CPP Is Increasing by 4.9% in 2021: Your Take-Home Pay Could Be Less

Description

The Canada Revenue Agency (CRA) has reminded Canada Pension Plan (CPP) users before 2020 ends of the upcoming year's contribution limits. The maximum pensionable earnings for 2021 will be $61,600, or a 4.9% increase from the $58,700 in 2020.

Furthermore, the employee and employer contribution rates will rise for the third time in as many years. For 2021, the rate is 5.45% from 5.25% this year. If you're employed, it means lower take-home pay again. Self-employed individuals will see their incomes drop by 10.9% because of a higher contribution rate.

Midway of CPP enhancements

The CPP enhancements are ongoing. It would be at the midway point next year of phase one that began in January 2019 and ends in 2023. The total increase in employer and employee contribution rates over five years is 1%. The 2021 maximum pensionable earnings (YMPE) will increase to $61,600 due to the new rates.

An employee's net paycheque will erode by as much as $600 once phase one is complete or fully implemented. The amount is $1,200 or double for the self-employed. In phase two (2024 to 2025), the second earnings limit beyond the YMPE kicks in. It will be called the year's additional maximum pensionable earnings (YAMPE).

Two thresholds

The YAMPE begins at 107% of the 2024 YMPE then moves up 114% in 2025. After which, the same standard indexation factor applies, although two thresholds will be indexed separately. Employer and employee contribution rates up to the YMPE remain at 5.95%, while the YMPE and YAMPE is 4% each. For employers, all contributions are deductible.

In the third quarter 2020 fiscal sustainability report by the Parliamentary Budget Officer (PBO), more

CPP changes might occur after the current enhancement process. The PBO estimates that increased contributions or reduced benefits equivalent to 0.1% of GDP may be required to sustain the plan.

Sizeable CPP supplement

Canadians maintaining a Registered Retirement Savings Plan (RRSP) are on the right track towards retirement. Because the CPP pension will not be enough, you need other sources of retirement. As a tax-deferred investment account, money growth in your RRSP is tax-free. Taxes are due only when you withdraw the funds.

If you want a sizable, pension-like income, consider investing in **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), or Scotiabank. The third-largest bank in Canada offers a 5.3% dividend, currently the highest yield in the banking sector. A $75,000 initial position will generate $3,975 in recurring annual passive income.

Assuming Scotiabank's dividend offer remains constant and you keep reinvesting the dividends, your capital will be worth $210,682.61 in 20 years. The bank's market capitalization stands at $82.31 billion. Its competitive advantages are a solid balance sheet and strong liquidity. More so, the dividend track record is an incredible 188 years. Invest in Scotiabank and hold the blue-chip stock forever.

Future reward

CPP users might have to adjust their budgets because of the increasing deductions in seven years. Also, CPP contributions are mandatory for employers and employees. You can consider your contributions as forced savings on your part. Over the long term, the enhancements should increase the CPP income replacement level from 25% to 33%. Thus, the reward for reduced take-home pay and belt-tightening today is higher pension income when you retire.

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Date
2025/08/27
Date Created
2020/12/22
Author
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