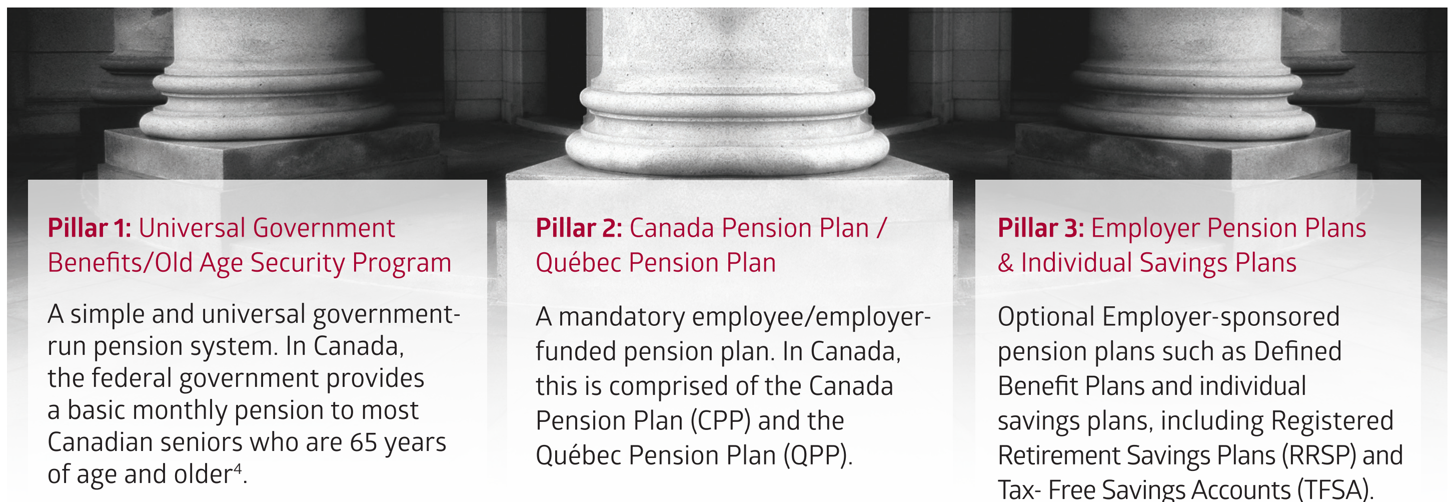
CANADIAN RETIREMENT PENSION SYSTEM

As Canadians, we have the luxury of benefiting from one of the best pension systems in the world. Based on its adequacy, sustainability and integrity, Canada's pension system was ranked seventh in the world in 2015, ahead of countries such as the United States, United Kingdom and France[1].

Canada's retirement pension system has enabled us to maintain one of the lowest poverty levels amongst other Organisation for Ecomonic Co-operation and Development (OECD)[2] countries, relative to an individual's average earnings[3].

Canada's pension system is built upon a 'three-pillar' retirement savings model, originally outlined by the World Bank. The goal of the three-pillar system is to fulfill the requirement for pensions through the following three components:



Pillar 1: Universal Government Benefits/Old Age Security Program

A simple and universal government-run pension system. In Canada, the federal government provides a basic monthly pension to most Canadian seniors who are 65 years of age and older[4].

Pillar 2: Canada Pension Plan / Québec Pension Plan

A mandatory employee/employer-funded pension plan. In Canada, this is comprised of the Canada Pension Plan (CPP) and the Québec Pension Plan (QPP).

Pillar 3: Employer Pension Plans & Individual Savings Plans

Optional Employer-sponsored pension plans such as Defined Benefit Plans and individual savings plans, including Registered Retirement Savings Plans (RRSP) and Tax- Free Savings Accounts (TFSA).

PILLAR 1 – UNIVERSAL GOVERNMENT BENEFITS / OLD AGE SECURITY PROGRAM

The Old Age Security (OAS) program was designed to provide a basic monthly pension to Canadians who are over the age of 65. Payments are based on the number of years an individual resided in Canada since the age of 18. OAS benefits are adjusted for inflation four times a year to reflect any increases in the cost of living, as measured by the Consumer Price Index. The OAS program consists of the Old Age Security Pension, Guaranteed Income Supplement (GIS) and the Allowance.

