THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

IFIC.CA

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Dear Sirs and Mesdames:

RE: Pre-Budget Consultation – House of Commons Standing Committee on Finance

We are writing to provide comments on behalf of the members of The Investment Funds Institute of Canada ("IFIC" or "we") with respect to the 2014 federal pre-budget consultations. IFIC is the voice of Canada's investment funds industry, bringing together 150 organizations – including fund managers and distributors – to foster a strong, stable investment industry through which investors can realize their financial goals. We are proud to have served Canada's mutual fund industry and its investors for more than 50 years.

In preparing our comments, we have focused on three of the committee's six consultation themes:

- Balancing the federal budget to ensure fiscal sustainability and economic growth
- Supporting families and helping vulnerable Canadians by focusing on health, education and training
- Improving Canada's taxation and regulatory regimes

1) Balancing the federal budget to ensure fiscal sustainability and economic growth

The investment funds industry fully supports the government's commitment to bring the budget into balance in 2015. We appreciate the challenges that the government has overcome in order to reach this goal and commend the discipline required to forego and defer worthwhile spending. Lower debt levels mean lower debt-servicing costs, which will enable the government to lower taxes for Canadians and engender a strong, stable investment climate that supports job creation and economic growth.

Lower taxes for individual Canadians will support a range of other important public policy goals. For example, leaving more money in the hands of hard working Canadians will enable more Canadians to start saving, or to save more, for their retirement.

2) Supporting families and helping vulnerable Canadians by focusing on health, education and training

Low levels of financial knowledge and poor economic decision making are significant challenges facing Canadians of all ages, education levels, and backgrounds – and by extension governments. The investment funds industry shares the government's commitment to addressing Canadians' financial literacy levels.

Support Financial Advice

From workplace pension plans to RRSPs and TFSAs to PRPPs, there are a multitude of retirement savings vehicles available to Canadians. No matter which vehicle Canadians choose, we believe that they should benefit from access to financial advice. As a 2012 study from Montreal's CIRANO Institute[1] demonstrates, having a financial advisor contributes positively and significantly to the accumulation of financial wealth, even after taking into account dozens of other socio-economic

[1] Montmarquette, Claude. *An Econometric Analysis of the Value of Advice in Canada.* July 2014. Summary available at: https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-Financial-Advice-November-2012.pdf/1653/

variables. In other words: by helping Canadians of all incomes, ages and levels of financial literacy save more, invest appropriately and prepare for retirement, financial advisors are directly supporting the government's public policy objective of promoting retirement security of all Canadians. We therefore believe that all efforts to improve Canada's retirement system consider and build upon the integral role played by advisors.

3) Improving Canada's taxation and regulatory regimes

Group RRSPs

From the successful introduction of TFSAs to the recent development of PRPPs, IFIC has consistently supported efforts to offer Canadians more ways to save for retirement. To foster a stronger and more competitive retirement savings marketplace, we believe that these new options, and indeed all options within the market, should enjoy comparable tax treatment. For retail investors and employers, different retirement savings options are highly substitutable, such that even small regulatory and tax differences can have a material impact on investment choices and business models.

The new PRPP framework, while a positive addition to Canadians' retirement savings landscape, creates some incongruities for other retirement savings vehicles, particularly Group RRSPs (GRRSPs). For employers, part of the appeal of PRPPs is that any employer contributions are payroll-tax exempt. Moreover, these employer contributions can be locked-in, in order to ensure that they are used for long-term savings as intended. Finally, employers can automatically enroll all of their employees in a PRPP, though employees retain the ability to opt-out.

These are all sensible features that will benefit employees, employers and administrators alike. GRRSPs fulfil the same overarching goal of PRPPs – long-term savings through a workplace plan – yet are not accorded similar tax and regulatory treatment. Such differences unnecessarily disadvantage GRRSPs, which are an accessible and efficient option within the retirement savings landscape.

As the federal government looks for ways to help Canadians save more for retirement, we therefore ask that it consider harmonizing the rules governing retirement savings products, such that:

- Employer contributions to GRRSPs be payroll tax, CPP and EI exempt
- Automatic enrollment of employees in GRRSPs be permitted (with reasonable opt-out provisions)
- Employer contributions be locked-in.

These changes would create a level playing field within the retirement savings marketplace and help to ensure that Canadians continue to have a range of choices when saving for the future.

TFSA Contribution Limits

During the 2011 federal election, Prime Minister Stephen Harper announced his intention to increase the annual individual TFSA contribution limit from $5,000 to $10,000 after the budget returned to balance. At the time, Prime Minister Harper said "This is another major step forward to allow Canadians to keep more of their hard-earned money to save and invest in their own priorities."[2]

We agree. As with harmonizing the rules governing GRRSPs and PRPPs, increasing the TFSA contribution limit would improve the options and flexibility available to Canadians as they save and invest. By pursuing an "all-of-the-above" strategy of strengthening every option within the retirement savings marketplace, the government can support Canadians as they save and invest in their own priorities.

[2] CBC News: "Tax-free savings accounts would double: Harper". April 7, 2011. Available at: http://www.cbc.ca/news/politics/tax-free-savings-limit-would-double-harper-1.1091397

RRIFs: Withdrawal Rules and Pension Income Splitting

A recent report published by the C.D. Howe Institute highlighted the impact of mandatory minimum withdrawal rules for registered retirement income funds (RRIFs).[3] As the report notes, these rules have not kept pace with gains in Canadian life expectancy, and, as such, can increasingly cause seniors to outlive their savings under the current withdrawal rates. We believe that this is a subject that warrants further attention and study by the federal government, and would support efforts – such as increasing the mandatory age for initial RRIF withdrawals and/or reducing the minimum drawdown amounts – to mitigate the risk that seniors outlive their savings.

