The Holdback Amount (AKA: The Ten Year Rule)

By Jack Styan

I've spoken with hundreds of people about the RDSP. While most have been positive conversations, some have highlighted elements of the RDSP that act as barriers to people opening an RDSP account. No issue is raised more frequently than the Holdback Amount, otherwise known as the Ten Year Rule. I am convinced that the Holdback amount is the single most significant reason that only 43,000 people have opened RDSP accounts.

Strictly speaking, the Holdback Amount is the amount of Grant and Bond received by an RDSP account in the previous ten years. This amount is significant because the rules state that when a withdrawal is made, the holdback amount must be returned to the federal government. This rule holds irrespective of the type of withdrawal: Lifetime Disability Assistance Payment or Disability Assistance Payment. It holds if the withdrawal is in a specified year and other restrictions around withdrawals are dropped. It also holds if the plan is being collapsed because the beneficiary has passed away or ceased to be eligible for the disability tax credit. (I should note that Minister Flaherty proposed some flexibility around the holdback amount for specified years in the government's last budget.) Of course, if ten years have passed when a withdrawal is made or the RDSP account is collapsed the holdback amount is equal to zero and no money has to be paid back.

The result of the rule is that the RDSP is a long term savings plan – a very long term savings plan. A person who wants to access the full grant or bond (and not return any funds to government) must wait 30 years from the time of making their first deposit before accessing their (or the government's) contributions – twenty years of contributions plus ten years of waiting for the holdback amount to diminish to zero.

None of us know what the future will bring – either health-wise or with respect to our financial situation. Many people with disabilities have health conditions and reduced life expectancies. These people cannot be sure that the RDSP will be useful for them. Many people with disabilities and many family members cannot be sure that they will not need a financial contribution within the next 30 years. These people must gamble that they will not need their contributions for a much as thirty years. Many people also live on fixed incomes. These people often have a one month financial cycle – their disability benefits cheque comes once a month. For these people, thirty years seems like an eternity. It's hard for them to imagine the benefits thirty years hence.

So…why is there a Holdback Amount? There were two reasons for including the Holdback Amount in the design of the RDSP.

The first is to prevent tax "slippage": the concern that a person could use the same money to get government contributions year after year. For example, I contribute $1,500 in 2008 and receive a matching $3,500 from the federal government. In 2009, I withdraw $1,500 from the RDSP and then re-deposit it. I get another $3,500 from the federal government. In other words, I would receive $7,500 from the federal government for my $1,500 contribution. That would defeat the purpose of encouraging personal saving.

The second is to make the RDSP a long term savings plan. The RDSP was not intended to act like either a bank account, where a person could make contributions and withdrawals as needed. Nor was it intended to act like an income program, where federal contributions are considered an income supplement each year.

Is it possible to achieve these public policy goals while at the same time reducing the current barriers that people have identified? I think so.

Option 1: Implement a Two Year Rule

Tax slippage is also a concern with Spousal RRSP Contributions. It's possible for a taxpayer to contribute to a spouse or common-law partner's RRSP and claim the deduction. What happens then, if the spouse withdraws the money and gives it back? Could a person use the same money to get a tax deduction for the following years? To prevent this happening, a taxpayer is required to report as income any amount that a spouse has received from a spousal RRSP in the current year and prior two years. This could be considered a "Two Year Rule"! The tax deduction resulting from a contribution to a spousal RRSP is lost if a withdrawal is made in the two years following the contribution.

What would be the implication of amending the Ten Year Rule to a Two Year Rule?

Under current rules, a person opening an RDSP account today (assuming retroactive eligibility for the disability tax credit and appropriate net taxable family income levels) would need to wait 26 years before utilizing the funds without paying any Holdback amount back to the government. Once the carry forward is fully implemented (7 years from now), the holding time will decrease to 20 years: still a long time for many people to wait.

If a Two Year Rule were implemented, a person opening an RDSP account today would only need to wait 19 years. Once the carry forward is fully implemented, the holding time would only be 12 years (assuming disability tax credit eligibility and adequate finances to optimize contributions).

How long is necessary to ensure the RDSP is a long term savings plan. There is no right or wrong answer. To me, an absolute minimum 12 years seems reasonable. To someone else it might not. To many people with disabilities and family members who don't want to wait 12 years to improve their financial situation, it might still seem long.

Option 2: Permit the withdrawal of personal contributions after a certain waiting period

From the outset, many people assumed that the restrictions on withdrawals were limited to government funds. They are not but it is an interesting idea.

Many individuals and families would like to contribute but worry about what they would do if they had some kind of emergency and need the money in the next 30 years. An option would be to permit account holders to make withdrawals from their own personal contributions without penalties, provided the contributions had remained in the account for a certain period of time – maybe ten years. This wouldn't prevent a person from withdrawing an amount after ten years and contributing it a second time to get a Grant.

A twist on this would be to permit a withdrawal for certain purposes or under certain circumstances, much as the government has proposed to do with specified years. The downside of the latter idea is that it increases the administrative burden of running the program, either to the government or the financial institutions or both.

Option 3: Borrowing from the RDSP

The existing Home Buyer's Plan permits people to withdraw up to $25,000 from their RRSPs to buy or build a qualifying home for themselves or for a related person with a disability. Generally, the funds must be repaid within 15 years.

A similar provision could be built into the RDSP. People could be permitted to make a withdrawal for certain purposes (medical expenses, purchase of a home, etc.). Rather than having to repay the amount, however – as many people would not be able to - it could be viewed as an advance and could reduce lifetime disability assistance payments until it is repaid.

What are your ideas for improving the Ten Year Rule?

My experience is that people are full of ideas about how to improve the plan – let us know what you think should be changed to reduce the negative impact of the Holdback Amount.

RDSP resource centre

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