Colin S. Ritchie

You, Me and the CPP – Part 1
Introduction

For many of us, our Canada Pension Plan will play a meaningful role in our retirement planning. All the same, many Canadians don't fully understand how it works and the choices we have when we look to start retirement benefits. In this article, I will first provide a brief summary of the CPP and some of the changes that have been enacted over the last 15 years to protect its ability to pay out the promised benefits going forward. In later articles, I will briefly discuss some of the non-retirement benefits you can receive, then describe your retirement benefit choices and some of the things you might want to consider when it is time to decide when to start your CPP retirement benefits.

The CPP – An Overview

The CPP has been around since the 1960's and is designed to provide a series of benefits to Canadians that have paid into the plan during their working lives. Unlike the OAS pension, which is based solely on years of residency in Canada, your CPP pension is based on how much you have contributed to the plan. In other words, if you haven't paid anything in, you won't be getting anything out.

When the plan was first created, life expectancies were much lower, which meant that the plan didn't need to set aside as much money per person as is the case today. Moreover, we are in the middle of a demographic shift that will result in a higher percentage of Canadians taking their retirement pensions compared to Canadians paying into the plan than was originally anticipated. In other words, there are not as many working Canadians per retiree than when the plan was first set up.

Fortunately, these types of changes do not occur overnight and the people running the plan have taken significant steps to increase the chances of the plan having the financial resources to pay the promised benefits in light of the current reality. The first significant change occurred around the dawn of the new millennium, when both workers and employers were forced to significantly increase their contributions into the plan to build up a cash reserve for the future.

Secondly, from that point onward, the formula for calculating combined survivor and retirement benefits post age 65 was altered. As a result, the combined benefit was capped so that the survivor's combined retirement and survivor benefits couldn't exceed the maximum retirement pension. The result: someone already receiving the maximum retirement pension will not receive <u>any</u> survivor benefits (other than the taxable death benefit of up to $2,500) on his spouse's death, no matter how much the

Colin S Ritchie - Lawyer & Financial Planner colinritchie01@shaw.ca
http://colinsritchie.com (778) 371-1994

deceased had paid into the plan (although the survivor would at least get a survivor's pension until age 65 if he was widowed before then and the combined pension is calculated by a different formula.) In contrast, non-working spouses are entitled to 60% of their spouse's pension. Although I suspect there is a reason for this difference in treatment, I doubt that I find it convincing.

Thirdly, and perhaps most importantly, the CPP began to be run like a real pension, hiring professional investment managers and investing the contributions strategically. Before that point, the federal government had simply loaned out the money we had paid in to the provinces at piddling interest rates. At this point, other countries look upon the CPP as an example to follow when setting up or making changes to their pension plans.

A few years ago, the plan made another series of changes that are in the middle of slowing being phased in over time. Although it was always possible to start collecting retirement benefits as early as age 60, it was previously necessary for some people to arrange to reduce their earnings in the month before and the month in which their payments commenced in order to qualify for their pension before age 65. At this point, your income no longer matters if you want to start your pension before age 65. On the other hand, there are some other factors that may discourage you from starting your pension early, even though it is easier to do so than ever before.

To begin, the penalty (although the government prefers the term, "actuarial adjustment") for starting your pension early is slowly increasing from .5% to .6% per month times the total months you receive your retirement pension before turning 65. In other words, if you start your pension at age 60, your pension will be 64% of what you would have received if you'd waited until age 65. A few years ago, you would have received 70% of your unadjusted amount if you started at 60. We'll talk a bit more about the pros and cons of starting your pension early in a later article

The second change is the requirement that workers must now continue to pay into the plan until age 65 even already on pension. On the other hand, these additional contributions will be used in part to fund a new top up plan called the, "Post-retirement Pension" or "PRP." Each ensuing January, workers already on pension will receive a small additional pension that is based on their contributions the year before that is indexed like the regular CPP. Put another way, although the government now requires all working Canadians to continuing paying into the CPP until 65 even if already on pension, at least they will get a small reward for doing so.

