Retirees: CPP Enhancement Will Cost You Money in 2020!

Description

If you're a CPP pensioner or retiree drawing close to taking CPP benefits, you've probably heard of CPP enhancement. Promising to increase CPP benefits from one-fourth of income (as they are now) to one-third, the program is supposed to deliver more benefits to pensioners.

By getting more premiums into the CPP program, it should result in higher payouts later. However, as you're about to see, the increased premiums will only cost soon-to-be retirees money this year.

Full benefits won't kick in for nearly 40 years

According to the Canada Revenue Agency website on Canada.ca, CPP enhancement will provide higher benefits to future beneficiaries. Specifically, the "enhanced" pension will take a greater percentage of future recipients' paycheques to provide higher payouts later. The promised increase will be substantial.

Increasing payouts from one-fourth of pensionable earnings to one-third will result in a $60,000-a-year earner getting $20,000 instead of $15,000.

That's a pretty generous increase. The maximum amount of pensionable earnings will also increase — a second factor that should drive payouts higher. However, the devil is in the details: in order to receive the advertised CPP benefits, you'll need to pay into the program for 40 years.

With enhancement having started in 2019, that means it will be 2059 before anybody actually sees a CPP pension that replaces one-third of their pensionable income.

If you're retiring soon, that means enhancement could be a net loser

What all the above means is that if you're already close to retiring, enhanced CPP could be a net loss. Although you should see somewhat higher benefits if you pay in a couple years of the higher rates, it won't be the promised one-third that the program is supposed to pay out "eventually."

Instead, it will only be a moderately higher payout in exchange for noticeably higher premiums, which could actually cost you more money than you end up paying in.

How to offset it

If you want to offset the higher tax bill that comes with CPP enhancement, a good idea would be to start making contributions to an RRSP. RRSP contributions generate large tax deductions that can more than offset the slight increases in CPP contributions you'll pay because of enhancement. For example, if you make a $10,000 contribution and your marginal tax rate is 30%, you'll save about $3,000.

Once you make your RRSP contributions, you should then move on to picking investments that will deliver returns in addition to the tax savings you realized by contributing. An excellent choice to consider here would be an ETF like **iShares S&P/TSX 60 Index Fund** (TSX:XIU). Index ETFs hold the stocks that comprise a major market index, weighted for market cap, so you get nearly guaranteed market average returns (less a small fee).

What makes XIU in particular a good ETF to choose?

First, it's based on the TSX 60, a relatively high dividend index that can produce cash income in up or down markets.

Second, it has a slight tendency to outperform the TSX composite –another index that many Canadian ETFs are based on.

Third, it has very low MER (total fees) of just 0.18%, which is low enough that you probably won't even notice it.

Finally, the fund is extremely popular and highly liquid, so you can easily sell it whenever you want to.

By buying a fund like XIU in an RRSP, you can enjoy tax deductions and tax-free growth, while avoiding the risk involved in picking individual stocks. Overall, it's a great way to offset increased CPP premiums while realizing a decent return.

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