



**A Proposal for a Tax Prepaid Savings Plan
Exempt from Welfare Restrictions on Assets and Income**

Registered Development Savings Plan (RDSP)

***Pre-Budget Submission to the House of
Commons Committee on Finance***

St. Christopher House is a community agency in Toronto, which provides a range of services to low- income people from a variety of different cultures. We are concerned about the lack of appropriate financial vehicles for low- income people.

November 2003

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Acknowledgements:

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The fellowship concentrates on the importance of the lived experience of St. Christopher House participants and the gaps and deficits in public policymaking that result when the lives and experiences of low income Canadians are not taken into account by governments and those who advise them. One of the significant oversights in current public policy as it relates to low-income people is the lack of programs that help (and the presence of policies that impede) low income Canadians to obtain, retain, and build assets. The adoption of a tax advantaged instrument to help low income build assets is one significant intervention that would not only help redress this policy oversight, but would begin the process of modernizing Canada's approach to overcoming poverty, consistent with Canadian values.

Our current policy fellow, John Stapleton, authored the proposal with input from a number of St. Christopher House Staff and program participants. We acknowledge significant assistance from our Technical Committee, especially Bob Brown and Malcolm Hamilton. We would also like to recognize the insightful comments of Finn Poschmann of the C.D. Howe Institute and the continuing support of Ellen Roseman of the Toronto Star and Richard Shillington, our first Policy Fellow. Finally the energetic support of the Maytree Leaders for Change allowed us to broaden the proposal to take into account the significant experience of new immigrants.

1. Introduction

The first purpose of this paper is to propose that the Government of Canada formally implement a particular type of a Tax Pre-paid Savings Plan (TPSP) as a true tax-advantaged savings plan for low-income Canadians who do not benefit from RRSP's. This type of TPSP, called a Registered Development Savings Plan (RDSP), is specifically designed to protect and maintain the assets and savings of low-income individuals and families.

The second purpose is to introduce the policy rationale and to provide evidence to make the case for exempting the proposed Registered Development Savings Plans from provincial and territorial social assistance program (welfare) restrictions on assets and income.

2. Problems with assets for low-income Canadians

2. A. Stripping of assets:

“When I lost my job, I lost my childcare and then I had to stay home again. When I worked, I saved \$1,000 and my worker was shocked but all this money is now gone”.

-- St. Christopher House participant

A majority of able-bodied social assistance recipients cycle between low-wage tenuous employment (when available), Employment Insurance (if eligible), and welfare. Each new application to welfare means that applicants have to deplete most of their assets first. On the one hand, this stripping of assets ensures that individuals receive welfare as their last resort. On the other and as now recognized in the United States and other OECD countries, the loss of liquid assets further increases longer-term dependency on the welfare system.

Andrey is a newcomer to Canada who arrived with his family, wife and 2-year-old son, one and half years ago. He is a qualified civil engineering technologist with several years of experience. He did his best to find a job in his field but was not successful.

The family exhausted all their financial resources and had to apply for social assistance.

Andrey decided to explore other alternatives for employment leading to self-sufficiency. He found out that the Toronto Property Management Association offered a Certificate Program for Superintendents. The program was offered on a part-time basis and the program fee was \$1,021. Andrey was excited by this opportunity to get out of the poverty trap and apply at least some of his professional skills. However, he did not have the funds for the course.

Andrey believes that he could solve his problem on his own if he was allowed to save some of the income he earns from occasional menial jobs.

From Maytree Leaders for Change Group research 2002/03

2. B. Lack of savings

“My last raise was 18 cents an hour and I do a good job – but I can’t get ahead. My younger son has health problems and I have to pay for his transportation to and from the doctor and I have to pay part of his medication costs. I would love to have some extra money to invest but right now, I don’t have any extra.”

Anna Resendes – low-income worker in Toronto

Rene Morissette’s important article¹ on the assets of Canadians shows that families with no financial wealth or no net worth increased in Canada from 8% in 1984 to 11% in 1999. This seemingly small increase over fifteen years refers to an aggregate of Canadians. In fact, there was a substantial increase in the percentage of working-age adults who had no net worth, especially lone parents, the longer-term unemployed and younger adults.

Clearly, as noted by Anna Resendes (above), many of these Canadians with no net worth are struggling to get by on limited incomes and they do not have enough income to generate savings.

On the other hand, Morissette’s research highlights the interplay between social assistance and assets. Most strikingly, the percentage of seniors with no net worth declined substantially during the same period. Seniors do not face asset testing in order to receive income assistance programs such as Old Age Security and the Guaranteed Income Supplement.

Working-age adults who need income assistance programs, such as welfare, or subsidy programs, such as licensed daycare and rent geared to income housing, face rules that penalize them for having liquid assets over a certain level. Generally, they must spend their assets and then apply for the social assistance programs and subsidies.

“They want to work and need to work. But the work they can do, or are doing, does not pay enough to keep them financially independent. The resources required to help them move forward financially (training and/or further education, affordable housing, child care and transportation) are either unattainable or only partially attainable. And acquiring some of those resources can either disqualify the person from some of the others or further entrench them in their trap!”

Lenore Ison: St. Christopher House Staff

2. C. Inappropriate savings vehicles such as RRSP’s

¹ Families on the Financial Edge: Rene Morissette in Perspectives; Autumn 2002.

