TD Wealth

Canada Pension Plan: Retirement Pension Overview

The Canada Pension Plan (CPP) was created in 1966 to provide basic benefits to contributors and their dependents when they retire, become afflicted with a disability or die. The CPP operates across Canada with the exception of Quebec, where the Quebec Pension Plan (QPP) is administered by the Régie des rentes du Québec.

There are three types of CPP benefits:

- **Retirement pension** – monthly income benefits paid to individuals who have contributed to the plan;
- **Disability benefits** – provides financial assistance to contributors with a disability and their dependent children;
- **Survivor benefits** – includes a one-time death benefit, a survivor's pension and a dependent children's benefit.

This article focuses on the CPP retirement pension and the new Post-Retirement Benefit. It will outline:

- The basis for contributions
- The eligibility criteria
- Instructions on how to apply for the CPP

Overview

The CPP is a contributory based program that is funded by contributions made by employees, employers and the self-employed, along with additional revenue earned on CPP investments.

The CPP retirement pension is designed to replace approximately 25% of the contributor's average pre-retirement earnings, up to a maximum amount and is indexed to the Consumer Price Index (CPI) annually.

In 2009, the federal Government made changes to the CPP to better accommodate the ways Canadians live, work and retire. These changes will be phased in gradually from 2011 to 2016. Throughout this article, we will briefly outline the changes in text boxes and examine how these changes may impact your benefits. For more information, please refer to our article "Changes to the Canada Pension Plan".

Contributions

Who contributes to the CPP?

Generally, every person in Canada over the age of 18 earning a salary of more than the basic exempted amount of $3,500 must contribute into the CPP. Individuals who are receiving CPP/QPP disability benefits do not have to make contributions to the CPP/QPP.

The CPP contributions are equally shared between the employer and the employee. If self-employed, the individual is required to pay both the employee and employer contributions based on net business income before tax.

If the individual is working and has not started their CPP retirement pension:

- **Under the age 70**: contributions into the CPP are mandatory or;
- **Age 70 or older**: contributions into the CPP stops.

If the individual is working and has started their CPP retirement pension:

- **Under the rules up to 2011:** contributions into the CPP must stop even if they continue to work.
- **Under the rules in 2012:** contributions into the CPP are mandatory under age 65 and voluntary from age 65 to 70.

Starting in 2012, the additional contributions made while the contributor is working and receiving CPP retirement pensions will form the newly created Post-Retirement Benefit (PRB). These subsequent contributions will allow the pensioner to continue building their PRB even if they are entitled to the maximum CPP retirement pension.

As indicated earlier, beginning in 2012, if an individual is working and receiving their CPP retirement pension:

Under the age 65: employees and their employers will have to make mandatory CPP contributions. Self-employed individuals will have to pay both portions.

Age 65 to 70: employees can either choose to make CPP contributions or opt out of making these contributions. If the employees choose to make the contributions, their employers will have to make matching contributions. Self-employed individuals who choose to contribute will have to pay both employee and employer portions.

How much am I required to contribute?

Contributions are based on annual pensionable earnings which are set between a minimum and a maximum level. The minimum level is currently set at $3,500 while the maximum level is determined by the Year's Maximum Pensionable Earnings (YMPE). For the 2011 taxation year, the YMPE is $48,300. The contribution rate, as of 2011, is 9.9% based on pensionable earnings and is split equally between the employer and employee (i.e. the maximum employee or employer CPP contribution for 2011 is $2,217.60 [($48,300 - $3,500) x 4.95%]). If you are self-employed your contribution rate is 9.9%.

Eligibility

When can I qualify for CPP retirement benefit?

Even a single contribution into the plan during an individual's working years makes them eligible for some form of CPP benefits.

Under the rules up to 2011: An individual may start receiving their CPP retirement benefit if they are:

- At least age 65 or older; or
- Between the age 60 and 64 and satisfy the work cessation test.

In order to satisfy the work cessation test, the contributor must meet the following conditions by the end of the month prior to the start of the CPP pension and during the month CPP pension starts:

- Stopped working or
- Earning less than the current monthly maximum pension (Maximum monthly CPP retirement pension is $960 in 2011).

Under the rules in 2012: an individual may start their CPP retirement benefit as early as age 60 without satisfying the work cessation test.

How much will I be entitled to?

CPP retirement pension payments are based on how much and how long an individual has contributed into the CPP and the age at which they start collecting payments. The maximum monthly CPP retirement pension is $960 in 2011.

Depending on the pensioner's benefit start age, here is a summary of how their retirement pension amount may be affected:

- **Between age 60 and 64:** for each month before age 65, eligible pension amount will decrease by 0.5% per month to a maximum of 30%. The reduced benefit amount is set when benefit starts and it will remain fixed;
- **At age 65:** entitled to the full pension amount based on the individual's contributions;
- **Between age 66 and 70:** for each month after age 65, eligible pension amount will increase by 0.5% per month to a maximum of 30%. The benefit amount is set when benefit starts and it will remain fixed.

