Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

Canada Pension Plan retirement pension

Understanding the government income that may be available to you in retirement

Please contact us for more information about the topics discussed in this article.

After years of contributing to the Canada Pension Plan (CPP), you may wonder how this plan will help you in retirement. This article examines how the CPP retirement pension works, your options for taking the pension and the implications of your choices. Although the CPP provides retirement and disability benefits, this article focuses only on the retirement benefits.

Any reference to a spouse in this article includes a common-law partner.

What is the CPP retirement pension?

The CPP retirement pension is a monthly, taxable benefit that replaces part of your income when you retire. If you qualify, you'll receive the CPP retirement pension for the rest of your life. The CPP also provides death and survivor benefits after you pass away.

Do you qualify?

If you've worked in Canada, made at least one valid CPP contribution and are at least 60 years of age, you qualify for CPP retirement benefits.

Most individuals who are age 18 and over, work in Canada and earn more than a minimum amount ($3,500) contribute to either the CPP or the Quebec Pension Plan (QPP). CPP applies to individuals who work in provinces and territories outside of Quebec.

I've contributed to the CPP and the QPP. Do I get retirement benefits from both plans?

The CPP and the QPP have sharing agreements and offer similar benefits at retirement. The retirement benefit you receive takes into account all contributions made to both plans. You don't have to apply to both plans; if you contributed to both the CPP and QPP, you should apply to receive QPP if you live in Quebec when you apply and to CPP if you live anywhere else in Canada. If you live outside of Canada, apply for CPP or QPP according to the last province or territory where you lived.

Applying for CPP

The standard age to begin receiving a CPP retirement pension is the month after your 65th birthday; however, you may receive a reduced CPP retirement pension as early as the month after your 60th birthday or an increased CPP retirement pension if it starts after your 65th birthday. There is no benefit to starting your CPP retirement pension after age 70, as the maximum monthly amount that you could receive is reached at this age.

Generally, you must apply to start receiving CPP retirement benefits. You should apply in advance of when you want your pension to start. You can apply online or by paper application. In certain circumstances, you must send a paper application. In general, it takes up to 28 days to process online CPP applications and up to four months for applications sent by mail or made in-person at a Service Canada Centre.

When you apply for the CPP retirement pension after you turn age 65, retroactive payments of CPP can be paid for up to 12 months (11 months plus the month you apply), but they can't begin earlier than the month after your 65th birthday There are no retroactive payments for a pension taken before age 65. Retroactive payments can only be made for 12 months; as a result, if you apply after the month you turn age 71, you will lose some benefits. Therefore, the latest you should apply to obtain your full pension entitlement is the month you turn age 71.

How much could I receive at age 65?

Your monthly CPP retirement pension is based on how much you've contributed, how long you've been making contributions at the time you want your pension to start and your age when you start receiving your retirement benefit.

You can get an estimate of your CPP retirement benefit from your CPP Statement of Contributions. The statement provides a record of your pensionable earnings and your contributions to the plan. It also provides an estimate of what your CPP pension benefit would be if you were eligible to receive it today. You can obtain your Statement of Contributions online by registering for the My Service Canada Account online portal or by mail with Service Canada.

In general, to be entitled to the maximum monthly CPP payment amount at age 65, you must have contributed to CPP for at least 39 years and have made the maximum

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contribution towards CPP in each of those years. Until December 31, 2023, you will only have made the maximum CPP contribution for a particular year if your employment or self-employment income was equal to or greater than the Year's Maximum Pensionable Earnings (YMPE), the earnings ceiling for that year. Beginning in 2024, you will only have made the maximum CPP contribution for a particular year if your employment or self-employment income is equal to or greater than the Year's Additional Maximum Pensionable Earnings (YAMPE) for that year. These changes to the CPP contributions and their impact on your CPP retirement pension are discussed in more detail in the following section.

Maximum monthly CPP payment amounts are indexed (annually) and posted on the Government of Canada website.

