MTR = 22.05 percent, 31.15 percent, 39.70 percent and 43.70 percent)[10] and for holding periods of 1, 5, 10 and 20 years. In each case, the child's EMTR is assumed to be zero. Thus the table provides an expansion of the first case in Table 2 with net proceeds of $2,339 and an annual rate of return of 8.87 percent. This case (parent's MTR = 39.70 percent, holding period = 10 years) is highlighted in Table 3.

Table 3
Annual rates of return on RDSP contributions
for different contributor MTRs and different holding periods*

Parent's MTR (%)	22.05	31.15	39.70	43.70
Holding period (Years)	Net proceeds ($)**			
1	1,328	1,503	1,716	1,838
5	1,524	1,725	1,970	2,110
10	1,810	2,049	2,339	2,506
20	2,553	2,890	3,300	3,524
	After-tax real rates of return (%)			
1	32.78	50.33	71.64	83.84
5	8.79	11.52	14.52	16.10
10	6.11	7.44	8.87	9.62
20	4.80	5.45	6.15	6.52

* Child's EMTR = 0.
** At the end of the holding period, but expressed in constant dollars.

It is worth noting that, when the child's EMTR is zero, the real after-tax rate of return on contributions to a TPSP-style RDSP, at 3.50 percent p.a., is unaffected by differences in the parent's MTR or the length of the holding period.

As seen in Table 2, the real after-tax rates of return fall below 3.50 percent for both the RDSP/RRSP and TPSP-style RDSP when the child's EMTR is 50 percent. With this EMTR, the rates of return decline as the holding period becomes shorter, and the advantage of the RDSP/RRSP over the TPSP-style plan disappears. With a holding period of five years, for example, the real after-tax rate of return is -0.31 percent for the RDSP/RRSP plan and 0.92 percent for the TPSP-style plan.

Estimating the Level of Saving in An RDSP

In this section, we provide estimates of the expected level of aggregate annual contributions to an RDSP, focusing on the RRSP-type plan since it is likely to be more attractive to most potential contributors than a TPSP-style plan.[11] We also present rough estimates of the associated revenue cost to the federal and provincial governments.[12, 13]

At first glance, the task of estimating the contribution level under an RDSP might seem to be simply a matter of combining an estimate of the population of eligible contributors with an estimate of the average contribution level per contributor. Indeed, this is a good starting point. However, a better estimate would take into account the precise details of the plan rules as well as other factors that affect the attractiveness of RDSP saving as compared to other alternatives.

Background: Saving in RRSPs and RESPs

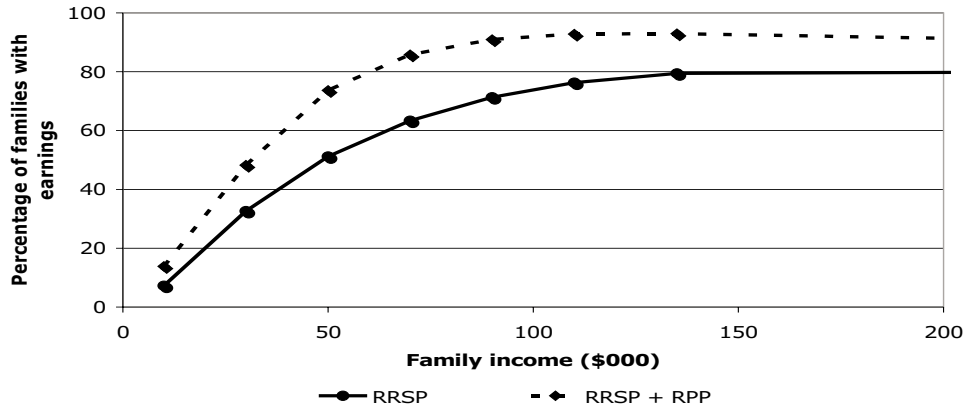
As background, consider the expected response to an increase of $1,000 in the limit on RRSP contributions. One might be tempted to approach this by noting that about six million taxpayers contribute to RRSPs in a given year. If on average, they took up, say, one-fifth of the extra contribution room, then the total increase in contributions would be $1.2 billion [= $200*6 million]. However, this approach does not recognize that a large majority of RRSP contributors do not currently contribute to the limits. Since these contributors have rejected the available option of contributing more at present, we should not expect an increase in the contribution limits to have any effect on their contribution levels.[14]

Because saving in an RDSP would in some ways substitute for that in an RRSP, it is worth looking at the pattern of RRSP contributions and the availability of unused RRSP contribution room. Figure 1 shows the proportions of 'families' (i.e., singles and couples) with earnings that contribute to RRSPs and to registered pension plans (RPPs), deferred profit sharing plans (DPSPs) and/or RRSPs.[15]

Figure 1 shows that the incidence of RRSP contributions and RPP (or DPSP) membership rises strongly with income up to around $80,000 and then levels off. Although not evident from the figure, close to half of those who contribute to RRSPs also belong to RPPs or DPSPs.

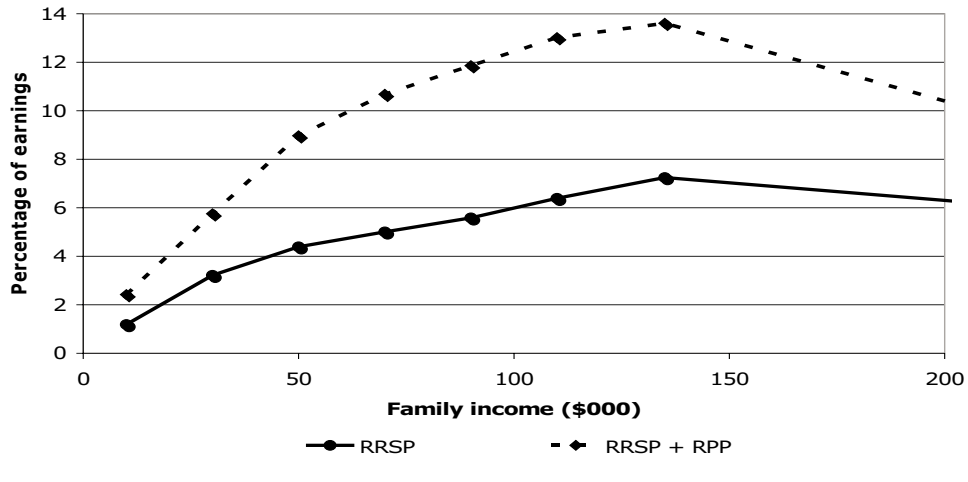
Figure 2 presents the contribution rates to these plans as a percentage of family earnings. For the RRSP + RPP line, the sum, 'RRSP contribution + PA,' is taken as a proxy for total contributions

Figure 1
Percentage of families with earnings that contribute to RRSPs and RPPs, 2002



Note: About 70 percent of families (couples and singles, with or without children) have income < $50,000; about 22 percent have income between $50,000 and $100,000; and 8 percent have income > $100,000.

Figure 2
Contribution rates to RRSPs and RPPs, 2002



to the plans. For a couple, the contributions and earnings of both spouses are added. In calculating the contribution rate, the earnings of non-contributors are included. Thus, the contribution rate is an average for all families in the income range, not just contributors.

