BEHIND THE NUMBERS / May 2015

The Number Games

Are the TFSA Odds Ever in Your Favour?

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Summary

The 2015 federal budget vehemently argued that, rather than providing a windfall to upper-income Canadians, raising the annual TFSA contribution ceiling from $5,500 to $10,000 would disproportionately benefit lower- and middle- income Canadians, an assertion that stood in stark contrast to any other examination of the benefits of TFSAs.[1]

And it's no wonder — the claims made in Budget 2015 regarding TFSAs are only possible when key contextual data has been excluded. Once this vital context is included, the exact opposite conclusions would be reached: doubling the TFSA limit will disproportionately benefit the richest Canadians.

Excluding key information and playing on misleading income groupings creates an erroneous impression to support a policy recommendation which, based on a fair interpretation, would otherwise not be supported. The TFSA data is strenuously massaged into appearing to show a distributional impact in direct opposition to the one it actually has. In order to maintain the stated goals of TFSAs, which is to target low- and middle-income Canadians, new lifetime contribution limits should be introduced at $150,000 with maximum TFSA assets limited to $300,000.

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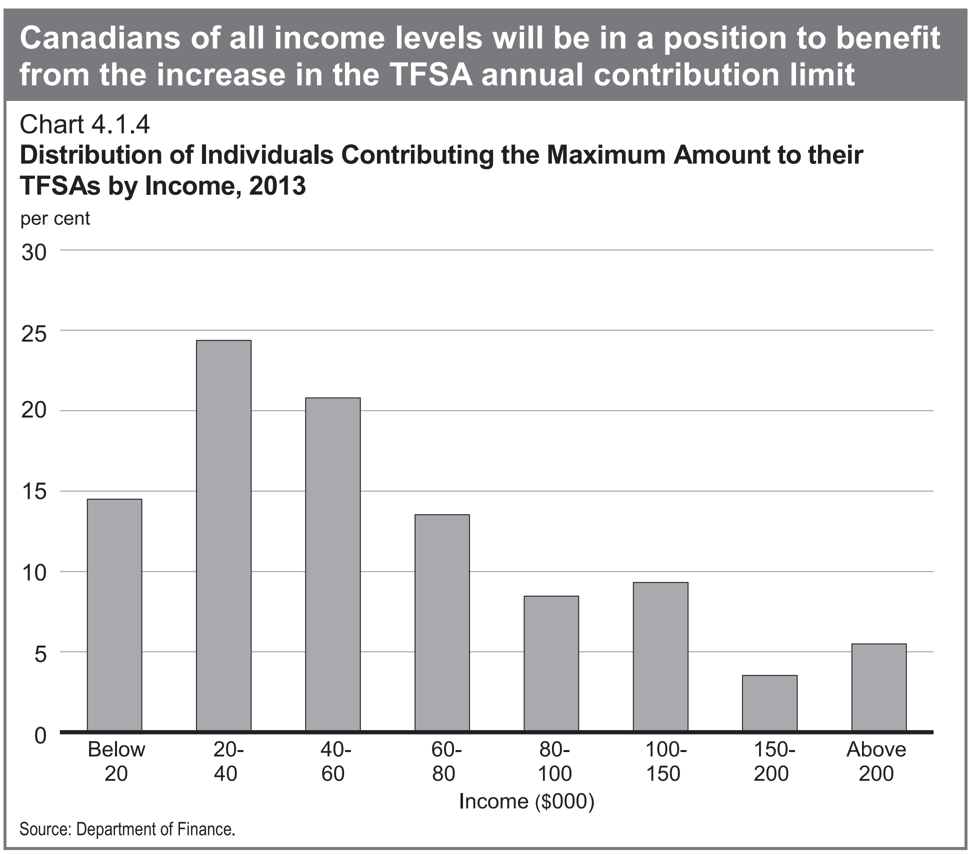
Fudging the Numbers

Let's start with *Figure 1*, reproduced exactly from Budget 2015, which indicates 15% of all TFSA maximizers[2] in 2013 made less than $20,000, suggesting those in this income group will gain 15% of the benefits of a TFSA limit increase. At the other end of the income chart, the graph shows that only 5% of the benefits from the TFSA cap increase would go to those making over $200,000 a year. *Figure 1* thus implicitly supports the premise that doubling the TFSA limit disproportionately benefits lower-income Canadians.