Currently, many low-income seniors with Registered Retirement Savings Plans (RRSP's) are worse off for having saved in an RRSP than not having saved at all. This is due to the relatively higher taxation of low-income seniors compared to their situation before age 65. It is also due to the 50% reduction rate on the Guaranteed Income Supplement for low-income seniors. (See Appendix B for a further discussion of this problem).

2. D. Perverse incentives for 'welfare spending sprees'

In most situations, individuals who receive a minor windfall face immediate loss of their eligibility for welfare and its associated benefits such as a drug card, resulting in a pressure to spend windfalls. Currently, there is nowhere safe for these individuals to 'park' windfalls until they can implement plans for education or training, employment or other steps to self-sufficiency.

3. Current Opportunities with Tax Prepaid Savings Plans (TPSP)

On February 18, 2003, the Honourable John Manley introduced new increased limits to RRSP's without any tax advantages that would benefit low-income people. However, the federal government did indicate an interest in Tax Prepaid Savings Plans (TPSP's) as a possible additional savings vehicle.

"Moving forward, it is important that the tax system continue to provide effective mechanisms to support saving.... In particular, the government will examine whether tax pre-paid savings plans could be a useful and appropriate mechanism to improve the tax treatment of savings and to provide additional savings opportunities for Canadians."

The Budget Plan 2003, p. 140. Government of Canada – Finance Minister John Manley.

A TPSP on its own will not assist low-income Canadians to save for longer-term financial security because TPSP's would not address 'deal-breaker' issues such as the following:

- The prospective tax advantages of TPSP's do not benefit low-income working age adults Canadians on their own; and
- The fact that assets are stripped from low-income people when they become subject to welfare restrictions on assets and income
- The need for improved accessibility to financial information and choices for lower-income people.

4. Proposal for a Registered Development Savings Plan (RDSP)

It is proposed that Tax Pre-paid Savings Plans be added to the Income Tax Act (Canada) as a savings vehicle. The principal in a TPSP would not be tax deductible upon registration or taxable on draw down option. Registered Development Savings Plans would be added as a special TPSP for negotiation between the federal, provincial and territorial governments in regard to assets restrictions on welfare programs.

As with a TPSP's, contributions to and withdrawals from RDSP's would be exempt from taxation. For TPSP's, no approval is needed regarding spending of the asset. For RDSP's, earnings realized within the plan would be exempt from taxation as long as the proceeds were eventually disposed of on (an) approved item or items.

Once approved for tentative inclusion in the Income Tax Act, provinces and territories would be approached to exempt RDSP's from welfare assets and income restrictions. Welfare recipients wishing to take out a TPSP would have no option but the RDSP vehicle (e.g. for windfalls or limited savings). Working-poor individuals could choose a TPSP or an RDSP (as well as the choice of RRSP's). TPSP's would only be exempt from welfare assets and income restrictions if converted to an RDSP. Consideration could be given to allow persons coming on to welfare to convert any RRSP's to an RDSP.

Unlike Registered Home Ownership Savings Plans (RHOSP's) or Registered Education Savings Plans (RESP's), the tax-exempt status of earnings within the RDSP plan would not be completely 'destination-dependent' in terms of how the savings are spent. Instead, there would be a 'basket' of approved destinations. The ultimate destination for spending RDSP's would be subject to demonstrating that a set of clear guidelines have been met.

RDSP's could allow people of low income and wealth to begin building their assets by saving in a structured way for the things that they need both in retirement and in their more immediate future, without penalty. RDSP's could also significantly lower rates of welfare dependency, as they would provide an economic cushion for persons who would otherwise be faced with returning to or going on to welfare.

The RDSP concept is not a completely new idea. In fact, it is comprised of a ‘policy mix’ or amalgam of program features found principally in Individual Development Accounts, lifetime savings account models, RRSP’s, TPSP’s, and American Roth Accounts². In this way, a savings vehicle in the form of an RDSP could be a specific form of TPSP that would actually work for low income Canadians.

5. Features of an RDSP

Key Feature: A Continuum of Options

RDSP’s may require a continuum of options to meet the range of circumstances that inform financial decisions of diverse low-income people. Controls on RDSP’s would also reassure the broader public that this anti-poverty strategy connected to income tax legislation are used for activities that contribute to self-reliance. The full implementation of RDSP’s will need to balance the level and type of controls with the flexibility to respond to the needs of low-income Canadians.

For low-income individuals, RDSP’s must provide greater flexibility than current savings vehicles so that they may respond to financial problems. However, overly paternalistic controls would be a disincentive to low-income people to fully utilize this new savings vehicle. This was clearly articulated by diverse low-income individuals in focus groups discussing RDSP’s conducted by St. Christopher House.

Some low-income families may want additional support and advice about their choices. Other groups of low-income people may have a demonstrated need for institutional sponsors to assist them in their financial matters.

At one end of the continuum would be an RDSP administered much like an RESP. Unlike an RESP, the basket of possible destinations (expenses) could be widened to include education, employment and housing for any family member.

In the middle of the continuum would be a mediated RDSP where matching contributions or an exemption from asset limits set by provincial social assistance programs are linked to a broader but still limited basket of pre-approved destinations. The matching contributions or asset exemption would be tied to successfully completing training in ‘financial literacy’ (see Section 8A).