Again, the contribution rates are seen to rise markedly with family income, to a peak in the $120,000-$150,000 income range.[16] Given that the comprehensive limit on RPP and RRSP contributions is 18 percent of earnings, we see that the large majority of families are far from exhausting their contribution limits. Critics of the tax preferences for pension and RRSP saving tend to see this as evidence that 'lower-income families just can't save' or that the deductibility of contributions skews the tax preference in favour of the rich. While there are elements of truth in these points, they obscure the main reason for the low contribution rates, especially among modest-income families. It is that people save primarily to replace earned income that will cease at retirement, and the amount of saving needed by a family depends on the level of public pension income (OAS, GIS, and CPP/QPP benefits) that it will receive. For families at relatively low earnings levels, the level of earnings replacement through the public pension plans is quite high, so they need to save very little to maintain their living standards in retirement. For higher-income families, on the other hand, the level of earnings replacement through public pensions is much lower and the need for private pension income correspondingly greater.[17] The decline in the contribution rate for the highest family income range reflects the dollar limit on RPP/RRSP saving that limits their contributions to less than 18 percent of earnings. The entitlement to public pension income means that, for all but the highest income groups, there is a considerable amount of redundancy in the RPP/RRSP limits, particularly taking into account the lifetime carry-forward of unused RRSP room. That is, a contribution rate well below the 18 percent limit is sufficient to achieve the maintenance of living standards in retirement.

Table 4 presents statistics from the T1 model for 2000 (for individual filers rather than families) that indicate how rarely the limit constrains RRSP saving and just how much unused room exists for RRSP contributions. Overall, only 17 percent of those with earnings contributed to the RRSP limit while more than 60 percent had unused RRSP limits in excess of half their annual earnings. Even in the highest income group, 40 percent did not contribute to their limit and 16 percent had unused room in excess of 50 percent of earnings.[18]

Table 4
Use of RRSP limits in 2000

Earnings level ($000)	Percent at the RRSP limit	Percent with unused room > 50 percent of earnings (%)
< 25	17	65
25 - 50	11	70
50 - 75	22	50
75 - 100	37	34
100 +	60	16
All	17	61

Returning to the question of the response to a $1,000 RRSP limit increase, when we limit the expected response to those currently contributing to the limits, even if we double the expected average contribution increase to $400, we arrive at a response only one-third as big as that suggested by the first estimate ($400 million vs. $1.2 billion).

It is also instructive to look at the pattern of participation in the RESP-CESG program. This program is closer in some ways to the proposed RDSP than are RRSPs. For example, RESP saving is destined for transfer to an adult child who often will have left the contributor's household by the time the funds are paid out of the plan. Like RDSP saving, RESP saving will often provide an income averaging benefit as it involves a transfer of taxable income from the parent to a more lightly-taxed child. As we have seen, the value of this benefit increases with the parent's income level and tax bracket. In addition, as in the case of RDSP saving, the decision to fund an RESP rather than contribute more to an RRSP involves a balancing of the parents' desire to help their children with their need to secure their own retirement income security. Table 5 presents an estimate of the percentage of households, by income level, that contributed to an RESP at any time over the four-year period, 1998-2001.[19]

Table 5
Incidence of RESP contributions, 1998-2001

Household Income ($ 000)	Participation* (%)
< 20	2.3
20 – 40	7.1
40 – 60	10.4
60 – 80	13.1
80 +	19.3
All	8.8

*Among families with a child under age 19.

The information in Table 5 indicates that 8.8 percent of families with children under age 19 contributed to an RESP at least once over the 1998-2001 period, and that the participation rate rose from 2.3 percent among low-income families to more than 19 percent for families with total family income over $80,000 per year. Other information suggests that a large majority of RESP contributions were at the $2,000 level, the maximum amount that is matched by a CESG grant.

Factors Affecting Take-up under An RDSP

With this background, let us turn to the issue of the take-up of an RDSP. Both the size of the eligible contributor population and their likely response to the plan will depend on the precise provisions of the plan as well as other factors, such as evolution in the eligibility rules for social assistance benefits. Some of these factors are examined below.

Eligibility of the Child. We could assume that the child is: (a) infirm and financially dependent on the parent; or (b) eligible for the disability tax credit (DTC) and financially dependent on the parent; or (c) simply eligible for the DTC. Alternative (a) follows the existing rule for a tax-free transfer of RRSP assets upon the death of the contributor. Alternative (b) would tighten the existing rule, which might be seen as necessary if other rules were loosened – e.g., the prohibition on tax-free transfers before the death of the RRSP or RDSP contributor. However, when combined with a financial dependency test, this tightening would probably have little effect. Alternative (c) would tighten the disability test to some degree but drop the financial dependency test. This would continue the trend of the 2003 federal Budget in which the default financial dependency test was loosened by increasing the child's allowable income from $7,634 to $13,814 ($14,498 in 2005).[20] It would also recognize that the incentive for the provision of support is greatest when the child's expected income is low. However, there are still grounds for reluctance by government to provide intergenerational tax deferrals where financial need for support is not demonstrated. For the purposes of this estimate, we define the child's eligibility by DTC-eligibility and a financial need or dependency test as under the existing tax-free transfer of RRSP funds on death.

Contribution Limit. We assume an annual contribution limit of $4,000. This is the same as the annual limit on contributions to an RESP. Assuming the limit is indexed, contributions at the limit made over a 15-year period should be sufficient to finance an indexed benefit payment of $5,000 per year for a 20-year period beginning when the contributions cease.[21]

An important consideration is whether the contribution limit would be independent of earnings and unaffected by the age-69 limit that applies to RRSP contributions. This would allow contributions by adults without earnings (e.g., homemakers) and by those over age 69 (e.g., grandparents). Since the purpose of RDSP contributions is unrelated to the replacement of earnings after retirement, there is no particular reason to maintain an earnings test. In addition, we may presume that an RDSP would not be subject to the minimum withdrawal requirements that apply to registered retirement income funds (RRIFs) beginning at age 70. We will assume a limit with no earnings or age test and no required withdrawals.

Another question is whether the limit should apply to contributions by a taxpayer in respect of a beneficiary, or to the total of all contributions by taxpayers in respect of a beneficiary (e.g., contributions by both a parent and a grandparent). An eligibility test that the beneficiary be financially dependent upon the contributor implies a limitation of one contributor per beneficiary, but a relaxation of this rule would likely have little effect on the aggregate level of contributions. We assume that the limit applies to total contributions in respect of a beneficiary.

