Expanding Tax-Free Savings Accounts — Doubly Troubling

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Abstract

The proposed doubling of contribution limits for Tax-Free Savings Accounts raises fundamental questions about the potential benefits for individuals and the economy; it also poses an occasion for examining deficiencies of the original TFSA scheme. This study provides the first detailed critical policy analysis of TFSA including an assembly of key available statistics on the provision. The existing TFSA contribution limits are found to be more than adequate for almost all individuals except for very high earners and some older workers and retirees. The proposed doubling of TFSA limits would, over the long run, be of highly disproportionate benefit to top earners and wealth holders and of little benefit to the great majority of workers, for whom the combination of existing access to tax-sheltered saving via TFSA, RRSPs, and workplace pensions is more than adequate. Raising the TFSA limits would also yield minimal if any benefits for the economy at large, since a series of financial and economic linkages between household savings and business investment are shown to be weak or broken. The study further assesses evidence on the long-run cost of the TFSA provision for federal and provincial tax revenues and the Old Age Security and Guaranteed Income Supplement programs; while subject to considerable uncertainty, the resulting figures are very large. Public perceptions that enlarged TSFAs would be of widespread benefit to many individuals and of little consequence for others not utilizing TSFAs are thus incorrect. The study proceeds to explore a range of possible remedies for TSFAs that would nevertheless give individuals an option to contribute more to their TSFAs at the cost of reduced RRSP contributions; that would place limits on lifetime TFSA accumulated balances; that would place limits on the currently unlimited immunity of GIS benefits and other income-tested tax and transfer benefits from even the largest TFSA balances; and that would provide older workers and retirees some additional TFSA room to reflect their shorter period to contribute since the scheme’s rollout in 2009. Thus, the proposal to double TFSA limits without any constraints should be rejected, but it is an occasion for fine-tuning the provision to improve its operation for the great majority of the population without breaking the bank for governments.

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# TABLE OF CONTENTS

**Introduction** 4

**TFSA Basic Features and Operation**

**TFSA Patterns of Participation and Distribution** 6

**TFSA Patterns by Income Levels** 8

**TFSA Impacts on Household Savings and the Economy** 10

**Long-Run Tax Revenue Costs of TFSA**s 12

**Long-Run Cost Impacts of TFSA on Old Age Security Program** 13

**Potential Lifetime TFSA Accumulation** 15

**Doubling TFSA: Benefits for Whom?** 16

**Summation: Deficiencies of Current and Doubled TFSA**s 19

**Potential Remedies for Current and Doubled TFSA**s 19

  - *Integrating TFSA Limits with RPP/RRSP Limits* 20
  - *Setting Limits on Lifetime TFSA Contributions or Balances* 22
  - *Adding TFSA Contribution Room for Older Cohorts* 23
  - *Limiting TFSA Immunity from Benefit Clawbacks* 24
  - *Permitting Workplace Pooled TFSA**s 25
  - *Publishing TFSA Statistics by Income* 25

**Discussion and Conclusion** 26

**References** 29

**Table 1: Summary Statistics on the TFSA, 2009-2014** 32

**Table 2: TFSA Holders Maximizing Their Contribution Limits, by Age**  
  Age, 2009 and 2012 33

**Table 3: Potential Accumulated TFSA Balances** 34

**Table 4: Distribution of Investment Income Sources and Savings Deduction Types, 2011 Tax Year** 35

**Table 5: Potential Annual Annuity Payments at Age 65, for Maximum TFSA and RRSP Contributions, Mature System** 36
1. Introduction
The proposal to double Tax-Free Savings Account contribution limits is a sleeping twin of the income-splitting proposal that has garnered so much analytical study as well as media coverage and political commentary.¹ This gap in scrutiny is surprising in that the two siblings—born at the same time on the Conservative Party of Canada’s 2011 election platform—are remarkably similar in their genetic deficiencies. A doubled TFSA would be heavily tilted toward high income earners and wealth holders; its long-run cost to public revenues could be far larger than that of income splitting; it would entangle the provinces inescapably in its distributional and revenue losses;² and relative to the alternatives it would do little to achieve its ostensible objectives. While typically described as the “big ticket” item in the CPC’s electoral platform,³ income splitting will have to defer to its bigger brother, the expanding TFSA, now stirring and soon to waken.

This study describes the key features and operation of the tax-prepaid TFSA and assesses similarities and differences with the main tax-deferred schemes: Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs). It investigates the distribution of TFSA usage to date, the impact on household savings and the economy, and the projected long-run revenue costs. The study then illustrates the adequacy of current TFSA limits for the great majority except older persons. From this material we can infer the deficiencies of the TFSA-doubling proposal as well as some flaws of the original scheme. We then canvass a range of potential remedies to these problems including a version that would permit the TFSA limits to be increased while moderating the adverse effects on revenues and distribution. In concluding, the similar shortcomings of the TFSA-doubling and income-splitting proposals will be revealed in more detail.

2. TFSA Basic Features and Operation
Since 2009 individuals have been able to establish and make non-tax-deductible contributions to TFSAs. These accounts permitted contributions up to an initial annual limit of $5,000 unrelated to the individual’s current earnings or income, and any unused part of the annual limit can be carried

¹ The campaign pledge was to double the TFSA’s annual contribution limit to $10,000. It is unclear whether that pledge would now translate into doubling the current $5,500 limit or the original $5,000 limit. I assume that doubling would mean an $11,000 limit, but none of this study’s conclusions hinge on that point.
² The original CPC formulation of family income splitting was to shift taxable income between spouses; the modified version announced in 2014 operates as a tax credit and thus insulates the provinces from any revenue impacts.
³ This characterization has been common in the media and political discourse (for example, Fitz-Morris 2014).
forward for contributions in future years. The annual limit has been indexed to inflation but increases only in $500 increments, rising to the current $5,500 figure in 2013. Funds in each TFSA accumulate free of tax on their investment earnings, and withdrawals are also tax-free. Moreover, the federal government promised at the TFSA’s introduction that account withdrawals and accruals would not be counted in any income-tested tax or transfer programs. It remains to be seen how long this federal immunity will last. For provincial cash and in-kind benefit programs, TFSA balances are typically counted in asset tests, but no income is attributed to TFSAs. Various features of the TFSA make it well suited for individuals to draw on for unexpected needs as well as part of retirement saving plans for particular groups and situations.

Several other similarities and differences of the TFSA relative to the tax-deferred RPPs and RRSPs are worth noting. All three schemes are forms of a consumption-based tax: the tax on TFSA contributions has been “pre-paid” since no deduction is allowed for them; the tax on RPPs and RRSPs is “tax-deferred” because of the up-front tax deduction on contributions and the taxable status of any withdrawals. The TFSA exempts the investment returns to saving, since the interest, dividends, and capital gains accruing in the account are never taxed. The tax-deferred accounts exempt the saving itself from tax on account of the deductibility of contributions. Both are equivalent to not taxing investment income in the respective accounts, and both remove the bias implicit in an income-based tax system against saving for future consumption. The two genres do differ in their sensitivity to changes in the individual’s marginal tax rate between the points of saving and consumption. TFSA contributions are after-tax earnings and thus hinge only on the tax rate at the point of contribution. In contrast, the individual’s net benefit to saving in a tax-deferred scheme hinges on differences in their marginal tax rate between contributing and withdrawing funds; if these tax rates are equal the two types of scheme are equivalent.

Both tax-prepaid and tax-deferred savings schemes allow for carry-forward of any unused contribution allowance from a given year to future years. Additionally, withdrawals from a TFSA can later be “re-contributed” to the account via a provision that allows the contribution limit to increase by the amount of any withdrawals; the tax-deferred plans offer no comparable feature.

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4 Even though withdrawals of funds from a tax-deferred account are taxable, the account holder has had the benefit of earning investment returns on what would otherwise have been paid in tax up-front and of deferring income tax on annual accruals in the account for the entire holding period. That explains the equivalence of the two types of plans.
6 Re-contribution to a TFSA in the same year as the withdrawal that exceeds the individual’s contribution limit (with carry-forward) can result in a penalty tax; waiting to the following year to re-contribute can avoid this penalty. Excess
Allowable contributions to the tax-deferred schemes are linked to and limited by the individual’s earned income—wages and salaries, net self-employment income, commissions, and bonuses—whereas the $5,500 allowance for TFSA contributions does not require earned income or income of any kind. Contributions to the tax-deferred schemes have a combined upper ceiling of 18 percent of the individual’s earned income or about $24,000 in 2014 (indexed to wage inflation), whichever is less. Allowable total contributions to RPPs and RRSPs are integrated by a “pension adjustment,” so that each extra dollar going into the RPP (including both employer and employee contributions) reduces the individual’s allowable RRSP contribution by one dollar.

