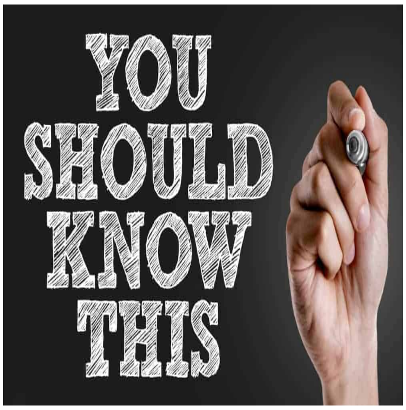

Canada Revenue Agency: What Should You Know About the CPP Changes in 2021

Description

It goes without saying that payday is important for everyone as you align your expenses and investments accordingly. And if there is a discrepancy, it puts your plans into question. Hence, it is better to know upfront about any changes to your paycheck. While I can't comment on the income side of your salary slip as it is at the discretion of your employer. But I can tell you about the deductions — and one of them is Canada Pension Plan (CPP).

The CPP lifecycle

The CPP is a self-funded pension plan which the government mandates to help you have a comfortable retirement. It impacts your finances in three ways: your working income, tax bill, and pension payout.

When you turn 18 and start earning more than $3,500, your employer deducts a certain percentage of your taxable income as the CPP contribution. For 2021, the contribution rate is 5.45% of your salary between $3,500 and $61,600. Your employer contributes an equal amount to your CPP and gives it to Service Canada, which then invests this money. You have no say in where to invest the money.

As the CPP contribution reduces your net income, the CRA gives you a tax benefit for the same. This contribution and tax benefit last till you turn 70. Under special circumstances, you can stop contributing to your CPP, but that will impact your payout.

You can claim your CPP payout from Service Canada as early as 60 years of age or delay it till you turn 70. As the CRA gave you a tax benefit on the CPP contribution, it will add the CPP payout to your taxable income. Service Canada determines your payout depending on your average work earnings, your CPP contributions, and the age you start your CPP payout.

The CPP changes in 2021

Before 2019, Service Canada used a base contribution rate of 4.95%, which could give you up to 25% of your average work earnings as a payout. In the light of the rising cost of living, Service Canada introduced the CPP enhancement program 2019-2025. Under the program, it will gradually increase your contribution to increase the payout to 33% of your average work earnings.

In 2021, your employer will deduct 5.45% of your salary under CPP contributions compared to 5.25% in 2020. Saving you the calculation, this means a $268 increase in annual CPP contribution if your income is above $61,600 in both years.

A TFSA pension is more efficient than the CPP

The CPP is a mandatory pension plan, and you benefit from an equal contribution from your employer. But you don't have the freedom to decide when, how much and where to invest and withdraw. A private pension plan gives you that freedom. You are your boss and dictate when, how much, and where you invest and withdraw.

The CRA offers many instruments for a private pension that gives you tax incentives, but the most flexible of all is the Tax-Free Savings Account (TFSA). The CRA allows you to invest up to $6,000 in 2021 plus any unused investment limits carried forward in the TFSA. It adds your TFSA contribution to your taxable income. After this, it doesn't touch your TFSA. So you can let your investment income grow tax-free and also withdraw tax-free.

Building your TFSA pension

When you plan your retirement savings, diversify your portfolio between dividend and growth stocks. Invest in stocks that you would want to hold for the next 10 years. **BCE** (TSX:BCE)(NYSE:BCE) is a good dividend stock to consider as it has been increasing its dividends at an average annual rate of 6.4% for the last 10 years.

Being a leader in Canada's telecom market, it enjoys the benefits of a broader consumer reach and communications infrastructure. The industry is undergoing a technology shift to 5G, and BCE is investing aggressively in this technology. Its revenue and cash flow growth will accelerate once it unleashes the 5G growth potential. The 2030 decade would be stronger than the 2020 decade for BCE, with higher cash flows and accelerated dividend growth.

A $3,000 investment in BCE can earn you an accumulated dividend income of $2,400 by 2030, assuming a 6% average dividend growth rate.

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