The third major change is actually a good news story for workers would wish to defer their CPP pensions. Although workers always had the choice to defer their start date until as late as age 70, the reward for doing so has now increased. Previously, workers would get .5% more per month compared to their age 65 amount for each month they delayed past their 65th birthday. Now, this has increased to .7% per month. Put another way, instead of getting 130% of what you would have received at 65 if you delay as long as possible, you will now qualify for 142% of your age 65 benefit. Of course, whether this is a good decision or not depends on how long you expect to live, your financial circumstances and your tax bracket. You also have the choice of continuing to pay into your pension past age 65 now as well, whether you have started your CPP pension or not.

Finally, there are a few more changes that have occurred over the last 15 years that I will not go into now that might affect some tax payers. Some of those modifications include:

- Workers now get to exclude more years from their work history when determining their benefits. As the pension depends on average earnings, each low or no income year that can be excluded will boost the ultimate payout.
- Retired couples (including common law and same sex couples) can now pool the portions of their pensions that they earned when they were together. Although the ultimate payout won't change, this change may mean that the couple gets to keep more if splitting their pension puts more income in the hands of the spouse in a lower tax bracket. Unlike the pension income splitting rules for work pensions and RRIFs, however, the CPP pension split can only be done on a 50-50 basis; the rules for the other pensions allow the couple to determine each year how much (up to 50% of the pension) they wish to split at tax time.
- Under the "Childrearing Dropout Provision," workers applying for their retirement pensions can also apply to exclude any years they were the primary caregivers their children under age 7 from their pension calculations. In many cases, excluding these low or now income years results in a larger pension, since these low income years would otherwise reduce the worker's average income come;

Conclusion

Although this article may not answer all your questions about the CPP and what to consider when deciding when to start your retirement benefits, hopefully it is a good first step down that road. My next article will continue that journey and the third installment will hopefully fill in the remaining pieces!

You, Me and the CPP – Part 2
Introduction

Although the CPP retirement pension is usually the centre of attention, it is not the only way you may collect CPP benefits. Although I do want to focus on retirement benefits and things to consider when deciding when to claim them, the lapsed Catholic in me would feel guilty if I didn't spend some time explaining some of the other ways to get paid by the CPP. By way of preamble, all of the amounts mentioned below, except the death benefit, are indexed yearly against inflation. I have included the 2013 amounts for the various amounts listed in this article.

Death Benefits

To presumably help with funeral costs, the CPP offers a death benefit. The exact amount is based on 6 months' worth of retirement benefits or, if you haven't started yet, 6 months of what you would have received if you had died at 65. While this may look like a significant chunk of change at first glance , the fine print is killer; the total benefit is capped at $2,500, no matter the size of your pension. Moreover, this amount is taxable.

To get this benefit, someone (usually your spouse or executor) has to apply for it. In some cases, funeral homes might assist with filling at the form. As of the time of writing, CPP advises that it will take between 6 and 12 weeks for the cheque to arrive once they have received the application.

Survivor Benefits

If your spouse or common-law spouse passes on, you are eligible to apply for CPP survivor benefits. What you get depends on a variety of factors, such as your age at the time of death, how much the deceased has paid in and whether you are already receiving other CPP benefits.

If you are between 45 and 65, your monthly pension is based on a flat fee of $176.95 plus 37.5% of the deceased's retirement pension or what s/he would have received if 65 at death for a maximum monthly benefit of $556.64. If you are under 45 but qualify for CPP disability benefits (which require a permanent or prolonged disability that prevents you from any type of employment) or are raising the deceased's children, you also get full survivor benefits. If you are between 35 and 45 and aren't disabled or raising the deceased's kids, your pension is reduced by 1/120 for every month you were under 45 at the time of the deceased's passing. If you are under 35 and don't fit either of the exceptions, you won't get any survivor pension until age 65.