Other differences between the TFSA and tax-deferred savings plans further increase the attractions of the former for short-term savings and, for some groups of the population, for retirement savings. Unlike the workplace RPPs and individual RRSPs, the TFSA imposes no age limit on contributions and no mandatory minimum rate of withdrawals after age 71. The immunity of TFSA withdrawals from federal tax and benefit clawbacks potentially is beneficial for workers at lower average earnings over their lifetimes who expect to be beneficiaries of the income-tested Guaranteed Income Supplement (GIS) in old age. Individuals who exhaust their RPP/RRSP contribution limits even with carry-forwards can use the additional contribution room afforded by TFSAs to enhance their scope for tax-favoured saving. Workers at moderate incomes approaching retirement can withdraw their RRSP funds early, facing their current marginal tax rate rather than the higher GIS clawback rate, and contribute the proceeds to a TFSA. Moreover, individuals over age 71 can use TFSAs to extend the tax shelter on their mandatory withdrawals from locked-in retirement funds that exceed their current consumption needs.

3. TFSA Patterns of Participation and Distribution
A Canada Department of Finance (2013) study provides statistics on the participation and usage patterns for TFSAs through 2011. The fact that investment earnings inside of TFSAs are indeed tax-free means that these incomes do not appear in the standard reporting of income tax statistics from the Canada Revenue Agency. However, the CRA (miscellaneous) has published detailed online statistics on TFSA usage through 2012.7 This study draws on those two sources and for

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7 The CRA statistics are unfortunately missing figures on various TFSA activities disaggregated by income of account holders, a deficiency to which I return in my proposals for reform.
subsequent years draws on limited data from a proprietary source.\textsuperscript{8} Institutions administering the TFSAs (such as banks and trust companies) are required to file with the CRA year-end annual information reports on each account’s contributions, withdrawals, and fair market value—but not on the incomes generated within each account.

Table 1 presents key aggregate and average figures for measures of TFSA participation, contributions, withdrawals, and year-end balances through 2012 and more limited measures for subsequent years. TFSA enrolment in the first year was a robust 4.8 million and rose to 9.6 million separate individuals holding accounts (some with multiple accounts) by 2012. By mid-2014 about 13 million TFSA accounts had been opened, with the number of distinct TFSA holders likely exceeding 10 million. Total annual TFSA contributions have risen each year, hitting $33.5 billion in 2012, which exceeds RRSP deductions of $32.4 billion in that year (Canada Revenue Agency 2014, Table 2).\textsuperscript{9} Total withdrawals from TFSAs have also risen over time but have been far outpaced by the mounting contributions. In 2012 about one-quarter of all TFSA holders made one or more withdrawals, and the withdrawals averaged $1,165 over all account holders.\textsuperscript{10} The aggregate market value of all TFSAs grew from $18 billion at year-end 2009 to an estimated $132 billion at mid-2014, which is a compound annual growth rate exceeding 50 percent.

Estimated aggregate incomes realized in TFSAs have been substantial, although the figures dipped into negative territory in 2011 because of equity market downturns. Still, even for that year about three-quarters of TFSA holders had positive investment income because they were heavily invested in more stable fixed-income and dividend-yielding assets.\textsuperscript{11} In the initial year TFSA holders had their account portfolios weighted most heavily in relatively secure fixed-term and savings deposits, at nearly 70 percent. The succeeding years have exhibited a continuing shift of TFSA balances toward greater holding of more risk-oriented equities and mutual funds, with that proportion rising to nearly 49 percent by mid-2014.\textsuperscript{12} This shift may reflect, in part, the fact that as time progresses more lower-income, lower-wealth TFSA holders will have transferred their

\textsuperscript{8} The author thanks Carlos Cardone and Andrew Dranfield at Investor Economics Inc., Toronto, for data beyond 2012 and other items.
\textsuperscript{9} The aggregate value of TFSA contributions exceed those for RRSPs by a large margin if one considers that, unlike TFSAs, RRSP contributions have future deferred tax embedded in them.
\textsuperscript{10} In that year, for TFSA holders making any account withdrawals, the average number of withdrawals was 3.85, and their total withdrawals averaged $4,460.
\textsuperscript{11} Note that eligible dividends on Canadian shares held in TFSAs are excluded from the dividend tax credit similar to such holdings in tax-deferred accounts.
\textsuperscript{12} Contrasting figures on the composition of TFSAs come from a survey undertaken by the Bank of Montreal (2014): “cash” at 60 percent, mutual funds at 25 percent, and GICs at 20 percent (total exceeding 100 percent).
previous cash savings into the account, so that incremental TFSA contributions will come more from higher-wealth individuals who are more risk tolerant and investment savvy.\textsuperscript{13}

Statistics on TFSA participation rates are computed relative to the total number of tax filers over age 18—the minimum age for TFSA eligibility.\textsuperscript{14} Geographically, TFSA participation rates are highest in Ontario, Alberta, and BC lying in the 33 to 36 percent range. Participation rates are lowest in the Atlantic provinces other than Nova Scotia, falling under 21 percent. TFSA participation rates are lowest at 21 percent for the 18 to 24 year-old group in 2011; they rise to 28 percent for the 25 to 29 year-olds; and they are relatively stable for ages up to 49 but then rise significantly with higher age groups. The participation rate tops out at 41 percent for 65 to 71 year-olds and slips to just under 40 percent for those aged 72 years and up. Individuals older than 71 years—who cannot make further contributions to RRSPs and must begin depleting those funds—constituted 15 percent of TFSA holders and made nearly 20 percent of all contributions. The cited participation rates for ages 18 to 24 years are likely inflated by contributions made by well-off parents. Females accounted for 55 percent of TFSA holders and total contributions in 2011, and their participation rates were 33 percent versus 29 percent for males.\textsuperscript{15}

4. TFSA Patterns by Income Levels

The profiles of TFSA participation and holdings by income are of particular interest for an assessment of the scheme and its proposed doubling. Unfortunately, the TFSA provision allowing a spouse to contribute to an account of the other spouse makes the official statistics particularly suspect for those reporting low individual incomes.\textsuperscript{16} Inter-spousal TFSA contributions are an attractive means for income splitting in cases where incomes of the spouses are divergent; inter-spousal TFSA contributions do not trigger the income attribution rules for tax that apply to most other inter-spousal asset transfers. One index of the how these inter-spousal TFSA transfers obscure the true income distribution of account holders is that in 2011 about 162,000 spouses and

\textsuperscript{13} A much stronger preference of higher income account holders toward holding of equities versus cash than lower income account holders is confirmed in the UK’s tax-prepaid savings scheme (HM Revenue & Customs 2014, p. 13).

\textsuperscript{14} All of the cited participation rates apply to 2011 unless otherwise noted and come from Canada Finance (2013). Many of the percentages reported in the text are based on the author’s best reading of bar graphs in this source.

\textsuperscript{15} This gender differential might be explained in part by the income splitting by couples explained next in the text.

\textsuperscript{16} The Canada Finance (2013) report asserts that most married and common-law TFSA contributors whose individual incomes were below $20,000 came from households where total incomes were moderate or not very high, but not enough statistics are presented to dismiss the notion that reported participation and contribution rates for the lowest income brackets are skewed by this inter-spousal transfer effect. Donnelly and Young (2012) discuss a comparable bias in reporting of participation in the United Kingdom’s similar tax-prepaid Individual Savings Account program.
common-law partners—of which almost 80 percent were female—made TFSA contributions that exceeded their individual incomes.\textsuperscript{17} Keeping this caveat in mind, we present results for the distribution of TFSA participation and contributions by individual (not joint) incomes.

Individuals with own income below $20,000 had the lowest TFSA participation rates in 2011 at 20 percent. As noted, some of these individuals were making contributions from partners with substantially higher incomes; thus even this low participation rate is artificially inflated when benchmarking by family rather than individual incomes. Participation rates rose steadily with individual income level, peaking at 58 percent for incomes over $200,000 (p. 37).\textsuperscript{18} Individuals with incomes below $20,000 accounted for 22 percent of all account holders and made 19 percent of total TFSA contributions; these figures fell short of their 37 percent share of all tax filers in that income range. Individuals with low and modest incomes below $40,000 accounted for 49 percent of all account holders and 46 percent of total TFSA contributions; this contrasts with their 62 percent share of all tax filers in that income range. At the other end of the spectrum, individuals reporting 2011 incomes exceeding $200,000 accounted for about 2.5 percent of all account holders and 3 percent of total TFSA contributions while constituting just an estimated 1.3 percent of all tax filers.\textsuperscript{19} Many top earners were constrained by the TFSA’s $5,000 limit and would have taken an even more disproportionate share of total contributions had a higher limit been in place.

Given the paucity of statistics on the TFSA activities by income of account holders, some insights can be garnered by examining the patterns of TFSA holders who maximized their limits. We compare account holders who maximized their contribution limits (including any carry-forward amounts) across age groups and between 2009 and 2012. Table 2 presents these results, with the overall percent maximizing their contributions falling from 64.0 in 2009 to 23.5 in 2012. This striking decline reflects primarily the transfer of pre-existing taxable asset holdings (mostly short-term bank savings) into TFSAs, with a large share of individuals having only modest savings available for shifting to TFSAs by the end of this four-year period.\textsuperscript{20} Two elements of the patterns across age groups and over time are notable. In each of the years shown, a steep gradient between

\textsuperscript{17} Canada Department of Finance (2013, p. 35).
\textsuperscript{18} A similar steep income gradient of participation and average balances has been observed in the tax-deferred saving program of the United States (Joulfaian and Richardson 2001) and the tax-prepaid saving program of the United Kingdom (HM Revenue & Customs 2014).
\textsuperscript{19} This general pattern of TFSA holding by income is confirmed by the figures in the last row of Table 4. For tax filers reporting incomes below $20,000 the share of TFSA holders is about half their share of all returns; for those reporting incomes of $250,000 and higher the share of TFSA holders is twice their share of all returns.
\textsuperscript{20} This sharp decline may also reflect, in part, lesser saliency of TFSAs after their roll-out year, though this appears unlikely given the ongoing high-level promotions of TFSAs by financial institutions over the entire period.
age of TFSA holder and percent maximizing contributions arises: holders aged 60 years and up are far more likely to max out their limits. Moreover, this age gradient steepens over time; in 2009 holders over aged 60-plus maxed out at twice the rate of those aged 18 to 29 years, whereas by 2012 the older holders maxed out at five times the rate of the younger holders. Again, this likely reflects the limited existing taxable asset holdings of younger cohorts available for transfer to TFSAs, and it further suggests that TFSAs induced little new saving.

