CRA Alert: These CPP Changes Will Cost You in 2021

Description

There are two big CPP changes coming up that could cost you big money in 2021. These changes were announced this year and you'll start to feel the effects next year. These two changes will increase the amount of money you'll have to pay out come tax time. Potentially, the increase could be substantial. In this article, I'll be exploring these two big CPP changes–and what you can do to counter them.

Enhancement

CPP enhancement is a program that will increase your CPP premiums and benefits. It aims to increase CPP payouts by 50%, but it will take 40 years to get there. In the meantime, it's going to increase your tax bill here and now. CPP premiums are going up every single year from 2019 to 2023. This year, the basic rate is going from 5.25% to 5.45%. That's a 0.2% increase. If you're self employed, you'll pay 10.9%.

A .2% increase might not sound like much. But remember that's as a *percentage of your income*. The increase as a percentage of 2019's amount is more like 3.8%. Over the course of the program, CPP enhancement will increase CPP premiums by around 20%.

Pensionable earnings increase

The second CPP premium hike that could affect you is the pensionable earnings increase. This is an increase in pensionable earnings from $58,700 to $61,600. This particular hike will only affect you if you earn over $58,700. If you earn $61,600 or more, the combined impact of both enhancement and the ceiling increase could be significant.

In that scenario, you pay both a higher rate in premiums, and you pay premiums on a higher percentage of your income. That's a tough spot to be in. Fortunately, there is one great way to counter the effect of higher CPP premiums.

How to offset higher taxes

If you want to lower your tax bill, a great way to do it is by investing in a TFSA. This doesn't directly counter CPP premiums–because they go solely off employment income–but it lowers your overall tax bill. Assuming, that is, you'll be investing one way or the other.

Imagine that you held $50,000 worth of **Royal Bank of Canada** (TSX:RY)(NYSE:RY) stock. Royal Bank stock yields around 4% at today's prices. That means that your RY shares would pay $2,000 in cash payouts every year. That's $2,000 in taxable income right there. Dividend taxation is somewhat complex, and sometimes you end up not paying taxes because of the dividend credit.

But if you're in a *high* tax bracket (let's say 50%), you'll definitely pay taxes on $2,000 in dividends. And if you realized a 20% gain, you'd have to pay taxes on half of that, too. So in a scenario where you got $2,000 in dividends from RY and a $10,000 capital gain, you have $7,000 in taxable gains.

Outside of a TFSA, that would produce substantial taxes. Especially if your marginal tax rate is high. *Inside* a TFSA, on the other hand, your tax rate would be zero. And since the TFSA has a $69,500 limit this year, you could easily shelter every penny of your position. Simply a great way to lower your taxes–assuming that you'll be investing one way or the other.

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