At the far end of the continuum would be an RDSP that requires a sponsor to ensure that spending is conditional on demonstrating financial literacy and demonstrating that the activity contributes to personal growth and self-sufficiency. Sponsors would need to be accredited in some fashion and located in community-based institutions.

Additional Design Features

² The American equivalent to RRSP’s in Canada are called Individual Retirement Accounts (or IRA’s) and these are complemented with what became known as Roth Accounts (or Roth IRA’s) which allow savers to invest in their retirement on an after-tax basis. The main benefit of Roth IRA’s is that they do not attract taxation on draw down mption. See Appendix D.

- Success in a financial literacy assessment could be a pre-requisite to RDSP draw down as an alternative to successful completion of basic financial literacy courses
- All non-approved withdrawals from the RDSP would not benefit from the value of the tax-sheltered portion of earnings in the plan.
- All monies would be exempt under assets and income rules under provincial/territorial assets and income rules
- Maximum contribution in any one year would be **\$2,000** for each family benefit unit. An exception would be made to allow up to the full \$25,000 in respect of a ‘windfall’ either paid in the form of compensation to the low-income person or from some other source (e.g. an inheritance). Low-income people who may be facing other challenges in their lives would benefit from having a place to ‘park’ a windfall until such time as they achieved greater income stability or until they had a cogent plan for the funds. Often, windfall money is ‘squandered’ at a certain point in a person’s life when it could have been be of optimal use at a later date.
- Maximum amount or ‘cap’ would be **\$25,000**. This amount could grow within the plan. All investments must be low-risk.
- If the family unit breaks up or re-forms, money would be placed in the name of the children or the custodian of the children. In the case of non-parents, money could be retained in the name of the original single person or couple.
- Draw down would be routinely approved but not mandatory where the registrant became eligible for welfare. Up to one half of the current value could be drawn down to prevent welfare dependency but would not be mandatory. The remaining one half (**50%**) must be retained for future.
- One half or **50%** could be drawn down to be placed in other tax-based vehicles such as an RRSP or RESP. This could work on a sliding scale like the RRIF³ concept but would only be allowed if the registrant recognizes the tax consequences. In most cases, the registrant would be better off cashing out before age 65.

³ Registered Retirement Income Funds. RRSP’s must be converted to RRIF’s at age 69 at which time there are forced redemptions that accelerate each year according to the age of the registrant.

"I have not found a stable, decent-paying job since I arrived in Canada. With all the living expenses I have to shoulder, my start-up funds have long dried up. My wife and I are past our 50's and we cannot look forward to a decent pension in our old age... I don't mind anymore that we may end up impoverished in our sunset years but we're hoping that our son, at least, can still rely on us when the time comes to finish his university..."

from Maytree Leaders for Change Group research 2002/03

- Pre-approved destinations for RDSP draw down would include purchase of a home, moving expenses, education for children or registrants, medical expenses, employment (e.g. transportation and child-care) and self-employment start-up. The pre-approved destination lists could be expanded. It is highly unlikely that there would be public acceptance of RDSP's unless the destination of the funds is considered socially and economically worthwhile. However, take-up (use) of RDSP's by low-income individuals is expected to be proportionate to the flexibility of RDSP destinations.

6. Social Assistance Rules on Assets and Income affecting RDSP's

6. A. Asset limits

The purpose of limitations on assets in social assistance (welfare) programs is to ensure that only those most in need of assistance are eligible to receive benefits while allowing recipients to retain a minimum level of personal assets consistent with maintaining a minimum standard of living. This standard of living also must be transparently less generous than the standard of living of a low-income working person.

In Ontario, assets tests have toughened over the last ten years to ensure that those who qualify for social assistance have no alternative resources. This is directly opposed to the position taken in Transitions: Report of the Ontario Social Assistance Review Committee (1988) that noted the importance of retained assets to support attempts to become self-sufficient.

In general, assets are judged according to their:

- source: i.e. where the assets come from
- destination: i.e. what the assets will be spent on
- liquidity: i.e. how easy it is to readily convert assets to cash; and

- regularity: i.e. how often and how regular an asset is realized

6. B. Value of allowing welfare recipients to retain assets:

Recipients of social assistance require some basic resources to make the move towards independence from social assistance, e.g. childcare, transportation, and clothing. They also require resources to prevent the cycle of dependency that sometimes occurs for some families, e.g. post-secondary education.

In recent years, thirty-nine of fifty US states have relaxed their assets rules as a way of keeping former social assistance recipients from returning to social assistance.

Dr. Pamela Loprest of the US-based Urban Institute has taken data from eleven separate US state studies and concluded that: "families receiving government support for necessary expenses also had a lower chance of returning to welfare than those who did not (about 12% compared to 23%)." Although the study notes return rates to welfare based on the presence or absence of government supports, Dr. Loprest supports the view that retained assets used for the return to employment perform the same function as government supports: lowering the incidence of returning to welfare.

Another important value to allowing social assistance recipients to maintain their assets is that it prevents a 'fire sale' approach to assets for those who may need to retain eligibility for social assistance in the short term (e.g. child need for prescription drugs).