If only this were the case. There is a key piece of data missing from *Figure 1* and that is the percentage of Canadians who fit into the various income categories as listed at the bottom of the chart. Without this information, there is no context for saying if one category benefits disproportionately compared to another.

FIGURE 1 Misleading Federal Budget 2015 Chart



Source Federal Budget 2015, pg 235

For example, if those making under $20,000 a year comprised 1% of the Canadian population and received 15% of the benefits from the TFSA doubling, then we could say the change disproportionately benefited that group. However, if those making under $20,000 constitute (as they do) 34% of the population but only receive 15% of the benefits of TFSA doubling then that is not an especially good deal for them. At the same time, those making over $150K (the right two bars in *Figure 1*) are set to receive 9% of the benefits but only represent 3% of the population, which means TFSA doubling is an especially good deal for them.

In short, once population distribution is included as a comparator — which it should be, in order to provide as complete a distributional analysis as possible — the interpretation of the very same data is completely reversed from what is implied in Budget 2015.

Median income in Canada is just over $30,000 a year: half of Canadians make less and half more than that amount per year. Doctors, lawyers or parliamentarians fit decidedly into Canada's list of upper-income professions. Canada's middle class is made up of retail salespeople, cleaners, office administrators and people in other sectors who work hard to make about $30,000 a year. They typically have little left over to contribute $5,500 a year into a TFSA, let alone the proposed $10,000.

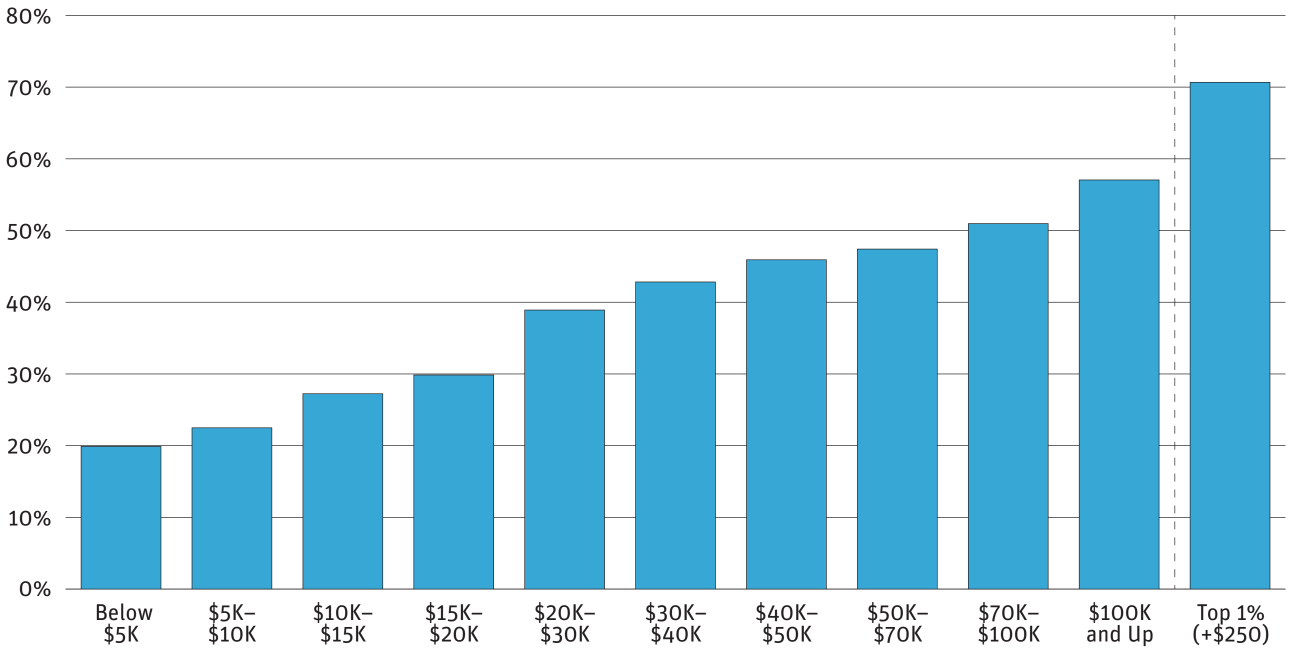
Returning to *Figure 1*, we can now see how the chart misrepresents the bottom half of Canadians by allotting them only 1.5 bars ("Below 20" and half of the "20–40" income categories). The top half of earners get 6.5 bars — far more than their actual population suggests — which visually diffuses the benefits of doubling the TFSA limit among the richest. For this kind of analysis, it is far more appropriate to divide the population into equally sized income deciles to clearly show the distributional impact of a tax policy on different income groups.

