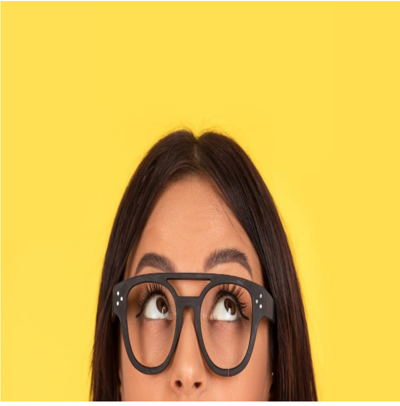

CPP Premiums: Your Paycheck Could Shrink in 2021

Description

Did you notice that your first paycheck for 2021 was a little smaller than your 2020 checks?

There may have been a good reason for that.

This year, CPP premiums are set to increase, and your employer is likely already taking out the higher amounts. While the percentage increases aren't enormous, they will continue over the next several years. By 2023, the effect will likely be quite noticeable. In this article, I'll explore the two CPP tax hikes that are coming, and how you can lower your tax bill overall.

CPP enhancement

The first CPP hike coming this year is enhancement. It's a program that aims to increase CPP payouts from 1/4th to 1/3rd of earnings over 40 years.

If CPP enhancement goes according to plan, then retirees will get a lot more money from CPP in the future. The problem is that more money is going to be coming out of your paycheck this year. In 2021, CPP premiums go from 5.25% to 5.45% of your paycheck. By 2023, you'll be paying just shy of 6%. This is oversimplifying a little, because CPP premiums have a tax credit applied to them. The ultimate net amount you pay will depend on the effects of the CPP premium increase and the tax credit. But unless you took a pay cut, you will be paying somewhat more in CPP premiums in 2021 than in 2020.

Insurable earnings maximum increased

The second "CPP premium hike" coming in 2021 is the maximum insurable earnings increase.

Before explaining this one, a little background information is needed. Your CPP taxes depend on two things:

1. The percentage of earnings taken out.

2. Your earnings level.

CPP insurable earnings are subject to a cap. Any money above that cap has no premiums taken out. In 2021, the “cap” is increasing from $58,700 to $61,600. Ostensibly this is to account for the effects of inflation. But if you earn between $58,700 and $61,600, and your pay did not increase this year, it’s pretty much just a larger share of your income being subject to CPP premiums.

The end result? A bigger tax bill.

A great way to lower your tax bill

If you want to counter the effects of higher CPP premiums in 2021, I have some good news and some bad news for you.

The bad news is you can’t really lower the CPP premiums themselves. Especially if you’re conventionally employed. Your employer takes a set amount out of your check and that’s pretty much that. You could try claiming more deductions to lower your take home income, but you’d need the help of a professional accountant to make sure you’re not breaking the law when aggressively claiming deductions.

The good news is that you can lower your *overall* taxes very easily. The way you do it is by holding more of your investments in a TFSA. Assuming you will be holding investments one way or the other, this lowers your tax bill.

Imagine that you held $50,000 worth of the **iShares S&P/TSX 60 Index Fund** (TSX:XIU). Outside of a TFSA, you could end up paying a lot of taxes on that position. Based on the fund’s current yield, you’d get about $1,450 in taxable dividends per year. If you realized a 10% gain and cashed it out, you’d also have a $5,000 capital gain, of which $2,500 would be taxable.

All told, you’d be looking at $3,950 in taxable gains and dividends. Unless, of course, you held that $50,000 position in a TFSA. Canadian ETFs like XIU are 100% tax-free if held in a TFSA. That fact could save you thousands a year in dividend and capital gain taxes. No, you don’t directly lower CPP taxes by doing this. But you lower your *overall* taxes, which has the same effect.

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