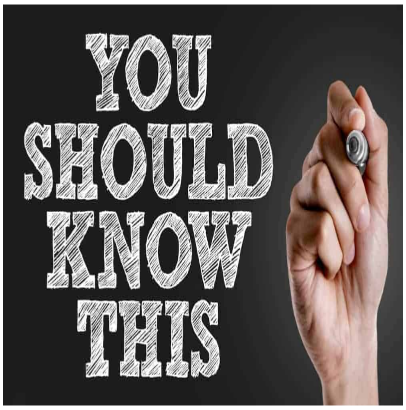

Canada Pension Plan: 3 Big Changes Coming in 2021

Description

Are you contributing or receiving the Canada Pension Plan (CPP)? Then you must know the three big changes Service Canada introduced in the CPP in 2021. The CPP is a self-funded government pension plan under which you enroll and contribute when you turn 18 and enjoy the payout after you turn 65. There are three elements of the CPP:

- Contribution
- Tax breaks
- Payout

Under the CPP enhancement plan, Service Canada will increase CPP contribution every year till 2025. With this, it aims to give you 33% of the average income you received after 2019 as a pension when you retire. See how the 2021 changes will impact the three CPP elements.

The CPP contribution in 2021

For 2021, Service Canada has increased the CPP contribution rate to 5.45% (from 5.25% in 2020) and maximum pensionable earnings to $61,600 ($58,700). Your employer will deduct 5.45% of your income above $3,500 and below $61,600 as the CPP contribution.

For instance, Jessica earned $62,000 in annual income in 2020 and 2021. Her employer deducted $2,898 in the CPP contribution (5.25% of $55,200) in 2020. But for 2021, her employer will deduct $3,166 (5.45% of $58,100) in the CPP contribution, up $268.5.

The CPP tax breaks in 2021

The Canada Revenue Agency (CRA) gives you tax benefits on your CPP contribution. Now, this tax benefit is divided into two:

- The tax credit on the base CPP contribution rate of 4.95%. A tax credit reduces your federal tax

bill.
- The tax deduction on the enhanced CPP contribution rate of 0.5%. A tax deduction reduces your taxable income.

Going back to the previous example, Jessica's CPP contribution tax credit will increase by $21.5 to $431.4 (15% on $2,876 base CPP contribution) in 2021. Her enhanced CPP contribution will increase by $125 to $290.5. This means she can reduce her 2021 taxable income by $290.5.

The CPP payout in 2021

If you are above 65 years of age, you can start receiving CPP payout. Service Canada computes your payout based on

- Your average earnings in your working life;
- Your CPP contributions; and
- The age you start your CPP payout.

You can collect the CPP payment as early as 60 years of age or delay it till you turn 70. If you start collecting CPP payments at age 65, you must have received the maximum monthly payout of $1,175.83. For 2021, Service Canada will adjust this amount for inflation and increase it by $20-$30. Your CPP payout will be taxable.

Don't wait till 65: Retire early with a TFSA pension

The CPP lifecycle and calculation is quite an overdose to understand. Instead of depending on the government's pension, create a personal tax-free pension that can allow you to retire early. Use your Tax-Free Savings Account (TFSA) to invest in Dividend Aristocrats like **Canadian Utilities** (TSX:CU).

Canadian Utilities has been paying incremental dividends for the last 48 years. It increased its dividend per share at a 10-year compound annual growth rate (CAGR) of 8%. This means if you earned $1,000 in annual dividend in 2010, your dividend income increased to $2,163 by 2020.

Such incremental dividend income will help you fight inflation, and you can start getting it as early as next month. If you invest through your TFSA, your dividend income will not be a part of your taxable income.

Canadian Utilities earns a steady cash flow from utilities and the transmission and storage of natural gas and electricity. The company increases its cash flow by revising tariffs as per inflation and building new power plants and pipelines. It has the potential to continue growing its dividends in the coming years.

Investor corner

This is the right time to buy Canadian Utilities stock, as it is still trading at a 25% discount from its pre-pandemic levels, after falling 40% in the March 2020 sell-off. This reduced stock price has created an opportunity to lock in a 5.46% dividend yield.

If you invest $25,000 in the stock now, you will get a tax-free annual dividend of $1,365 in 2021. This amount will increase to $3,000 by 2030 if the company increases its dividend at a CAGR of 8%.

CATEGORY

1. Dividend Stocks
2. Investing
3. Personal Finance

TICKERS GLOBAL

1. TSX:CU (Canadian Utilities Limited)

PARTNER-FEEDS

1. Business Insider
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