Once you turn 65, your survivor pension is calculated by a different formula. For many of us, we have already started our own CPP survivor pension at that point. If you are already on your CPP retirement pension, your combined survivor and retirement benefit is capped at the maximum retirement pension you could have received based on your age when you started your retirement pension. If you start your pension at 65, your combined pension is capped at $1,012.50. As pointed out in the last article, this amount permanently decreases for each month you receive your pension prior to turning 65. To underscore the key catch in this calculation, no matter how long the deceased has paid into the pension, your combined survivor / retirement benefits are capped at the maximum retirement pension for your age of retirement. If you are already receiving the maximum retirement pension, this means that you will no longer receive any retirement benefit from age 65 onward.

If, on the other hand, the survivor has not paid into CPP, s/he would receive 60% of the deceased's pension from age 65 onward. If you lie somewhere between the maximum retirement pension and no retirement pension at all, the top up to your existing pension is determined by a complicated formula that I don't have the heart to repeat. I do want to answer one common question, however, before moving on; the survivor remains eligible for survivor benefits even if s/he remarries.

Orphan's Benefits / Benefits to Children of Disabled Parents

If the deceased leaves behind dependent children (minors or children up to age 25 attending a recognized post-secondary educational institute), they qualify for a flat-fee of $224.62 if the deceased had paid into the plan for a minimum period. Despite the name, children do not have to be truly orphaned to get this benefit; children with a surviving parent are still eligible.

Children of a parent who qualifies for the CPP disability pension also get the same flat fee on the same terms, assuming the parent remains disabled.

CPP Disability Benefits

As stated earlier, it is not easy to qualify for these benefits. The disability must be, "severe and prolonged, and must prevent you from being able to work at **any job** on a regular basis." As well, you must have paid into the plan in at least 4 of the last 6 years or, if you have paid in for 25 years, at least 3 of the last 6. There are a few exceptions to these requirements, such as if you were taking care of young children during that period, that I will not go into.

In any event, disability benefits are calculated as follows: 75% of your projected retirement benefits plus a flat amount of $453.52) for a current maximum benefit of $1,212.90. If you are already receiving a survivor benefit, your maximum combined benefit is capped at the maximum disability amount. In other words, if would have already qualified for the maximum disability pension based on your own contributions, you will not really receive any survivor benefits until you are no longer disabled or until you turn 65, which is when disability benefits stop anyway.

Conclusion

There you have it – a list of the various other benefits that you or your loved ones may receive under the CPP, excluding retirement benefits. Now that we have put this behind us and assuaged my guilt, we can focus our attention on retirement benefits. Unfortunately, that will have to wait until next time, for which I do not feel guilty at all.

You, Me and the CPP – Part 3
Introduction

Introduction

If you have made it through my first two articles on the CPP (little of which actually discussed retirement benefits), congratulations. It is now time to make amends and drill down into the heart of the CPP – the retirement pension. More specifically, I shall talk about the things you can do to maximize your benefits and minimize the tax bill. As well, I will also discuss some of the other considerations to keep in mind when making your pension decision. At the end, I have also assembled an insane amount of links to help you learn more about your CPP and even calculate your potential benefits. As in the previous figures, all CPP amounts are based on 2013 entitlements. These amounts are indexed to inflation and, barring disaster, will increase over time.

CPP Retirement Pension – Recapping and Elaborating

When you start your benefits has a huge difference in your monthly payments. Although pension entitlements are based on the assumption you will start collecting when you turn 65, you actually have the option of starting as early as age 60 or delaying until as late as your 70^{th} birthday. As stated in my first article, your pension will be reduced for each month you start prior to turning 65 and bumped up for each month you delay after that point until you turn 70. The adjustments for early or late starts are in the process of being tweaked, but after these changes have been fully implemented, your pension at age 60 will be 64% of your age 65 entitlement, while you will get 142% of your age 65 entitlement if you decide to wait until age 70 to begin cashing in. In other words, when deciding the best time to start your pension, part of your consideration will likely be whether it makes sense to take less each month but start earlier or wait for a larger payday in the future in the hope that you live long enough to justify your delayed gratification.

The current maximum retirement pensions at the different ages are as follows (although those of you who crunch the numbers will see that the adjustment for an early start aren't yet as drastic as indicated above, as the gradual increase in the penalty won't be fully implemented until 2016):

- If you start your pension at age 60, your maximum monthly entitlement will be: $684.45;
- If you start age 65, you will get $1,012.50 each month; and
- If you wait until 70, you will receive $1,437.