Time of Transfer. Another important question is whether the transfer of funds should be allowed only upon the death of the RDSP contributor or at earlier dates as well. If the transfer were allowed only upon death, then the introduction of an RDSP might not represent much of a policy change from the existing RRSP rollover on death. Admittedly, the provision for contributions by those without earnings and those over age 69 would provide a channel for some additional support. On the other hand, as noted earlier, many potential contributors might prefer to contribute to an RRSP rather than an RDSP in order to preserve the option of allocating the funds to their child or to their own retirement income security, depending on how these competing needs evolve over time. The idea of RDSP transfers during the life of the contributor raises a number of questions. Allowing contributions to a plan while the child is young and at home in order to provide support once the child leaves home seems logical. Such contributions would parallel those now permitted under RESPs.[22] The rationale for a savings vehicle to provide support to an already adult child in the relatively near future is less clear. Since annual transfers to the child out of current income are an obvious alternative, the savings motive seems secondary to that of obtaining an income-averaging benefit through the taxation of a deductible RDSP contribution in the child's hands rather than those of the contributing parent.[23]

Given these issues, we will provide take-up estimates for three RDSP options based on different transfer restrictions:

(A) transfers allowed only upon the contributor's death;

(B) transfers allowed upon the contributor's death or, for contributions made in respect of a minor child, after the child reaches age 18; and

(C) transfers allowed as under (A) and (B) and, in any other case, after a five-year holding period.[24]

Eligibility Rules for Social Assistance Benefits. As discussed in Section 1, the EMTRs on support payments to social assistance (SA) recipients (as affected by the levels of asset and income disregards under SA programs) are likely to play a big role in determining the level of contributions to an RDSP. While these rules are the subject of continuing representations by relatives of social assistance recipients, they are not under the control of the federal authorities that might introduce an RDSP. As one province already provides an exemption from income-testing under SA of up to $5,000 in annual financial support, and as the trend appears to be toward increases in such exemptions, we assume that RDSP payments do not reduce SA benefits. We will also assume that RDSP benefit recipients are non-taxable. Note, however, that this is the most advantageous possibility in terms of the rate of return on RDSP saving and one that cannot be known with certainty at the time RDSP contributions are made. Uncertainty about EMTRs – for example, the possibility that social assistance rules might be tightened in the future – could well lead potential contributors to base their savings decisions on more pessimistic rate of return assumptions than those used here.

RDSP Contribution Estimates

The first step in estimating expected RDSP contribution levels is to consider the population of eligible beneficiaries. (While we have cast the discussion mainly in terms of children as beneficiaries, we also allow for beneficiaries who are siblings or other relatives of the contributor.)

First consider an estimate of the total population of people with disabilities sufficient to qualify them for the DTC. The Department of Finance has recently estimated the size of that population, in 2001, to be in the range of 498,000 to 745,000 persons.[25] In order to simplify the development of the estimates, we will take a single estimate of 670,000 persons, somewhat higher than the mid-point of this range.

Next, we need to limit the eligible population to those who meet the test for financial dependency. To that end, we will simply subtract 270,000, the approximate number of taxfilers who claimed the DTC for themselves in 2002 and did not also transfer an unused portion of the credit to a spouse. See Annex Table A1. This leaves an eligible population of 400,000.

About 60,000 of this group are minor children.[26] Annex Table A2 indicates that among those claiming the DTC for themselves, close to 60 percent were seniors and, averaging couples and singles together, roughly twice as many claimants were in the 45-64 age group than the under 45 age group. However, because many DTC-eligible seniors may have generated significant pension income before becoming disabled, this is likely to overstate the incidence of seniors in the population who meet a financial dependency test. Accordingly, we will assume that the eligible population is distributed by age as set out in Table 6.

Table 6
RDSP: Estimated eligible beneficiary population by age

Age group	Eligible beneficiaries
< 19	60,000
19 - 44	75,000
45 - 64	130,000
65+	135,000
All	400,000

The next step is to consider how many potential beneficiaries will have relatives able and willing to contribute to an RDSP. This goes beyond the question of take-up rates. For example, parents are the most likely relatives to be contributors, and few eligible beneficiaries in the 65+ age group will have parents still alive. Accordingly, we will consider take-up estimates separately for minor children, working age adults and seniors under the different transfer rules.

Contributions in Respect of Minor Children. Under RDSP option A (transfers only upon death), we would expect few RDSP contributions. The option of transferring RRSP funds fulfils the same role as would a transfer of RDSP funds with the advantage that the decision regarding the amount of the transfer can be deferred.[27] (Note that Tables A5 and A6 in the Annex, which compare the RRSP contribution rates of families with support obligations and other families, suggest that families with support obligations currently contribute more to RRSPs than other families.)[28] Those likely to make RDSP contributions are high-income parents who are homemakers or who are already contributing to their RRSP limits, and grandparents over age 69. Assume that such contributions, at a $3,000 average, are made on behalf of 5 percent of the eligible population of 60,000 children. This would imply total annual contributions of about $10 million.

Under RDSP options B or C, the RDSP would become an alternative to RESPs, allowing parents to save while their children are young to help with their financial support when they leave home. We might expect higher take-up than under the RESP because the need for assistance is greater and because (assuming exemption of the benefits from income-testing under SA) the tax treatment is generally more advantageous. While the extra spending demands associated with supporting children with disabilities while they are young might be an offsetting factor, the analysis reported in Annex Tables A5 and A6 indicates that families with support obligations appear to be able to save as much or more in RPPs and RRSPs as other families.

As set out in Table 7, we assume take-up rates that are about double those reported in Table 5 for RESPs, and a sliding scale of average annual contribution levels. The proportions of children by family income range were obtained as a weighted average of the income distributions of Support families (couples and singles) in the <45 and 45-64 age groups presented in Annex Table A4. The result is an estimated total contribution level of about $40 million. Together with the option A contributions, the total is $50M.

Table 7
Estimate of option B RDSP contributions for minor children

Family income ($000)	Distribution of children (number)	Take-up rate (%)	Average contribution ($)	Total contributions ($ million)
< 20	6,300	5	1,000	0.3
20 – 40	16,380	15	2,000	1.5
40 – 60	15,180	20	3,000	9.1
60 – 80	9,420	25	4,000	9.3
80 +	12,720	40	4,000	20.4
All	60,000			40.6

Contributions in Respect of Adults Age 19-64. Under RDSP option A, the alternative of RRSP transfers would again keep RDSP contributions low. In addition, some individuals with disabilities will not have living relatives. Applying the same assumptions as for minor children to the larger population of working-age eligible beneficiaries suggests an annual contribution level of about $30 million.

Under RDSP option C, additional contributions would be encouraged by the allowance for transfers of funds from the plan during the lifetime of the contributor. In addition, the significant tax advantages of the plan (again assuming exemption of the benefits from SA income testing) would make it an efficient means of providing financial support. However, the goal of providing support through an RDSP would be in competition with other financial demands including the desire to provide immediate assistance to the child (or other relative) and the contributor's own retirement income security needs. Table 8 presents an estimate of the additional RDSP contributions based on the same take-up rates and average contribution levels as for the case of minor children, but using as a family income distribution of the contributors, the income distribution of all families with support obligations, including those in the 65+ age group. The estimated total of the additional contributions is about $130 million, bringing the total for this group to $160 million.

Table 8
Estimate of option C RDSP contributions for working age adults

Family income ($000)	Distribution of eligible beneficiaries (number)	Take-up rate (%)	Average contribution ($)	Total additional contributions ($ million)
< 20	21,500	5	1,000	1.1
20 – 40	67,200	15	2,000	10.5
40 – 60	51,300	20	3,000	30.8
60 – 80	28,700	25	4,000	28.7
80 +	36,300	40	4,000	58.1
All	205,000			129.2

* By the family income of the RDSP contributor.

