Canada Pension Plan: How to Plan for a Big Change in 2021

Description

When the Justin Trudeau-led Liberals kept their hold on power in 2019, they had committed themselves to several program enhancements. These enhancements were designed to give Canadians more financial breathing room. One of the key changes was to the Canada Pension Plan (CPP). Back in November, I'd discussed this change. Today, I want to review the Canada Pension Plan enhancement and discuss how Canadians may need to shake up their budgets in 2021.

What are the new changes for the Canada Pension Plan?

Phase one of the Canada Pension Plan enhancement began in 2019. It increases employee and employer contribution rates by 1% over five years. The cumulative increase will end up being 0.50% in 2021. Moreover, that will take the contribution rate from 4.95% to 5.45%.

The rate applied for the year's maximum pensionable earnings in 2021 will be $61,600. At this new rate, the maximum contribution in 2021 will be $3,166.45 each for employer and employee. That rate is double — $6,332.90 — for self-employed Canadians.

Why Canadians need to budget for this change

While the Canada Pension Plan enhancement is designed to help Canadians, it may require some budget adjustments for many of us in 2021. Indeed, once the five-year phase-in period for the enhancement is complete, it will eat into a Canadian employee's net paycheque by as much as roughly $600. Again, that rate will be double for those who are self-employed. That is not an insignificant amount, especially with many facing financial hardship due to the COVID-19 pandemic.

Instead of trimming the fat, you can explore generating more income. In March, I'd discussed why it is challenging to retire on a Canada Pension Plan and Old Age Security alone. One of the best ways todo this is with a Tax-Free Savings Account (TFSA). Any income generated in the TFSA is tax free. **TransAlta Renewables** (TSX:RNW) is one of my favourite dividend stocks to add in late 2020. Its shares have climbed 20% as of close on December 2.

TransAlta currently offers a monthly dividend of $0.078 per share. That represents a strong 5.2% yield. A TFSA investor with 750 shares of TransAlta at $17.47 per share would be able to generate over $700 in annual tax-free income. Moreover, you'll get a shot at solid capital growth that this stock has generated in recent years.

Are more Canada Pension Plan changes forthcoming?

The cumulative addition to the Canada Pension Plan will finish at 1% by 2023. By this time, the contribution rate will have risen to 5.95%. In its fiscal sustainability report for 2020, the parliamentary budget officer (PBO) suggested that additional funding may be required for the Canada Pension Plan. The PBO has said that the program is "not sustainable" long term. A rattled post-pandemic economy may only add to the headaches for the budget office. Canadians should prepare for more changes to the CPP in the years ahead. In the near term, they need to get ready for the challenges that an increased rate could bring in 2021.

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