Other Adjustments to Your CPP Entitlement

There are a few other factors that might affect the size of your CPP retirement pension or how much of it you actually keep, after taxes and reductions to other benefits, including:

- **The "Childrearing Dropout Provision."** You can apply to exclude any years in which you were the primary caregiver of a child under 7 from your CPP retirement benefit calculations. Currently, your pension is based on an average of about your 40 best contribution years between 18 and retirement. Excluding low or no income years will likely bump up your average and increase your monthly pension cheque. For example, if you stayed home for 4 qualifying years, CPP would now look at essentially your best 36 years and excluding any income earned during those 4 years from their calculations. If this applies to you, you don't have to apply for the people at CPP to recalculate your pension until you are also applying to receive your retirement benefits.

- **Time On A CPP Disability Pension.** This provision works a lot like dropout provision; any years you were receiving CPP disability benefits will be dropped from your retirement pension calculations. For example, if you qualified for 10 years of disability payments, your retirement pension will be based on essentially your best 30 years of employment rather than your best 40. If you are on a CPP disability pension, you might wish to delay starting your CPP retirement pension until 65, as your disability benefit will stop when your retirement pension starts, the disability benefit might be larger than the retirement benefit anyway and your retirement pension will be larger at 65 than if you start ahead of schedule. Put another way, it usually doesn't make sense to take a reduced retirement pension before age 65 if you are on a CPP disability pension.

- **Whether You Are Receiving A Work Pension That Is Fully Integrated With CPP.** In some cases, particularly if you worked for the Federal Government, your work pension includes a 'bridge benefit' that is integrated with the CPP. These bridge benefits are designed to pay out until you start taking your CPP retirement pension or age 65, whichever comes first, at which point the bridge benefit stops. In most cases, if the bridge benefit is significant, it likely doesn't make sense to take your CPP retirement pension before 65. Not only do you throw away extra years of bridge benefit payments, you also end up taking a smaller CPP retirement pension than you would have received if you had waited until the bridge benefit runs out at age 65. Not all government pension have their bridge benefits integrated like this. For example, pension plans sponsored by the B.C. government generally continue paying bridge benefits until age 65 even if you start your pension before then.

- "**Credit Splitting" After A Divorce Or Upon The End Of Common-Law Relationship.** Unless the Divorce Order or Separation Agreement says otherwise, the CPP credits earned by both partners during their time together from 1977 onward may be subject to division. If both partners maximized contributions, this provision won't affect pension payouts. If, however, one partner stayed home while the other worked, the working spouse might end up with a lot smaller pension at retirement than s/he might have anticipated and vice versa. There have been many changes to the rules and requirements over time, such as allowing for common law spouses and, then later, same sex spouses. In some cases, there are time limits for applying for the split and requirements that the relationship lasted for a minimum time period. If this might apply to you, I suggest checking out the link below for more detailed information.

- **"Pension Sharing" Between Retired Spouses Or Partners.** If there is a big difference between retirement incomes or if government-related benefits are affected, spouses may be better off applying to share their pensions. If they both agree in writing, all of the pension amounts they earned while together can be pooled and divided equally, with 50% taxed in each of their names. For example, assume that Jack receives $1,000 per month and is in a higher tax bracket that Jill, who gets a pension of only $200 each month. Further assume they have been married since they both turned 18. After applying, they would each receive $600 per month and, since Jill is in a lower tax bracket, their combined tax bill will go down. You must apply for pension sharing and can only do so when both spouses are started their pensions or are applying to start their retirement pensions.

- **Whether You Are Working Between 60 and 65.** If you stop work at 60 and have some other employment gaps in your past, the amount of your pension you might receive at 65 might decrease if you don't start your pension at 60. As your pension is based on about 40 years of work history, some of your zero income years between 60 and 65 might drag down what you would get at 65 if you don't have 40 years of solid contributions, although this reduction is usually a lot less than the discount you pay for starting your pension early. The calculator linked in below or the people at CPP can help you calculate how this will affect your potential benefits.