Contributions in Respect of Seniors. In the case of seniors as eligible beneficiaries, setting aside funds for the future often will not make sense. Moreover, the benefit reduction rate of 50 percent under the GIS program for low-income seniors may remove much or all of the potential tax advantage of an RDSP contribution. Where the intended beneficiary receives GIS, the most effective form of support by family members is probably the direct provision of goods and services.

One exception could be the use of an RDSP to increase the amount of tax-deferred funds available for transfer to the contributor's spouse upon the death of the contributor. This could apply where a contributor is over age 69 or is younger but has a zero RRSP limit. Income-testing under the GIS will not always be a factor in such cases. In a one-pensioner couple, the lower-income spouse may be financially dependent upon the other spouse while they are both alive but have rights to survivor pension income under an RPP and the CPP or QPP after the death of the higher-income spouse. Only a small fraction of elderly couples would be in the situation described above. An estimate of the annual RDSP contributions in respect of this group of eligible beneficiaries is $20 million.

Table 9 summarizes the estimated contributions under the three RDSP options. The estimated total contributions range from $60 million under option A (transfers only on death) to $230 million where transfers are permitted to adult children at any time upon completion of a five-year holding period.

Table 9
Estimated total contributions under three RDSP options

Option	A	B	C
Eligible beneficiaries	($ million)	($ million)	($ million)
Minor children	10	50	50
Working age adults	30	30	160
Seniors	20	20	20
Total	60	100	230

Estimated Government Revenue Costs

In the federal Budget papers, the federal Department of Finance provides estimates of the revenue gain or loss associated with proposed tax changes. These estimates are calculated on a 'cash-flow' basis. That is, in the case of deferred tax plans such as RRSPs, they take into account the revenue loss associated with the deduction provided for contributions but they ignore the eventual taxation of RRSP withdrawals in later years. The estimates presented below follow this method.

The estimates are based on the following assumptions. First, the average marginal tax rate (at the federal level) on all RDSP contributions is 25 percent. (This is the approximate average for all RPP and RRSP contributions.) Second, we assume that contributions under option A are additional to existing RRSP contributions. However, for the additional contributions under options B and C, we assume a 25 percent offsetting reduction in RRSP contributions. That is, we assume that the contributor shifts 75 percent of the RDSP contribution away from household spending (or non-RRSP assets) and 25 percent from personal retirement saving.

This leads to the following estimates for annual federal revenue costs:

- Option A $15 million
- Option B $23 million
- Option C $47 million.

Total provincial revenue costs would be approximately one-half these amounts.

Public Policy Issues

Promoting Family Support of Relatives with Disabilities

PLAN's goal for its members is to ensure a safe and secure future for their relatives with disabilities. A major part of this is to assist and encourage families to support family members with disabilities.

Families assist adult relatives with disabilities in three main ways: (a) by providing care and other goods and services directly, (b) by providing current financial support, and (c) by setting aside funds for future support. Governments also provide programs and tax measures to assist people with disabilities, as outlined in Table 10 for the three types of support.

Table 10
Government assistance to persons with disabilities

Expenditure programs	Goods & services in-kind	Current financial assistance	Future financial assistance
	• Assisted housing • Community services • Disability supports	• Social assistance • C/QPP disability • OAS/GIS	
Tax measures	• Medical expense tax credit (METC) • Caregiver credit	• Disability tax credit (DTC) and its transfer • Infirm dependant credit	• RRSP transfer on death

Note: In addition to these forms of assistance are measures for families with minor children, such as the Child Disability Benefit and the child supplement to the DTC, and special provisions attached to other tax measures such as the child care expense deduction and the education credit.

Looking first at the expenditure programs, we see that the goods and services provided directly by governments often substitute for family support of persons with disabilities.[29] The income support programs – social assistance, the C/QPP disability pension and, for seniors, OAS/GIS – substitute for family income support and may be barriers to such support. SA benefits, in particular, are generally reduced by one dollar for each dollar of the recipient's other income including monies transferred from family members. C/QPP and OAS/GIS benefits are unaffected by income transfers that are not included in taxable income. However, the 50 percent benefit reduction rate under GIS would apply to the taxable income paid out of an RDSP.

On the tax side, the METC and the caregiver credit benefit those who provide care or purchase medical services to support family members with disabilities. The tax-free transfer of RRSP funds to an infirm dependant on the death of the RRSP annuitant also encourages this form of support. The benefits of the infirm dependant credit and the transferred DTC, by reducing the tax liability of the taxpayers who claim them, increase to some extent their capacity to support family members with disabilities. Thus, the tax measures tend to reward family support of persons with disabilities, rather than competing with it as in the case of SA. However, apart from the METC and the RRSP rollover on death, the tax benefits are generally triggered by the fact of support but do not increase in proportion to the level of support provided. As a result, they do not provide incentives for families to increase the level of support to their relatives with disabilities.

The programs and tax measures listed above have two main goals. The expenditure programs are designed to support those with special needs and few financial resources of their own. The tax measures are intended to make the tax system fairer by recognizing the negative effect of disabilities (of the taxpayer or members of his or her family) on the taxpayer's ability to pay. It seems reasonable to suggest that governments adopt a third objective in this program area – that of encouraging private support of persons with disabilities. In fact, this goal is already implicit in the tax support provided for charitable donations to disability groups and other organizations that assist people with disabilities. Extending the idea to apply to assistance to adult family members deserves consideration.

It may be objected that public support of charitable giving is appropriate only because the donor and recipients are at arm's length, so the donor does not gain direct satisfaction from the additional monies available to the recipient. By contrast, parents not only gain satisfaction from supporting a child with a disability but also have an obligation to provide such support. However, this argument is weak in two respects. For one thing, people very often donate to charitable organizations in which they have a strong interest – e.g., opera lovers to opera companies; parents of hockey players to amateur hockey associations. Moreover, in modern societies, the obligation to provide care and support for family members applies with much less force in the case of adult family members than that of minor children.

Private giving to charities is considered worthy of public subsidy because the services and financial support that charities provide have advantages over the alternative of increased public

provision of the same services. Due to their number and diversity, and their direct attachments to the communities they serve, charities are often better placed than governments to respond to the particular and changing needs of their beneficiaries. Moreover, charities can often deliver their services more cheaply than governments. These arguments for subsidizing the activity of charities appear to apply as well to the support by families of adult relatives with severe disabilities.

Family support for adults with disabilities could be encouraged in at least two ways: by reducing the barrier to family income support created by the very high tax-back rate, or benefit reduction rate, under SA, and by providing a tax advantage for income transfers. The two approaches could be combined.

Reducing the Social Assistance Tax-back Rate

At first glance, the idea of altering the design of SA programs seems problematic. The goal of encouraging family income transfers to SA recipients appears to be in complete conflict with the need to keep social program costs at sustainable levels and with the principle that assistance under a program of last resort should be tightly targeted on those who, because they have no other resources, are most in need of the benefits. However, it is not at all clear that focusing completely on social assistance benefit targeting at the expense of any encouragement of family support provides the best trade-off between these conflicting goals. What is the best trade-off is a question that can be investigated, both theoretically and through experimentation. It must depend on the effect of a change in the SA rules on the level of family income transfers and the level of SA program costs. This depends on how families would respond to such a change.