5. TFSA Impacts on Household Savings and the Economy

In common economic parlance, increased savings implies increased investment in the economy, resulting in higher growth, productivity, jobs, and living standards. However, this transmission chain can suffer weak connections at four distinct links when applied to tax incentives for household saving in a small open economy such as Canada’s. First, the tax incentive must raise the level of savings in the targeted type of account. Second, the savings in the targeted accounts must come from incremental new saving by households, not merely the diversion of existing assets held in taxable form or other types of tax-favoured accounts or the diversion of ongoing saving that would have occurred anyway but been held elsewhere. Third, the additional net saving of the household sector must add to financing for the domestic business sector, not merely displace investment that would have occurred in any event from internal cash flows of firms or foreign investors. Finally, the loss of tax revenues to finance the tax incentive is a drain on national savings, and this works to offset any incremental household saving.

We next apply this sequence of economic behaviours to inquire whether the TFSA is likely to promote aggregate investment and growth of the economy. At the first stage, provision of the TFSA has unquestionably increased saving in the targeted tax-free accounts, as evidenced by the large accumulated balances shown in Table 1. At the second stage, the extent to which TFSA contributions have been savings-creating versus savings-diverting is an empirical question about household behaviour. No doubt much of the funds contributed to TFSAs would otherwise have gone into RRSPs or was drawn from existing holdings of taxable assets. We do not have direct empirical evidence on this issue, and even Finance Canada noted, “An empirical assessment of the long-term impact of TFSAs on savings behaviour would require much longer time series on individual savings and other economic variables …” (2013, p. 31). The Finance Canada study further noted the possibility of savings-diversion behaviour, citing individuals “redirect[ing] their stock of existing savings to tax-assisted accounts such as the TFSA” (p. 36).
In fact, economists have undertaken extensive research on the effects of tax incentives for saving, focusing mainly on the tax-deferred format. Given the complexity of programs, the heterogeneity of individuals, the noise of other economic events, and data limitations, the findings are diverse and even contentious. Many studies find little or no net impact of tax incentives on individual, voluntary savings behaviour; others that find a positive impact on savings for the most part yield relatively modest estimates. For a various reasons one would not necessarily expect the savings-creation effect to be large relative to the savings-diversion effect. Providing individuals with a tax-favoured channel for saving allows them to reach any targeted level of cumulative savings—whether for a major trip, a rainy-day fund, home renovation, or retirement—with less current saving since their investment returns will be relieved of tax. Moreover, for households that would be saving more than average even in the absence of the tax incentive, its provision lowers their tax burdens; this raises their net-of-tax incomes, which in turn raises their current consumption and thereby lowers their saving rate. In short, tax incentives for saving can actually reduce household net saving even while raising contributions to tax-favoured accounts.

The next two links of the transmission chain leading to enhanced business investment and economic growth are similarly uncertain. Even if tax incentives induce households to increase their net saving, that may not translate into significant increases in business investment given the openness of the Canadian economy to international capital flows. For large businesses that can access major capital markets, the marginal investment project is determined by the world rate of return on investments of similar type and risk. Thus, an increase in domestic personal savings invested in Canadian equities may simply displace foreign investment to maintain the marginal rate of return at the world level. Moreover, the finding that the marginal source of investment funds for large businesses in Canada is internal cash flow rather than new equity issuance weakens the linkage between household saving and business investment. Finally, tax incentives for saving carry a revenue cost to governments, and this revenue cost reduces the fiscal surplus or increases the deficit. This fiscal impact is a drain on national saving that partially offsets any increase in saving from the household sector, further dampening any stimulus to domestic

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21 For major critical reviews of the extensive literature see Bernheim (2002) and Attanasio and Wakefield (2012); also the findings in Chetty et al. (2012); Kesselman (2015) for a non-technical overview of the research findings.
22 This argument and supporting evidence draw on Kesselman and Spiro (2014). Boadway and Tremblay (2014) come to a similar conclusion about the limited impact of domestic saving on domestic investment, while Milligan (2014) argues that international capital mobility is less salient for financing of investment in smaller firms.
23 See the analysis and findings in McKenzie and Thompson (1995) and Auerbach and Hassett (2003).
In short, three of the four critical links required for tax incentives for household saving to have positive real economic impacts are either weak or broken.

6. Long-Run Tax Revenue Costs of TFSAs

A tax-prepaid scheme like the TFSA has an interesting feature in terms of its forgone revenue cost, or its so-called tax expenditure. Because the funds that an individual contributes to such an account are not tax deductible, they have fully borne tax and thus incur no immediate revenue cost. The revenue cost of the TFSA stems from the tax exemption on the investment earnings of those funds in the future, which presumably would have borne tax at the individual’s ordinary rates. The forgone revenue begins very small in the year of contribution, when little investment income arises, and grows over time with the compounding of investment returns in the account plus those on additional contributions made in future years. Accordingly, the aggregate tax expenditure of the TFSA begins very small but grows over time to be much larger. Table 1 shows official figures on the TFSA’s revenue cost at a meagre $65 million in its first year but more than sextupling to $410 million just four years later in 2013. The figure is bound to continue steep growth reflecting the subsequent and ongoing growth of TFSA contributions and compounding tax-free investment earnings.

One way to measure the loss of tax revenues due to the TFSA is to examine its impact on taxable investment income. Finance Canada reported that the share of tax filers reporting any taxable interest and dividend income declined from 37 percent in the two years preceding the TFSA’s introduction to 33, 30, and 29 percent respectively in years 2009 through 2011 (2013, p. 42). But these are just the first three years of a tax-deferred scheme that is far from mature; it will take 40 to 50 years or longer to observe the full effects on individuals who have been able to access the TFSA for their lifetimes from age 18 onwards. Economist Kevin Milligan (2012) has simulated the potential impact of a mature TFSA system on the proportion of families with taxable assets exceeding their cumulative TFSA contribution room. With cumulative room of $200,000

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24 Attanasio and Wakefield (2010, p. 677) estimate that slightly more than 90 percent of any additional savings at the household level is offset by lost tax revenue, so that less than 10 percent constitutes new national saving.

25 The methodology in computing these “tax expenditure” figures is provided in Canada Finance (2013, p. 44). Some of the key assumptions are no behavioural changes (hence, no substitution of RRSP contributions for TFSAs and no impact on GIS costs) and that only one-fifth of capital gains accruing within TFSAs would be realized that year.

26 This method assumes that the individual will utilize all available TFSA room, which somewhat overstates the situation for individuals wishing to hold some readily available balances to cover cash-flow needs. However, even as a limiting bound the results are striking. For more complex methodologies, see Antolín et al. (2004).
(say 36 years at $5,500 per year in real terms) only 3.3 percent of families would have any taxable assets; with cumulative room of $300,000 for a couple (less than 28 years at $5,500 per year for each spouse), the figure would fall further to 1.8 percent. Even Finance Canada has projected that by 2030 the TFSA along with other tax-preferred accounts will allow over 90 percent of Canadians to hold all their financial assets in “tax-efficient savings vehicles” (2013, p. 42).

Milligan’s simulation exercise next estimated the revenue loss associated with a mature TFSA given its current contribution limit. Based on several assumptions, he reports a potential decline in the total federal tax base of 5.4 to 6.0 percent, and because the lost taxable income would have been taxed at a higher than average rate this yields an estimated 10.6 percent loss of federal personal income tax revenues. Translated into contemporary dollar figures, this would constitute a federal revenue cost of $15.5 billion based on the 2015-16 forecast income tax revenues of $145.8 billion. On top of the federal revenue cost, one must also reckon the related revenue loss to provincial income taxes; typically calculated at about 60 percent of federal revenue, this amounts to another $9 billion annually once the TFSA has fully matured. These figures do not consider any increase in the TFSA’s current limit of $5,500 per year. Clearly, the proposal to double the TFSA limits would further boost the revenue costs to both governmental levels. Yet the increase would be less than a doubling because relatively few individuals—mainly the wealthy and some elderly—would be able to exploit all the additional contribution room.

