

Canada Pension Plan and Old Age Security

A. CPP Overview

Canada Pension Plan is a contributory, earnings-related insurance program. This means that you must have contributed to the program in order to receive benefits. The CPP is designed to replace approximately 25% of pre-retirement income, up to 25% of the average industrial wage.

CPP offers **three different benefits**:

- The retirement pension
- Disability benefits including benefits for disabled contributors and also dependant children
- Survivor benefits, including death benefit, and the children's benefit.

Contributions

Generally, if you're over 18 years of age, you must make contributions to CPP on your pensionable earnings and your employer must match your payment. A few exceptions include migratory workers, casual workers and members of religious orders who take a vow of poverty. The CPP program began in 1966.

Your **contributory period ends** at the earliest of the following:

- When you start to collect your retirement pension (unless you continue work, in which case your contributions must continue to age 65)
- When you turn 70 years old
- When you die

The **contribution shared** between you and your employer is based on the YBE: Yearly basic exemption. Your contribution is based on the amount of income over the YBE up to the yearly maximum (YMPE). The YBE is fixed at \$3,500 and is not indexed for inflation. The YMPE (maximum) is tied to inflation. **In 2011, the YMPE was \$48,300.**

Pensionable earnings is calculated by subtracting YBE from actual earnings if lower than YMPE. If higher, then YMPE less YBE.

The contribution rate is 4.95% for each of the employee and employer. If self-employed, then both portions are paid for a total of 9.90%.

Receiving Benefits

Standard benefit begins at age 65 with **\$960 monthly as current maximum**. Last year, the average pension paid to Canadians was \$512. A statement of

contributions is available online at www.servicecanada.gc.ca for anyone 30 years old or more. The pension benefit is indexed annually.

Beginning pension at age 60 is allowed however a penalty of 31.20% is applied (2012). For those turning age 60 in 2013, the penalty increases to 32.4%. Penalty increases slightly per year until 2017 where maximum penalty will be 36% of maximum at age 65.

When your pension is calculated, up to **7 years of lowest earnings** are not factored into the formula. This helps increase your maximum CPP pension. For 2012, this drop-out provision was increased to 7.5 years. For 2014, it will increase to 8 years.

For those who stopped working or received lower earnings because you were the primary care-giver of children under the age of 7, you will be eligible for the child-rearing drop-out provision. This excludes that period from the calculation of average earnings, and thus ensures that you get the highest possible retirement pension. **The child-rearing drop-out is not automatically applied.** This must be applied for. Both parents cannot apply.

Taking CPP Pension Early

In order to **receive benefits**, you need not retire prior to collecting prior to age 65. While collecting CPP and working at the same time, your employer is mandated to continue your CPP contributions. This is a new rule for 2012. Minimum contributions of \$2,300 for employer and employee are necessary. After age 65, and collecting benefits, you can make further CPP contributions to increase your monthly pension. Both employer and employee are required to contribute.

For 2012, a reduction of 0.52% is in effect for each month of pension beginning prior to age 65. For 2013, the reduction increases to 0.54%. At 2016 and thereafter, the reduction is 0.60% per month.

Delaying CPP Pension

There are incentives to delaying your pension past age 65. The amount of incentives depends on when you start. Beginning in 2012, your benefit will increase by 0.633% per month of delay (past age 65). In 2013 and thereafter, the increase will be 0.70% per month.

Working past age 65 also increases your CPP pension, in addition to the monthly incentive. There is no benefit for starting your CPP pension after age 70. Pensions will not be paid out retroactively beyond 12 months, so application for benefits before age 71 is very important.

Contributing after Starting your CPP Retirement Pension

Beginning 2012, if you are under age 65, and you are working, you MUST continue to make CPP contributions, even if you are collecting CPP pension.

If you are between 65 and 70, and working, you may elect to pay into CPP. Should you choose to contribute, your employer will contribute as well (mandatory). Each year of contribution adds a **post retirement benefit (PRB)** of up to one-fortieth of the maximum CPP pension. This addition is given even for those at maximum payout already.