While there is no direct empirical evidence on this question, it can be examined with the help of a consumer choice model using parameters that are based on empirical analyses of related questions. In Annex B to this note, we develop such a model and use it to simulate the effects of reducing the SA tax-back rate from a starting level of 100 percent. (The model incorporates an existing exemption for the first $5,000 of parental income transfer.) The results are quite startling. Reducing the SA tax-back rate applicable to family income transfers below 100 percent does more than increase the income of the beneficiaries. It also leads to a reduction in the social assistance benefit level and, in the base case, the minimum SA level is reached at a tax-back rate of only 40 percent. Examining the results of a variety of cases based on different parameter values leads to the general conclusion that reducing the SA tax-back rate on family income transfers from 100 percent to somewhere in the range of 30 percent to 70 percent would generate significant additional income support for adult children with severe disabilities while reducing social assistance costs at the same time.[30]

Policy Issues Related to the Proposed RDSP

PLAN has proposed the creation of an RDSP to encourage family support of adult relatives with disabilities. This measure could complement changes in the SA tax-back rate. As we saw in Section 1, for a middle-income contributor, an RDSP provides an attractive after-tax rate of return for contributions leading to benefit payouts up to the income disregard under SA, and a modest but positive rate of return even when the payouts are subject to an SA benefit reduction rate of 50 percent.

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Two issues deserve particular consideration with regard to the proposed RDSP. First, is the savings aspect of the plan really central to it, or is it mainly a vehicle for shifting the tax liability on contributed amounts from a higher-income contributor to a lower-income recipient? Second, if the savings aspect is important, could the same objective be attained more simply using the RRSP as a vehicle?

There seems to be a valid savings motivation for the proposed RDSP in three cases: where contributions are made to support a child after the contributor retires or dies or after the (minor) child leaves home (as under the RESP).

However, for transfers after the contributor's death, the existing right to transfer RRSP funds serves the same purpose except where: the parent (or grandparent) has exhausted his or her RRSP limit (true of only about 17 percent of contributors), the parent has no earnings and thus no RRSP contribution room, or the parent is age 70 or over and so is barred from contributing to an RRSP.

As noted in Section 2, RDSP contributions in respect of an adult child for the child's use in the near-term could be problematic. Current transfers are an alternative, and the savings motivation for the contributions seems weak. Under these circumstances, the RDSP would seem to be little more than a vehicle for lowering the tax burden on contributed income.[31] To ensure some savings element to the contributions, the government might wish to require a minimum holding period of, say, five years for contributions in the plan. Such a rule applied to contributions to a UK savings plan, the Tax-Exempt Special Savings Account (TESSA).[32]

The question of eligibility to contribute to an RDSP is also important. Given the significant tax advantage associated with RDSP contributions and the potential for abuse of any such plan, governments would likely wish to limit eligibility to cases involving both severe and permanent disability and financial dependence of the beneficiary on the contributor.[33] While the financial-dependence test is fairly easy to apply in the case of RRSP rollovers on death, it would become more difficult in the case where the test must be applied when the contributions are made rather than when the funds are transferred. This would be especially true of contributions made on behalf of minor children. One option would be to replace the current test by an 'expectation of dependence' test.

Administering such a test would not be easy though. For example, it might require ongoing tests of whether the eligibility conditions continue to be met in respect of already-contributed RDSP funds.

Another issue with any special purpose tax-advantaged savings plan is what should be done with the funds in the plan (prior to their transfer to the intended beneficiary) should the need for them no longer exist. A reasonable rule would have them transferred to the contributor's RRSP with a corresponding reduction in the contributor's RRSP limit.

Annex A

Tables from the CRA's Family Tax File

These tables are derived from a special purpose tabulation of the T1 Family model for taxation year 2002 provided by the Client Services Team in the Statistics and Information Management Directorate of the Canada Revenue Agency (CRA).

In these tables:

- 'Families' include couples and singles, with or without children;
- 'Support families' include couples and singles where one or both tax filers claims any of: (a) the disability tax credit (DTC) for other than self (i.e., for a spouse, child or other relative), (b) the infirm dependant credit, or (c) the caregiver credit;
- 'DTC-self families' are those where a tax filer claims the DTC for self and there is no claim of the DTC for another person. For example, where a spouse claims the DTC for self, becoming non-taxable as a result, and so transfers the unused portion of the credit to the other spouse, the family is counted as a 'Support family' rather than a 'DTC-self' family.
- 'Other families' are all couples and singles not included in the preceding two groups;
- Family income includes the incomes of both spouses in a couple where both are tax filers but does not include the income of any children or other family members.
- The measure of 'family income' used is adjusted gross income, a modification of total income as reported on the tax return that includes actual rather than taxable (grossed-up) dividends and the full amount of capital gains income rather than the (50 percent) taxable portion. It also includes non-taxable income components such as GIS, social assistance and workers' compensation benefits;
- By 'earnings' is meant 'earned income' as defined in the *Income Tax Act* for purposes for the RRSP limits;
- The Pension Adjustment (PA) reported on the tax return by members of RPPs and deferred profit sharing plans (DPSPs) is taken as an indicator and measure of employee and employer contributions to RPPs and DPSPs by or on behalf of the tax filer.

Table A1
Populations of families by type

	Numbers (000)			(%)		
	Couples	Singles	Total	Couples	Singles	Total
Support	194	60	255	76.1	23.9	100.0
Other	5,873	9,643	15,515	37.9	62.1	100.0
DTC-self	85	183	268	31.7	68.3	100.0
Total	6,152	9,886	16,038	38.4	61.6	100.0

In all tables, numbers may not add to totals due to rounding.

Other families are shown after Support families to facilitate comparison between them.

Observations

- 76 percent of Support families are couples versus only 38 percent of Other families.

Table A2
Distribution of families by type and age (%)

	Couples				Singles			
Age	< 45	45-64	65+	All	< 45	45-64	65+	All
Support	27.5	45.7	26.8	100.0	38.1	46.7	15.2	100.0
Other	39.9	42.4	17.7	100.0	63.0	20.6	16.4	100.0
TC-self	7.1	34.7	58.2	100.0	16.5	24.4	59.2	100.0

Observations

- About 73 percent of Support couples are age 45 or older vs only 60 percent of Other couples; for singles it is 62 percent versus 37 percent;
- Nearly 60 percent of DTC-self claimants (both couples and singles) are seniors (age 65+).