7. Long-Run Cost Impacts of TFSAs on Old Age Security Program
The federal government’s commitment to disregard TFSAs in all federal program income tests will impose significant costs for the Old Age Security program over the long run. This immunity will affect both of the Act’s two main components: the income-tested Guaranteed Income Supplement (GIS) and the universally paid Old Age Security (OAS). GIS benefits are based on income of the claimant, but incomes generated within TFSAs and account withdrawals will be disregarded in this income test. In contrast, all RRSP withdrawals, annuity payments, non-

27 Alternative more complex computation methods could consider behavioural effects such as the extent to which the provision of, or expansion of, TFSAs results in the creation of new savings versus the diversion of existing savings, but the empirical factors are unresolved; see OECD (2007). Milligan notes that his methodology understates the potential revenue loss because it ignores the tax sheltering of investment returns accumulating within the TFSAs (2012, p. 356, note 4). Also see Milligan (2011).
28 The Conservative Party of Canada’s original estimates of the federal revenue cost of doubling the TFSA limits were $7.5 million and $30 million in the first and second years (p. 65), which are far less than the actual first and second year cost of the original TFSA, which Table 1 shows as $65 million and $165 million, respectively.
sheltered investment incomes, and private and public pension receipts constitute taxable income and thus affect GIS eligibility and benefits. For a single claimant in the fourth quarter of 2014, the maximum GIS payment is $764 per month and is phased out at 50 percent of net income; it is fully phased out for net annual incomes of $23,856 and above. The OAS benefit of $564 per month for singles is taxable and also subject to a “recovery tax” that reduces benefits at 15 percent of net income between $70,954 and $114,815, above which no benefits are paid.

Accumulations in TFSAs could over time significantly increase the total number of GIS beneficiaries, benefits paid, and program costs. The Office of the Superintendent of Financial Institutions Canada (OSFI) is required to undertake detailed actuarial projections of the OAS program’s finances every three years. Using ad hoc assumptions about future TFSA saving behaviour, the OSFI 12th actuarial report on the OAS program offers long-range forecasts of these impacts. It projects the proportion of the cohort attaining age 67 in 2050 receiving full or partial GIS benefits at 30.9 percent—five percentage points higher than would arise without TFSAs (2014, p. 78). A background document to the OSFI 12th actuarial report projects that the TFSA will boost GIS expenditures in 2050 by $2.8 billion to $35.6 billion, an increase of 8.6 percent relative to the absence of TFSAs. In contrast, the OSFI’s previous triennial report had projected a TFSA impact on GIS expenditures in 2050 of $4.2 billion or 12 percent (2011, p. 10). The 12th actuarial report also forecasts that TFSAs will reduce the amount of OAS recovery tax collected in 2050 by $1.2 billion to $5.4 billion (2014, p. 76). Based on these figures, the projected future annual fiscal cost of the TFSA with respect to the total OAS program could exceed $4 billion.

A study by tax and pension analyst Keith Horner (2011) uses economic modeling to

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29 Nominally, the GIS is phased out for singles with incomes above $17,088; however, OAS benefits of $6,768 per year are disregarded in the GIS income test, yielding the figure cited in the text.
30 The report states that its estimated TFSA impacts “should be interpreted with caution” (OSFI 2014, pp. 75, 79) because of the lack of long historical data on TFSAs. The report itself does not explain its assumptions about future TFSA saving behaviour, but the OSFI provided the author with a detailed description in private correspondence.
31 The report also presents “low-cost” and “high-cost” projections for alternative assumptions about the growth of TFSA balances, yielding GIS recipient rates ranging between 27.4 percent and 37.2 percent (OSFI 2014, p. 92).
32 The 12th actuarial report presents detailed projections of the TFSA impact in 2050 on the distributions of GIS by benefit levels of recipients, but no dollar figure for the impact on aggregate GIS program cost. It also offers “low-cost” and “high-cost” figures for alternative assumptions about TFSA behaviour that would alter GIS benefits by 5.6 percent lower or 17 percent higher relative to the best-estimate scenario for 2050 (OSFI 2014, p. 97); thus, the high-cost estimate of the TFSA impact on GIS expenditures amounts to $8.8 billion ($2.8 billion + 0.17 x $35.6 billion).
33 In private correspondence, OSFI attributed the decrease in projected TFSA impacts on GIS expenditures between the 9th and 12th actuarial reports to changed assumptions and the increase in OAS eligibility age to 67.
34 Also in 2050, the TFSA is projected to reduce the number of individuals subject to OAS recovery tax by 132,000 (from 850,000 to 718,000), with 63,000 relieved of full repayment and 69,000 relieved of partial repayment (OSFI 2014, p. 76).
predict long-run impacts of the TFSA on GIS participation rates and program costs far larger than the OSFI projections. His study finds that of the three-quarters of households who need to undertake saving beyond public pension provisions in order to maintain their accustomed living standard at retirement, almost 60 percent would be better off saving solely through TFSAs. This group includes all those with family earnings up to about $80,000, very few of whom are found to be constrained by the TFSA’s current contribution limits. Instead of the current 32 percent of seniors receiving GIS benefits, this shift of saving toward clawback-immune TFSAs could raise the proportion to more than half. The GIS program’s total cost could rise by as much as 84 percent relative to its cost in the absence of the TFSA. And the number of seniors subject to income tax could decline by 54 percent, from more than half to just one-quarter—though most would have paid more income tax while working on account of lower RRSP contributions.

8. Potential Lifetime TFSA Accumulation

For individuals who turned age18 on or after 2009, the year that TFSAs were introduced, the potential lifetime accumulation in a tax-free account is enormous. We shall illustrate this point by taking the current $5,500 annual limit and assume that an individual makes full contributions every year for a long continuous period. We also assume that the individual invests in a diversified equity-heavy portfolio and reinvests all dividends and other income accruing within the TFSA without making withdrawals. The long-run total real rate of return on one of the broadest measures of equities, the S&P 500 index, has been 6.5 percent over the extended period 1871 through 2012 (Rcube 2012). We compute the potential TFSA terminal balances for two periods and three real rates of return ranging from 3 percent to 8 percent. All terminal balances are shown in real dollars of purchasing power of the year of the initial TFSA contribution.

The upper panel of Table 3 shows the results for an individual making continuous annual TFSA contributions at the full limit for 52 years, such as starting at age 18 through age 69. With the current $5,500 limit her account could accumulate between $690,000 and $4 million depending on the rate of return; an individual with the doubled limit or a couple with the current

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35 His study implements an economic model of saving behaviour over the life cycle with several simplifying assumptions. It assumes that current holdings in tax-deferred forms would eventually be supplanted with TFSA savings by later cohorts for whom it was more beneficial and that all households would save solely through TFSAs if that were to their benefit. Thus, the study’s projections represent a long-run, upper bound on potential TFSA impacts.

36 Laurin and Poschmann (2010) reach a roughly similar conclusion.

37 The cited figure includes gains plus dividends; I thank Paul Buigues of Rcube for confirming that the data runs through November 2012. The subsequent year, 2013, witnessed spectacular gains for the S&P 500 stocks.
limit could accumulate twice that amount, or between $1.4 million and $8 million; and a couple with the doubled limit could achieve a terminal balance between $2.8 million and $16 million. The lower panel of Table 3 shows the results for a shorter 42-year period of contributions at the annual limit but without using any carryover amount, such as from age 30 through 71 or from age 21 through 62. The terminal TFSA balances would be smaller than in the first case, but they could still exceed three-quarter of a million dollars and up to $1.8 million for an individual with the current limits, or as much as $7.2 million for a couple with doubled limits.

While $5,500 may not appear like a large sum, these examples demonstrate that over a lifetime this annual amount can yield very large accumulated balances. Even over a much shorter period, a few astute and lucky investors may accumulate large sums; one individual was reported to have run his TFSA balance above $275,000 by 2014 (Marr 2014). MoneySense magazine has been running the “Great TFSA Race” to identify individuals achieving the largest TFSA balances, and in its latest issue reported a couple who had each accrued over $500,000 by investing in a single penny stock (Cazzin 2015). All of the cited terminal balances in TFSAs raise critical questions about whether these funds should be fully immune from all benefit clawbacks and income-tests at both the federal and provincial levels. These results also raise questions about whether there is any justification or compelling need to increase the TFSA’s contribution limit from its current level—other than, perhaps, for older individuals who cannot access many years of TFSA contributions. TFSAs have become an essential part of tax planning for saving along with RRSPs and other tax-favoured vehicles and strategies (Pape 2013).

9. Doubling TFSAs: Benefits for Whom?

To explore the likely distribution of gains from a doubling of the TFSA contribution limits, we begin by examining the patterns of taxable investment income under current taxing provisions. The three main categories of investment income outside of tax-favoured accounts are interest, dividends, and capital gains. Table 4 shows all these forms of investment income to be highly skewed toward very high-income individuals relative to their share of total income assessed. For example, of all returns filed for the 2011 tax year, the 0.8 of one percent with incomes above

\[ \text{\textsuperscript{38}} \] The US Government Accountability Office (2014) reported an estimated 300 Individual Retirement Accounts with balances exceeding $25 million each, but the US accounts permit types of assets such as founders’ shares and non-publicly trade assets that are prohibited in the counterpart Canadian RRSPs and TFSAs.

\[ \text{\textsuperscript{39}} \] For present purposes we ignore net rental incomes from real property and royalties from patents/copyrights, as these types of asset do not qualify for inclusion in any of the types of tax-favoured accounts.
$250,000 reported 10.6 percent of all income assessed but 19.5 percent of all interest income, 38.1 percent of all taxable dividends, and 52.8 percent of taxable capital gains. The disproportionately small share of these three income types, relative to their total income shares, for lower and middle-income tax filers is explained in part by their low asset holdings and also by the fact that they already have extensive means to shelter most of their financial assets in RRSP/RPP/TFSAs. The table displays the $250,000-plus filers’ relatively smaller share of RRSP deductions and RPP contributions, which is explained by their occupational mix and the ceilings on those provisions.

