CPP Pension Users: Your CPP Contributions Could Soar by 9.2% in 2021

Description

The pension landscape in Canada is evolving. If you've been contributing to the Canada Pension Plan (CPP), the enhancements in the plan that took effect on January 1, 2019, should matter to you. The employee and employer contribution rates increased last year, which should reflect in your payslips for 2019.

In case you didn't notice, your contribution rate to the CPP rose from 4.95% to 5.10%. Check your 2020 contribution, and the rate rose to 5.25%. Next year, the rate will increase to 5.45%, which should translate to a 9.2% increase in the total combined employee and employer contribution. Only the basic exemption amount remains constant at $3,500.

Benefit to future beneficiaries

The provincial ministers met in 2016 and forged a historic agreement to enhance the CPP so Canadians could save enough for retirement. Increasing CPP contributions should result in a net increase in overall retirement savings.

CPP users might feel the pinch of the gradually increasing contributions, but there's a flip side to implementing the enhancements. Higher contributions (or forced savings) today will benefit future beneficiaries. Hence, you'll get your money back and more when you retire.

Pensionable earnings

As mentioned, the contribution rates are gradually increasing. The increases will bring the maximum annual employee and employer contribution to $2,748.90, $2,898.00, and $3,166.45 in 2019, 2020, and 2021, respectively. For self-employed individuals, the contribution rate and the maximum annual contribution is double.

The CPP enhancements will impact the maximum annual pensionable earnings as follows:

Year	Maximum Contributory Earnings	Basic Exemption Income	Maximu
2021	$58,100	$3,500	
2020	$55,200	$3,500	
2019	$53,900	$3,500	

Before 2019, the CPP retirement pension makes up only 25% of the average work earnings. With the enhancements, it should replace at least one-third of the average pre-retirement income. However, it could happen that lower savings will offset any CPP enhancements. Thus, it would be best if Canadians can curb their spending, set aside money, and save for retirement in other ways.

Supplement your CPP

An argument against the mandatory increases in the CPP contribution rate is the potential drop in private savings. Soon-to-be retirees would still need to save more to fill the inadequacy of the pension. If time is on your side, you can use your savings to invest in dividend stocks to create another income source.

Bank of Montreal (TSX:BMO)(NYSE:BMO) is the pioneer in dividend payments. It has been providing extra income to Canadians for 191 years already. CPP users can start with a small investment and gradually increase holdings later on. Over time, you would be receiving a pension-like income from this investor-friendly stock.

BMO currently trades at $87.54 per share and pays a 4.81% dividend. A $25,000 position will already produce $1,202.50 in passive income. Keep reinvesting the dividends and see your money compound to $63.972.66 in 20 years. The payouts should be sustainable as the bank maintains a payout ratio of not more than 60.5%.

Two income streams for life

The CPP is not enough as a standalone income source in the sunset years. You can enjoy retirement more with investment income from an established dividend payer. Two income streams for life are better than one.

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