Table A3
Earnings by family type

	Couples			Singles		
	< 45	45-64	65+	< 45	45-64	65+
Percentage with earnings (%)						
Support	99.4	98.2	44.7	95.2	87.9	28.5
Other	95.9	94.5	44.6	82.6	76.8	15.5
DTC-self	97.5	97.0	38.9	51.2	76.9	12.2
Average earnings – among families with earnings ($)						
Support	58,481	62,177	19,623	33,915	32,984	16,396
Other	63,730	78,268	34,670	21,437	36,641	12,934
DTC-self	58,644	48,479	18,280	16,200	16,042	7,402

Observations

- As would be expected, the presence of earners among Support families is higher than among Other families. The biggest differences are between singles in the two groups;
- However, average earnings among Support families with earnings are often lower than for Other families, particularly among couples. This could reflect fewer two-earner Support families as a consequence of the time demands of caregiving; and
- The incidence of earnings and average earnings levels are lowest among DTC-self families.

Table A4
Family income distributions (% of families)

	Couples			Singles		
	< 45	45-64	65+	< 45	45-64	65+
Support						
< 20*	6.0	4.4	3.4	27.5	25.0	38.5
20-40	21.7	23.2	52.6	39.7	41.5	40.6
40-60	28.0	26.8	27.6	19.5	19.6	13.0
60-80	18.7	17.7	9.3	8.7	9.1	5.7
80-100	11.3	10.5	2.9	3.0	3.0	0.5
100 +	14.3	17.3	4.3	1.7	1.8	1.8
All	100.0	100.0	100.0	100.0	100.0	100.0
Other						
< 20	13.1	10.0	10.2	61.8	42.4	61.6
20-40	17.4	14.7	41.4	23.6	27.0	26.1
40-60	20.7	19.4	22.1	9.6	16.9	7.3
60-80	18.9	18.2	11.7	3.2	8.0	2.5
80-100	12.8	13.1	5.5	1.0	2.8	1.0
100 +	17.1	24.7	9.1	0.9	3.0	1.7
All	100.0	100.0	100.0	100.0	100.0	100.0
DTC-self						
< 20	5.5	9.1	3.7	76.1	69.7	51.8
20-40	21.1	22.8	36.4	19.1	20.7	35.2
40-60	21.1	26.9	27.9	3.1	7.2	8.0
60-80	22.6	18.9	15.0	1.3	1.2	2 .3
80-100	17.1	9.8	6.9	0.1	0.3	0.9
100 +	12.6	12.7	10.0	0.3	0.8	1.7
All	100.0	100.0	100.0	100.0	100.0	100.0

* Family income ranges in thousands of dollars.

Observations

- Reflecting the earnings information in Table A3, the family incomes of Support families are considerably more concentrated in the modest- and middle-income range ($20K-$60K) than those of Other families. There are fewer low-income (under $20K) couples and singles, and fewer high-income (over $100K) couples;
- The income distribution of DTC-self couples is similar to those of the Support and Other groups, but DTC-self singles are concentrated in the low-income group.

Table A5
RRSP and RPP/DPSP contribution rates

	Couples			Singles		
	< 45	45-64	65+	< 45	45-64	65+
RRSP Contributors – as a % of those with earnings						
Support	49.8	49.8	21.4	42.6	42.9	23.8
Other	51.6	56.9	27.2	25.6	40.9	11.4
DTC-self	52.1	43.4	16.3	22.2	15.5	5.3
RRSP Contribution Rate – % of earnings*						
Support	4.8	5.4	9.1	5.0	6.4	8.5
Other	4.5	5.4	6.4	3.9	5.1	5.5
DTC-self	4.5	6.5	10.9	4.2	3.7	3.3
RPP/DPSP Contribution Rate – % of earnings**						
Support	4.1	4.9	2.8	4.3	6.2	2.0
Other	4.0	4.8	2.1	3.3	5.7	1.5
DTC-self	4.8	6.0	2.2	3.2	5.1	2.2

* RRSP contribution rate for a group = 100 percent * total RRSP contributions/total earnings.

** With RPP/DPSP contributions measured by reported Pension Adjustment (PA) amounts.

Observations

- Support families appear to have higher RRSP contribution rates than Other families, and this is not offset by lower saving in employer-sponsored RPPs and DPSPs;
- The contribution rate differences are most notable among seniors, suggesting that the availability of RRSP rollovers on death may encourage additional contributions;
- Only among singles age 45+ are RRSP and RPP/DPSP savings rates lower for DTC-self claimants than for the other family types.

Table A6
RRSP contributions: Support vs. standardized Other

	Other	Standardized Other*	Support
Number of families (000)	15,515	255	255
Total earnings ($M)	510,032	10,867	10,582
Total RRSP contributions ($M)	24,687	539	575
Total pension adjustment (PA) ($M)	21,502	476	488
Average earnings ($)	32,873	42,694	41,572
Average RRSP contribution ($)	1,591	2,117	2,259
Average PA ($)	1,386	1,870	1,917
RRSP contribution rate (%)**	4.84	4.96	5.43
PA rate (%)**	4.22	4.38	4.61

* Standardized means that for each cell (defined by couple or single, age group and income group), the aggregate amounts of earnings, RRSP contributions and PA amounts are adjusted by the ratio, 'number of Support families/ number of Other families' for that cell. This provides an estimate of the RRSP contribution and PA amounts for the Other families population under the assumption that it had the same size and composition – by couple or single, age and income level – as the population of Support families.

** Expressed as a percentage of earnings.

Observations

- Using a standardization technique to correct for differences in the distribution of Support and Other families by couple vs. single, age group and family income level, we see that, despite earning slightly less than Other families on average, Support families contribute $36 million more to RRSPs ($142 per family) than Other families;
- Support families have an RRSP contribution rate that is almost half a percent of earnings higher than that of Other families (5.43 percent vs. 4.96 percent);
- The higher RRSP contribution rate is not a consequence of lower saving in employer-sponsored RPPs and DPSPs.

Annex B

Modelling Family Income Transfers under Varying Social Assistance Tax-back Rates

This Annex presents a simplified model of parent-to-child income transfers that is used to examine the effect of varying tax-back rates (or benefit reduction rates) under SA on the level of transfers, the level of SA benefits and the child's income.[34]

The model considers a single time period of one year. A parent (or parent and spouse) chooses an amount of after-tax income to transfer to his (or her/their) adult child who has a severe disability and receives income support under SA.[35] The amount of transfer chosen depends on how effective it is in benefiting the child. This depends directly on the extent to which SA benefits are reduced as a consequence of the transfer. The level of SA benefits is reduced according to a single tax-back rate that applies to each dollar of the transfer, above a transfer income exemption or disregard, until the SA benefit is reduced to zero. The effect of tax-back rates varying from zero to 100 percent is examined. The amount of transfer chosen by the parent also depends on the strength of the parent's desire to help support the child and how this is balanced against the parent's (and spouse's) own income needs. These factors are modelled in the following way.

The parent maximizes the utility function

$$U = \frac{1}{(1-\delta)}\left(C_P^{1-\delta} + BC_C^{1-\delta}\right). \qquad (1)$$

In this function, the parent's utility level depends on both his level of consumption, C_P, and his child's, C_C. The form of the function, with $\delta > 0$, implies that the value of an additional dollar's worth of consumption declines as the level of consumption rises. The higher is δ, the steeper the decline and the more averse is the parent to low levels of either C_P or C_C. With B < 1, the parent would gain more satisfaction from a unit of his own consumption than his child's. This would also reflect the case where C_P is divided between two spouses.