Once these key population comparisons are made using the exact same data presented in Budget 2015, we get very different results. The bottom 25% of income earners (making under $10,000 a year) would only see an 8% potential benefit from TFSA doubling, as only 8% of TFSA maximizers are in this category. However, the richest 10% (making over $100,000 a year) would see 22% of the potential benefits from TFSA doubling.

An Honest Analysis

To allow for more accurate understanding of the benefits of TFSA doubling, income groupings have been recreated in this analysis to represent equal groupings of 10% of the population so that half the population isn't crammed into 1.5 bars, as in *Figure 1* of Budget 2015. While I use the same data from the same source and year as

FIGURE 2 Who Has a TFSA Account by Income Level (2013)



Source Revenue Canada & authors calculations

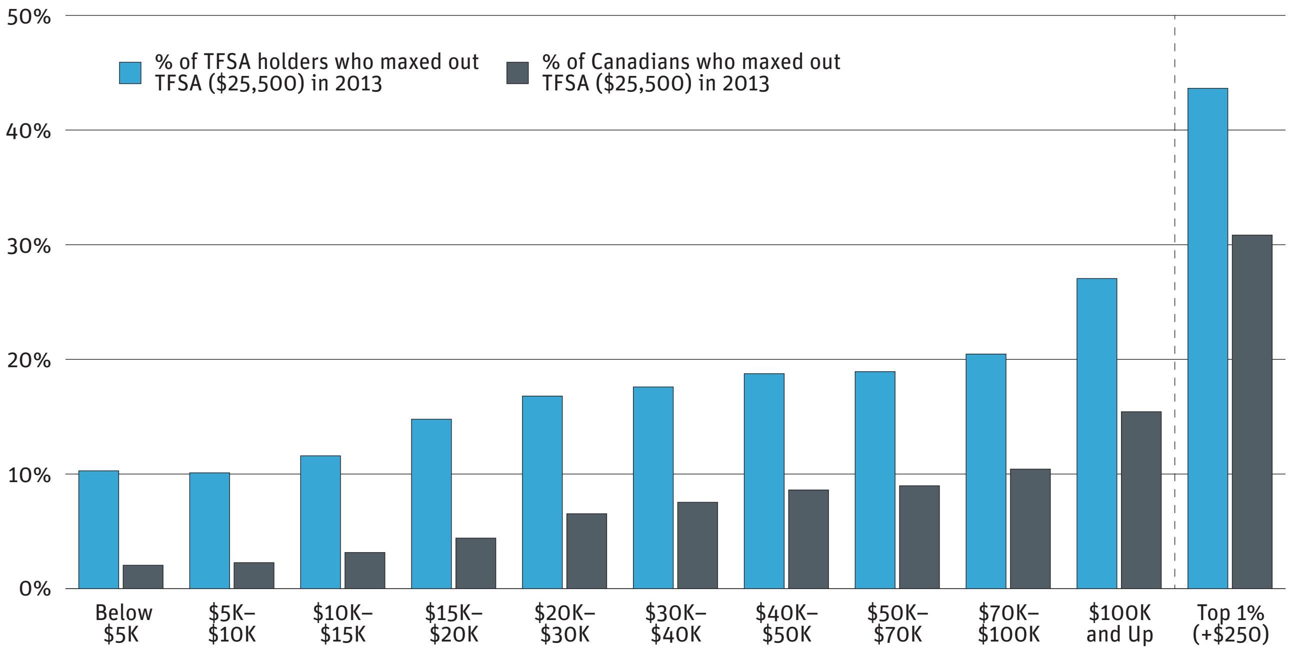
the budget, all figures below are adjusted for population so as not to repeat the misrepresentation. I also take into account the large number of people who have not opened a TFSA, which is also missing from the budget analysis.