6. C. Current exemptions from welfare restrictions:

It is important to note the exemption of certain types of income or awards that are usually, but not always, paid out by government in compensation for events or situations such as Hepatitis C through blood contamination. For low-income people, these awards, along with minor inheritances and back payments from other benefit programs, are ways for them to (suddenly) have assets. These awards are usually exempt from welfare restrictions on assets and income because any reductions in social assistance would be seen as the same as reducing the original compensation award. However, after some time, it is difficult to distinguish the award from income and other savings in a bank account and then often welfare restrictions on assets are activated.

6. D. How to allow assets in social assistance programs:

There are three possible alternatives for reform of assets testing in social assistance programs:

- Implement large-scale reforms to welfare according to the Vision of Transitions whereby assets testing would only be applied to able-bodied adults;

- Revise assets rules within existing social assistance programs; or
- Leave existing assets rules alone and to propose and implement something entirely different – in this case – a Registered Development Savings Accounts (RDSP's) for all low-income individuals that would be exempt from those assets rules.

Assets and income rule changes are far less costly than increasing benefits. However, given the variation in social assistance rules across the provinces and territories, the easiest way to allow assets to be retained by social assistance recipients is to have RDSP's exempt from all social assistance asset and income restrictions. The controls in the RDSP model meet the goals of moving to self-sufficiency and responsible spending: – these are the same goals that social assistance programs have in the first place.

One of the most important standards that could be imposed by the federal government is that TPSP's be extended in the form of RDSP's that would be exempt from welfare income and assets rules as a condition of receiving earmarked federal funds for this purpose.

7. Costs of an RDSP

It is unlikely that RDSP's would add additional costs to Tax Prepaid Savings Plans should the federal government implement TPSP's. It is also unlikely that RDSP's would add additional costs to the tax system if RDSP's were implemented on a stand-alone basis. The reasons are as follows:

- Compared to the status quo, the cost of a RDSP over a RRSP is zero since the RDSP does not provide a tax deduction.
- RDSP's at retirement would not reduce the value of the Guaranteed Income Supplement (GIS) for low-income seniors. However, it may be argued that anyone contributing to an RRSP, who is on a clear trajectory towards being a recipient of GIS, is getting poor advice in the first instance and is already saving in a way that is not in their own best interest. Such contributors could just as easily be purchasing non-registered instruments or buying a home and they would be substantially better off. It would be wrong to attribute higher GIS liability to an RDSP when contributors currently have a choice to refrain from contributing in any event. As more media attention and public education raise awareness of the problems that RRSP's can create for low-income seniors, it is likely that more lower-income people will not choose to invest in RRSP's.
- Although it is arguable that welfare costs could rise, the opposite is the case in the US where these policies have already been implemented. In one of the largest studies ever conducted on returning to welfare in the US, the rate of returns to welfare dropped in half when former recipients were provided with a non-welfare cushion.

In the final analysis, in order to definitively cost the RDSP concept, one must speculate as to what a prospective contributor would have otherwise done had an RDSP not been available. There is little evidence to support that the income that would be put into RDSP's would have otherwise gone into investments or other vehicles that would attract additional taxation. For example, spending patterns at the 15th percentile ranking in Canada (used by both the Low Income Cut-offs and the Market Basket Measure) indicate that the poor do not spend their incomes on items that would have resulted in higher income tax paid.

8. Complements to an RDSP

8. A. 'Financial literacy'

The term 'financial literacy' has a number of connotations. Here it is used to denote full and accessible information about the various systems and vehicles affecting the economic status of individuals. In particular, it is important to flag the need for information and tools that are income-sensitive. Financial literacy in this sense means that low-income people learn about the variety of factors that affect their income and assets and then are better able to negotiate and manage these factors. It also means that financial services, institutions and vehicles would be more accessible to them.

Many middle-income individuals increasingly turn to professional financial planners for assistance, as most high-income people have done traditionally. There are no equivalent financial services for low-income people.

The benefits of improved access to appropriate financial information has been noted in the American experiences with Individual Development Accounts (IDA's), Canada's experiments with IDA's and through St. Christopher House's work on financial issues affecting low-income people (see also Appendix A). There are a variety of 'traps' for low-income people in current financial systems, such as the widespread promotion of RRSP's for 'everyone' (see Appendix B).

Financial literacy would be an important complement to RDSP's to ensure that the assets and income of low-income people are maximized for their long-term self-sufficiency.

8. B. Matching funds to build assets

RDSP's provide a focus on preserving the assets of low-income people. A complementary strategy is to build their assets through the provision of matching funds. In the USA, these Individual Development Accounts match the savings of the low-income people, sometimes as high as 5:1, through funds from philanthropic organizations and government.

A Canadian experiment with matching Individual Development Accounts (IDA's) is underway, led by SEDI with funding from HRDC. See Appendix E for more detail.

9. Conclusion and Recommendations

The Government of Canada is considering Tax Prepaid Savings Plans (TPSP's) as an additional financial vehicle for Canadians. Tax Prepaid Savings Plans, like the current Registered Retirement Savings Plans (RRSP's), do not generally have much value for low-income people. However, a proposed type of a Tax Pre-paid Savings Plan (TPSP), named in this proposal as a Registered Development Savings Plan (RDSP), could be a true tax-advantaged savings plan for low-income Canadians. The Registered Development Savings Plan is specifically designed to protect and maintain the assets and savings of low-income individuals and families.