Furthermore, of ongoing concern is income-splitting for RRIF income prior to age 65. Currently, income from a registered pension plan (RPP) can be split with a spouse or common-law partner prior to age 65. RRIF income, however, can only be split once the RRIF annuitant reaches age 65.

To ensure equal treatment between those seniors who choose to receive their retirement income from a RRIF instead of an RPP, we believe that pension income-splitting prior to age 65 for RRIF income should be permitted.

Increasing the Age Limit for RRSP contributions

As a corollary to the C.D. Howe report cited above, rapid gains in Canadian life expectancy and increasing workforce participation among seniors also suggest that the government consider raising the age limit – currently 71 – on RRSP contributions. While the limit was last raised in 2007 (from 69 to 71), recent studies suggest that an appropriate age limit, given life expectancy trends, would be 75.[4]

Income Adequacy Among Canadian Seniors

In a recent research paper, Jack Mintz and Philip Bazel identify a particular gap within Canada's current retirement savings system: the retirement income adequacy for single seniors who live alone.[5] As the report notes, although the poverty rate among Canadian seniors is among the lowest in the industrialized world, there remain pockets of income inadequacy. One such pocket consists of elderly singles – mainly elderly women – who live alone. This group is four times more likely to be below the Low Income Cut-Off threshold than the elderly population as a whole. Moreover, low labour-force participation rates among this cohort means that many are entitled to few or no CPP benefits of their own, while survivor CPP benefits are substantially reduced for those who have been widowed.

The paper offers two targeted policy recommendations that could directly benefit this pocket of income inadequacy: raising the Guaranteed Income Supplement (GIS) top-up for elderly people living alone, and expanding the CPP survivor benefit from 60 per cent of the deceased spouse's entitlement to 100 per cent.

While these targeted policies would cost approximately $1.35 billion, they would cut the number of single seniors living below the low income cut-off by one half. We believe that this proposal offers the kind of targeted and evidence-based measure that the federal government should consider as it seeks to strengthen Canada's retirement savings system.

The Impact of the GST/HST on Retirement Savings

The higher level of GST and HST levied on mutual funds relative to other investment products negatively affects the many Canadian investors who rely heavily on funds to save for and earn income in retirement.

[3] Robson, William B.P. and Alexandre Laurin. *Outliving our Savings: Registered Retirement Income Fund Rules Need a Big Update*. June 4, 2014. Available at: http://www.cdhowe.org/pdf/e-brief_175.pdf
[4] Mintz, Jack M. and Thomas A. Wilson. *Reform Proposals for Replenishing Retirement Savings*. February 2013. Available at: http://www.policyschool.ucalgary.ca/sites/default/files/research/mintz-wilson-retsavings-final.pdf
[5] Bazel, Philip and Jack Mintz. *Income Adequacy Among Canadian Seniors: Helping Single Seniors Most*. February 2014. Available at: http://www.policyschool.ucalgary.ca/sites/default/files/research/mintz-bazel-seniors-income.pdf

Since its inception in 1991, the GST has applied four to five times more heavily to the value of services provided to mutual and other funds than to the equivalent value of services provided to non-fund investment products. While other financial services products are given exempt treatment, mutual funds have been fully taxed.

The HST, being based on the GST, has exacerbated this long-standing unequal treatment of fund holders. The inequity of the GST, and greater inequity of the HST, exists because the labour/salaries and net earnings that are part of delivering a mutual fund are fully taxable for funds, but tax-exempt in the case of providing guaranteed investment certificates (GICs), equity and debt.

Financial products are highly substitutable. Unequal tax treatment of highly substitutable products will distort consumption patterns and erode economic efficiency. From a purely economic perspective, financial advisors and investors should be making recommendations and consumption decisions based on suitability, risk and investment criteria, not on the relative tax treatment of alternative investment products.

This tax is borne by mutual fund investors. Today, almost 57% of assets under management (AUM) in Canadian mutual funds are held in registered plans as Canadians have been substituting mutual fund investments for fixed income and deposit accounts to diversify their holdings in this low interest rate environment. In doing so, they have been taxed more heavily. A more neutral tax policy, particularly for financial products that assist the building of individual savings, would remove this inequity.

Taxation of Canadian Mutual Fund Corporations

When calculating their taxable corporate income, most corporations in Canada are entitled to apply the 13% "General Rate Reduction" to their "full-rate taxable income" (or income that is not eligible for another corporate tax reduction). Mutual fund corporations, however, are not allowed to apply this reduction, as their full-rate taxable income is deemed to be nil. This is because two of the principal forms of mutual fund corporation income – capital gains and dividends – are already subject to tax reductions.

Yet mutual fund corporations may earn income from sources other than dividends and capital gains, such as interest income or income from foreign sources. For these income sources, mutual fund corporations pay the full-rate taxable income, yet are not allowed to use the General Rate Reduction as other corporations do. To rectify this imbalance, we request that Canadian mutual fund corporations be entitled to apply the General Rate Reduction to all eligible income.

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Conclusion

Thank you for providing us with an opportunity to comment on these important issues of shared interest. Should you have any questions or desire to discuss these comments, please contact Graham Smith, Senior Policy Advisor at 416-309-2328 or by email at gsmith@ific.ca.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

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