When you do this, you notice the distribution of those who have opened a TFSA account is strongly correlated with income. Obviously, you can't maximize contributions to an account that doesn't exist, which is the situation for 80% of those earning under $10,000 a year (the lowest two income classes which are roughly deciles). These people spend all their earnings meeting basic needs, leaving little room for savings of any kind, a TFSA included. Even for the middle two classes (those earning between $20,000 and $40,000 a year), 60% have not yet opened a TFSA, much less maximized it.

For all but the richest Canadians, participation rates in TFSAs in general (much less maximization) remain under 50%. Compare this to the group making over $250,000 a year (the richest 1%) among whom 70% have at least opened a TFSA.

Whatever the *distribution* of benefits across income groups, the *actual* benefits of doubling the TFSA contribution limit within each income group are minimal. The percentage of Canadians who managed to put $25,500 in their TFSA by 2013 is very small, as shown in *Figure 3*, and it gets smaller as incomes decline.

FIGURE 3 TFSA Maximizers by Income Group (2013)



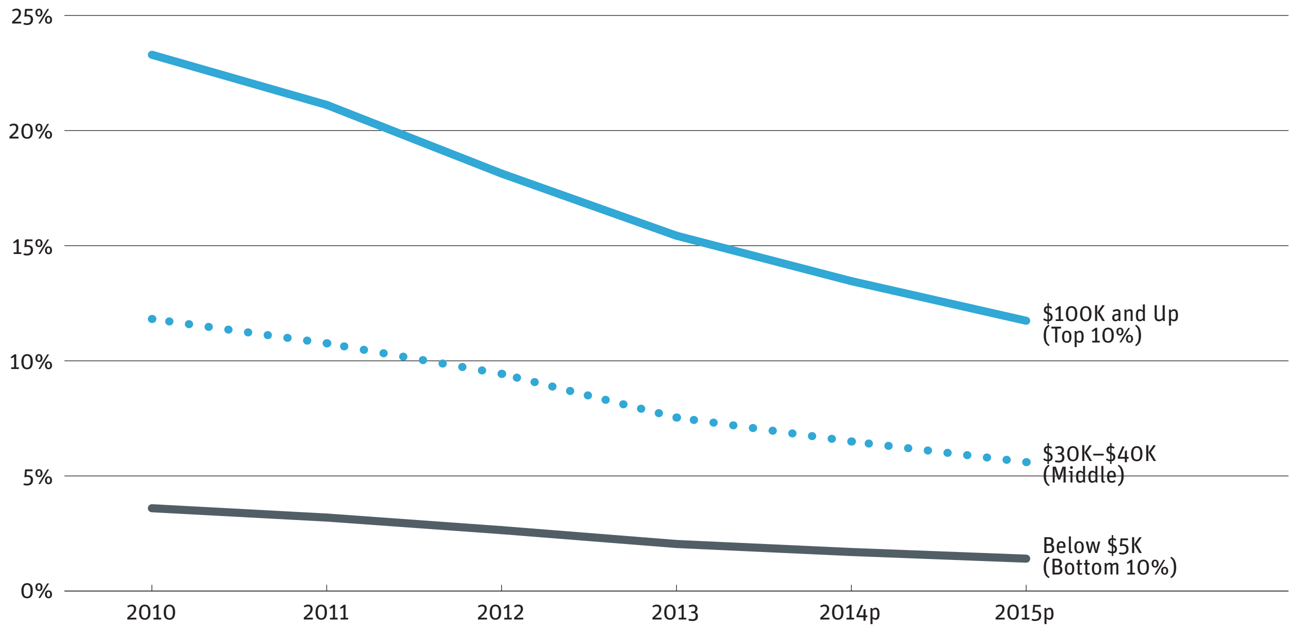
Source Revenue Canada & authors calculations

For the half of the population making under $30,000, only 5% or less have maximized their TFSAs. In other words, for the bottom half of Canadians, less than 5% stand to gain *anything* from doubling contribution limits. Even for higher incomes, TFSA maximization (even at the 2013 level of $25,500) is far from universal. For instance, of the richest 10% only 15% have maximized their TFSAs, and only one-third of the top 1% have done so. In other words, for the majority of Canadians, TFSA maximization — even at the lower $25,500 cap in 2013, let alone the $36,500 limit for 2015 — is a distant goal, to a large extent because most Canadians don't have a TFSA.