The take-away from Table 4 is that low, middle, and even upper-middle earners (up to at least $100,000) for the most part do not have large holdings of taxable assets that would gain from many years of increased TFSA contribution room. Most of their financial wealth is already held in RPP/RRSP/TFSA forms, and the rest is held primarily in cash and savings deposits to cover cash-flow and emergency needs. A household with, say, $20,000 unsheltered in the bank and in mutual funds will have the option to shift these funds into TFSA s over several years even with the current annual contribution limits—even more so if it is a couple which already has a joint annual TFSA allowance of $11,000. In contrast, very high earners have large holdings of taxable assets that would benefit for many years from higher TFSA limits. A household having, say, $2 million in unsheltered financial investments would gain from doubled TFSA limits for its entire lifetime.

Next we undertake a series of scenarios to illustrate the extent to which the current RPP/RRSP/TFSA contribution limits meet the retirement saving needs of individuals at various income levels. The scenarios focus on single individuals; the situation for couples is even more favourable, because they have double the limits but enjoy the benefits of scale economies in living expenses. Each scenario assumes that the individual has a constant earnings level across their lifetime in terms of 2014 dollars. Each scenario further ignores the income that individuals might receive in retirement from Quebec/Canada Pension Plan and Old Age Security. We also assume that the individual has no workplace pension plan, so that their total access to tax-deferred saving is consumed by RRSP contributions. Since we are interested in knowing whether the current contribution limits are adequate, each case assumes that the individual makes the maximum

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40 For the two tabulated income classes of Loss-$19,999 and $20,000-$34,999, the shares of total interest incomes somewhat exceed their shares of total incomes. This situation might be explained by the fact that over 90 percent of the first-cited income class are non-taxable filers, and the other income class generally faces low tax rates.
41 These scenarios also ignore the ability of high earners such as top managers, senior-level executives, and majority shareholders to access additional tax-deferred saving beyond the normal limits of RRSPs and RPPs via special schemes such as Plans, Retirement Compensation Arrangements, and Supplementary Executive Retirement Plans. For details see Gosselin and Laporte (2013) and Kahane et al. (2013).
permitted contributions to RRSPs and TFSAs over the lifetime. If the individual starts saving later than age 18, the carry-over provisions allow catch up in later years, although the terminal balances will be reduced by the loss of investment compounding in the missed years.

We compute the terminal balances that an individual can attain at age 65 if making the maximum allowed contributions to both the TFSA and RRSP. The scenarios further assume that the TFSA scheme has been in place since the individual reached age 18 years to portray the full potential of a mature system. Computations apply the current TFSA and RRSP limits in real terms. A real rate of return of 4 percent is assumed, a figure well below the historical long-run real return on a diversified equity portfolio. One real dollar contributed each year to a TFSA over 47 years (from age 18 to 65) at that rate of return compounds to $138.26 in real dollars of the initial year.\(^{42}\) We then assume that the individual at age 65 uses the balances in their TFSA and RRSP accounts to purchase life annuities (no indexing, no guarantee period, no joint feature, and registered funds). At recently quoted rates for such annuities, each $100,000 of payment would obtain monthly guaranteed payments for life of $607.01 for males and $556.86 for females.\(^{43}\)

Table 5 shows the results of this analysis for males and females earning constant real incomes at annual rates of $50,000, $100,000, and $200,000. Clearly, for all earners at these levels who utilize existing contribution limits consistently, the resulting annuity payments they can achieve from age 65 for their life duration will substantially exceed their annual earnings during their working years. This divergence is even larger when considering that the earnings figures are prior to deducting income taxes and social insurance premiums, whereas a portion of the annuity reflecting TFSA proceeds will be non-taxable. Even for an individual earning at the $200,000 level, the income achievable in retirement by maximizing use of existing RRSP/TFSA limits significantly exceeds their earnings while working. The resulting annuity incomes are somewhat lower for females than males because of the differential gender pricing of annuities. The figures are so large that they allow for lower rates of return or fewer years of contributions without negating the conclusion that current TFSA limits, combined with existing RPP/RRSP limits, are more than adequate for workers at all earnings levels up to and beyond the top 1 percent.

\(^{42}\) That value is about triple the total contributions. The calculation uses the formula given in the notes to Table 3. Note that through investment in exchange-traded funds, an individual can have a highly diversified portfolio with annual expense of just 0.1 to 0.2 of one percent and thus dodge the much higher management fees of mutual funds.

\(^{43}\) These figures are the most competitively priced annuities (both Sun Life) quoted for January 6, 2014, at the website [http://lifeannuities.com/annuity_rates/index.html](http://lifeannuities.com/annuity_rates/index.html).
10. Summation: Deficiencies of Current and Doubled TFSAs

Tax-Free Savings Accounts have served a useful purpose for many savers, but they suffered deficiencies from their inception that would be exacerbated by the doubling of contribution limits. Here we summarize these deficiencies, which will be addressed with remedies in the next section.

- Although intended in part as a saving vehicle for low- to moderate-earners, TFSA take-up rates and contribution levels have been significantly tilted toward higher earners.
- Doubling the TFSA contribution limit would in the long run be of even more lopsided benefit to the wealthy and of limited or no benefit for the great majority of lower-, mid-, and upper-income earners who already have adequate tax-favoured contribution room.
- The lack of immunity from income tests or clawbacks on TFSA holdings regardless of their size poses issues for future beneficiaries’ expectations and high TFSA wealth individuals drawing benefits intended for low-income individuals; this issue affects provincial as well as federal benefit programs, and the doubling of TFSAs would exacerbate this problem.
- The creation of TFSAs and their prospective doubling exert drains on provincial revenues that the individual provinces have not consciously chosen; they also reduce the progressivity of provincial income taxes in ways that the provinces have not chosen.
- The creation of TFSAs in 2009 with annual contribution limits favours younger workers who will have full lifetimes of contribution room and sharply limits saving opportunities for older workers and retirees who have much shorter periods and smaller total limits for contributions.
- The exclusion of a TFSA option within Pooled Registered Pension Plans works to the disadvantage lower-earning workers, who might erroneously be guided to enrol in RRSP-type accounts (as noted by Pierlot and Laurin (2012)).
- Despite their large long-run impacts on total tax revenues and distribution of the income tax burden, detailed statistics on TFSA usage by income level are not provided by government.

11. Potential Remedies for Current and Doubled TFSAs

Various policy reform options can be considered to remedy the identified deficiencies of both the original TFSA provision and the proposal to double the TFSA annual contribution limit. We explore these options addressing the deficiencies individually, but many of the options would operate best if they were undertaken as a joint, comprehensive reform package for the TFSA.
11.1. Integrating TFSA Limits with RPP/RRSP Limits

The original research laying the foundation for the TFSA had three major concurrent objectives: 1) encouraging saving by low and moderate earners who found tax-deferred saving in RRSPs unattractive because of the benefit clawbacks in retirement; 2) facilitating higher overall room for tax-favoured saving by higher earners who were then constrained by a $13,500 annual limit for RRSP plus RPP contributions; and 3) providing a tax-prepaid as well as a tax-deferred saving vehicle to allow greater flexibility for saving choices by many individuals in diverse situations. Since that time the combined annual RRSP/RPP contribution limit has been sharply increased, by 85 percent to nearly $25,000 in 2015, far outstripping the rate of increase in median earnings over the period. The provision of TFSAs beginning in 2009 has further raised the opportunity for tax-favoured saving by high earners.

Given the sharply increased scope for individuals to save on a tax-favoured basis since the original case for the TFSA, anyone earning up to $200,000 per year now has ample room for sheltered saving. This level means that less than 1 percent of the population is constrained by the current limits, and apart from individuals in special situations (to be described) only that top tier of earners would benefit categorically from doubling the TFSA limits. Moreover, the earlier $13,500 limit for RPP/RRSP contributions was intended to cap access to tax-favoured savings for those with more than twice average full-time earnings; in contrast, the current $30,500 total RPP/RRSP/TFSA limit caps such access only for those with up to nearly four times average full-time earnings. The validity of further expansion of TFSAs has been debated. Some observers support TFSA doubling and dismiss the skewed distributional impacts (Poschmann 2012), while others critique the prospective pro-rich bias (Cayo 2014; Kesselman 2014a; Yalnizyan 2014).

