Canada Pension Plan: Your Paycheck Could Be Smaller in 2021

Description

The Canada Pension Plan (CPP) has undergone mandatory increases between 1996 and 2004. During the period, the rate rose to 9.9% from 5.6% of eligible earnings. The consequence was that for every $1 increase in CPP contributions, the private savings of the average Canadian households reduces by $1.

Fast forward to 2021, CPP contributions increased again, effective January 1. The CPP enhancements, a multi-year plan approved by provinces and the federal government, began in 2019. The first bump in the employer and employee contribution rate was 5.1%. For this year, the rate is 5.45%.

If you're a CPP contributor, your paycheck could be smaller again. It also means the yearly maximum pensionable earnings (YMPE), or upper limit on earnings, will go up alongside the higher premiums. Thus, the YMPE in 2021 is now $61,600. Enhancement proponents argue the program expansion is good for CPP contributors.

Pension calculation

The CPP calculates an individual's retirement pension based on 25% of the average pensionable earnings during the contributory period. Every Canadian worker who earns more than the basic annual exemption amount must contribute to the pension system. Generally, the contributory period ends when a user starts collecting the pension.

Maximum employee contribution

The maximum contributory earnings in 2021 is $58,100 ($61,600 minus $3,500), while the contribution rate is 5.45%. Hence, the maximum employee and employer contribution is $3,166.45 ($58,100 X 5.45%). A self-employed individual will contribute $6,332.90 ($3,166.45 X 2).

Regarding the paycheck cut, the amount is $263.87 per month instead of the $241.50 in 2020. After this year, the contribution rates will increase to 5.7% and 5.95% in 2022 and 2023. Therefore, the contribution rate for self-employed individuals is 11.4% and 11.9% in the next two years after 2021.

Five-star income stock

The older you are, the less time you'll have to contribute to the enhanced CPP. Baby boomers, however, can start payments at age 70 to increase benefit amounts permanently by 42%. The usual recourse to fill the income gap is to create an income stream apart from the pension. The company's oil sand assets are among the best in North America.

Canadian Natural Resources (TSX:CNQ)(NYSE:CNQ) is a top choice among income investors because of dividend sustainability. The $36.61 billion independent energy producer derives its revenue from the sale of crude oil and NGLs (89%) and natural gas (11%). Its oil sand assets are among the best in North America.

Dividend payments have been regular since 2001. Management has likewise raised dividends for 21 consecutive calendar years. The energy sector is volatile, although CNR endures commodity price cycles. Its asset base has low sustaining capital, while the reservoir risk is also low.

The share price is $30.84 (+29.8% year to date), and the dividend offer is an attractive 4.76%. This well-managed, low-cost producer is for keeps.

Increase in replacement level

Younger CPP users will benefit the most from the ongoing enhancements but not Canadians at or near retirement. With higher contributions, the CPP's replacement level will increase to one-third of the average pre-retirement earnings from one-quarter.

Remember that the benefits depend upon how much and for how long you contribute to the enhanced CPP. If you received your pension in 2065 or later, you would realize as much as a 50% increase to what you would receive before the enhancements.

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