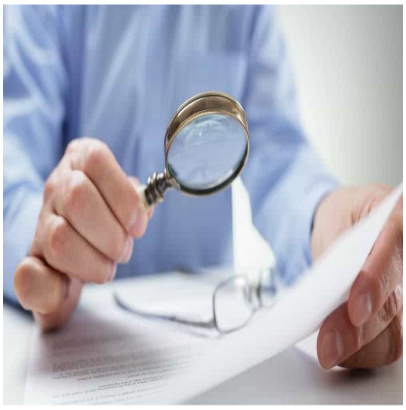

Canada Pension Plan: The 2021 Changes Will Impact Your Paycheck

Description

Did the first paycheck of 2021 catch you by surprise? Did the deductions look different? Service Canada has made a few changes to the Canada Pension Plan (CPP), which has increased your CPP contribution, tax benefit, and the CPP payout. I will discuss how the CPP changes in 2021 will impact your paycheck.

The Canada Pension Plan cycle

The Canadian government introduced the Canada Pension Plan as a mandatory deduction from your income. Under special circumstances, you can stop contributing to the CPP. The aim is to help you save for your retirement.

From the age of 18 and till you turn 65, your employer will deduct a CPP contribution and give it to Service Canada. In return, the Canada Revenue Agency (CRA) gives you a tax benefit. When you turn 65, Service Canada calculates a payout amount based on various factors and gives you a monthly pension that is taxable.

The Canadian retirement age is increasing, as people have higher expenses, jobs are physically less stressful, and life expectancy has increased. Hence, Service Canada designed the CPP enhancement program intending to give you 33% of the average income you earned after 2019 as the payout.

So, if your average monthly income was $5,000 after 2019, Service Canada strives to give you $1,650 in the payout. To give a higher payout, it needs a higher contribution regularly and for longer. It did the math and devised an accelerating contribution rate between 2019 and 2025.

How will the Canada Pension Plan changes affect your 2021 paycheck?

For 2021, your employer will deduct 5.45% in CPP contribution on your total income above $3,500 and up to $61,600. If your 2021 total income comes at $50,000, your employer will deduct 5.45% on $46,500, which comes to $2,534. If everything is the same, your 2021 contribution is $93 more than the $2,441 in 2020 contribution when the CPP rate was 5.25%.

The CRA rewards you for the higher CPP contribution with higher tax benefits. Before the CPP enhancement program began, the CRA gave a federal tax credit on the basic CPP contribution rate of 4.95%. Nothing changes in this. The change is in the enhancement rate, which is 0.5% (5.45%-4.95%) in 2021. The CRA allows you to deduct the enhanced CPP contribution amount from your 2021 taxable income.

In my previous example, the $2,534 CPP contribution is divided into:

- $2,302 basic contribution, on which you can reduce your federal tax bill by $345, and
- $232.5 enhanced contribution, which you can use to reduce your $50,000 taxable income to $49,767.

On $50,000 taxable income, you pay a federal tax bill of $7,554. After applying for the CPP tax benefits, your bill reduces to $7,161, which equates to tax savings of $399. This is higher than your 2020 tax savings of $345. The CRA compensated you for the $93 higher CPP contribution with a $48 higher tax savings. So, the real impact on your paycheck is $45.

Build your TFSA pension portfolio

The CPP will only give you 33% of your average income in the payout. What about the remaining 67% income? You will have to arrange for that by yourself, and a good way to save is using the Tax-Free Savings Account (TFSA). The CRA gives no tax benefits on the contribution but exempts the income you earn from the investments from taxes.

If you have another five to 10 years until retirement, and you don't need passive income, invest in growth stocks to build a good portfolio. You can consider **Shopify** (TSX:SHOP)(NYSE:SHOP), the e-commerce sensation that has the potential to be the next **Amazon**. Shopify ended 2020 with 86% revenue growth and $491 million in adjusted net income.

The company was one of the biggest beneficiaries of the pandemic. Its stock tripled in 11 months from $590 to $1,800. Although the stock is trading at 75 times its sales per share, which is high compared to its peers, it has strong growth potential. Many brand-conscious retailers are leaving Amazon because of the e-commerce giant's unfavourable terms and poaching of their customers. Shopify is the preferred e-commerce platform by these retailers.

While Shopify's revenue growth will slow this year as an after-effect of the pandemic, it will grow in the 2030 decade, as it gains market share. The stock can double your money in three to four years.

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