Old Age Security Pension

The OAS pension is a monthly, taxable benefit provided to most Canadians who are over the age of 65, and who resided in Canada for at least 10 years since they were 18 years old. You have the option to defer receiving your OAS pension for up to 60 months after the date you become eligible, in exchange for a higher monthly payment.[5]

Generally, to receive a full pension, you must have been a resident of Canada for at least 40 years after turning 18 years old. Individuals who worked outside of Canada may be able to include their time working abroad towards their residency in Canada if they were employed by a Canadian employer or by an international organization. If an individual spent less than 40 years in Canada, they would be eligible to apply for a partial OAS pension. The partial pension payments would be equal to 1/40th of the full monthly pension payment for each full year of residency in Canada, since the individual turned 18 years old.

High-income individuals must pay back some or all of their OAS pension if their annual net income exceeds a certain threshold, as determined by the Canada Revenue Agency (CRA). To determine the net income thresholds that would require a claw back of your OAS pension, visit the Government of Canada's website at https://www.canada.ca.

If you are required to repay part of your OAS pension in any given year, a specific amount will be deducted from future OAS payments as a Recovery Tax[6]. These repayments are spread out over a 12 month period rather than applying a large lump sum payment due when you file your income tax return.

If you live outside of Canada, you can continue to receive an OAS pension only if you were a resident of Canada for at least 20 years after turning 18 years old. If this requirement is not met and you cease to be a resident of Canada, OAS pension payments would only be payable for six months following your departure from Canada.

If you receive an OAS pension while residing outside of Canada, a non-resident withholding tax will be applied to your monthly OAS pension payments. The non-resident withholding tax is generally 25%, however, certain countries have a tax treaty with Canada that may reduce the non-resident withholding tax rate. A recovery tax may also be applied, depending on your country of residence, however, if non-resident withholding tax is applied to your monthly OAS pension payments, the amount of recovery tax that is applied is reduced accordingly.[7]

Guaranteed Income Supplement (GIS)

An individual who is eligible to receive an OAS pension, and has little or no earned income during a year, may be eligible to receive the Guaranteed Income Supplement (GIS), which is an additional monthly non-taxable benefit. The amount of GIS payments is dependent upon the applicant's annual income and marital status. If the individual is married or living in a common-law relationship, the couple's combined income is taken into consideration when determining the amount of GIS they will receive. Unlike the OAS pension, GIS is only payable for six months following the applicant's departure from Canada, irrespective of how long the person resided in Canada during their life.

Allowance

The Allowance is an additional benefit for individuals who are between the ages of 60 and 64 and who have a spouse or common-law partner who is receiving GIS payments. This benefit is aimed to lower the financial burden experienced by couples living on a single pension. When the individual starts receiving an OAS pension, the allowance will cease to be paid to the individual. The Allowance will also cease if the individual divorces or separates from their spouse or common-law partner, or if their spouse or common-law partner passes away.

Allowance for Survivor

Similar to the Allowance, the Allowance for Survivor is a benefit paid to individuals between the ages of 60 and 64 who have little or no earned income during a year, and whose spouse or common-law partner has passed away. It ceases once the individual is eligible to receive an OAS pension, or if the individual remarries, enters into a common-law relationship for more than 12 months, ceases to be a resident of Canada for more than six months, or passes away.

The current rates of monthly OAS, GIS, Allowance and Allowance for Survivor pension payments are available on the Government of Canada's website at https://www.canada.ca.

PILLAR 2: CANADA PENSION PLAN (CPP) / QUÉBEC PENSION PLAN (QPP)

The Canada Pension Plan (CPP) and Quebec Pension Plan (QPP*) are pension payments available to all working Canadians, funded by mandatory contributions from employers, employees and self-employed Canadians. To be eligible, individuals must be at least 18 years old and earn an annual income of at least $3,500. Contributions made by self-employed individuals are based on their net business income after expenses. The CPP/QPP may provide several benefits, depending on individual circumstances, including:

- Retirement pension
- Disability benefits
- Survivor benefits

* The QPP is a compulsory public insurance plan. Its purpose is to provide basic financial protection for those who work in Québec (or have worked in Québec) in the event of retirement, death or disability. For more information on the QPP, visit the *Régie des rentes Québec* website at http://www.rrq.gouv.qc.ca.

Retirement Pension

The CPP/QPP retirement pension is a taxable benefit that can be obtained by any individual who has made at least one valid contribution to the CPP/QPP. An individual can elect to receive their pension as early as age 60, or can elect to defer their pension up until they are 70 years old. The CPP/QPP retirement pension is protected from inflation and is adjusted annually to account for any increase in the cost of living.

