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FINANCIAL ADVISORY SUPPORT

New Changes for CPP Pensioners Coming

Changes may penalize those taking CPP pensions early

On December 15, 2009, several changes to the Canadian Pension Plan (CPP) recommended by the federal, provincial and territorial governments became law with the passing of Bill C-51. The new rules will gradually restore the pension adjustments for early and late CPP take-up, remove the work cessation test, mandate plan participation for working beneficiaries under age 65 and enhance the general drop-out provision.

These new changes will be gradually phased in over five years starting in 2011. However, the changes will have no impact on you if you are already receiving a CPP retirement pension, disability benefit, survivor benefit or combined benefits, or if you will begin to receive these benefits in 2010. The CPP operates throughout Canada, except in Quebec, where the Quebec Pension Plan (QPP) provides benefits.

Once the new changes come into effect for early CPP take-up, if you are between the ages of 60 and 65 and plan to apply for a CPP pension early your benefits may be reduced.

Details of these changes, including when they come into effect, are discussed below.

PENSION ADJUSTMENTS FOR EARLY AND LATE CPP TAKE-UP

Current rules – If you decide to collect a CPP pension early (i.e. before age 65) or instead wait until after you are age 65 to take-up your CPP, there are downward or upward adjustments to the calculation of the monthly pension benefit you will receive.

If CPP is collected early, your CPP pension benefit is reduced by 6% per year or 0.5% per month for each month that the pension is taken before your 65th birthday to a maximum of 30% over 5 years. For example, if you take-up your pension as early as age 60, the pension benefit would be reduced by 30% (5 years x 12 months x 0.5%).

If CPP is not collected until after age 65, your CPP pension benefit is increased by 6% per year or 0.5% per month up to the age of 70 to a maximum of 30% over 5 years. If you wait until age 70 you will receive an increase of 30% of your basic CPP benefit.

New rules – The percentage amounts used to reduce or increase your CPP pension benefit if you take-up your pension early or late will increase gradually.

For early CPP take-up, there will be a reduction in benefits by 7.2% per year or 0.6% per month for each month that the pension is taken before age 65 to a maximum reduction of 36%. This increase will be implemented gradually over a five year period beginning in 2012.

For late CPP take-up, there will be an increase in benefits by 8.4% per year or 0.7% per month for each month that the pension is taken after age 65 and up to the age of 70 to a maximum increase of 42%. This increase will be implemented gradually over a three year period beginning in 2011.

If you plan to start receiving early benefits under the CPP between the ages of 60 and 65, and if you apply for benefits in 2012 or later, the new changes could reduce the benefits you will receive. This may influence your decision on whether to take a CPP pension early.

Removal of work cessation test for early CPP take-up

Current rules – Before 2012, in order to apply for CPP benefits early, from age 60 to 64, you must either stop working by the end of the month before your CPP retirement pension begins and during the month in which it begins, or your earnings must be less than the current monthly maximum CPP retirement pension benefit in the month before your pension begins and in the month it begins.

New rules – Starting in 2012 the requirement to stop working or significantly reduce your earnings to take-up early CPP will no longer apply.

These new rules allow you to take-up your CPP pension while continuing to work, which may help you phase into retirement or supplement your employment earnings. For example, with a CPP pension, you may be able to reduce your work hours and still maintain roughly the same income from the combined CPP and reduced employment earnings.

Mandatory contributions to CPP for CPP pensioners under age 65

Current rules – Currently, if you are retired and receive CPP pension benefits and decide to go back to work, you are not required to restart contributions to CPP on your salary or wages. With the current rules, once you start receiving your CPP pension, you can work as much as you want but you are not required nor will you benefit from any further contributions made to CPP.

New rules – If you are under age 65 and are receiving your CPP monthly pension and continue to work, you and your employer are required to continue to contribute to CPP. If you are between the ages of 65 to 70 collecting a CPP pension and continue to work, the decision to continue to contribute to the CPP is voluntary so you may elect not to make CPP contributions. However, if you opt to participate in the CPP your employer will be required to also contribute. These contributions will result in increased retirement benefits.

Although these new changes require that you continue to contribute to CPP, if you take an early CPP and continue to work, they also enable you to increase the amount of the CPP benefits you will receive. The additional contributions after CPP take-up are intended to increase your retirement benefits at a rate of 2.5% of the maximum pension amount per year of additional contributions.

Depending on your earnings level, these changes have the potential to increase your CPP pension above the maximum monthly benefit limits.

Increase in general low earnings drop-out

You can apply to begin to receive a monthly CPP pension benefit between the ages of 60 and 70. The amount of your benefit depends on how many years you contributed to the plan, the amount of your contributions, and the age at which you decide to start receiving your pension. Your benefit is calculated as 25 percent of your “average career earnings”, starting at age 18 and ending at the age of CPP take-up. However, there is a general adjustment in the calculation that allows for a “drop out” of certain periods of low or no income. In addition, there are certain drop-out provisions such as for child rearing and for periods spent receiving a CPP disability benefit. When these periods are excluded there is the potential to increase your monthly CPP benefit up to the maximum amount.

Current rules – Before 2012 the general drop-out provision is 15% of the years where your earnings are low or nil. For example, the contributory period if you are age 60 when you take-up CPP is 42 years (age 18 to 60) and 47 years if you are age 65. Therefore, if you take your CPP at age 65 your CPP benefit calculation will drop almost 7 years of low or zero earnings.

New rules – The general drop-out provision will increase to 16% in 2012 and 17% in 2014. This will allow a maximum of almost 7.5 years of low or zero earnings to be dropped in the CPP benefit calculation for years 2012 to 2013 and 8 years of low or zero earnings to be dropped starting in 2014.

These changes can increase your CPP pension benefit if you have multiple years of low or no income years, which may have resulted from pursuing educational opportunities, caring for family members, or due to entering the Canadian workforce later in life because you immigrated to Canada as an adult. Since the average CPP disability and survivor pensions are based on the retirement benefit calculation, the new rules can increase the average CPP disability and survivor pensions as well.

Summary

If you are between the ages of 60 and 65 and plan to take-up your pension early, you should consider how the new changes to CPP may influence your decision. The increase in the low earnings drop-out may increase the amount of your pension benefit if you had years of no or low earnings, however, the amount of the pension adjustment is also increasing which will reduce your pension benefit amount with early CPP take-up. You will be able to continue to work without reducing your earnings, but you will be required to continue to make contributions to CPP at least until age 65. These additional contributions will increase your CPP pension.

Based on your projected lifespan, coupled with your cash flow requirements and your overall health you can determine whether it makes sense in your particular circumstances to apply early for CPP benefits.



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