The figures presented above are only for 2013. However, maximization rates have been dropping rapidly across all income groups since 2010 (*Figure 4*).[3] This is intuitively predictable as the amount required to maximize all TFSA room has risen from $10,000 in 2010 to $36,500 in 2015 (excluding the proposed TFSA contribution limit doubling).

For those in the lowest income decile, only 4% managed to put $10,000 in their TFSA in 2010. By 2015, only 1% of the poorest Canadians will reach the TFSA cap of $36,500, and this is prior to doubling the TFSA annual contribution. For those making between $30,000 and $40,000 a year, 12% put away $10,000 in 2010, and this number dropped to only 5% in 2015 with the higher $36,500 cap.

FIGURE 4 TFSA Maximization Rates by Year (Selected Classes)



Source Revenue Canada & authors calculations

This trend extends to the wealthiest. In 2010, 23% of those making over $100,000 annually managed to put $10,000 in their TFSA. By 2015, it is expected that only 12% will hit the $36,500 cap.

No matter the income grouping, the numbers of people managing to maximize their TFSAs remain quite small. Doubling the TFSA limits from the current cap, one that most Canadians aren't even reaching, seems like a misplaced emphasis.

Conclusion

In theory, the main beneficiaries of the TFSA should be low- and middle-income Canadians saving for retirement by allowing them to avoid the aggressive Guaranteed Income Supplement clawback on RRSP withdrawals or pension plan benefits upon retirement.[4] However, given the minimal likelihood that those making under $30,000 a year will manage to save even $5,500 in a TFSA, the idea that increasing the annual limit to $10,000 disproportionately benefits low-income Canadians is pure fantasy.

Rather than facing up to the facts, the government tried to hide them in misleading charts within Budget 2015. Those facts include an abysmal take-up rate, much less maximization rate, for low- and middle-income Canadians. We are again left with the conclusion, as exposed by any economist or researcher who has examined the issue, that TFSAs disproportionately benefit the wealthy. In contrast to its initial goal, it has become another means by which the wealthy can avoid paying tax on their investment income.

Because the tax system should not be used as a tool to make inequality worse, consideration of the distributional impacts of policy changes is key to sound decision-making in an age of inequality. Research must be conducted responsibly to ensure that the bulk of the benefits go to those who need them most, not to the richest, as this analysis demonstrates will unfortunately be the case with the doubling of TFSA contributions.

In order to have TFSAs target low- and middle-income Canadians, their stated goals, new lifetime limits on TFSA contributions should be set at $150,000 with maximum assets within a TFSA set to $300,000. These limits will avoid TFSA millionaires[5] gaining access to programs meant for low-income seniors like the Guaranteed Income Supplement (GIS) and Old Age Security (OAS).

While the Canadian Centre for Policy Alternatives was the first[6] at suggesting dollar limits both for maximum holdings in a TFSA as well as lifetime contributions, the concept of lifetime caps on TFSAs has broad support.[7] Lifetime caps have been advocated for by the father of TFSAs, Rhys Kesselman.[8] They have also been floated by the Parliamentary Budget Officer[9] and the Globe and Mail's Report on Business.[10]

The time to implement these reasonable limits on TFSAs is before most Canadians start hitting them. The longer the government waits to implement caps, the harder it will be, and the more the program will benefit Canada's wealthy instead of those with middle and lower incomes.

Data and Methodology

The figures and statistics in this report use the Tax-Free Savings Account Statistics available through the Canada Revenue Agency.[11] Those statistics for the 2013 tax year are the most recent available and are the source for the statistics in Budget 2015 and for much of the report above.

To make population adjustments, the Canada Revenue Agency Preliminary Statistics (Table 2) total number of returns is used.[12] The most recent version of these statistics is only available for the 2012 tax year. In order to make population adjustments to the 2013 TFSA statistics the 2012 total number of tax return figures are adjusted on an income grouped level based on the average change in those same income groupings over the previous three years.

Although the income groupings and data source is the same for both income tax returns and TFSA data, some discrepancies may exist between these statistics:

1. Canadians under 18 can file income taxes that count towards the total number of tax returns. However, one must be 18 or older to have a TFSA. That being said, strong incentives to file an income tax return, like the GST tax credit, don't apply until one turns 18. It's unclear how many Canadians under 18 file income taxes although they are likely to be at the bottom of the income spectrum.

