CPP 2021 Changes: Pension Contributions to Rise by 4.9%

Description

The Canada Revenue Agency (CRA) has been issuing updates lately to make Canadians aware of essential changes in the upcoming year. One important reminder is the increase in the Canada Pension Plan (CPP) contributions.

The contribution increase translates to a 4.9% increase in the maximum pensionable earnings for 2021. From $58,700 this year, the new amount next year is $61,600. The employer-employee and self-employed contribution rates will be higher, too.

Modest contribution rate increases

The increased contribution rates for 2021 are part of the federal government's CPP enhancements approved in 2016.There'll be a total of five increases to CPP contribution rates starting in 2019 until 2023. The increases will gradually increase the maximum amount of CPP benefits.

In 2019, the employee and employer contribution rate increased to 5.10% from 4.95% in 2018. The succeeding contribution rates are as follows:

Year	Employer/Employee Rate	Self-Employed Rate
2020	5.25%	10.50%
2021	5.45%	10.90%
2022	5.70%	11.40%
2023	5.95%	11.90%

After 2023 or 2024 until 2025, pensionable earnings above the Yearly Maximum Pension Earnings (YMPE) will be subject to a CPP contribution rate of 4% for employees and employers or 8% for self-employed individuals. The CRA considers these earnings as additional pensionable earnings.

Two phases in seven years

The CPP enhancements are essentially two phases in seven years. From 2019 to 2023, or phase one, the contribution rate increase is one percentage point (4.95% to 5.95%). If you earn less than the projected CPP YMPE or the earnings ceiling in 2023, there'll be no further rate increases. The rate remains constant at 5.95% for both employer and employee.

Phase two begins in 2024 but will only affect CPP users belonging to higher-income levels. By then, the second higher limit applies where you can invest an additional portion of earnings to the CPP. The year's YMPE will not replace the first one, but the earnings are subject to two earnings limits.

Less income gap to fill

The rationale to raise the contribution rates is for retiring Canadians to have more financial support after they retire. Currently, the CPP pension replaces only 25% of the average lifetime earnings. With the enhancements, the replacement level increases to 33.3%.

However, it's best to supplement the pension with investment income for a more comfortable retirement living. Consider investing your savings in a buy-and-hold dividend stock like **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), or Scotiabank. This blue-chip asset pays a higher-than-market average 5.24% dividend.

A $150,000 investment today will generate a recurring quarterly income of $1,965. If you don't touch the principal and reinvest the dividends, your money will compound substantially to nearly $416,600 in 20 years. The payouts should be sustainable, as Scotiabank maintains its payout ratio at less than 70%.

Scotiabank's dividend track record is a remarkable 188 years. Canada's third-largest bank is well capitalized with its $83.25 billion market capitalization. With the economy stabilizing and COVID-19 vaccines rolling out soon, analysts forecast the stock price to appreciate 12.1%, from $68.71 to $77, in the next 12 months.

Future bonus

Consider your increasing CPP contributions as forced savings. If the increases aren't mandated, you might not even save at all. The smaller paychecks mean a higher bonus or pension when you retire.

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