Between federal, provincial and territorial income and taxation policies and programs, low-income Canadians are often trapped in poverty, stripped of any meaningful financial assets. The proposed Registered Development Savings Plans would be most effective in asset-building and as an anti-poverty strategy if they were exempt from provincial and territorial social assistance program (welfare) restrictions on assets and income.

The RDSP proposal recognizes the public need for controls and accountability for the use of the permitted savings of low-income Canadians who are, at some point, requiring social assistance. This must be balanced with the need to encourage and support low-income Canadians to save and build their assets, recognizing the many diverse financial pressures on them and their families. 'Financial literacy' and flexibility are two of the key supports that complement the proposed RDSP.

"Assets matter ... Having the savings to put your children through school can mean the difference between financial security and economic exclusion ... As a new field, asset-building is fast being recognized as a new approach to alleviating and preventing poverty."

From Peter Nares, SEDI ⁴

⁴ Peter Nares: Building Assets and Opportunity: Towards a New Vision for Social Policy in Canada: Working Paper #1; SEDI; 2002, p.1

Appendix A

Summary of Community Feedback about RDSP's

1. Consultation Process

Throughout this Community Undertaking Social Policy project, the authors met with frontline program staff, program participants and volunteers, many of whom shared their stories as reflected in the body of this report. In addition, the Maytree Leaders for Change group organized two community consultations and provided stories from their frontline agencies' experiences. These have, in particular, provided useful and nuanced descriptions of the problem of lack of assets.

St. Christopher House also organized an additional 4 focus groups to explicitly explain and test the proposal with people who would be the likely target population to use an RDSP. In total, 35 diverse low-income community members gave feedback on the RDSP model.

The focus groups were held in English, Mandarin, Spanish, Portuguese and Vietnamese. Most participants were recruited directly from programs of St. Christopher House through a flyer or a program staff member encouraging people to participate if they were interested. An honorarium was provided to the focus group members for their time. The only selection criteria used was a stated interest in savings and an income at or below 120% of Statistics Canada's Low Income Cut-offs for the City of Toronto.

Two-thirds of participants in the focus groups were on Ontario Works, the Ontario Disability Support Program, Canada Pension Plan and/or Old Age Security. Most of these individuals also had some work experience. About 25% of participants were working-poor, with some of them also on and off social assistance. Another 10% were newer Canadians living off their savings while they sought employment.

The focus groups covered three main areas of inquiry:

- a) The participants' savings history, goals, abilities, barriers/opportunities and current strategies
- b) Their response to an open-ended RDSP model versus current registered savings vehicles
- c) Their response to a continuum of destinations and controls/conditions that could be associated with an RDSP

2. Participants' Feedback

2. A. Savings:

- Savings are not possible for many of the focus group participants in their current circumstances, especially if they were receiving Ontario Works. However, some individuals indicated that from time to time they did have some money left over after all their expenses were met or if they received income tax refunds or birthday gifts. Many had experienced a windfall (inheritance or retroactive payment).
- The savings goal most often cited was 'emergencies'. One respondent, a single mother of two, said "It rains every day in my life" in responding to the question about saving for a rainy day. Types of emergencies named by different participants included: dental work, travel to their country of origin for illness or death of family member, payment of rent and bills while unemployed, and waiting for social assistance or Employment Insurance.
- The second most common savings goal was education for oneself or for children. Home ownership, starting a small business, retirement, travel, vehicle, family sponsorship, electronic goods, paying down the principal on debts were also goals listed.
- Many participants felt trapped by the asset limits attached to government social assistance programs. Participants felt that the current rules limited their independence and attachment to the labour market. A few participants described a situation when they were on social assistance and had 'too much savings' (e.g. through an inheritance). They had to spend down their savings and pay social assistance back for 'overpayments'. They then exhausted their savings and while paying back overpayments, ending up worse off than they had been before.
- Some participants cited working for cash and having someone else hold their savings. A few people keep their money 'under the mattress' to avoid government scrutiny.

2. B. RDSP versus Other Savings Options

- Participants were clear that they would want to make sure their savings would be secure and that they would have access to their savings in an emergency before considering an RDSP. They also wanted to know exactly what the rules would be.
- Many people had a difficult time thinking about an RDSP or any registered savings option. Some participants described being stuck in a 'survival mode' where the thought of having savings and planning for the future was 'surreal'.

- Several participants were reluctant to be associated with any government program because of distrust or fear of the program being abandoned by a change in government or public opinion. Concern about privacy arose several times.
- A large number of participants had low financial literacy. Some were familiar with RRSP's and RESP's but had never considered them a real option and did not know how they worked.
- The flexibility of multiple destinations that characterized an RDSP and the asset exemption were seen as the real advantages over other savings options and addressed two significant barriers to their savings. The tax-free status of RDSP interest did not generate any significant reaction as an incentive to save.