For the cited reasons, we assess methods by which the TFSA limits could be expanded to allow individuals in special situations greater access without increasing the overall room for tax-favoured saving by the wealthy. A further consideration is that top earners who are constrained by

44 These objectives were discussed in my earlier joint research (Kesselman and Poschmann 2001a, 2001b). Those papers demonstrated how the two types of tax-favoured savings vehicles complement each other.
45 An individual having gross taxable income of $200,000 pays on average about $70,000 in federal plus provincial income and payroll taxes, leaving a net income of $130,000. The total $30,500 allowable for RPP/RRSP/TFSA contributions constitutes almost 24 percent of net income, a relatively high saving rate. This figure ignores the bite of property and sales taxes, and the opportunity to accrue home equity provides additional room for tax-prepaid saving.
46 For example, Poschmann argues, “the fact that an economically beneficial tax policy choice offers benefits to high-income households, as opposed to low, does not disqualify it” (2012, p. 396).
current limits are most likely to have stores of accumulated taxable assets that they would merely shift into expanded TFSAs if provided that option. For them the doubling of TFSA limits would be a tax windfall rather than an incentive for more saving, and it would be at the expense of everyone else in terms of lost tax revenues and the associated public services. Some of this group already have access to exceptional limits for tax-favoured saving through Individual Pension Plans, Retirement Compensation Arrangements,47 and/or the Lifetime Capital Gains Exemption.

To address this issue the TFSA annual limit could be increased for individuals who wish to acquire additional TFSA contribution space at the cost of reduced limits to RPPs and RRSPs.48 For example, an individual wishing to contribute more than $5,500 in a given year (or a higher limit with any TFSA carryover) would draw on their unused RRSP contribution space (either for the current year or unused carry-forward amounts). The cost per dollar of additional TFSA room should be more than a dollar of forgone RRSP room, as the TFSA dollar is worth more because it has the tax prepaid whereas the RRSP dollar carries a future tax liability. The charge might be about $1.3 of RRSP room forgone for each dollar of additional TFSA room chosen. Each year the individual could notify the CRA of how much additional TFSA room they were purchasing, and the choice would be irrevocable (no option to convert back from TFSA room to RRSP room).49

The proposed way of structuring the increase in TFSA contribution room—which could be the original pledged doubling—would preclude any additional room for individuals who had already exhausted their RPP/RRSP contribution room including carryover. This group consists mainly of very high earners who are constrained by their cumulative RRSP dollar limits.50 All other individuals would enjoy a new, expanded option to utilize TFSAs as part of their overall saving strategy. The 2012 statistics indicate the large numbers who would be eligible for this new option: nearly 22 million Canadians had total unused RRSP room of $735 billion for an average unused RRSP room of nearly $34,000 each (Statistics Canada, CANSIM Table 111-0040).

We can illustrate a few situations where this option would be useful for individuals. Many modest-earning individuals who have contributed to their RRSPs sporadically or over many years

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47 See note 41 above.
48 This format for accessing tax-prepaid saving, as a tradeoff with and integrated with the individual’s existing tax-deferred contribution limits, was one of the options originally posed in Kesselman and Poschmann (2001a, 2001b). Similarly, Laurin and Poschmann suggested “allow[ing] taxpayers more freedom in allocating saving room between RRSP/RPP accounts and TFSAs” (2010, p. 5).
49 The CRA could implement this policy simply by additions to the individual’s Pension Adjustment amount.
50 Pierlot and Siddiqi (2011, pp. 16-17) state that no reliable data are available on this point but express their expectation that primarily “older, higher-income Canadians without pension coverage use all their RRSP room.”
may come to understand that this will work against their interests because of impending benefit clawbacks in retirement. Higher TFSA limits would give them a second chance; prior to attaining the age at which they will be eligible for GIS, they could withdraw their accumulated RRSP funds in annual bundles to keep the associated income tax low and contribute the net proceeds to a TFSA. Other individuals may wish to utilize some of their RRSP room to make larger TFSA deposits because of the accounts’ option to draw funds for unexpected needs without bearing tax and the further option to re-contribute any withdrawals. Seniors may wish to draw on lifetime accumulated but unused RRSP room to make larger TFSA contributions because they face mandatory disbursements from Retirement Income Funds after age 71 in excess of their current spending needs. Still other situations would also make increased TFSA contribution room useful to individuals without the need to provide a large tax windfall to the wealthy.

11.2. Setting Limits on Lifetime TFSA Contributions or Balances

As alternatives to the “trade-off” proposal described above, other options could be pursued to constrain access to, or balances in, TFSAs if that is deemed to be a policy concern. Rather than expanding access to TFSAs, these options would be restrictive but in different ways:\footnote{Pierlot and Siddiqi (2011) discuss the mechanics of implementing lifetime limits albeit in a different context.}

- Impose a lifetime limit on an individual’s total contributions to TFSAs; to be effective, this approach would need to be less than the current annual limit of $5,500 times the number of years in the individual’s life expectancy beyond age 18; a drawback of this approach would be that those with large holdings of taxable assets could deposit them all at once, thus magnifying their period for investment compounding; this method would also not prevent some TFSAs from growing to extremely large sums

- Maintain an annual contribution limit but impose a ceiling on the balance that any TFSA could attain; our earlier numerical examples suggest an appropriate limit might be about $800,000;\footnote{This figure also parallels the Lifetime Capital Gains Exemption for 2014 (available for qualified small corporation business shares and qualified farm and fishing properties), which will be indexed for inflation in subsequent years.} after attaining this ceiling, no further contributions would be allowed and any returns broaching the limit would be disgorged tax-free but would become taxable assets

- In the most restrictive approach, income limits would be imposed on individuals entitled to participate in TFSAs so as to exclude those at high incomes; while following the structure
of the American counterpart scheme, this approach would be a radical departure from the structure and original intent of the Canadian scheme, and it would complicate the practical operation and understanding of TFSAs.

11.3. Adding TFSA Contribution Room for Older Cohorts

As noted earlier, individuals aged 65 years and above display the highest participation of all age groups, at rates of 40 percent or higher in 2012. Moreover, at the end of 2011, about 440,000 GIS recipients held $4.3 billion in their TFSAs, representing 6 percent of TFSA holders, accounting for 7 percent of total TFSA assets, and had a 23 percent participation rate (three percentage points higher than their age cohort of those with incomes under $20,000) (Finance Canada 2013, p. 41). One might inquire whether seniors at all income levels as well as older working-age individuals warrant higher access to TFSAs than would be provided even by the doubling of limits under the scheme outlined above. The sharp age gradient for TFSA holders maximizing their limits, and our earlier discussion of the results in Table 2, further support the notion that the elderly and those approaching retirement have above-average “need” for more TFSA contribution room. This results from the scheme’s introduction in 2009 and will abate for future cohorts as they age.

Older workers and seniors are doubly disadvantaged by the TFSA relative to younger cohorts: facing lower lifetime aggregate limits since the scheme’s introduction and much shorter periods to reap the tax-free compounding. In terms of cross-generational equity, one could argue that older Canadians deserve some allowance for these disadvantages. Yet, providing older cohorts with extra TFSA room would allow more opportunity for transfers of existing taxable assets into plans without incremental saving incentives. TFSA reforms could provide additional contribution room—beyond the option to “buy” additional TFSA room—for older individuals to reflect their fewer years to make TFSA contributions. To balance the considerations of equity, revenue cost, and windfall gains, any additional room should fall short of full offset for the lack of contribution years since age 18. Although the specifics of any such proposal are unavoidably

53 The US tax-prepaid scheme is called a “Roth Individual Retirement Account,” which allows maximum annual contributions of US$5,500 and limits participation to individuals with incomes below specified (albeit fairly high) levels. See http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Amount-of-Roth-IRA-Contributions-That-You-Can-Make-for-2014

54 This consideration is reflected, for example, in the American saving schemes, which allow additional “catch-up” contribution limits for persons aged 50 and older: an extra US$1,000 per year for the IRAs and an extra US$5,500 per year for the 401(k) plans for the self-employed and small business owners. However, the US schemes offer no provision for carry-over to future years of amounts not used within a given year.
arbitrary, one could consider providing a one-time addition to TFSA contribution room equal to $2,000 times the number of years between the individual’s age and 50. That provision would mean, for example, that a 65-year-old would have $30,000 added to their cumulative TFSA limit, available for use at any time.

11.4. Limiting TFSA Immunity from Benefit Clawbacks

The fact that individuals can accumulate very large balances in their TFSAAs, as illustrated by examples in this study, suggests that the immunity of such wealth holdings from the clawbacks and income tests of various benefit programs should be limited. Moreover, rather than waiting to a future time when this issue becomes inescapable, the rules for how such limits will be applied should be established now to avoid false expectations by savers. Already financial advisors are formulating schemes for individuals to exploit the TFSA immunity to maximize their access to GIS benefits even with substantial wealth holdings. So long as the CRA does not require institutions that offer TFSAAs to report the annual incomes on each account (including a breakdown among interest, dividends, and capital gains), several policy options are available:

- A program could simply apply an asset threshold that counts the claimant’s total liquid financial holdings including their TFSA balance, with any amounts below that figure not disqualifying the individual or reducing benefits, and with any amount above that figure leading to disqualification; the threshold should be sufficiently high, such as $100,000 or more, so as not to undermine the TFSA’s goal of encouraging saving by lower earners
- An income could be imputed to the individual’s total TFSA balances at year end, a figure already recorded and reported by the CRA; the imputation rate could be the recent interest rate on term deposits or some other figure; the imputed income on the TFSAAs could then be added (possibly allowing an exempt amount) to other income sources in applying an income test or clawback to determine a claimant’s net benefits
- The income actually accruing within each TFSA could be computed even if it is not reported to the CRA, and this figure could be used in any benefit program’s income test or clawback provision, possibly with a specified exempt amount of TFSA income; an individual’s annual TFSA income can be computed by taking the sum of current year-end balance and year’s

55 Stapleton and Shillington (2008) assess the role of TFSAAs in encouraging saving by low-income earners and discuss methods of exempting limited amounts of TFSA savings from provincial asset-tested and income-tested programs.
56 For example, see Chevreau (2014) and Vittese (2014).
withdrawals and subtracting the sum of previous year-end balance and contributions for the year;\footnote{This method was used by Finance Canada (2013) in its reporting of estimated TFSA investment income or loss at the aggregate level; we use the same method for computing aggregate TFSA income in Table 1.} one drawback of this method is that the figure can be highly volatile for TFSA holding equities, as the accruing capital gains and losses would be fully counted each year.

