Canada Revenue Agency: Squeeze Out Maximum Tax Savings From CPP Enhancement

Description

Service Canada has made sweeping changes to the Canada Pension Plan (CPP), the mandatory pension the government funds from the contribution you make. If you are above 18 years of age and earning more than $3,500, a certain percentage of your income goes towards CPP contribution. Service Canada started CPP enhancement in 2019, wherein it will increase the contribution rate and pensionable earnings every year till 2025. It looks simple, but the enhancement will have a significant impact on you depending on which stage of life you are in.

The lifecycle of CPP

You contribute to the CPP throughout your working life from age 18 to 65. After you turn 65 and before 70 years of age, you can choose whether or not to contribute to the plan. The Canada Revenue Agency (CRA) gives you tax benefits on your contribution.

For the 2021 tax year, Service Canada has increased the CPP contribution rate to 5.45% and maximum pensionable earnings to $61,600 from 5.25% and $58,700 in 2020. This means your maximum contribution will increase by $268 to $3,166 in 2021. The higher contribution will increase your maximum CPP contribution tax credit by $17 to $430.

You can start collecting the CPP payment as early as 60 years of age and as late as 70 years of age. If you turn 65 next year and decide to start collecting CPP then, Service Canada can give you an average of $710.41 and a maximum of $1,175.83 per month. Which payout you get will depend on the age you decide to collect CPP, your contribution, and your average earnings for the lifetime.

Service Canada's CPP enhancement will increase the maximum annual CPP payout by $255 in 2021. While this is good news, pensioners beware of the tax bill as the CPP payout is taxable.

Higher taxes coming in 2021

If you are 65 and still earning, decide whether you want to receive the CPP payout now or delay it till you turn 70. After 70, you have no other option but to claim the pension. Here's how you should look at the tax angle before you start the payout.

Jane turns 65 in January 2021. She works as a business consultant and draws a fixed salary of $70,000/year and has no plan to quit work for the next three to four years. What should Jane do?

Jane falls under the higher income tax bracket. If she collects around $1,000 in monthly CPP payout, it will increase her taxable income to $84,000. Hence, a wise decision for Jane would be to delay her payout and continue contributing toward CPP. She can benefit from the $430 CPP contribution tax credit and also increase her payout when she reaches the age of 70.

Make your CPP payout tax-free

Around $400 in CPP contribution tax credit can help you earn the tax on the payout. When you get the CPP contribution tax credit, invest that money in a stable stock through your Tax-Free Savings Account (TFSA). The CRA exempts all withdrawals from taxes and also allows your investment to grow tax-free.

Every year, invest your CPP contribution tax credit in **Descartes Systems** (TSX:DSG)(NASDAQ:DSGX). The stock is resilient to the economic crisis and has delivered significant growth in the last 10 years. The stock rose at a compound annual growth rate (CAGR) of 20% in the last five years as its revenue and adjusted EBITDA surged at 16% and 14% CAGR, respectively. The company provides supply chain management solutions — a market that will only grow with trade growth.

Assuming that Descartes's stock average annual growth rate slows to 15%, a $400 investment every year will convert to $11,000 in 10 years, (your contribution being $4,000) — and this amount will be tax-free. The $14,000 annual CPP payout will result in a federal tax bill of $2,100 excluding all tax breaks. The TFSA investment will at least make your payout tax free or the next four to five years.

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1. NASDAQ:DSGX (Descartes Systems Group)
2. TSX:DSG (The Descartes Systems Group Inc)

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