CPP Enhancement Is Going to Increase Your Tax Bill … Here's How to Lower it!

Description

Are you an employed or self-employed Canadian who will be working until 2023 or later?

Then you can expect your tax bill to take a bit of a jump.

That's because of CPP Enhancement, a new program being rolled out by the federal government to increase CPP benefits. The program will see employees' and employers' CPP contributions gradually increase until they hit 11.9% of pensionable income in 2023. The program will also see the CPP earnings ceilings increase — another factor that could increase the percentage of your income you pay into CPP.

While these enhancements may increase the amount of CPP you receive later, they'll also increase what you pay in. Here are three ways to combat the increased premiums.

Hold stocks in an RRSP

Any time you transfer money to an RRSP, you get a tax deduction on the amount contributed. This can result in thousands of dollars of tax savings every year. Not only that, but you can watch your dividends and capital gains accumulate tax-free once inside the account. So, if you plan on holding stocks, consider holding them in an RRSP. Doing so could generate tax savings that greatly exceed the tax increase caused by CPP enhancement.

Max out your TFSA

Getting tax deductions on your RRSP contributions is a great way to lower your taxes. But what happens when you run out of RRSP contribution room? If you're a high earner, you could max out that RRSP pretty quickly. Fortunately, you still have the TFSA at your disposal. TFSAs are accounts that let you not only grow but also *withdraw* your investment proceeds tax-free. They don't give you a deduction like RRSPs do, but they lower your tax rate overall by saving you the taxes you'd ordinarily pay on dividends and capital gains.

An example of how much you could save

To illustrate how much money you can save by holding investments in RRSPs and TFSAs, let's consider a hypothetical example of an investor holding $10,000 worth of **Fortis** (TSX:FTS)(NYSE:FTS) shares.

If that investor earned $55,000 a year and was self-employed, they would have to pay $5,407 in CPP contributions in 2020 (that's $55,000 minus the basic claim amount of $3,500 times the 2020 CPP rate of 10.5%). Combining that with all the other taxes would lead to an overall tax burden of about $14,000 if the individual lived in Ontario.

Now imagine that that investor deposited $10,000 into an RRSP before buying their FTS shares. That would be a $10,000 tax deduction, which would lower their tax bill by just shy of $3,000. It wouldn't technically reduce the CPP payments themselves, because that's based solely on employment/self-employment income, but it would offset other taxes, resulting in a lower overall bill.

And that's just the start of the story. By holding Fortis shares in an RRSP or TFSA, you'd also avoid paying taxes on the dividends and capital gains — another big tax cut compared to holding the shares outside a registered account. The big takeaway is, while you can't reduce your CPP payments, you can more than offset them by lowering your overall tax burden with registered accounts.

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1. Dividend Stocks
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