Contributions made after your CPP pension is received will not create eligibility for , or increase the amount of , any CPP benefits other than the PRB. The PRB is also not eligible for spousal income splitting.

How to Choose when to Start your CPP Pension

There's no easy answer to this one. Every situation is unique and now the complexities added from incentives and working after 65 add to the calculations.

Some people are intent on squeezing every possible dollar out of their CPP benefits. Best approach is to choose the age that provides the maximum benefit for your life expectancy (use tables or family history as best estimate).

- Average Canadian life expectancy for females is 85 and males 83. Cash flow after retiring is key for most people. Taking a reduced government pension benefit is a decision that cannot be changed in the future.
- Some considerations to delay the need for taking early pension include continuing to work part-time or reducing spending on discretionary items, or drawing on personal savings.

Beginning your pension at 60 (in 2016 after all pension changes are implemented) and assuming life expectancy of 85, you will receive \$182,400. If you waited to 61, the amount is \$194,800 (\$12,400 difference). Waiting to age 65, the payout to age 85 is \$228,000.

The key is while you wait for CPP, you're likely using your own savings to fund retirement expenses. In my opinion, in event of your earlier death prior to age 85, the CPP benefit is \$2,500. Using government benefits earlier and saving your own money allows for greater estate value transfer (money left for your loved ones). Taking the CPP pension earlier allows for more flexibility when using your own savings.

- My recommendation would be to complete a retirement income plan before deciding on government pension (and/or private pension) options. Our clients are offered this planning service complementary.

CPP Pension Sharing Between Spouses

Spouses may be able to reduce tax burden by choosing to share or assign your CPP pension benefits. Assigning some of the pension to a spouse with lower income (marginal tax rate) can be done. The amount you can share depends upon the amount of time you've lived together compared to your total contributory period. Contributory period begins at age 18 (assuming employment begins there) and ends at time of last contribution. Sharing CPP pension requires application to government. Once approved, pension income will be adjusted at source.

B. Disability Benefits Overview

Eligibility for disability benefits is based on membership to the pension plan.

Definition of disability:

CPP definition of disability is **more strict** than the definition used by private short-term or long-term disability insurance policies. There is no guarantee that if you qualify for disability from private programs (or other government programs) that CPP will also grant you a benefit.

In order to receive a CPP disability benefit, your disability must be both severe and prolonged.

To be considered severe it must prevent you from doing your former job or ANY job on a regular basis. To be prolonged, it must be indefinite duration or likely to result in your death.

Other eligibility requirements required to be satisfied deem it necessary that you have made CPP contributions for a minimum period of time:

- at least 4 of the past 6 years of contributory period or
- if you have less than 6 years in your contributory period, then at least 4 years, or
- if you have contributed for at least 25 years, then at least 3 years of the last 6 years.

Disability Benefits

- The benefit is a flat monthly \$433.37 (2011), plus 75% of your retirement pension earned to date, to a maximum of \$1,153.37 (2011).
- You may qualify for child benefit to help with supporting a dependent, of \$218.50 flat. Your child must be under the age of 18, or between 18-25 and enrolled in school full time.

- In event that both spouses qualify for CPP disability, the child's benefit is received twice (by each spouse).

C. Survivor Benefits

When you die, CPP survivor benefits may be paid to your estate, your surviving spouse or common-law partner and dependent children. Three types of benefits:

- a death benefit maximum \$2,500
- a survivor's benefit, paid to the legal spouse or common-law at the time of death (includes same sex)
- a child's benefit, dependant under age 18 or 18 to 25 attending school

These are not automatically provided. You must apply. Eligibility requires at least 3 years contributions.

- If a surviving spouse is age 65 or greater, the benefit is up to 60% of the contributor's retirement pension with limits if the survivor is already receiving CPP benefits.
- From ages 45 to 64, the survivor receives a flat \$169 (2011). For those under 45 with children, the benefit is up to 37.5% of contributor's retirement pension, plus \$218.50 per qualifying child. Should both parents of a child die, the amount of \$218.50 is paid twice, per child.