2. C. Destinations and Controls

- Some participants were adamant that any limitation on RDSP destinations or third party interventions in their choices was unfair. They felt that the money involved was their money.
- The majority felt that having some limits and some controls were not unreasonable given the tax advantages and income security advantages a RDSP would offer. What should be in a basket of destinations and an acceptable level of third party control over the destinations varied greatly depending on the personal orientation and life stages of individual participants.
- Most people felt that education, home ownership, start-up costs of a small business, employment preparation, retirement and funerals are the key destinations.
- Most participants expressed concern that the money be available for emergencies. Emergencies such as medical and dental needs, a family crisis, job loss, crime and other uninsurable (for low-income people) events were cited examples of financial stresses that cannot be anticipated and are often not covered adequately by social programs. A couple of participants suggested that in an emergency one could borrow against an RDSP interest free as long as it was paid back (similar to borrowing against an RRSP for home ownership) before withdrawing it for predetermined designations.
- A number of people felt that personal development associated with travel should be a recognised form of education. The security and economies of extended family associated with family sponsorship was also cited as an investment in a family's ability to collectively provide the leverage to help them out of poverty.

- Participants recognized that there may be some penalty associated with undesignated withdrawals in an emergency but felt that the penalties should be in line with their financial abilities and circumstances. Depending on the nature of an emergency, losing the asset exemption could be catastrophic compared to losing benefits associated with the RDSP's tax status.
- Participants differed over the level of third party control associated with an RDSP. If participants accepted that the unique status of a RDSP necessitated an intermediary process, participants generally were positive about having access to an advisor offering education and advice compared to a sponsor who had control over their money (similar to substitute decision-makers in the mental health system or trustees).
- The option to have access to a financial advisor and educator was more attractive to participants who felt intimidated and unsure of the world of investment. The participants who felt they were already financially literate would not be averse to passing a test (like a driver's licence) as a demonstration of their knowledge and ability to capitalize on the unique advantages of the RDSP.
- Some participants noted that the limits and conditions attached to the RDSP should be uniform with the advantages. Including a possible matching contribution may justify a greater limits on destinations.

3. Key Findings

A. The RDSP concept received generally positive feedback, with reservations by many and several individuals not interested at all. It was a difficult concept for some participants to fully understand. Generally, the RDSP proposal was felt to be a good option for low-income people as an enhancement or extension of existing income security programs.

B. If a RDSP is overly bureaucratic and differs too much from other mainstream savings options, there will be less take-up (use) of RDSP's.

C. The destinations and conditions attached to a RDSP need to reflect the diversity of circumstances and high risks of emergencies associated with low-income families. A 'one-size fits all' program would also diminish the take-up rate.

Appendix B.

The Problems with RRSP's for Low-Income People

I am a worker who has been laid off and I am looking for another job. I am currently receiving Employment Insurance. I have two children aged twelve and nine. The last time I received welfare, I got \$28.00 per month. I was making \$9.00 per hour working in a mailroom sorting things.

I have some savings in an investment certificate but I don't know whether it is in an RRSP. I am not going to plan right now for the future because my plans never go right. I had some savings before but twice I had to cash them out because I needed the money.

St. Christopher House participant

In February of each year (earlier in 2003), there is a considerable amount of advertising and media attention given to RRSP deadlines, noting both the urgency and importance of contributing to a plan before the deadline in early March. Although this attention is valuable for middle and upper-income people, many low-income people make the very inappropriate decision to contribute to an RRSP.⁵

RRSP's find a good part of their rationale in the assumption that working-age people with higher income in their years of earnings will have lower incomes later on as retirees. RRSP's also offer a postponement of tax liability on contributions, which are deductible when made and only taxable on later withdrawal. Further, the tax advantage gained from deducting a contribution now may well result in taxation at a lesser rate later on in life.

Poor working-age Canadians generally face low minimum wages and welfare rates that have fallen in the face of inflation while poor seniors receive higher benefits through indexed Old Age Security (OAS), Canada Pension (CPP), and the Guaranteed Income Supplement (GIS). From a tax and benefit point of view, Canada's low-income seniors are, on the whole, better off than working-age low-income persons.

However, as Richard Shillington noted during his tenure as policy fellow at St. Christopher House, when low-income Canadians draw down their RRSP's at the normal retirement age of 65, they inevitably pay tax at a high rate (combined income tax and Guaranteed Income Supplement benefit clawbacks). Old Age Security and the Canada Pension Plan are fully taxable and recipients of the Guaranteed Income Supplement face an additional 50% clawback on any additional income, such as income from an RRSP draw down.

⁵ See Canada's Retirement Income Programs: A Statistical Overview (1990-2000); Statistics Canada, Cat. # 74-507-XIE; p.90, where it is noted that 152,000 Canadian tax filers with less than \$10,000 in yearly income have contributed \$160,000,000 to RRSP's.

Accordingly, RRSP's may not be financially advantageous to the poor. Low-income and low wealth Canadians face a situation where the RRSP, as the only tax-deferred way they can save for later years, provides them with a contribution-based deduction that is of little or no value since it is based on largely non-taxed sources.

It may be argued that people simply need to educate themselves as to their own financial situation and set out to obtain appropriate financial advice as to their best financial planning and taxation options. However, the tax system is sufficiently complex that most Canadians have difficulty predicting their tax liability. For low-income people, this issue is made worse by a massive imbalance in the quantity and quality of financial planning and tax advice available in the marketplace. Financial advice from mainstream financial services is often unhelpful as there is no incentive to really understand the financial dynamics of low-income people, as they are generally perceived as an unprofitable market segment.