CPP enhancement

Up until 2019, the CPP retirement pension replaced one-quarter of your average work earnings. Since 2019, the CPP has gradually been enhanced, with the ultimate goal to replace one-third of your average work earnings. As part of the enhancement, CPP contributions have progressively increased over a seven-year period that first began in 2019. In exchange for increased CPP contributions, you'll receive higher CPP retirement benefits. Note that the CPP enhancement will only affect you if, as of 2019, you were working and making contributions to CPP. If you stopped working before that time or are already receiving a CPP retirement pension and are no longer contributing to CPP, you will not be impacted by these changes.

Prior to 2019, if you were an employee, you and your employer were each required to contribute 4.95% of your earnings above $3,500 up to the YMPE to CPP. If you were self-employed, you contributed both the employee and employer portions, which was equal to 9.9% of your earnings above $3,500 up to the YMPE.

Since January 1, 2019, increases to CPP contributions have gradually been phased in using two steps:

1. From 2019 to 2023, the contribution rate for employees increased by 1% (from 4.95% to 5.95%) on earnings between $3,500 and the YMPE. As such, the contribution rate for those who are self-employed ultimately increased by 2% (from 9.9% to 11.9%).

2. In 2024, a second earnings lmit, the YAMPE, was introduced. A separate additional contribution rate of 4% for both an employee and employer, and 8% for self-employed persons, now applies to earnings above the YMPE (projected to be $71,200 in 2025) up to the YAMPE (projected to be $81,100 in 2025). This means additional CPP contributions will be required for those who earn higher wages. The YAMPE will be phased in over two years. It will be 7% higher than the YMPE in 2024, and 14% higher than the YMPE in 2025 and the following years. It's important to note that this additional contribution rate will only have an impact on you in years when your employment or self-employment income exceeds the YMPE.

How do periods of zero or low earnings affect CPP?

Your contributory period is used to calculate the amount of CPP retirement benefits you may become eligible to receive. Your contributory period for the base CPP begins when you reach age 18 (or January 1, 1966, whichever is later). Your two contributory periods for the enhanced CPP also begin when you reach age 18 or January 1 of the appropriate year (2019 for the first part of enhancement and 2024 for the second part of enhancement), whichever is later. Each of your contributory periods ends when you start receiving a CPP retirement pension, turn age 70 or pass away (whichever happens earliest).

The base component of your CPP includes provisions which help compensate for periods where you may have had low or no earnings during your contributory period. For example, to accommodate periods of low or zero earnings, a "general drop-out provision" automatically excludes a number of years, when your earnings were lowest, from the base CPP retirement pension calculation. Low or zero earnings periods can occur if you are at school, unemployed or if you leave the workforce to care for a family member. This provision affects 17% of your base CPP contributory period, allowing up to eight years of your lowest earnings to be dropped from the calculation.

The enhanced component of your CPP retirement pension is calculated using your best 40 years of earning.

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The base CPP also has drop-out provisions (or drop-in provisions — i.e. credited earnings for the enhanced component of the CPP) for months you may have been disabled or for months you were at home caring for your children under age seven during your contributory periods.

Taking CPP before age 65

If you start CPP before age 65, your CPP is permanently reduced by 0.6% for each month you receive it before age 65, including the month you turn 65 (a reduction of 7.2% per year). If you start receiving CPP the month after your 60^{th} birthday, for example, you will receive 36% less than if you start your pension at age 65.

Taking CPP after age 65

If you start receiving a CPP retirement pension after age 65, your CPP will permanently increase by 0.7% for each month (8.4% per year) you delay receiving it, starting the month after your 65^{th} birthday. This means if you begin receiving CPP in the month after your 70^{th} birthday, your monthly CPP retirement benefit will be 42% higher than it would have been if you'd begun CPP at age 65. The maximum possible increase is 42%, so there's no benefit to delaying receipt of CPP retirement benefit after age 70.

When should I take my CPP retirement pension?

Determining when you should begin taking CPP involves many considerations and should include a complete analysis of your financial needs and resources. Consider the following factors in deciding when to start receiving CPP retirement benefits.

Taking CPP early

- If you need the money to support yourself and/or your family, taking CPP early may make sense.
- If you choose to receive your CPP retirement pension early, this may enable you to reduce your working hours, while maintaining your current income level until you decide to completely retire.
- Consider your current health and family health history; if you have a shortened life expectancy or greater potential for health issues based on family history, it may make sense to take CPP early.