Utility is maximized subject to the following constraints

$$C_P = Y - T \qquad (2)$$

$$C_C = S + T \qquad (3)$$

$$S = \begin{cases} Sm & T <= D \qquad (4a) \\ Sm - t(T - D) & D < T <= Sm/t + D \qquad (4b) \\ 0 & T > Sm/t + D. \qquad (4c) \end{cases}$$

Here Y is the parent's after-tax income, T is the amount of income transferred from the parent to the child, S is the level of the SA benefit, Sm is the maximum SA benefit level, D is the transfer income disregard under SA and t is the SA tax-back rate.

In the case of most interest, where constraint (4b) applies so that T depends on the social assistance tax-back rate, the following equations provide the solution of the model:

$$C_C = B^{1/\delta}(1-t)^{1/\delta} C_P, \tag{5}$$

$$C_P = \frac{(1-t)Y + Sm + tD}{(1-t) + B^{1/\delta}(1-t)^{1/\delta}}, \tag{6}$$

$$T = \frac{B^{1/\delta}(1-t)^{1/\delta} Y - Sm - tD}{(1-t) + B^{1/\delta}(1-t)^{1/\delta}}, \text{ and} \tag{7}$$

$$S = \frac{(1+B^{1/\delta}(1-t)^{1/\delta})(Sm+tD) - tB^{1/\delta}(1-t)^{1/\delta} Y}{(1-t) + B^{1/\delta}(1-t)^{1/\delta}}. \tag{8}$$

To explore the effect of different SA tax-back rates on the level of the parental income transfer, the level of SA benefits, and the level of income and consumption available to the child, the model was implemented with plausible income and benefit levels and various values for the utility function parameters, δ and B. The following income and benefit levels were used: after-tax income, Y = $40,000, the maximum SA benefit, Sm = $10,000, and the transfer income disregard under SA, D = $5,000. This is the level applicable in Ontario but it could also represent a level of in-kind transfers informally ignored by the provincial SA authorities.

For the utility function parameter, δ, values of 1.5, 2.0 and 3.0 were used with $\delta = 2$ as the base case. This accords with the values of this parameter most commonly used in studies of consumption and savings over the life cycle.[36] For parameter B, which reflects the relative weight given to C_C versus C_P in the utility function, values of 1.0, 0.8, 0.6 and 0.4 were used, with $B = 0.6$ as the base case. Table B1 provides the base case results.

Table B1
The effect of the social assistance tax-back rate on the level of parental income transfers, SA and child's income

Tax-back rate (%)	Transfer ($)	SA benefit ($)	Child's income ($)
100	5,000	10,000	15,000
90	5,000	10,000	15,000
80	5,000	10,000	15,000
70	5,000	10,000	15,000
60	7,412	8,553	15,965
50	8,980	8,010	16,990
40	10,000	8,000	18,000
30	10,699	8,290	18,989
20	11,195	8,761	19,956
10	11,557	9,344	20,901
0	11,825	10,000	21,825

In this simulation, we see that at SA tax-back rates of 70 percent or higher, transfers remain at the $5,000 disregard level and SA benefits at their maximum level of $10,000. As a result, the adult child's total income is $15,000. However, as the tax-back rate drops below 70 percent, an incentive is created for increased parental transfers with the double result that SA benefits fall and the child's income increases. As shown by the shaded row of the table, the minimum level of SA is reached at a tax-back rate of 40 percent (though the benefit is virtually the same at a rate of 50 percent). Further decreases in the tax-back rate lead to increases in both the transfer level and the SA benefit.

It might be concluded that these results indicate that an SA tax-back rate of 40 percent applicable to parental transfers would be most appropriate since it would minimize SA costs while increasing support to the adult child with a disability. However, based on the treatment of charitable donations, an argument can be made for an even lower tax-back rate. Governments provide a tax credit for charitable donations as a means of encouraging the private provision of services and support to persons with disabilities and other people in need of support. The tax credit is provided at the top tax rate, which is 43.7 percent in BC. This implies that for each dollar of benefit to the charity, the support of governments is 43.7 cents. Let us now compare this benchmark to the results of lowering the SA tax-back rate below 40 percent. Lowering the rate from 40 percent to 30 percent results in a gain to the child of $989 at a cost to government of $290 (the increase in SA). This implies a government cost of 29.3 cents per dollar of increased assistance, considerably lower than the charitable donations cost. Dropping the rate from 30 percent to 20 percent would increase income to the child by $967 for an SA cost increase of $471. The cost per dollar of benefit here would be 48.7 cents, slightly higher than the charitable donations benchmark.

How are these results affected by changes in the assumed parameter values? First, consider a change in the transfer income disregard. If the disregard were increased from $5,000 to $7,000, the SA-minimizing tax-back rate would decline to 30 percent; if the disregard were reduced to $3,000, the SA-minimizing rate would increase to 50 percent.

Table B2 shows how the SA-minimizing tax-back rate varies with the parameters δ and *B*. We see that a lower value of δ, which implies greater sensitivity of the decision-making parent to price incentives and less to income disparities, tends to reduce the SA-minimizing tax rate. So does a reduction in the weight, *B*, given by the parent to the child's consumption in making his transfer decision.

Table B2
The SA tax-back rate that minimizes
social assistance costs under different model parameters

□ =	1.5	2.0	3.0
B =		(%)	
1.0	50	60	70
0.8	40	50	70
0.6	30	40	60
0.4	20	30	60

Note: The shaded cell is the base case.

This simulation analysis is purely theoretical, as it is not based on any direct empirical evidence of the response of parental income transfer levels to different SA regimes. However, it is similar in form to common models of consumer choice, and it employs parameter values that are consistent with empirical estimates made using those models.

The cases examined differ in their specific results. However, taken together, they provide a strong suggestion that reducing the SA tax-back rate on family income transfers from 100 percent to somewhere in the range of 30 percent to 70 percent would generate significant additional income support for adult children with severe disabilities while reducing SA costs at the same time.

Endnotes

1. The term 'income-averaging' is used to refer broadly to taxation of benefits from a deferred-income plan at a lower marginal tax rate (MTR) than applied when the income was earned. As the tax liability in the RDSP/RRSP is also transferred from one taxpayer to another, the tax advantage might equally well be described as 'income-splitting.'

2. See Kevin Milligan. (2004). *Who Uses RESPs and Why?* Vancouver: University of British Columbia Economics Department, Discussion Paper 04-03, March.

3. Marginal tax rate (MTR) is the tax rate applicable to the last $1 of income.

4. More specifically, the assumed shares of investment income are interest, 35 percent; dividends, 25 percent; and capital gains, 40 percent. Taking the dividend tax credit and 50 percent capital gains inclusion rate into account, the MTRs on the three income components are 39.7 percent, 31.2 percent and 19.85 percent, respectively.

5. At the contributor's marginal tax rate of 39.7 percent, the tax deduction on a contribution of $1,658 is worth $658, leaving a net cost to the taxpayer of $1,000.

6. Because of the tax treatment of certain options, it is important to identify separately the contribution of positive taxes and benefit reduction rates to the effective marginal tax rate. In particular, some plan benefits might be excluded from taxable income but still give rise to a reduction in social program benefits.