- A program could simply exempt a specified amount of TFSA withdrawals each year before applying its income test; for example, the GIS currently exempts the first $3,500 of labour earnings from its benefit clawback, and amounts of both TFSA and RRSP withdrawals could be subject to clawback but only for amounts exceeding this exemption\footnote{Treating the TFSA and RRSP the same might be deemed fair to individuals who had “mistakenly” saved in tax-deferred rather than tax-prepaid forms. However, the initial saving in TFSA already was tax once, and amounts above the threshold would be further “taxed” by clawback upon withdrawal; RRSPs never were taxed previously.}

The most suitable option to pursue could vary with each jurisdiction choosing how to treat TFSA in its income-tested benefit programs. For example, the federal GIS might implement an income attribution for TFSA, while a province might apply a TFSA balance threshold for eligibility in its housing subsidy program.

11.5. Permitting Workplace Pooled TFSA

Federal enabling legislation for Pooled Registered Pension Plans permit plans of the tax-deferred format but not of the tax-prepaid format such as the TFSA. This omission is curious in that employers are allowed to offer Group TFSA outside of the pooled plan umbrella. Moreover, for many lower-paid workers any contributions to tax-deferred schemes could run against their long-run personal financial interests if they are likely to draw GIS benefits when retired (see Pierlot and Laurin 2012). A simple legislative amendment to the PRPP act would extend the option for employers to offer TFSA-type plans on a pooled basis, thus giving their employees the option of selecting a saving vehicle that could better serve their interests.

11.6. Publishing TFSA Statistics by Income

Statistics on TFSA are published online with a typical two-year lag by the Canada Revenue Agency. However, while the statistics provide detailed usage patterns (contributions, withdrawals, number of account holders who contributed or withdrew funds in the year, those who maximized contributions or opened or closed accounts) disaggregated by age groups and by province, they do
not provide comparable breakdowns by income.\textsuperscript{59} This omission is curious, since the Canada Finance (2013) document detailing TFSA patterns clearly had access to such income breakdowns. This gap in the CRA statistics is a serious shortcoming, as policy analyses of the TFSAs will take a natural interest in the distributional patterns by income, and it should be remedied quickly.

12. Discussion and Conclusion

It is well past wake-up time for the sleeping sibling of the income-splitting baby—the proposed doubling of TFSA contribution limits. Once wakened, this baby will prove far more rambunctious and troublesome than the sibling that has already received such extensive attention and critique. But the siblings are at least fraternal twins displaying major features in common. Without the types of reforms proposed here, unconditional doubling of the TFSA limits would share and even exceed the deficiencies of income splitting:

- A doubled TFSA would over the long run confer large benefits highly skewed toward top earners and wealth holders, to a significantly greater degree than the modified, capped income-splitting plan announced by the government
- A fully mature TFSA scheme, particularly with the doubled contribution limits, would impose far larger drain on federal tax revenues than the modified income-splitting scheme: up to $15 billion in annual revenue costs versus about $2 billion for income splitting
- A doubled TFSA scheme would impose burdens on the treasuries of all provinces—including Québec—at about 60 percent of the federal revenue cost; in contrast, the income-splitting scheme is formulated as a tax credit and does not impinge on provincial revenues\textsuperscript{60}
- Allowing greater access to TFSA contributions without addressing the unlimited immunity of even large TFSA balances from the income tests or clawbacks on benefits intended for the needy would compound an existing problem that demands an appropriate reform
- Unconditional doubling of TFSA limits has objectives related to saving and the economy that are unlikely to be realized; similarly, the income-splitting scheme has muddled and conflicting rationales and is afflicted by numerous deficiencies (Kesselman 2014b)

The existing TFSA provision could ultimately deprive the federal treasury of as much as

\textsuperscript{59} Contacted on November 21, 2014, the director of the CRA’s Individual Statistics Division acknowledged that income breakdowns of TFSA holders’ activities were not published and could not commit to releasing them.

\textsuperscript{60} The original CPC income-splitting proposal would have allowed the transfer of taxable income between spouses and thus have impacted income tax revenues for all provinces except Québec (which collects its own taxes).
$15 billion per year, with an additional $9 billion annual cost to provincial treasuries, and a cost to the OAS program of $4 billion or far more.\textsuperscript{61} The long-run incremental revenue cost of doubling TFSA limits would be substantially less than the cost of the current provision, because far fewer individuals will have the savings to exploit all the additional contribution room. The other side of this coin is that the additional tax relief from doubled limits would be increasingly garnered by very high income earners. Despite its smaller revenue cost than the existing provision, an unconditional doubling of the TFSA’s contribution limits would entail no clear economic rationale or benefit. Like an overdose of medicine, too much of a good thing is not always such a good thing. The deficiencies of the TFSA from its inception and the problems that would attend an unconditional doubling can all be addressed by reforms of the kinds outlined in this study.

Apart from some readily remediated deficiencies, the existing TFSA serves many useful purposes for individuals in diverse circumstances and at varied incomes. Many persons in varied situations would benefit from the increased TFSA access proposed here; at the same time, the disproportionately large windfall gains that would accrue to the wealthy from unconditional doubling of TFSAs can be constrained through appropriate redesign of the provision’s structure. Various reforms could be pursued—integrating TFSA contribution limits with those for RPP/RRSPs, or alternatively setting limits on TFSA balances or lifetime contributions; providing additional contribution room for older cohorts; and limiting the immunity of large TFSA balances from various benefit clawbacks. In addition, a TFSA option should be added to Pooled Registered Pension Plans, and TFSA statistics disaggregated by income need to be published.

The federal government can fulfill its electoral pledge to increase the amounts that most individuals are allowed to contribute to their TFSAs, even more than doubling the limits for some. But reforms should be structured so as provide maximum flexibility for most individuals without tilting the gains heavily toward top earners. Minimal opposition to the proposed TFSA doubling likely can be explained by the small up-front revenue cost and the misperception that this option will benefit savers of every description. Yet, like a little baby who looks cuddly and cute, this proposed initiative would grow up to be the hulking teenager who eats everyone out of house and home. The fiscal cost of an unconstrained doubling of the TFSA would be incurred not by the government that institutes the change. Rather it would be borne by successor administrations a generation or two down the road—and by persons suffering the reduced public services or bearing

\textsuperscript{61} The $4 billion figure is OSFI’s projected annual impact in 2050 of TFSAs, whereas Horner (2011) projects far larger TFSA impacts; see earlier discussion in the text.
the increased taxes needed to offset the revenue losses from relief enjoyed by the wealthiest.
References (all URL links in the references were active as of February 9, 2015)


Investor Economics. 2014b. Deposit and Fixed Income Advisory Service (Fall). Toronto.


Marr, G. 2014. “Here’s How One Man Got His TFSA Balance Up To $277,000.” Financial Post (November 6).


Table 1: Summary Statistics on the TFSA, 2009-2014

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014c</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of accounts(^a) (millions)</td>
<td>5.3</td>
<td>7.9</td>
<td>10.1</td>
<td>11.9</td>
<td>12.3</td>
<td>13.0</td>
</tr>
<tr>
<td>Number of individuals with a TFSA (millions)</td>
<td>4.8</td>
<td>6.9</td>
<td>8.4</td>
<td>9.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total annual contributions ($ millions)</td>
<td>18,963</td>
<td>25,399</td>
<td>31,105</td>
<td>33,503</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average contribution per TFSA holder ($)</td>
<td>3,918</td>
<td>3,701</td>
<td>3,718</td>
<td>3,491</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TFSA holders who maximized contributions (%)</td>
<td>64.0</td>
<td>39.6</td>
<td>30.2</td>
<td>23.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total annual withdrawals ($ millions)</td>
<td>1,937</td>
<td>4,912</td>
<td>8,129</td>
<td>11,175</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average withdrawal per TFSA holder ($)(^d)</td>
<td>400</td>
<td>716</td>
<td>972</td>
<td>1,165</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TFSA holders who made withdrawals (%)</td>
<td>14.5</td>
<td>20.7</td>
<td>24.2</td>
<td>26.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total year-end fair market value ($ millions)</td>
<td>18,156</td>
<td>40,701</td>
<td>62,584</td>
<td>87,503</td>
<td>108,858</td>
<td>131,536</td>
</tr>
<tr>
<td>Average fair market value per TFSA holder ($)</td>
<td>3,751</td>
<td>5,931</td>
<td>7,481</td>
<td>9,118</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estimated investment income/loss(^b) ($ millions)</td>
<td>1,130</td>
<td>2,058</td>
<td>-1,093</td>
<td>2,591</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal tax expenditure on TFSA ($ millions)</td>
<td>65</td>
<td>165</td>
<td>160</td>
<td>295</td>
<td>410</td>
<td></td>
</tr>
<tr>
<td>Share of TFSA funds in mutual funds, equities (%)</td>
<td>31.0</td>
<td>37.4</td>
<td>38.9</td>
<td>41.0</td>
<td>45.1</td>
<td>48.6</td>
</tr>
<tr>
<td>Share of TFSA funds in fixed-term and savings (%)</td>
<td>69.0</td>
<td>62.6</td>
<td>61.1</td>
<td>59.0</td>
<td>54.9</td>
<td>51.4</td>
</tr>
</tbody>
</table>