The Post-Retirement Benefit (PRB) is a lifetime benefit that increases your retirement income and is adjusted to the cost of living, even if you are drawing the maximum pension from the CPP. Individuals between the ages of 60 and 65 who continue to work while receiving CPP pension payments are required to make mandatory contributions to the PRB. Contributions to the PRB are optional for individuals receiving CPP pension payments and are between the ages of 65 and 70. If you choose to make contributions to the PRB, your employer is also be required to make contributions.

Did you know?

Delaying your CPP retirement pension until you reach 70 years of age can increase your pension by up to 30% compared to the pension you would receive if you started receiving payments when you were 65 years old.

CPP pension payments are reduced by 0.60% for each month you begin receiving pension payments before the age of 65. Conversely, if you decide to delay your pension amounts, your CPP payments are increased by 0.70% per month.

For more information, please refer to the Government of Canada's website. Information regarding the adjustment factor for the QPP can be found on the *Régie des rentes Québec* website.

Disability Benefits

The Disability Benefit provides a monthly taxable benefit to individuals who have contributed to the CPP and who are disabled. Disability benefits may be available to you if you are under the age of 65, unable to work regularly, and are not receiving the CPP retirement pension. To be eligible, you must have made valid CPP contributions in four of the previous six years. If you have made at least 25 years of CPP contributions, this requirement is reduced and you must have made valid CPP contributions in only three of the previous six years. When you turn 65 years old, the disability benefit is automatically converted to a retirement pension.

Survivor Benefits

The CPP survivor benefit is paid to a deceased contributor's estate, surviving spouse or common-law partner and to their dependent children. There are three types of benefits:

- **The death benefit** is a one-time payment to, or on behalf of, the estate of a deceased individual who made CPP contributions;
- **The survivor's pension** is a monthly pension paid to the surviving spouse or common-law partner of a deceased individual who made CPP contributions. If the surviving spouse or common-law partner is already receiving a CPP retirement pension or disability benefit, the survivor benefit will be combined with the other benefits into a single monthly payment.
- **The children's benefit** is a monthly benefit for dependent children of a deceased individual who made CPP contributions. The child must be under the age of 18 to receive the benefit, or between the ages of 18 and 25 if they are attending a qualifying school or university on a full-time basis.

To qualify for the death benefit or children's benefit, the deceased individual must have contributed to the CPP for the lesser of one-third of the years they were eligible to make contributions, or 10 years.

NOTE: The current rates of monthly CPP/QPP payments, along with information on Disability Benefits and Survivor Benefits can be found on the Government of Canada's website.

FACTORS AFFECTING PENSION AMOUNTS

Drop Out Provision

The drop out provision allows an individual to exclude some years from their CPP pension calculations when they had little to no earned income. An individual is able to exclude up eight years of their earnings used to determine CPP pension payments.

Child Rearing Provision

The child rearing provision allows an individual to exclude some years from their CPP pension payment calculations when they had little to no earned income as a result of being the primary caregiver for their children under the age of seven. In order to qualify for the child rearing provision, an individual must have either stopped working or reduced the number of hours they work, be eligible for the Canada Child Tax Benefit or receive family allowance payments for children up until age seven.

Pension Income Splitting

Pension Income Splitting can potentially help avoid OAS claw backs for individuals earning a significant income and could result in income tax savings if one individual is in a lower tax bracket than the other.

An individual and their spouse or common-law partner are able to re-allocate their CPP/QPP pension to each other in order to minimize tax owing provided they are living together and one of the individuals contributed to the CPP and/or QPP. If both individuals contributed to the CPP and/or QPP, they may receive an equal share of the combined pension payments.[8]

The amount of pension that can be split is pro-rated based on the number of months that an individual has been married or in a common-law relationship in the contributory period, subject to the requirement that the total combined pension must be equally split or not split at all.

Marriage Breakdown

If a marriage or common-law relationship ends, the CPP/QPP pension that was accumulated by the individuals during their relationship can be divided equally. These credits can be split even if one of the individuals in the relationship made no contributions to the CPP/QPP.

PILLAR 3 – EMPLOYER PENSION PLANS & INDIVIDUAL SAVINGS

Employer Pension Plans

Many employers in Canada offer a form of pension to their employees to assist them with saving for retirement. Registered Pension Plans are registered with the CRA and the appropriate federal and provincial authorities, as applicable, and must comply with the Income Tax Act (Canada) and any pension standards rules put in place for each plan type. Depending on the employer, individuals may accumulate pension earnings through a defined benefit plan or a defined contribution plan during their years of service, to be paid out upon retirement.

