Canada Revenue Agency: How Much Are You Paying Into CPP?

Description

The Canadian government has a pension plan for retires known as the Canada Pension Plan (CPP). This is a monthly, taxable benefit that aims to replace a part of your income on retirement.

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In order to qualify for the CPP, you would have had to make at least one contribution to the CPP and need to be over the age of 60.

The CPP payout amount is based on an individual's average earnings throughout his/her working life, contributions to the CPP and the age at which one avails the pension. The standard age for CPP payouts is 65, though it can begin by the age of 60 and can be delayed until the age of 70.

So should you start your CPP at the age of 60, 65 or 70? In case you start CPP payments at the age of 60, the amount will be reduced by 0.6% every month or 7.2% every year. This means pension payments will be reduced by 36% compared to the pension amount of a 65-year old.

Conversely, payments will increase by 0.7% every month or 8.4% every year in case you delay pension payouts after the age of 65 and up to the age of 70.

Maximum pensionable earnings are $58,700

In 2020, the maximum pensionable earnings are $58,700. The basic exemption stands at $3,500 with an employee contribution rate of 5.25%, which indicates that the maximum amount an employee can contribute to the CPP per year is $2,898.

In 2020, the maximum monthly amount for Canadians starting CPP payments at the age of 65 is $1,175.83 and the average monthly amount is $672.87.

The CPP is gradually being enhanced as of 2019, which means individuals will receive higher benefits on higher contributions. Until 2019, the CPP replaced 25% of your average work savings. The enhancement suggests that the CPP will grow and replace 33% of the average work earnings received after 2019.

Further, the maximum limit that is used to calculate average work earnings will increase by 14% by 2025. The CPP enhancements will increase the maximum retirement pension by up to 50% for those who make these contributions for 40 years.

CPP payout is insufficient

The CPP may be insufficient for most individuals. The average monthly expenses for retirees is about $2,400 and they will need another stream of income to support their lifestyle. You will need to support CPP payouts with the old age security program (OAS), workplace pensions and personal savings.

This shows investors need to max out their Tax-Free Savings Account (TFSA) contributions every year. The TFSA contribution limit for 2020 is $6,000 and investors can look to add low cost, well-diversified ETFs such as the **iShares S&P/TSX 60 Index ETF** (TSX:XIU) to their portfolio.

XIU has exposure to large-cap Canadian companies. It's the largest and most liquid ETF in the country and has returned 14.6% in the last year. Since its inception, XIU has generated annual returns of 7.2%.

XIU is rebalanced quarterly and the ETFs top five holdings include **Royal Bank of Canada, Toronto Dominion, Enbridge, Bank of Nova Scotia** and **Canadian National Railway** that account for 7.9%, 7%, 5.7%, 4.6% and 4.5% respectively of the ETF.

The two largest sectors in Canada- Financials, and Energy dominate the XIU and account for 35.8% and 17.8% respectively of the fund. The fund's exposure to large-cap companies makes it a low-risk investment. XIU also has a trailing dividend yield of 2.7%, making it a top pick for income investors.

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Date
2025/08/25
Date Created
2020/02/17
Author
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