D. Old Age Security

OAS is a non-contributing social insurance program that provides monthly pension to most Canadians aged 65 +. Eligibility requirements apply. Additional benefits may be available to spouses and low income pensioners.

Current maximum OAS pension as of 2011 was \$537.97 monthly, with indexing to quarterly inflation. Full or partial pension depends on how long you have lived in Canada after the age of 18.

Three factors that determine eligibility:

- Age requirement 65+
- At approval time, you must live in Canada and be legal resident or citizen
- Must have lived in Canada for at least 10 years after age 18 (consecutive not required)

If living outside of Canada:

- Age requirement 65+
- You were Canadian citizen or legal resident before you left

- You lived in Canada for at least 20 years after age 18 (consecutive not required)

Should neither of these requirements apply, you may still qualify if Canada has a social security agreement with your current country of residence.

For full pension, requires certain conditions as follows:

- Either you have lived in Canada for at least 40 years since turning age 18 or
- you were born on or before July 1, 1952 and at the time you reached age 25 (on or before July 1, 1977) you lived in Canada or
- you lived some time in Canada with a valid Canadian Immigration Visa AND you lived in Canada for the 10 years immediately before the approval of your OAS application.

Should you move to another country after beginning OAS pension, and not satisfy minimum residency requirements, then OAS will only pay for six months. The OAS pension will resume once you return to Canada.

OAS Clawback

OAS pension is a means-tested benefit, meaning that it will be reduced or clawed back by 15% of net income that exceeds the OAS income threshold of \$67,688 (2011). The clawback effectively increases your marginal tax rate on any net income that is above the OAS threshold but below the income cut off limit of \$110,123 (2011).

Calculating the OAS clawback excludes certain income streams: pension contributions, RRSP contributions, annual union dues, business investment losses, split pension income transferred to a spouse and tax-deductible support payments made.

OAS Clawback Strategies

Many investors favour dividend and capital gain income due to the lower tax inclusion (up to 50% less tax) than interest income. Caution on the strategy of using dividend income for reduction of taxes in event of OAS Clawback as dividend income could have a greater impact than interest. I recommend a full review of your investment portfolio and income tax return with your investment and tax professionals.

Guaranteed Income Supplement

The GIS provides additional benefit on top of the OAS pension for low-income seniors living in Canada. GIS is income dependant (single or joint). Maximum

GIS for single person is \$729.44 (effective October 2011). If both spouses receive supplement, then maximum is \$483.68 monthly. GIS is not a taxable income.

Allowance

For a person receiving OAS and GIS, who has a spouse between the ages of 60 and 64, your spouse may be eligible for ALW (allowance) benefit. Maximum ALW is \$1,021.65 monthly (same amount as OAS and GIS combined). This benefit is for low-income married pensioners.

- The ALW can be also received should you die and have a spouse within the age limits.
- ALW and ALWS is not taxable as income.

Proposed Changes to OAS

- The proposed changes will not affect those who are age 54 or older as of March 31, 2012 (those born March 31, 1958 or earlier).
- Those born between April 1, 1958 and January 31, 1962, will be eligible to collect between 65 and 67.
- Those born Feb 1, 1962 or later, will be eligible to collect OAS at age 67 (versus 65)
- Voluntary deferral of up to 5 years will provide a bonus of 0.6% each month after age 65. The maximum increase is 36% should you defer to age 70.
- There is no requirement to cease working before starting OAS.
- The Allowance changes would provide monthly income from 62 to 66 vs 60 to 65

Top Up for Very Low Income Seniors

- In Budget 2011, Government of Canada introduced a new measure to enhance the GIS, ALW and ALWS. This new benefit is in place as of July 1, 2011.
- Single recipients with annual income (other than OAS and GIS benefits) of \$2,000 or less will receive an additional benefit of \$600 annually (\$50 per month).

- Couples with annual income of \$4,000 or less (excluding OAS and GIS) will receive additional \$840 annually or \$70 per month.