Approximately 30% of Canadian tax filers are exempt from paying income tax. Therefore, even though they may have RRSP 'room' to make a contribution⁶, any deduction they receive through a contribution to an RRSP has no positive value in the present year. Having contributed the money to an RRSP, they receive refunds made up of various federal and provincial tax credits that they understand as including the value of their tax deduction for their RRSP contribution.

For example, a single parent who has no tax liability without an RRSP contribution will receive no benefit from the deduction. However, should she cash out her RRSP in a reasonable manner starting at age 65, her Old Age Security (OAS) is fully taxable while her Guaranteed Income Supplement (GIS) is reduced by 50% of the drawn down portion of the RRSP. When the tax on the RRSP itself is taken into account along with taxable Canada Pension Plan (CPP) and OAS contributions, she stands to lose much of the money she has in the plan.

In contrast, the income sources many single parents now have in the form of social assistance, the Canada Child Tax Benefit, child support, GST credits, property and sales tax credits, are all non-taxable. These sources of income are also much lower than the benefits that seniors receive. It is also important to note that seniors do not have the deductions or credits available to younger adults with children living at home, often resulting in even greater tax exposure. Finally, the earnings of low-income persons are limited and although taxable, they are often insufficient to attract positive taxation at year-end.

Turning to the issue of credit, RRSP's are one of the few investment vehicles where it makes sense for the majority of tax filers with income tax liability to take out loans to realize tax deductions. The resulting refunds are then used to pay down the RRSP loans and registrants realize a short-term positive return.

For low-income individuals who receive no tax advantage from the deduction, there is no logical reason for taking out the loan. As there is no refund, there is no further short-

⁶ A minimum wage worker making \$10,000 in a year would gain \$1,800 in RRSP 'room'.

term money available to reduce the principal on the loan itself, meaning that low-income people will likely pay more in interest than their better-off counterparts.

What is worse is that low-income people, who cannot obtain retail credit in most instances, are able to take out RRSP loans since the RRSP itself remains with the lending institution. This is like getting a car loan and leaving the vehicle on the lot. Accordingly, an RRSP, which is a bad idea for the poor in the first place, is unfortunately more available than it otherwise would be.⁷ If there was ever a place to start for a person with a risky credit history, this is not it.

In recent interviews with St. Christopher House participants, three single parents who would gain no tax benefit from an RRSP deduction, all planned to borrow money to contribute to RRSP's by the deadline. Each of them was surprised to hear that making these contributions was not in their best short term or post-retirement interests.

Perhaps RRSP's should have the same type of warnings placed in their advertising and other literature as those seen for many other commercial products. These warnings could note that RRSP's are not for everyone. Pointed questions in plain language concerning low income or low tax liability would go some way to illustrating that persons with low income should not be purchasing them.

RRSP's: A Tally of Advantages and Disadvantages

Feature	Advantage for Well-off	Disadvantage for Poor
Tax deduction	Increases with income	Has little (or no) value
RRSP 'deadline'	Often relevant	Irrelevant
Investment advisors	Plentiful; most knowledgeable	Few; most ill-informed
Publicity	Relevant, timely	Irrelevant, often wrong
Prevalence of taxable income (amount & form)	Greater during working years	Greater during retirement years
Tax liability at retirement	Lower than pre-retirement years	Higher than pre-retirement years
Seniors' benefits clawbacks	OAS at high thresholds, low tax-back	GIS at low threshold, high (50%) tax-back
RRSP loans	Early payback through refund; well-off pay less	No refund, poor pay more for loan

⁷ Even though deferral of a deduction to a later year when income may be higher would benefit a contributor with no tax liability, taking out a loan to obtain a fixed-income instrument is likely still a bad idea. In addition, most loans are specifically geared to contributing now in order to immediately access a refund.

Appendix C.
Comparisons between Tax Deferred and Savings Vehicles

RDSP Proposal	Similarities: Other Tax Deferred and Savings Instruments	Differences: Other Tax Deferred and Savings Instruments
1. Tax is prepaid	TPSP, Roth IRA, Individual Development Accounts (IDA's)	Traditional savings and investment accounts, RRSP's, RHOSP's, RESP's
2. Not taxable on draw down	TPSP, Roth IRA, IDA's	Traditional savings and investment accounts, RRSP's, RHOSP's, RESP's
3. Exempt from welfare rules on assets and income	<ul style="list-style-type: none"> • RESP's in some instances • IDA experiments e.g. Learn\$ave in limited circumstances 	<ul style="list-style-type: none"> • RRSP's unless truly locked in like a pension • traditional savings and investment accounts • TPSP's
4. Earnings in the plan are tax exempt	Roth IRA, IDA's, TPSP's	RRSP's, traditional savings and investment accounts
5. Designed to combat dependency and pre-retirement asset accumulation	IDA's, traditional savings and investment accounts	TPSP, Roth IRA's, RRSP's
6. Matching contributions encouraged	IDA's	TPSP, Roth IRA's, RRSP's, RESP's, traditional savings and investment accounts
7. Sponsor/partner	IDA's	TPSP, Roth IRA's, RRSP's, RESP's, traditional savings and investment accounts
8. Financial literacy component	IDA's	TPSP, Roth IRA's, RRSP's, RESP's, traditional savings and investment accounts
9. Specific draw down component to avoid welfare	(Some US states with assistance re: lifetime limits)	TPSP, Roth IRA's, RRSP's, RESP's, traditional savings and investment accounts
10. Variability in destination – case management	Some IDA's, IRA's, TPSP's RRSP's and traditional savings accounts are not destination dependent.	IDA's RHOSP's, RESP's etc.