- If you don't need these monies to support your lifestyle and could invest your CPP payments taken early, consider the expected rate of return on these funds, and compare this with the guaranteed, inflation-indexed higher CPP payments you would receive if you waited to take CPP until age 65 or later.

Delaying CPP

- You may decide to delay receiving your pension if you have sufficient income or resources for a comfortable retirement. The longer you wait, the higher your benefit payments will be. CPP benefits are indexed and guaranteed for your lifetime. You may also decide to continue working and contributing to CPP.
- If you plan to continue working, have sufficient income for your desired lifestyle and are in a higher tax bracket, it may also make sense to delay taking your CPP retirement pension. If you take CPP now, you will keep less of your CPP income because you'll pay more of it in tax. By delaying CPP, your payment will be higher when you do start to receive it and you may be in a lower marginal tax bracket by then.

There are tools available on Service Canada's website that can help you determine the best time to start your CPP retirement pension and get an estimate of how much you might receive.

Working while receiving CPP

You don't have to stop working to start receiving CPP. However, if you're under age 65, receiving CPP and still working, you and your employer must both contribute to CPP when your annual earnings are over $3,500. If you're self-employed, you have to pay both the employee and employer portion. If you're age 65 to 70, still working and receiving CPP, you can elect not to contribute to CPP. Your contributions will stop when you reach age 70, even if you are still working.

If you contribute to CPP while receiving a CPP retirement pension, the contributions you make go towards a lifetime benefit, which will increase your retirement income. This additional benefit is called the Post-Retirement Benefit (PRB). Similar to the CPP retirement pension, the amount of each PRB will depend on how much you earn, the amount of CPP contributions you made during the previous year and your age as of January 1 of the year the PRB starts. The maximum PRB you can receive in one year equals 1/40th of the maximum CPP retirement pension. If you do not make the maximum contribution to CPP, your PRB will be proportionate to your contributions. For example, by contributing half the maximum contribution level, you'll receive 50% of the maximum PRB.

There are tools available on Service Canada's website that can help you determine the best time to start your CPP retirement pension and get an estimate of how much you might receive.

You will be paid the PRB automatically the year after your contributions have been made, effective January 1 every year. The first PRB payment of the year is usually made in April and will include a lump-sum payment calculated back to January. The PRB for the rest of the year is then paid monthly, with your CPP retirement pension, as a single payment.

Each year of contributions while collecting a CPP retirement pension will create a new PRB, which is added to the total income from the CPP. This means if you continue to work, you can receive multiple PRBs at the same time.

If you're age 65 or over and receiving your CPP retirement pension, you may want to consult with a qualified tax advisor as to whether you should continue contributing to CPP. You'll want to consider the cost of contributing, which takes into account your earnings and whether you're an employee or self-employed, as well as the annual amount of the PRB that you'll receive.

You will receive the PRB even if you're already receiving the maximum CPP retirement pension.

Working between ages 65 and 70 and not receiving CPP

If you continue to work between ages 65 and 70, and are not receiving your CPP retirement pension, you'll need to continue to contribute towards CPP. Your earnings during those years, however, can be used to replace any periods of low earnings before age 65. Service Canada only includes these earnings if it would increase your pension amount.

If you already have sufficient years of maximum contributions that would generate the maximum CPP retirement benefit, any additional contributions may not increase your CPP retirement pension and could be wasted. You can obtain a Statement of Contributions from Service Canada to get an estimate of your retirement benefit. In this case, you may wish to consider whether you should take your CPP pension immediately. This would allow you to opt out of making additional contributions towards the regular CPP retirement benefit and either save those funds or contribute towards the PRB.

Non-residents and CPP

You can receive your CPP retirement benefits even if you decide to leave Canada. If you receive CPP while living outside of Canada, non-resident withholding tax of 25% will be withheld from your CPP pension payments, unless this rate is reduced by a tax treaty between Canada and the country where you are resident.