Defined Benefit Plans

A defined benefit plan provides a pre-determined pension income and is calculated based on a formula that takes a number of factors into consideration, including years of service and salary levels. Retirement income is defined regardless of the investment returns. The employer is required to make up for any deficits in the plan if a prescribed rate of return is not achieved. When an employee retires, or otherwise leaves the employer, they will generally receive a pension payment from the plan or have the ability to receive the commuted value as a lump sum transfer to another registered plan that is generally locked-in with minimum and maximum withdrawal requirements.

Defined Contribution Plans

Defined contribution plans have a specific accumulated value made up of contributions to the plan, plus tax-sheltered investment earnings. The amount of contributions placed into the plan is known, but the eventual pension that the employee will receive upon retirement is unknown and depends on the market value of the plan at retirement. When an employee retires, the accumulated proceeds, including investment returns, will be used to provide an annual income through a life annuity or other registered product that is generally locked-in with minimum and maximum withdrawal requirements.

Deferred Profit Sharing Plans

A Deferred Profit Sharing Plan (DPSP) is funded by the annual profits of a company for the benefit of the employees. Taxes on employer contributions and investment income are deferred until the plan member receives the plan benefit. Employee contributions are not permitted in this type of plan. Upon retirement, an employee's share of a DPSP is generally transferred to their RRSP.

Group Registered Retirement Savings Plans

A Group Registered Retirement Savings Plan (Group RRSP) is a benefit that employers can provide to their employees. For employees, the biggest difference between contributing to a group RRSP versus an individual RRSP is that the contributions can be paid directly into the RRSP, and are generally contributed with pre-tax income; that is, tax is not deducted before the contribution is made. Employers may encourage employee contributions by matching them by a certain percentage, so long as this does not exceed the employee's RRSP contribution room. RRSPs are owned by the employee who can elect to transfer the assets to another registered plan, redeem and/or add to the amounts. Employers can still maintain a degree of control by restricting withdrawals during the employment term.

INDIVIDUAL SAVINGS

Individuals can also save using personal savings vehicles, such as non-group RRSPs and Tax-Free Savings Accounts (TFSAs) to supplement their retirement income. Registered plans can be opened at financial institutions and investment firms across Canada. Individuals receive government support in the form of special tax measures and regulatory oversight with these plans.

Registered Retirement Savings Plans

An RRSP allows individuals to defer taxes on some of their earned income because they are permitted to deduct the amount of any RRSP contributions, up to their RRSP contribution limit. Furthermore, as long as funds remain within an RRSP, investment returns are not taxable. Over the long-term, the tax-sheltered compounding of investment returns can add up to a significant advantage.

Tax-Free Savings Accounts

A TFSA gives Canadian residents a way to save, tax-free. Contributions to a TFSA grow tax-free and no tax is paid on income earned within the account, even when withdrawn, unless an over-contribution is made. Contributions to a TFSA are made with after-tax dollars and cannot be deducted from annual income for the year. Annual TFSA dollar limits are determined by the Federal Government and are not based on an individual's earned income.

TFSA contributions can be made in addition to RRSP contributions; TFSA contribution room is not affected by contributions made into an RRSP or vice versa. Any withdrawals made from a TFSA are added back to an individual's TFSA contribution limit in the following year, excluding amounts withdrawn to correct an over-contribution.

We're Here To Help

There is no question that saving for retirement should be one of your primary financial planning objectives. After all, with Canadians living longer, you could be spending up to one third of your lifetime in retirement. While that period of your life may still be a few years away, it is crucial that you take the steps during your prime working years to safeguard your personal financial independence in retirement.

To ensure that you are on the right track for a comfortable retirement, or for further information on any of the topics discussed, please contact your CIBC Wood Gundy Investment Advisor.

1 http://www.theglobeandmail.com/globe-investor/retirement/retire-taxes-and-portfolios/canadas-pension-safety-net-is-strong-but-showing-strains/article28835663/

2 The OECD (Organisation for Economic Co-operation and Development) is an international organization of countries with highly developed economies and democratic governments. http://www.oecd.org/canada/44008042.pdf

3 http://www.oecd.org/canada/44008042.pdf

4 https://www.canada.ca/en/services/benefits/publicpensions.html

5 Old Age Security pension. Service Canada. October 2015

6 http://www.cra-arc.gc.ca/E/pub/tg/t4155

7 http://www.cra-arc.gc.ca/E/pub/tg/t4155/t4155-e.html#P43_1816

8 https://www.canada.ca/en/services/benefits/publicpensions/cpp/share-cpp.html

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