Appendix D

Policy Context for Social Assistance Restrictions on Assets

Social assistance programs in Canada have three present-day goals in common:

- to provide a level of basic income and benefits to people who are otherwise without resources in order to meet their basic needs;
- to set program rules and provide other supports and benefits that provide the means by which recipients may reduce and finally end their need for social assistance; and
- to put in place measures to break the cycle of dependency whereby the children of social assistance recipients sometimes become dependent on social assistance themselves.

Although there is disagreement in regard to the levels of benefits provided and how social assistance goals are achieved, there is a good public understanding that social assistance or 'welfare' should provide short-term benefits until recipients get back on their feet. To put it more positively, the goal of progressive welfare policies is to assist the recipient to get off welfare.

Social assistance programs are charged with the responsibility of providing income support to people whose level of income and personal resources are at or below generally recognized levels of subsistence in Canada.

For people who design social assistance programs, this responsibility means that income and personal resources in the form of assets must be tested to ensure that persons who do have income or personal resources are not eligible for social assistance. Restrictions on the assets that social assistance recipients may own and income they produce have been an integral part of social assistance needs-testing since the advent of modern social assistance programs in Ontario and Canada.

The Canada Assistance Plan (CAP), the federal cost-sharing vehicle for social assistance in Canada, imposed a number of limits on provinces and territories while paying welfare costs on a 50-50 basis. Before CAP was overtaken by the Canada Health & Social Transfer (CHST) in 1996, the CAP Directorate within HRDC introduced a number of asset rules that allowed for exemptions on savings and inheritances and made special note that cost-sharing would be available for recipients' savings for items considered beneficial to them.

Appendix E

Individual Development Accounts (IDA's) in Canada

Individual Development Accounts (IDA's) to assist low-income people to build assets were introduced in the United States in 1998. IDA's are savings vehicles in which individuals and outside interests are co-contributors for building savings in order to spend on designated items aimed at individual and community self sufficiency. They are "family and community development programs that might be utilized by any low wealth household"⁸.

At this time, SEDI has received federal government support on an experimental basis through a national policy pilot project called Learn\$ave, funded by the Applied Research Branch of Human Resources Development Canada (HRDC) and evaluated by the Social Research Development Corporation (SRDC).

Canada's IDA Learn\$ave experiment is framed within the context of lifelong learning in that individual savings and lifelong contributions are designated for goals such as education, skills training, and micro-enterprise financing.

Learn\$ave is an education-based IDA experiment that experienced some early difficulty in some sites obtaining participants for its multi-year study which may be, in part, due to the limited destinations for funds although this is a matter of conjecture until the evaluation becomes available.

"States are permitted to use TANF (Temporary Assistance for Needy Families) funds to match savings in IDA's ... Allowing IDA's as a state option in TANF was an important step toward establishing asset building as a policy option on equal footing with income support for welfare households."

**From Research to Policy: Lessons from Individual Development Accounts"
(Michael Sherraden, 2000 (page 11).**

⁸ Dr. Michael Sherraden: Policy Report: Asset Building Policy and Programs for the Poor, Centre for Social Development, Washington University; 2000; p.7

Appendix F

St. Christopher House's CUSP Project: Policy from the Frontline

The Community Undertaking Social Policy (CUSP) program at St. Christopher House began in 2000 to create a dialogue and mutual learning between policy-makers and community. In particular, St. Christopher House is concerned with the inadequacy or ineffectiveness of current income assistance programs in addressing poverty.

The first CUSP Fellow, Richard Shillington, an Ottawa-based policy consultant, focused on the negative consequences that result from the interaction of different income assistance programs, taxation and various related programs. This analysis included a critique of the different ways in which the assets of low-income people are treated by various income security programs. Shillington also has pointed out the significant financial problems created by current Registered Retirement Savings Plans (RRSP's) for many low-income people (i.e.: many will be worse off for having saved in an RRSP, as noted in Appendix B).

In 2002/03, the second CUSP Fellow, John Stapleton, a former provincial civil servant, joined St. Christopher House to focus on the role of assets for low-income people as an anti-poverty strategy. Widely considered an expert on welfare programs, Stapleton proposes a form of a Tax Prepaid Savings Plan that would be appropriate for low-income people who have to resort to welfare.

The details of the plan for a Registered Development Savings Plan (RDSP) were designed by John Stapleton, based on the input of St. Christopher House participants and staff over five months. The proposal was also explored in depth with a rich and diverse array of community, academic, and senior business advisors. In addition, Massey College continues to support the CUSP Fellows. St. Christopher House's local involvement in the national Learn\$ave project of Social and Enterprise Development (SEDI) has also informed this work on assets (see Appendix F). Stapleton also was supported as well by a group of community workers from the Leaders for Change program of the Maytree Foundation.

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