London Life

Canada Pension Plan: Changes and planning

The Canada Pension Plan (CPP) is the subject of additional changes as retirement saving for Canadians becomes a major focus. An agreement in principle has been reached between the federal and provincial governments to enhance the CPP, with a gradual phase-in scheduled to start on **Jan. 1, 2019**. Currently, all provinces support this CPP expansion except Quebec. Quebec, which operates a similar but separate Quebec Pension Plan (QPP), has indicated it will adopt some, but not all of the enhancements.

CPP operates throughout Canada, except in Quebec where the QPP provides benefits. These changes do not apply to QPP.

Changes to the enhanced CPP:

1) Increase income replacement from 25 per cent to 33.3 per cent.

Currently, the CPP is designed to replace 25 per cent of pre-retirement income up to the yearly maximum pensionable earnings (YMPE), which for 2017, is $55,300. (The YMPE is indexed to the Consumer Price Index (CPI), so it increases every January if there is an increase in the cost of living.) This CPP change would result in a potential increase in income replacement to $17,500 per year, up from $13,000.

2) Yearly maximum pensionable earnings threshold will rise from $55,300 in 2017 to $82,700 upon full implementation in 2025.

To ensure ample time is provided for all stakeholders to prepare and adjust to the new CPP, a gradual seven year phase-in will be undertaken. This phase-in will be done in two steps:

- A five year contribution rate phase-in below the YMPE (at the new 33.3 per cent level)
- A two year phase-in for the upper earnings limit (increasing the actual YMPE amount).

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3) Contribution rates will increase one per cent, up to 5.95 per cent

Early estimates of the increased cost of providing expanded benefits will result in a one per cent increase in contribution amounts required by each of the employer and the employee. This increase will provide a stronger future pension by increasing the CPP benefit from 25 per cent to 33.3 per cent and a gradual increase in total benefit up to the new YMPE. People earning $55,300 a year will see premiums increase by about $9 a month in 2019, rising to $43 a month when fully phased in.

4) Enhance the Federal Working Income Tax Benefit

The Federal government has indicated its intention to enhance the current working income tax benefit to offset the impact of the increased contributions. This deduction will provide a tax reduction to individuals so the same level of after-tax income is maintained, after paying the increased contributions. No further details have been provided at this point, but the intention seems to be to provide an additional tax deduction for the increased contribution described above, especially for low-income earners.

5) Continue to provide a tax deduction for employee contributions

The increase in contribution amount will be deductible for tax purposes to ensure there is no after-tax cost of the CPP enhancements.

The root of these changes is to benefit younger individuals and future generations, with a minor impact being experienced by those looking to retire in the next few years.

Retirement planning

CPP benefits are based on total contributions by both the employee and their respective employers while working in Canada. All CPP amounts increase with the cost of living, as measured by the CPI.

When it comes to retirement planning, start time considerations for beginning a CPP pension may depend on age, health, work history, when they plan to transition to retirement and how long this transition takes. The CPP is only one part of a holistic retirement plan. Other components of retirement income include Old Age Security (OAS) pension, employer pension plans, personal savings and registered and non-registered investments.

1) If still working

If an individual is between the ages of 60 and 70 and working while receiving CPP, by default, the individual and their employer must make mandatory CPP contributions. However, once an individual reaches age 65, they can choose to opt out of making CPP contributions by filing an election. These contributions create a post-retirement benefit (PRB). The PRB is payable January 1 of the subsequent year, even if they're already receiving the maximum CPP amount. These additional contributions increase the individual's future retirement benefit. The value of the PRB is equal to 1/40 of the maximum CPP retirement pension. If you contribute less than the maximum, the amount of the year's PRB will be proportional to your contributions.

The work cessation test no longer applies. This means individuals can take CPP as early as age 60 without having to stop working or reduce their earnings.

2) CPP sharing

CPP sharing is not the same thing as pension income splitting, as CPP income does not qualify under pension income splitting rules.

Sharing your CPP pension may result in tax advantages. You must apply to share your pension directly with Service Canada. The PRB is not eligible for CPP sharing.