2. Not all Canadians over 18 file income taxes. The number of tax filers under-represents the Canadian population to some degree, particularly for those with low incomes. Although the financial incentives to file for low income Canadians do exist in the form of refundable tax credit and income support programs.

3. For 6% of TFSA holders CRA does not have corresponding income data. It is unclear where these TFSA holders would fit in the income spectrum.

Several of the figures above examine distribution based on income classes. Each one of those classes represents as close to 10% of the population as possible. Given the CRA pre-defined income reporting, these deciles do not always represent exactly 10% of the population of filers. The "20K to 30K" class (the 5th approximate decile) represents 14% of the population, the largest over-representation. The "5K to 10K" class (the 2nd approximate decile) represents 7% of the population, the largest under-representation. However, in all figures where deciles are displayed, the income grouping is consistent between the income tax returns and TFSA holders providing a fair comparison based on the specified income range.

Notes

1 For instance see: Office of the Parliamentary Budget Officer, Update of PBO's Tax-Free Savings Account Analysis, April 2015.; Armine Yalnizyan, Doubling Contributions to the Tax Free Savings Account: Even Nastier Than Income Splitting, Progressive Economics Forum, March 2015, http://www.progressive-economics.ca/2015/03/02/doubling-contributions-to-the-tax-free-savings-account-even-nastier-than-income-splitting/; Jonathan Rhs Kesselman, Double Trouble: The case against expanding Tax Free Savings Accounts, The Broadbent Institute, February 2015.; Department of Finance Canada, Tax-Free Savings Accounts: A profile of Account Holders, Tax Expenditures and Evaluations: Part 2, 2012.

2 Note that "TFSA maximizers" refers to those who have hit their lifetime TFSA maximum which for most people in 2013 was $25,500.

3 It wasn't possible to start in 2009 due to changing income groupings in the data in 2010. Post-2010, the same income groupings allow for consistent comparisons through 2013.

4 For original idea behind TFSAs see: Kesselman, J.R., and F. Poschmann. 2001a. "Expanding the Recognition of Personal Savings in the Canadian Tax System." *Canadian Tax Journal* 49 (1), 40–101.; and Stapleton, J., and R. Shillington. 2008. "No Strings Attached: How the Tax-Free Savings Account Can Help Lower-Income Canadians Get Ahead." E-Brief No. 64. (September). Toronto: C.D. Howe Institute.

5 For scenarios of TFSA asset accumumulation see: Jonathan Rhs Kesselman, Double Trouble: The case against expanding Tax Free Savings Accounts, The Broadbent Institute, February 2015, pg 15–16.

6 Armine Yalnizyan, Submission to the Standing Committee on Finance: Pre-Budget Submission, Canadian Centre for Policy Alternatives, September 2009.

7 For initial dollar limits see Armine Yalnizyan, "The TFSA Shouldn't Be Scrapped, It Should Be Fixed: Budget 2015", Behind the Numbers, April 20th, 2015 (http://behindthenumbers.ca/2015/04/20/the-tfsa-shouldnt-be-scrapped-it-should-be-fixed-budget-2015/) and David Parkinson, "Economists highlight the key questions for this year's budget" The Globe and Mail, April 29th, 2015, (http://www.theglobeandmail.com/report-on-business/rob-commentary/executive-insight/how-a-balanced-budget-raises-questions-in-oil-shock-ravaged-canada/article24020124/)

8 See Jonathan Rhs Kesselman, Double Trouble: The case against expanding Tax Free Savings Accounts, The Broadbent Institute, February 2015.

9 Office of the Parliamentary Budget Officer, The Tax-Free Savings Account, February 24, 2015, pg 19. (www.pbo-dpb.gc.ca/files/files/TFSA_2015_EN.pdf)

10 Ian McGugan, The Long View: TFSA and RRIF rule changes miss the mark, Globe and Mail, April 26th, 2015 (http://www.theglobeandmail.com/globe-investor/personal-finance/retirement-rrsps/tfsa-rrsp-and-rrif-rule-changes-miss-the-mark/article24130207/)

11 http://www.cra-arc.gc.ca/gncy/stts/tfsa-celi/menu-eng.html

12 http://www.cra-arc.gc.ca/gncy/stts/ntrm-eng.html

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