If you're a U.S. resident receiving CPP, the Canada-U.S. Tax Treaty reduces the non-resident withholding tax to nil. Note that the maximum percentage of your CPP pension that may be subject to tax in the U.S. is 85%.

Cancelling CPP

You can cancel your CPP pension up to 12 months after you begin receiving it. You must request the cancellation in writing and repay all of the CPP benefits you've received.

Sharing CPP retirement pensions

CPP retirement benefits are taxable to the recipient in the year received and are not eligible for the pension income tax credit. You cannot split your CPP pension with your lower-income spouse under the pension income splitting rules in the Income Tax Act. CPP rules do, however, allow "pension sharing." This is different to pension income splitting, but it can result in tax savings if one spouse is receiving a higher CPP retirement pension than the other spouse and is also in a higher tax bracket than the other spouse.

If you want to share your CPP retirement pension, you must apply to do so. Pension sharing involves an actual transfer of payments from one spouse to the other, but the overall benefits paid don't change. Note that retirement pension sharing is based on the period you and your spouse lived together while accumulating retirement benefits.

For more information, please ask your RBC advisor for the article on CPP retirement pension sharing.

Splitting CPP credits/earnings after separation or divorce

If you separate or divorce, you can divide the CPP contributions you and your spouse made during the time you lived together. You can divide CPP contributions even if only one spouse contributed to CPP. This is called "CPP credit splitting."

Eligibility for CPP credit splitting varies depending on when you divorced or separated and whether you were married or living in a common-law relationship. You or your former spouse can request a CPP credit split by completing an application form and providing other required documentation. Note that a marriage contract or cohabitation agreement generally does not prevent a credit split, unless you entered the agreement before June 4, 1986, or you live in a province which allows couples to agree not to split CPP pension credits.

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After a death

After your passing, there are three types of benefits your survivors may receive:

CPP death benefit

The CPP death benefit is a one-time payment of $2,500, payable to your estate or other eligible individuals, on your death. To qualify for the death benefit, you must have made contributions to CPP for at least one-third of the calendar years in your contributory period (and this must be a minimum of three calendar years), or 10 calendar years.

If an estate exists, your executor can apply for the death benefit, and should do so within 60 days of death. If no estate exists, or your executor does not apply for the death benefit, the payment may be made to others who apply for the benefit in the following order of priority: the person or institution that has paid or is responsible for paying for your funeral expenses, your surviving spouse, or your next-of-kin.

CPP survivor's pension

The CPP survivor's pension is a monthly payment paid to your surviving spouse on your death. The amount of the survivor's pension will depend on how much, and for how long, you contributed to CPP, as well as whether your spouse is younger or older than age 65 at the time of your death. The CPP enhancement component of your retirement pension will be added to the survivor's pension and will not be subject to any maximums.

If your spouse is already receiving a CPP retirement pension, the retirement pension and the survivor's pension will be combined into a single monthly payment. The combined benefit will not necessarily be the sum of the two separate benefits, as there's a maximum that can be received. The most that can be received in this case is the maximum retirement pension (which is more than the maximum survivor's pension). Note that the enhancement portion of your spouse's survivor's pension will be added to the combined benefit and is not subject to this maximum.

Your surviving spouse should apply for the survivor's pension as soon as possible after your death. If your spouse delays applying, they may lose benefits since the CPP can only make back payments for up to 12 months.

The survivor's pension will continue even if your surviving spouse remarries. In the case your surviving spouse is widowed more than once, only one of the survivor's pensions, the larger one, will be paid to them.

CPP surviving child's benefit

The CPP children's benefit is a monthly flat rate payment (adjusted annually) to your dependent child or children after your death, provided you've made sufficient contributions to the CPP. To be eligible, at the time of your death, your surviving child must be under the age of 18 or between age 18 and 25 and in full-time attendance at a recognized school or university.

Your child (or their other parent or guardian if your child is a minor) should apply for the benefit as soon as possible after your death or application for the disability benefit. If there's a delay in applying, they may lose benefits since the CPP can only make back payments for up to 12 months.

Conclusion

CPP can be an integral part of your retirement plan. It's important to understand how it works, when you can take it and the different survivor benefits available to you and your family.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.

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