You can share your CPP retirement pension with your spouse or common-law partner. To do so, you must be receiving your pension, or be eligible to receive it, and be living with your spouse or common-law partner. Both spouses' benefits are combined and each spouse will receive one half of the total and the tax obligation of the amount received.

Pension sharing ceases in the month any of the following events occur:

- A cancellation request is approved; submitted by both you and your spouse or common-law partner
- A divorce
- The spouse or common-law partner who has never paid into the CPP begins contributing
- Upon the first death

When pension sharing ends, the pension of the individual will revert back to the amount received before the pension-sharing arrangement was initiated.

3) Start CPP early or late?

When contemplating whether to take CPP early or late, it may appear to be more beneficial to delay. When considering CPP in isolation, an argument in favour of taking CPP later than age 65 may exist. However, each case is unique, and theoretical CPP amounts cannot be used in isolation. Life expectancy may be a deciding factor, as will availability of other sources of retirement income.

a) Physical age

The standard age for beginning to receive your CPP retirement pension is the month after your 65th birthday. There is some flexibility available:

- A reduced pension as early as age 60, which results in the pension amount being 36 per cent less than if taken at 65. The pension reduction is 0.6 per cent per month if the pension is taken before the age of 65.
- An increased pension after age 65, which results in the pension amount being up to 42 per cent more than if taken at 65. The pension increase is 0.7 per cent per month if the pension is taken after the age of 65.

b) Other sources of income

The key decision here is whether the cash flow is needed or not. If the pension is needed for living or lifestyle expenses, the planning opportunity may not be available. However, if other sources of income are available to cover these expenses, the ability for planning opens up.

If the CPP is not needed, you have the option of deferring your pension up to age 70. There may be an opportunity to contribute these amounts into a registered retirement savings plan (RRSP) – if contribution room exists – to obtain a tax deduction to offset the income inclusion of the CPP. You may also contribute these amounts into a tax-free savings account (TFSA) – if contribution room exists – to increase the flexibility of where to take income from in the future.

c) Based on life expectancy…

Life expectancy would be another consideration to take into account in determining when to take your CPP. Obviously, if there are health concerns or family history of early death, it may not be wise to defer CPP, as CPP is a “use it or lose it” proposition.

As per Appendix A, the break-even point for individuals is age 76 (based on a maximum CPP pension). If an individual’s life expectancy is less than age 75, they may be in a better position taking their CPP early at age 60. For those who expect to live to between ages 76 and 83, they should consider taking CPP at age 65. If they expect to live beyond age 84, they would benefit from taking their CPP at age 70.

d) Time value of money

There is an argument relating to the present value of a dollar. When inflation is considered, a future dollar has less purchasing power than a dollar today. In the same vein, if you take your CPP early at age 60, you would have actual dollars in your hand compared to waiting until 65 to take your CPP pension.

In addition, you may have more money available to you when you are younger and perhaps healthier, to better take advantage of this money.

e) No capital value of benefits

By deferring your CPP, there is no increase in survivor benefits or any capital value left to your estate. In order to take advantage of the increased pension amount, you must be alive to collect it.

f) Max benefit already

There may be a scenario in which you have contributed over your career to CPP and already achieved the maximum pension entitlement by age 60. If you continue to work and pay more contributions into CPP, you may not receive any more benefit, because you are already entitled to the maximum. Consideration should be given to taking the CPP pension early to take advantage of the benefit now and also contributing into the PRB, which you would still obtain benefits from by working while collecting CPP.

g) Spouses with both at maximum

The manner in which the CPP legislation is written, no individual is eligible to receive any more than the maximum CPP amount. Another strategy to consider is a scenario where both spouses are entitled to maximum CPP. In this scenario, if both spouses started their pensions at age 65, upon the first death, the surviving spouse would not be entitled to any additional CPP from the survivor benefit, because they are already at the maximum amount.

If both spouses were to start their CPP early and take the reduced pension amount, upon the first death, the survivor benefit would likely top the surviving spouse back up to the maximum.

