Let's try the RLSP

A capital gains tax deferral is plutocratic; the new Conservative finance minister should bring back the party's proposed Registered Lifetime Savings Plan that would benefit low and moderate earners, and society generally

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The incoming federal finance minister faces a critical decision: To pursue tax policies that reinforce the Conservatives' populist campaign program of a goods and services tax rate cut and a $1,200 child care allowance, or to give tax policy a distinctly plutocratic tilt by implementing a tax deferral for capital gains -- a proposal slipped into the Tories' platform just 10 days before the election.

If the tax deferral were unconstrained, it could cost the treasury nearly $1.5 billion per year, 10 times the party's projected $750 million total over five years. And its benefits would be concentrated on the wealthy, as 55 per cent of all capital gains went to the one in 300 taxpayers with incomes above $150,000 (and averaging $332,000) in 2002.

The Conservatives would be well advised to sideline this proposal and instead to revive the Registered Lifetime Savings Plan from their 2004 campaign. An RLSP would avoid the tax deferral scheme's move toward inequality, channel incentives for savings where they are most needed, and give a bigger boost to economic growth.

The RLSP would allow individuals to save up to $5,000 per year out of their after-tax income; those funds would never bear any further taxes on the principal or investment returns.

This structure is opposite to Registered Retirement Savings Plans and pension plans, where contributions are tax deductible but all withdrawals including principal and cumulative returns are fully taxable. Both forms, however, offer an economically efficient form of consumption-based tax.

Let's compare the RLSP with the proposal for capital gains tax deferral.

To begin, individuals with low and moderate incomes receive little in capital gains, so they would reap scant benefit from tax deferral, but the wealthy gain enormously. The $5,000 annual limit on RLSP contributions

would focus benefits on moderate and middle-income individuals.
The RLSP would extend its zero tax rate to all forms of investment earnings -- capital gains, interest, dividends or trust distributions. In contrast, a capital gains tax deferral would create strong distortionary incentives -- for individuals to shift their investments to forms that yield capital gains and for financial experts to devise methods of converting incomes into capital gains.
Moreover, unlike the large upfront revenue cost of instituting a capital gains tax deferral, the RLSP approach entails little revenue cost in its initial years since account contributions are not tax deductible. If some individuals chose to contribute funds to an RLSP rather than their RRSP, as has occurred in the United States with similar policies, public revenues could actually rise in earlier years.
Introducing an RLSP is also superior to simply increasing the contribution limits for RRSPs.
Low and moderate earners typically do not use even their current allowable RRSP limits, in part because the up-front tax deduction is worth little to them but also because RRSP withdrawals during retirement incur heavy burdens via taxes and benefit clawbacks.
RLSP withdrawals, in contrast, would bear no taxes or benefit clawbacks.
The RLSP would stimulate additional savings for productive investment and thereby spur economic growth.
It would foster new savings habits from younger and moderate-income households, groups that are not habitual savers, yielding lifetime benefits for them and the economy. In contrast, deferring tax on capital gains provides a windfall for the returns to past savings by upper-income groups that are already regular high savers.
Proponents of tax deferral argue that it would eliminate portfolio "lock-in," where investors hold onto assets simply to avoid tax, thus freeing capital to move to more productive uses.
But this view ignores the fact that investors can sell their appreciated assets only if others buy them. Those financial assets still exist in the form of specific real capital, which cannot be transmuted into new capital for growing economic sectors.
Far more important to the economy than reducing lock-in (which does not arise within RRSPs, pension accounts, or RLSPs) is to create a large new group of savers who become more financially sophisticated. Britain has had a form of RLSP since 1999 with the objective "to develop and extend the savings habit, and to ensure that the tax relief on savings is fairly distributed" -- goals that have been met.
Individuals and couples who made the full $5,000 RLSP contribution each year over their adult lives and invested in the market at historical rates of return could accumulate more than $1.5 million tax-free by age 65. That

would liberate many retirees from reliance on income-tested public pensions and provide a comfortable retirement.

Based on experience with similar schemes in the U.K. and the U.S., implementing a RLSP would be simple for government, individuals and financial institutions. In contrast, a capital gains tax deferral would involve uncharted complexities in enforcement, record-keeping and tracking asset-cost bases across periods as long as a lifetime.

The next finance minister would be wise to burnish the Conservative government's populist image by pursuing the RLSP rather than a capital gains tax deferral.

The RLSP also offers the advantages of relative simplicity, proven effectiveness, and greater economic benefit.

And the RLSP acronym would join the RRSP in daily discourse as a marker of Tory tax policies.

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