Notes: \(^a\) An individual may hold more than one TFSA, similar to other tax-assisted savings vehicles.
\(^b\) Although TFSA holders sustained a net investment loss at the aggregate level in 2011, about three-quarters of TFSA holders had positive investment income in the year; TFSA investment income is estimated by the author using CRA data and the same method as used in Canada Department of Finance (2013).
\(^c\) As at June of 2014.
\(^d\) Average over all TFSA holders in that year (not just those TFSA holders making contributions or withdrawals).
Sources: Canada Revenue Agency (misc. years); tax expenditure figures from Canada Department of Finance (2014, p. 16); figures for 2013 through 2014 (except tax expenditure item) and figures for all years for share of TFSA funds by asset type are from Investor Economics (2014a, 2014b).
Table 2: TFSA Holders Maximizing their Contribution Limits, by Age, 2009 and 2012 (percent)

<table>
<thead>
<tr>
<th>Age range (years)</th>
<th>Percent maximizing TFSA contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>in 2009</td>
</tr>
<tr>
<td>All (18+)</td>
<td>64.0</td>
</tr>
<tr>
<td>18-29</td>
<td>39.3</td>
</tr>
<tr>
<td>30-49</td>
<td>53.9</td>
</tr>
<tr>
<td>50-64</td>
<td>69.5</td>
</tr>
<tr>
<td>18-59</td>
<td>54.5</td>
</tr>
<tr>
<td>60+</td>
<td>81.6</td>
</tr>
<tr>
<td>65+</td>
<td>82.1</td>
</tr>
<tr>
<td>75+</td>
<td>86.2</td>
</tr>
</tbody>
</table>

Source: Canada Revenue Agency (2009, 2012); author’s calculations.
Table 3: Potential Accumulated TFSA Balances (constant dollars)

<table>
<thead>
<tr>
<th>Years of contributions</th>
<th>Real annual rate of return (%)</th>
<th>Single person with $5,500 limit</th>
<th>Couple or single with $11,000 total limit</th>
<th>Couple with $11,000 limit for each</th>
</tr>
</thead>
<tbody>
<tr>
<td>52</td>
<td>3</td>
<td>$690,000</td>
<td>$1,380,000</td>
<td>$2,760,000</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>$1,340,000</td>
<td>$2,690,000</td>
<td>$5,380,000</td>
</tr>
<tr>
<td></td>
<td>8</td>
<td>$3,990,000</td>
<td>$7,980,000</td>
<td>$15,950,000</td>
</tr>
<tr>
<td></td>
<td>42</td>
<td>3</td>
<td>$460,000</td>
<td>$930,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5</td>
<td>$780,000</td>
<td>$1,560,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>8</td>
<td>$1,810,000</td>
<td>$3,610,000</td>
</tr>
</tbody>
</table>

Notes: Contributions are assumed at the start of each year in the specified inflation-adjusted amounts; investment earnings are accrued at the end of each year; terminal value of balances in real dollars of the initial year; the formula assumes full indexation of the TFSA contribution limit each year and ignores the lags in indexation; all figures rounded to the nearest $10,000.

\[ T = \frac{X}{r} \left[ \frac{(1 + r)^n - 1}{r} \right] \]

X = annual contribution (constant real dollars)
r = real annual rate of return
n = number of years of contributions

Source: Kesselman (2012, p. 379); author’s computations.
Table 4: Distribution of Investment Income Sources and Savings Deduction Types, 2011 Tax Year (percents)

<table>
<thead>
<tr>
<th>Assessed income range</th>
<th>Loss-19,999</th>
<th>20,000-34,999</th>
<th>35,000-69,999</th>
<th>50,000-99,999</th>
<th>70,000-149,999</th>
<th>100,000-249,999</th>
<th>250,000+</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total returns</td>
<td>36.9</td>
<td>19.6</td>
<td>15.3</td>
<td>12.3</td>
<td>9.2</td>
<td>4.2</td>
<td>1.6</td>
<td>0.8</td>
</tr>
<tr>
<td>Total income assessed</td>
<td>8.3</td>
<td>12.5</td>
<td>15.1</td>
<td>17.1</td>
<td>17.8</td>
<td>11.7</td>
<td>6.9</td>
<td>10.6</td>
</tr>
<tr>
<td>Interest income&lt;sup&gt;a&lt;/sup&gt;</td>
<td>9.8</td>
<td>14.6</td>
<td>13.6</td>
<td>13.0</td>
<td>12.0</td>
<td>9.5</td>
<td>7.9</td>
<td>19.5</td>
</tr>
<tr>
<td>Taxable dividends&lt;sup&gt;b&lt;/sup&gt;</td>
<td>1.1</td>
<td>3.2</td>
<td>6.4</td>
<td>10.3</td>
<td>12.9</td>
<td>14.1</td>
<td>13.8</td>
<td>38.1</td>
</tr>
<tr>
<td>Taxable capital gains&lt;sup&gt;c&lt;/sup&gt;</td>
<td>2.0</td>
<td>3.1</td>
<td>4.3</td>
<td>6.3</td>
<td>8.6</td>
<td>10.3</td>
<td>12.6</td>
<td>52.8</td>
</tr>
<tr>
<td>RPP contributions</td>
<td>0.6</td>
<td>3.5</td>
<td>12.2</td>
<td>23.5</td>
<td>36.2</td>
<td>17.2</td>
<td>5.0</td>
<td>2.0</td>
</tr>
<tr>
<td>RRSP deductions</td>
<td>1.1</td>
<td>5.0</td>
<td>10.8</td>
<td>17.4</td>
<td>23.1</td>
<td>21.0</td>
<td>13.0</td>
<td>8.6</td>
</tr>
<tr>
<td>Net federal tax</td>
<td>0.5</td>
<td>5.0</td>
<td>10.4</td>
<td>16.1</td>
<td>20.8</td>
<td>16.0</td>
<td>11.0</td>
<td>20.2</td>
</tr>
<tr>
<td>TFSA holders</td>
<td>22.4</td>
<td>20.1</td>
<td>18.1</td>
<td>15.8</td>
<td>12.7</td>
<td>6.5</td>
<td>2.8</td>
<td>1.6</td>
</tr>
</tbody>
</table>

Notes:  
<sup>a</sup> Includes bond, bank, and mortgage interest; income from trusts; foreign investment income including dividends.  
<sup>b</sup> Taxable amount of dividends from taxable Canadian corporations; includes 44 percent gross-up for eligible dividends and 25 percent gross-up for non-eligible dividends; offset by dividend tax credits; foreign dividends are included with interest income.  
<sup>c</sup> Taxable amounts are 50 percent of net capital gains realized in 2011.

Source: Author’s calculations from Canada Revenue Agency (2013, Table 2, All Returns); last row of this table from Canada Revenue Agency (2011, Table 4).
Table 5: Potential Annual Annuity Payments Beginning at Age 65
For Maximum TFSA and RRSP Contributions, Mature System

<table>
<thead>
<tr>
<th>Annual earnings ($)(^a)</th>
<th>Balances at age 65 ($)</th>
<th>Annual annuity income ($)(^b)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>TFSA</td>
<td>RRSP</td>
</tr>
<tr>
<td>Males</td>
<td></td>
<td></td>
</tr>
<tr>
<td>50,000</td>
<td>760,430</td>
<td>1,244,340</td>
</tr>
<tr>
<td>100,000</td>
<td>760,430</td>
<td>2,488,680</td>
</tr>
<tr>
<td>200,000</td>
<td>760,430</td>
<td>3,456,500</td>
</tr>
<tr>
<td>Females</td>
<td></td>
<td></td>
</tr>
<tr>
<td>50,000</td>
<td>760,430</td>
<td>1,244,340</td>
</tr>
<tr>
<td>100,000</td>
<td>760,430</td>
<td>2,488,680</td>
</tr>
<tr>
<td>200,000</td>
<td>760,430</td>
<td>3,456,500</td>
</tr>
</tbody>
</table>

Notes:
\(^a\) Gross earned income, all taxable.
\(^b\) A portion of payments from the annuity purchased with TFSA proceeds will be non-taxable.
Source: Author’s calculations; see text for assumptions.
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