Summary

Many planning opportunities arise with CPP and the integration of other retirement income sources. It is important to understand the options and various courses of action one could take when planning this ever-increasing segment of your life.

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In his current role, he is responsible for sales strategy development and supports all individual wealth strategies by creating tax and planning articles, communicating changes in tax legislation and providing expertise on product solutions.

Appendix A

Break-even analysis using 2017 figures

The 2017 maximum CPP amount calculated for a person aged 65 is $13,370 annually. By using simple addition, this person would collect a total of $26,740 after two years and $40,110 after three. In reality, however, the annual CPP amount could grow with inflation, as measured by the CPI. To simplify for the calculations in appendix A, an inflation rate of zero is assumed. Please note: the conclusions of this article would not change if inflation were considered.

In 2017, the reduction for taking CPP at age 60 is 36 per cent, making the maximum annual pension amount $8,557. Similar to the calculations above, cumulative benefits received after two years would be $17,114. If a person waited until age 70 to start CPP, their benefit would increase by 42 per cent to a maximum of $18,985 per year. After two years, the cumulative pension amount is $37,971. However, the person would have had to make five more years of mandatory contributions to CPP (2017 maximum $2,564 per year) than the person who left the workforce and started to collect CPP at age 60.

The cash flow break-even analysis in appendix A illustrates which option is better on a cumulative basis and in isolation of other retirement income, at any given age. For example, if, at age 60, the individual expects to live only 10 more years based on health and family history, they would most likely take their CPP at age 60. In this situation, the cumulative benefit at age 70 is greatest if they'd been collecting it since age 60. It's less if they started taking it at age 65 and minimal if they waited until age 70. This analysis is also based on making an election to opt of continuing CPP contributions from age 65 to age 70.

In summary, using 2017 figures, individuals could be better off taking their CPP early if their life expectancy is less than 75. For those who expect to live to between ages 76 and 83, the illustration indicates they'd be better off taking their CPP at age 65. Those who expect to survive beyond age 84 would benefit from taking their CPP at age 70.

Retirement planning

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2017 CPP cash flow break-even analysis:

Early or late CPP for 2017			
Age	CPP age 60	CPP age 65	CPP age 70
60	8,557	(2,544)	(2,544)
61	17,114	(5,089)	(5,089)
62	25,670	(7,633)	(7,633)
63	34,227	(10,177)	(10,177)
64	42,784	(12,722)	(12,722)
65	51,341	649	(15,266)
66	59,898	14,019	(17,810)
67	68,455	27,389	(20,354)
68	77,011	40,759	(22,899)
69	85,568	54,129	(25,443)
70	94,125	67,499	(6,458)
71	102,682	80,869	12,528
72	111,239	94,239	31,513
73	119,796	107,609	50,499
74	128,352	120,979	69,484
75	136,909	134,349	88,470
76	145,466	147,719	107,455
77	154,023	161,089	126,441
78	162,580	174,459	145,426
79	171,137	187,829	164,412
80	179,693	201,199	183,397
81	188,250	214,569	202,382
82	196,807	227,939	221,368
83	205,364	241,309	240,353
84	213,921	254,679	259,339
85	222,477	268,049	278,324
86	231,034	281,419	297,310
87	239,591	294,789	316,295
88	248,148	308,159	335,281
89	256,705	321,530	354,266
90	265,262	334,900	373,252
91	273,818	348,270	392,237
92	282,375	361,640	411,223
93	290,932	375,010	430,208
94	299,489	388,380	449,193
95	308,046	401,750	468,179

For each age, maximum cumulative CPP benefit is disclosed

For illustrative purposes only.
Situations may vary according to specific circumstances.

Based on 2016 maximum amounts, without indexing.

Assumptions:	
Maximum monthly CPP benefit for 2017	$1,114.17
Maximum annual contribution for 2017	$2,564.10
Age 60	Cease working
Age 65	Work until age 65; mandatory contributions
Age 70	Work until age 70; mandatory contributions