7. Net income does include spousal support payments made pursuant to the breakdown of a marriage or common-law relationship.

8. As proposed, for retirement savings rather than disability support purposes, in Jonathan Kesselman and Finn Poschmann. (2001). *A New Option for Retirement Savings: Tax-Prepaid Savings Plans.* Toronto: CD Howe Institute, February.

9. Jonathan Kesselman notes that, under a pure consumption tax base rather than the mainly income tax base we have at present, parallel treatment would not require inclusion of TPSP investment income for benefit determination purposes. Under such a system, the treatment of the two plans would be equivalent on a present value basis. However, it is not clear that the choice of a tax base would carry over to the definition of income for purposes of determining eligibility for income-tested benefits. For example, several components of income (social assistance benefits, GIS and workers' compensation benefits) are included in income for benefit reduction purposes despite the fact that they are non-taxable.

10. Since the income thresholds of the federal and BC tax brackets are not the same, other federal-provincial MTRs apply for some taxpayers. However, these rates cover the largest income ranges.

11. Because of the lower rates of return in most cases, and because an up-front tax deduction is likely more attractive than the promise of future tax relief, we would expect a lower level of net saving under a TPSP-style plan than under the RDSP/RRSP option. By net saving, we mean the TPSP contribution or the net-of-deduction cost of an RDSP/RRSP contribution.

12. In the event of the introduction of an RDSP, the federal Department of Finance would, of course, prepare its own revenue cost estimates, based on the details of the plan as actually implemented.

13. As there is no deduction for contributions to a TPSP, the initial revenue costs for this option would be much lower than those provided here, but the future costs would likely be greater.

14. A qualification to this point is that the publicity and advertising surrounding an increase in RRSP limits could lead some non-limit contributors to revise their savings goals and plans. However, we would expect such effects to be relatively small in most instances.

15. The Pension Adjustment (PA) reported on the tax return by members of RPPs and DPSPs is taken as an indicator and measure of employer and/or employee contributions to RPPs and DPSPs. By 'earnings' is meant 'earned income' as defined in the *Income Tax Act* for purposes of the RRSP limits. The measure of 'family income' used is adjusted gross income, a modification of total income as reported on the tax return that includes actual rather than taxable (grossed-up) dividends and the full amount of capital gains income rather than the (50 percent) taxable portion. Family income includes the incomes of both spouses in a couple where both are tax filers but does not include the income of any children or other family members. These figures are derived from a special purpose tabulation of the T1 Family model provided by the Client Services Team in the Statistics and Information Management Directorate of the Canada Revenue Agency.

16. Figures 1 and 2 are based on data grouped into the following income ranges: under $20,000 ($20K), $20K-$40K, $40K-$60K, $60K-$80K, $80K-$100K, $100K-$120K, $120K-$150K, and $150K +.

17. For higher-income earners, GIS is not a consideration, OAS is a flat benefit that is also reduced as retirement income rises above $60,806, and the C/QPP pension declines as a percentage of pre-retirement earnings above the maximum covered earnings level of $41,100 (2005 level).

18. RRSP contributions were subject to a dollar limit of $13,500 in 2000. A 2003 federal Budget measure increased this limit to $16,500 (for 2005), and further increases were proposed in the 2005 Budget. These increases should reduce the proportion of high-income earners who contribute to their limit.

19. The estimate is derived from data on the incidence and distribution of RESP participation presented in Table 5.2 of *Formative Evaluation of the Canada Education Savings Grant Program*, Human Resources Development Canada, April 2003. The data in the evaluation report come from a CESG/LAD merged file maintained by Statistics Canada. The evaluation report includes the comment that the 8.8 percent take-up estimate might be somewhat low because of over-sampling of lower-income families in the CESG-LAD database.

20. Under subsection 146(1.1) of the *Income Tax Act*, the allowable income of the child for purposes of the financial dependency test is set at the sum of the basic personal credit amount and the disability tax credit amount for the preceding taxation year. Thus, it is set at the level at which the child may be expected to become taxable in his or her own right.

21. This assumes a nominal rate of return of 5.57 percent p.a. and 2 percent inflation. The $5,000 benefit level was chosen to match the income disregard for gifts and payments out of trusts under the Ontario social assistance program as reported by Richard Shillington.

22. One complication is that it will often be difficult to assess whether or not a DTC-eligible minor child will remain financially dependent as an adult. We assume that no test of expected future financial dependency applies to RDSP contributions on behalf of minor children.

23. Note that the RRSP rules allow deductions for contributions to a spousal RRSP but deny those deductions where the funds are withdrawn within a three-year period. Note also that there would not be an income-averaging benefit under a TPSP-style RDSP.

24. A five-year holding period would ensure that RDSP contributions involved some degree of saving and were not simply tax-favoured income transfers.

25. See "The Disability Tax Credit: Evaluation Report" in *Tax Expenditures and Evaluations, 2004*, Department of Finance Canada.

26. This is taken from Richard Shillington's extrapolation of Ontario's Assistance for Children with Severe Disabilities program caseload. The Department of Finance report notes that the DTC supplement for children was claimed in respect of 37,000 children.

27. This assumes that any expansion of income disregards under SA programs would apply in the same manner to payments derived from RRSP transfers as to those from RDSPs.

28. By a family with support obligations is meant a couple or single individual (with or without children) with a claim for any of the infirm dependant tax credit, the caregiver credit or the DTC for other than self. See the Annex for more detail.

29. Some services, such as respite care, may complement family support.

30. This should not be too surprising. The well-known Laffer curve analysis provides a close parallel. It shows that, beyond some level, increases in income tax rates cease to generate additional revenue because they lead to increasingly significant reductions in the actual or reported amounts of income.

31. As indicated above, there might well be a rationale for government subsidy of current-year transfers from family members to adults with disabilities. However, this would not require the RDSP as a vehicle.

32. TESSAs never achieved great popularity and were superseded in 1999 by a new plan called the Individual Savings Account (ISA), which does not have a minimum holding period. However, contributions to TESSAs and ISAs are not deductible, so the plans do not provide a vehicle for reducing the tax rate applicable to contributed income.

33. However, where, for example, an individual is financially dependent on a parent, it seems reasonable to allow contributions by grandparents or other family members as well.

34. To the author's knowledge, this particular model is original. However, consumer choice models of similar form have often been used to examine labour supply responses and retirement savings choices. See, for example, John Karl Scholz, Ananth Seshadri and Surachai Khitatrakun, *Are Americans Saving "Optimally" for Retirement?* National Bureau of Economic Research, WP 10260, January 2004.

35. With the deductibility of contributions to an RRSP or RRSP-style RDSP, the parent might be able to effectively transfer pre-tax income to the child. However, this possible advantage is ignored to simplify the analysis.

36. Scholz et al, cited in fn. 33, use a value of 3. However, James Pemberton, in "The Empirical Failure of the Life-Cycle Model with Perfect Capital Markets," *Oxford Economic Papers, 49* (1997), pp. 129-151, surveys a variety of estimates and concludes that a value of d = 2 lies in the mid-range of them.