Canada Revenue Agency: Here's How Much Your CPP Pension Can Be Taxed

Description

Would-be retirees look forward to receiving the Canada Pension Plan (CPP). More than 90% of Canadians claim the pension at age 65, although you can take it early at 60 or delay until 70. The CPP replaces part (one-third) of the average work earnings or average pre-retirement income.

Individuals who qualify for CPP payments must apply in advance if they want the pension to start. While payments are not automatic, pensioners can choose the month of the start date. However, users must know that the CPP retirement pension counts as income and is therefore taxable.

Early or delay options

When is the right time to take CPP benefits? The standard age to claim the pension is 65, but, as mentioned, there's an early or delay option. Assuming you decide to start receiving at 60, you forfeit 7.2% each year you receive it before age 65 or a 36% permanent reduction.

Usually, retirees with health concerns or urgent financial need take the first option. Those who don't have such issues defer until 70 to receive higher CPP payments. The incentive for deferring is an increase of 8.4% each year after 65 or 42% more total.

CPP retirement benefits are taxable

Regardless of the option you choose, all CPP retirement benefits you will receive are fully taxable. There's no automatic tax deduction, but you may owe the Canada Revenue Agency (CRA) at tax season. However, you can voluntarily request the tax agency to deduct a certain percentage or amount for monthly or quarterly taxes.

Retired couples could have potential tax savings by adding together the pension benefits of each and divide it equally between them. Each person's pension benefits would be taxed, resulting in a lower tax bill, depending on their relative incomes.

Unlike the Old Age Security (OAS), you don't have to worry about a CPP clawback, because there's none. All CPP benefits do not get clawed back based on other benefits. Note, however, that the CPP Disability benefits are likewise taxable.

Pension-like income

The CPP is a public-source retirement income. Most Canadians fill the pension's shortfall with investment income, because the CPP payments (plus the OAS) aren't enough to live comfortably in retirement. If you have savings, you can earn pension-like by investing it in dividend pioneer **Bank of Montreal** (TSX:BMO)(NYSE:BMO).

This $52.31 billion company and fourth-largest bank in Canada holds the longest dividend-paying history record. The practice began 191 years ago, back in 1829. Today, the dividend aristocrat trades at less than $100 ($81.38 per share) and pays a hefty 5.21% dividend.

A $163,635 investment will produce $710.45 in monthly income that matches the average CPP monthly payment in 2020. Add the maximum $613.53 monthly OAS, and your annual income would be $24,413.13. Also, your money in BMO will compound to $451,873.23 in 20 years.

In the pandemic, BMO is proving to be Canada's bank for business. The investor-friendly bank helps small businesses, like hospitality and professional services, severely affected by shutdowns to recover.

Make the best choice

If retirement is on the horizon, consider the consequences or advantages of taking your CPP early at 65 or 70. However, make sure too that you have investment income to supplement the pension.

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