Other Factors to Remember When Deciding When to Start Your CPP Pension

- **Post-Retirement Benefits And Continued Contribution Requirements.** In the past, starting your CPP retirement pension meant stopping paying into the plan. Now, not so much. Even if you are on pension after age 60, you (and your employer, which includes you if you are self-employed) must continue paying into the plan until age 65. Contributions after 65 are voluntary until age 70. To ease the pain, the Feds created a new benefit called the Post Retirement Benefit or "PRB." Each January after you have started your retirement pension and have paid CPP premiums during the previous year, you get a small additional indexed payment each month for life based on how much you paid in. At this point, if you made the maximum contribution last year, your benefit is $25.31 per month, which is about enough for breakfast for two (if you don't order the freshly squeezed juice).

- **Size of your Partner's CPP Pension.** As mentioned in Part 2, if both partners are already getting the maximum retirement pension, there will be no survivor benefits (excluding the $2,500 death benefit and orphan benefits) on the first passing. Some people may decide that it makes sense to start both pensions as early as possible, especially if one of them is in poor health, in order to ensure that they at least get something out of their CPPs.

- **Life Expectancy.** The decision as to when to start your CPP benefits may also be influenced by your health and life expectancy. If you start your pension early, you will be getting less per months but will start collecting your payments up to 5 years earlier. To determine if this makes sense, you will need to determine your "break even age," which is the point when the larger cheques you get by putting off your pension until age 65 (or later) have paid you enough to compensate you for the money you have given up waiting. I have attached a link to a government presentation on the subject, although I suggest taking it with a grain of salt – a lot depends on your assumptions of how the money you get early performs for you and also assumes that you are in the same tax bracket throughout. I attended a presentation on the CPP

in January and noted that the breakeven age for holding off on your pension in most cases ranged from your early to late 70's using the presenter's assumptions. For those of you curious about your life expectancy, check out the calculator I have attached below. For many of us, however, we will likely live longer than we expect if we are currently in reasonable health.

- **Tax Situation.** Most people who crunch the numbers on starting your CPP early assume that you are in the same tax bracket throughout your retirement. In many cases, this is a dodgy assumption. Many of us continue to work full part time after retirement, which may directly impact how much of your CPP you will actually get to keep. For example if you start your pension at 60 but continue earning the big bucks until 65, the extra tax you will be paying on the money until then means that the real "break even age" for your pension will come a lot sooner than if you were only paying 20.06% tax on the money until 65. On the other hand, perhaps somebody worried about their OAS pension being clawed back (i.e. if their taxable income exceeds $70,945) once they turn 65 might want to start their CPP early (although they also have the choice of also postponing the start of their OAS pension as well) so they can reduce their taxable income after age 65. On a similar note, people with large RRSPs or RRIFs may worry about big tax bills and OAS clawback may need to plan ahead to minimize their taxes and benefit clawbacks.

- **Lifestyle Goals.** I went to a retirement seminar a few years ago that broke retirement into 3 phases: the go-go years, the slow-go years and the no-go years. Of course, most of us cannot predict when each of these phases will start (or end). I recently came across a scary term called the "Disability-Free Lifespan." According to the Globe and Mail, in 2011 Canadians could expect to live disability-free until 68.6 even though their average lifespan was 81.4. Although this stat should also be ingested with salt, it does suggest that many of us won't have as long a "go-go period" as we might expect. Accordingly, if it really important to see the pyramids or go snorkeling off of the Great Barrier Reef, then maybe it makes sense to take your CPP early to help you fund chasing these dreams while you are able. I would feel even better about this decision if you had insurance like Long Term Care Insurance to help with the health costs by the time you hit those "no-go years."

- **Opinion on the CPP's Future Solvency.** In a nutshell, if you don't think that the CPP is going to be able to pay the promised benefits into the future, you might want to cash in when you can. I have attached an article put out by the federal government on the plan's solvency for those of you that are interested. Although I am often been accused of being a starry-eyed dreamer, I remain relatively optimistic about the CPP at this point.

