CRA Pension Rules: How Canadians Can Create a Tax-Free Pension Plan

Description

Canadians wonder whether they will have enough retirement income to cover their living expenses and enjoy a reasonable lifestyle in their senior years.

Company pensions

The emergence of the gig economy means many people might not have any company pensions when they retire.

Full-time employees normally receive some form of a pension as part of their overall remuneration package. In the past, a defined-benefit (DB) plan was common. This guaranteed employees a set pension amount for life after they retire.

Defined-contribution (DC) plans are now replacing the DB pensions at most firms. Under the DC plan, the company kicks in a certain amount for every dollar the employee contributes. The responsibility for the eventual payout shifts to the worker, as the pension amounts received ultimately rely on how much the investments grow. In this case, there is at least *some* pension component from the company.

Contract workers, however, simply get paid for the work they perform. Benefits are generally not part of the package.

All company pensions are taxable income.

CPP

Everyone has to contribute to the Canada Pension Plan (CPP), but self-employed Canadians are required to make both the employee and employer contributions. The CPP becomes available at age 60 at a reduced payout. Full payout is available at 65 and people can defer taking CPP to age 70 to boost the amount they receive.

CPP payments are taxable.

OAS

Old Age Security (OAS) payments are based on how long you have lived in Canada. To get the full amount, a person needs to reside in Canada for at least 40 years after the age of 18. The OAS pension is available at age 65. People can defer to age 70 to boost the pension amount.

OAS pension payments are taxable. In addition, people who have net world income that tops a minimum threshold are hit with the OAS claw back.

RRSP and RRIF

Many people contribute to RRSP plans to save for retirement and reduce their taxable income. Funds can grow tax-free inside the RRSP, but the withdrawals are taxable.

In the event people don't remove the RRSP money before the end of the year they turn 71, the CRA requires the funds to be converted to a Registered Retirement Income Fund (RRIF). The money can grow tax-free inside the RRIF, but the RRIF must pay out a minimum amount determined by the CRA each year and the income is taxable.

How to create your own tax-free pension?

The arrival of the Tax Free Savings Account (TFSA) in 2009 provided Canadians with a tool to create their own tax-free pension plan.

Contribution space in the TFSA is now as high as $69,500 per person and increases each year. This is adequate to create a decent self-directed pension fund. Investments held inside the TFSA can grow tax-free. When the money is removed, the payments are not counted toward net world income calculations and can go straight into your pocket.

One popular strategy to build TFSA wealth is to hold top dividend stocks and use the distributions to buy more shares, setting off a powerful compounding process that can turn small initial amounts into a large retirement portfolio.

The **TSX Index** is home to many great dividend payers that have generated strong returns. The pullback in the market this year gives new investors a chance to buy these stocks at attractive prices.

Top stock examples

A $10,000 investment in **TD Bank** 25 years ago would be worth $270,000 today with the dividends reinvested.

The same investment in **Fortis** would be worth $215,000.

Bank of Nova Scotia investors saw $10,000 increase to $197,000 over that time frame with the dividends reinvested.

The bottom line

Canadians can use the TFSA to create their own self-directed pension plan to replace a company pension. In addition, the money withdrawn is tax-free and doesn't put OAS pension payments at risk.

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