The early pension reduction rate will gradually increase from 0.5% to 0.6% to a maximum of 36% from 2012 to 2016. Similarly, the late pension will gradually increase from 0.5% to 0.7% to a maximum of 42% from 2011 to 2013.

With the newly introduced PRB, individuals may continue to add to their existing CPP retirement benefit amount while working. PRB payments are in addition to the retirement pension amount even if the recipient is entitled to the maximum CPP retirement pension. PRB will be equal to 1/40 of the maximum pension amount ($11,520 in 2011) per year of additional contributions. PRB will also be adjusted based on the contributor's earnings level (in relation to the YMPE) and age. Similar to the CPP retirement pension, PRB payments will be indexed to the CPI starting in 2013.

Drop Out Provisions

In order to maximize your pension entitlement, the CPP allows for certain adjustments to be made to minimize the impact of 'low income' or 'no-income' years.

The portion of the contributory period that is excluded from the calculation includes:

- Time spent caring for children under the age of seven, often referred to as the Child Rearing Dropout Provision;
- Low earning months after the age of 65.
- The months an individual was eligible for CPP disability benefits;
- 15 percent of the contributory period in which earnings were lowest (approximately 7 years of lowest earnings).

In 2012, the general drop-out rate percentage for the lowest earning is 16% (approximately 7.5 years) and 17% (approximately 8 years) in 2014.

For example, if an individual contributed to CPP for 47 years, 16% of this time period (approximately 7.5 years) will be excluded from the benefit calculation, potentially allowing for a larger CPP benefit.

Survivor's Pension

A surviving spouse or common law partner may be eligible for CPP survivor benefits upon the death of a contributor who has made sufficient contributions to the plan.

A CPP retirement pension can be received in conjunction with CPP survivor pension; however, the maximum that can be received from the combined benefit is the maximum retirement pension (i.e. $960 per month in 2011).

Example: Pat, a 65 year old widow, was receiving a CPP retirement pension of $500/month, prior to the death of her spouse, Nicky. Upon Nicky's death, Pat is entitled to receive up to 60% of Nicky's CPP retirement benefit but the combined payment cannot exceed the monthly maximum. Nicky was receiving a maximum CPP payment of $960/month. To establish Pat's entitlement:

- $960x 60% = $576
- $576 (Survivor Benefit) + $500 (Pat's CPP Benefit) = $1,076

Pat's CPP combined payment will only be $960/month, since she cannot exceed the monthly maximum payment (based on maximum payment in 2011).

What if I live outside of Canada?

A retiree who is eligible to receive CPP retirement pension does not need to live in Canada to receive the payment. The pension payment can be made to any location in the world. However, a non-resident tax of 25% will be withheld from the payment unless it is reduced or exempted by a tax treaty between Canada and the country of residence.

What if I worked and lived in another country?

If an individual has worked in another country during their contributory period, they may get pensions or benefits from either country. Time spent in the other country may be added to the contributory period eligible in Canada. If an individual has worked in another country during their contributory period, they should contact Service Canada to determine if Canada has a social security agreement with that country.

Statement of Contributions

The CPP Statement of Contributions provides individuals with information on their earnings and contributions into the CPP. The statement also provides an estimate of how much the monthly retirement pension could be at age 65, based on their average earnings from age 18, on the assumption that the earnings will continue at the same level until age 65. In addition, the statement provides estimates of disability and survivors' benefits that are provided under the plan. To request a copy of the statement, visit Service Canada at www.servicecanada.gc.ca.

How Do I Apply?

An individual must apply for the pension to initiate payments unless they have been receiving CPP disability income. Individuals aged 65 who are receiving CPP disability benefits will have this benefit automatically convert to a CPP retirement pension. An application should be filed approximately six months before the income is anticipated to begin. Visit the Service Canada website to apply online or complete an application form.

If an individual has applied for CPP retirement benefits before his or her 65th birthday and the pension payment had not as yet begun, the request can be converted to a CPP disability benefit if the individual becomes afflicted with a disability.

An individual can discontinue his or her CPP retirement pension up to six months after it starts. CPP pension payments must be reimbursed; and CPP contributions must be paid on any employment earnings realized while receiving the pension. An individual may want to do this to receive a larger CPP pension in the future.

What if I Contributed to both CPP and QPP

If an individual who has contributed to both CPP and QPP over their work life, they should apply for benefits to:

- QPP, if he or she lives in Quebec at retirement or
- CPP, if he or she lives elsewhere in Canada.

For more information on your CPP benefits, please contact Service Canada at www.servicecanada.gc.ca

Revised 13/09/2011