

# THE CANADA PENSION PLAN

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## What is the Canada Pension Plan and how much will I get?

The Canada Pension Plan (CPP) is a mandatory government-sponsored pension plan that came into effect on January 1, 1966 and was fully implemented on January 1, 1976. The only province that does not use the CPP is Quebec.

The CPP is funded by Canadians that are employees, employers or self-employed. Contributions are required as soon as you reach the age of eighteen and are no longer required either after you reach the age of seventy, become disabled or start receiving a CPP retirement pension.

Here is how the government calculates the maximum monthly CPP retirement pension for anyone receiving it prior to 2012. It's 25% of the last five years' average maximum pensionable earnings.

For example, here's how they calculated the maximum monthly CPP retirement pension for 2008.

Last five year's Yearly Maximum Pensionable Earnings:

2004	\$40,500	
2005	\$41,100	
2006	\$42,100	
2007	\$43,700	
2008	\$44,900	
Average of 2004 to 2008 YMPE		\$42,460
25% of the Average		\$10,615
Monthly (\$10,615 / 12)		\$884.58

It is important to note that the monthly benefits paid under the plan are adjusted annually, based on the increases in the Consumer Price Index (CPI), the most common measure of inflation in Canada. In short, the CPP is an inflation-adjusted defined benefit pension plan that is paid until you die.

## **NEW CPP CHANGES EFFECTIVE 2011**

January 1, 2011 will see the first of a number of changes impacting how people incorporate Canada Pension Plan ("CPP") retirement benefits into their financial plans. These changes will become effective between 2011 and 2016. For those who are thinking about retirement you need to understand these new rules. The benefits will differ depending on your age and earnings history, as well as your ability or desire to work past the age of 60.

While most of the changes will take place starting in 2012, there is one that takes effect in January 2011. That is, if you are delaying collection of the CPP retirement benefit beyond age 65, your pension enhancement will be greater than it is under current rules. Currently, for those who take CPP retirement benefits between ages 60 and 65, there is a pension reduction of 0.5% per month to a maximum of 30% (60 being the earliest age at which an individual can draw CPP retirement benefits).

On the other hand, where CPP retirement benefits are postponed beyond age 65 (70 being the latest age at which an individual can apply for unreduced CPP retirement benefits), their pension is increased by that same 0.5% per month to a maximum of 30%.

Beginning in 2011, the new pension increase for late take-up of CPP will increase from .50% to .57% in 2011; to .64% in 2012, and finally to 0.70% in 2013. The pension reductions for client's collecting before age 65 will take effect beginning in 2012. A summary of the reduced and enhanced rates are as follows:

Age CPP commences	Current Pension Adjustment	2011	2012	2013	2014	2015	2016
60	-30%	-30%	-31.2%	-32.4%	-33.6%	-34.8%	-36%
65	0%	0%	0%	0%	0%	0%	0%
70	+30%	+34.2%	+38.4%	+42%	+42%	+42%	+42%

### **Helping you with the timing**

There are a couple of planning factors that need to be discussed. While the pension adjustments discussed above will not affect current pensioners, there is a change that takes effect in 2012 that could impact this group.

#### **Example:**

*Bob lost his job in the recession, and, in 2011, decided to take his CPP retirement benefit at age 60. Since his benefits began, he has been receiving reduced benefits totaling \$7,847 for the year. In October 2011 Bob was re-employed. Under current rules, he and his employer do not contribute to CPP – and Bob's benefit will remain at the 30% reduction.*

*However, because Bob is under age 65, as of 2012, both Bob and his employer will have to begin contributing to CPP for 2012, 2013, 2014 and 2015. Due to the new contributions, Bob's CPP benefit will increase by up to 2.5% of the maximum CPP pension in each year until Bob reaches age 65. This means that Bob's 30% reduction will become (4 x 2.5%) 20% over the four years. If Bob had waited until age 65 he would have been able to apply for a full CPP retirement benefit, and would have had the option to contribute to CPP on future earnings as opposed to being required to do so prior to age 65.*

The above example becomes more complicated if Bob is self-employed. Under the new rules, Bob would have to begin paying into CPP again – at both the employer and employee levels (4.95%) for the 4 years until Bob reaches age 65. The corresponding increase to Bob's CPP benefit would remain at the maximum of 2.5% of his earnings.

While a tax deduction is available to Bob (or his company if he is incorporated) for the 4 years in respect of a portion of his CPP contribution, the doubling of CPP premiums will not enhance Bob's retirement pension more than if he was an employee. While CPP contributions are mandatory for working pensioners under the age of 65, pensioners can voluntarily contribute after age 65, up to age 70 if s/he chooses. Therefore, this will be a discussion factor if Bob decides to continue working past age 65. If, as a self-employed individual, Bob chooses to continue contributing to CPP, then he is also responsible for the employer portion as well.

### **Removal of the Work Cessation Test**

Under current rules, in order to qualify for a CPP benefit before age 65, individuals must not earn more than approximately \$900 in the month the CPP retirement pension commences, or in the month prior. Under the new rules, this stipulation will be eliminated for employees who begin to receive CPP benefits in 2012 and thereafter. Keep in mind though; working pensioners under age 65 will have to contribute to CPP until the year in which they are 65 years of age. You will have to decide if waiting, to receive a maximum pension, is important to you so that you avoid the necessity of additional CPP contributions.

### **Change in Calculating Average Career Earnings**

CPP calculations use average career earnings, but allow for certain years of low or no earnings to be disregarded. Currently 15% of an employee's potential working career may be disregarded. Under the new rules, the drop-out percentage will increase to 16% in 2012 and 17% in 2014. This provision is intended to help more Canadians maintain their highest possible CPP retirement pension, especially for those for whom 2008 and 2009 were not their best earning years, or for those who decided to go back to school to improve their skills. Individuals already taking their CPP benefit prior to 2012 will not be affected by these changes.

### **Summary**

The changes to CPP are a reflection of the changing employment environment and retirement trends for many Canadians. A full financial review as a person approaches retirement should now include a discussion of timing of CPP retirement benefits.