- **Income Needs And Expenses.** Quite simply, if you need the money, you need the money. On a related note, part of your decision on when to start your benefits may depend on what you plan to do with it. For example, if you have credit card debts charging 28% interest, the benefits of starting your CPP as soon as possible likely push back the "breakeven age" significantly, since most assumptions assume a significantly lower rate of return on your money if you start getting those cheques ahead of schedule.

- **Risk Tolerance.** In my experience, many people get hung up on concepts like the “break-even point” when deciding when to start their CPP; they want to make sure that they get as much out of CPP as possible in the event that they died relatively young. While I also hate leaving money on the table, I don’t think this should be the only factor in your decision. One of those factors is the possibility that we might live to 100 like my grandfather. As for me, if I die in my 60’s, I will have lost out if I decide not to start my pension on my 60th birthday. On the other hand, so long as I have enough money to live the life I wanted until I pass into the great beyond, my pension decision doesn’t really affect my lifestyle. Conversely, if I start my pension at 60 and live to 100, there might be a real chance of me pinching pennies in my 90’s. In other words, the downside of starting my pension early and living to a ripe old age seems a lot larger than me missing out on a few dollars early in my retirement that I really didn’t need anyway. Although this is just my personal philosophy and I expect that others will differ, I am willing to risk losing the CPP game if I die ahead of schedule more than I am willing to risk missing out on decades of indexed pension benefits.

Conclusion

If you started reading this article looking for a magic formula for determining the best time and way to start your CPP, I am sorry disappoint you; unfortunately, the CPP (nor life for that matter) does not work that way. In the past, planners generally recommended starting as soon as possible in most situations. Of course, that was before the penalty for starting a pension ahead of schedule increased and before the recent change that requires workers to continue paying into the plan until 65 even if on pension (despite at least now also receiving PRB benefits). If pushed, I would acknowledge that many planners still suggest taking your benefits as soon as possible, but I still think that is approach is too simplistic and a lot depends on your personal circumstances and whether you can afford to risk living to 100 on a pension was reduced by 36% because you started it 5 years early. On the other hand, despite a lack of a clear conclusion, I am hopeful that you have a better understanding of your choices, ways of getting the most out of the plan and the key factors to keep in mind when making your decision. I do suggest checking out the links below, especially the one that calculates your potential CPP benefits, or calling the surprisingly friendly folks at CPP to get them to help you crunch the numbers. In the meantime, best wishes for a wonderful Easter and may your future be CPP Disability benefit-free!

Useful Contacts

http://www.servicecanada.gc.ca/eng/isp/statistics/rates/infocard.shtml This is a link to a federal government site that tells you the current rates for the CPP and OAS pensions, as well as similar benefits, and how some of them are calculated:

http://www.servicecanada.gc.ca/eng/isp/common/proceed/socinfo.shtml

If you want to see your current CPP entitlements and get some estimates of your future benefits, this is the place to go. If you prefer the personal touch, you can always just call the folks at CPP at 1-877-454-4051.

http://www.servicecanada.gc.ca/eng/isp/pub/factsheets/cppretirement/applying.shtml

Here is a link telling you how to apply for the pension (they suggest doing so 6 months before your planned start date) and some of the things to consider when deciding when to start:

http://www.servicecanada.gc.ca/eng/isp/cpp/soc/50-70/willbethere.shtml

This is an article that discusses that solvency of the CPP

http://www.servicecanada.gc.ca/eng/isp/pub/factsheets/credit.shtml

Here is an article from the federal government website that elaborates on the rules and requirements for splitting credits after a divorce or the end of a common law relationship:

http://www.hrsdc.gc.ca/eng/oas-cpp/legislation/bill_c51/tech_pres/page00.shtml

Here is another article from the federal government. This one provides an overview of the changes and some calculations of the 'break even' for people who start their pensions at different points in time.

http://www.livingto100.com/ Here is a life expectancy calculator that I came across a few years ago. Most of us underestimate how long we will likely live based on the statistics, especially if we have already made it to our 50's and 60's and survived some of the things that most commonly take us middle-aged people out of the picture early.