Deciding when to apply for your CPP Retirement Benefit

For Canadians who came of working age in the immediate post-war era and who retired before the advent of the new millennium (generally, the parents of today's baby boomers), retirement planning was a relatively straightforward proposition. For nearly all such individuals, a lifetime of working (often for a single employer) was followed, at age 65, by a complete departure from the work force, the start of collecting their Canada Pension Plan and Old Age Security benefits (often an employer-paid pension), and settling into a comfortable retirement.

To say that things have changed when it comes to making decisions about retirement is a huge understatement. Since the beginning of the millennium (over a decade and a half ago!) the pendulum has swung widely from the idyllic retirement picture shown in the "Freedom 55" ads, which now appear almost painfully optimistic, to the current reality. This reality has many baby boomers, those faced with multiple competing financial obligations and diminished investment returns, seeing their projected retirement date delayed further and further.

Part of what has complicated the retirement planning picture is, paradoxically, the fact that options for structuring retirement income, particularly from government-sponsored retirement plans, have never been greater. Flexibility in structuring retirement income is, of course, a good thing, since, like any other major life change, retirement can't be a "one size fits all" proposition. Nonetheless, increased flexibility means more choices, and with greater choices comes a greater burden on the individual to make the right decisions when it comes to structuring the timing of retirement income as most retirement plans, once made, can't be reversed.

While the available sources of retirement income will be different from one individual to the next, almost all Canadians are eligible to receive retirement benefits paid by the federal government. Those benefits come from two programs: the Canada Pension Plan (CPP) and Old Age Security (OAS), both of which have undergone significant changes in the last few years. Generally speaking, all of those changes provide Canadians with greater flexibility in determining when they want to begin receiving CPP or OAS benefits, but there are permanent financial consequences which follow from making that determination and, for CPP, those consequences are changing each year between now and 2017.

When the Canada Pension Plan came into being in 1966, retirement benefits were paid no sooner than the traditional retirement age of 65 with no exceptions. It wasn't until 1987 that the option to receive benefits as early as age 60 became available. It was always the case that receiving benefits before age 65 would result in a lower monthly benefit, but in 2009, however, changes were introduced which increased the "penalty" for accelerating receipt of benefits with those changes to be implemented between 2011 and 2017. The combined effect of all of these changes is that government retirement benefits, once paid at age 65 with no exceptions, can now be received any time between ages 60 and 70 (for CPP benefits) or between age 65 and 70 (for OAS benefits). All of this leaves Canadians who are approaching the age of 60 with a decision to make with respect to the CPP retirement benefit.

Just as there is no single retirement plan that fits everyone, there is no "right" answer when it comes to deciding when it's time to start accessing CPP retirement benefits. As is the case with pre-retirement income, the goal is to provide for an income stream sufficient to ensure a comfortable lifestyle while minimizing the tax bite on that income. In doing so, the following general tax considerations will apply to everyone:

- For federal tax purposes, taxable income of up to about $44,000 is taxed at a rate of 15%, while income between $44,000 and about $87,000 is taxed at a rate of 22%. Keeping those tax bracket thresholds in mind while planning an income stream can help minimize the tax hit.

- All Canadian resident taxpayers are entitled to claim a basic personal credit of about $11,000. Taxpayers aged 65 and older whose total income is less than about $34,500 can also claim an age credit of about $7,000. That age credit is reduced for those having income over the $34,500 threshold, and is unavailable to those with total income over about $80,000. Taken together, those two credits mean that taxpayers over aged 65 whose income is less than $34,500 can earn their first $18,000 in income effectively free of federal

tax. Similar credits and thresholds apply for purposes of provincial or territorial tax, but will differ in each jurisdiction.

•Canadians who have private retirement savings through RRSPs will be required to begin receiving income from those RRSPs by the end of the year in which they turn 71. It is, however, possible to withdraw funds (which are then fully taxable) from an RRSP at any age.

In addition to the general tax considerations listed above, there are additional tax rules which apply specifically to the receipt of CPP retirement benefits. As follows:

•All CPP retirement benefits received are fully taxable, regardless of the amount received or the age of the recipient.
•The federal pension income credit claimable on up to $2,000 in pension income cannot be claimed for CPP amounts received, no matter what the age of the recipient.
•The amount of CPP benefits receivable is unaffected by the total amount of the recipient's income (in other words, there is no clawback for CPP benefits such as currently under the OAS program).

There is, additionally, a further wrinkle to the decision on when to begin receiving CPP benefits in that the rules on the percentage by which a retirement pension is reduced for early receipt are themselves in a state of flux between now and 2017. The general rule provides that the monthly benefit is reduced by a fixed percentage for each month before age 65 by which receipt of benefits is accelerated. That percentage amount itself, however, will increase each year between 2012 and 2016 from 0.52% in 2012 to 0.60% reduction on a monthly basis.

As noted on the Service Canada website, these figures mean that for a person who applies for and receives their CPP retirement pension beginning at age 60, the effect will be a maximum reduction of 31.2% in 2012, 32.4% in 2013, 33.6% in 2014, 34.8% in 2015, and 36% in 2016. In other words, the "cost" of receiving a CPP retirement pension before age 65 is going to get higher each year between now and 2017. To illustrate that effect in a more practical way, Service Canada provides the following example.

Richard is employed as a production manager. Based on his CPP Statement of Contributions, he expects his annual CPP retirement pension to be $13,577 if he retires at 65 in 2022. However, for personal reasons, Richard decides to retire earlier and to take his CPP pension when he reaches 60 in 2017. In this case, his CPP retirement pension amount of $13,577 will be reduced by 36%. Therefore, the annual amount of his pension will start at $8,689 in 2017, and will then grow with the cost of living, as measured by the Consumer Price Index. Without the change, his pension would have been reduced to $9,504.

Much of the complexity in determining when to begin receiving CPP retirement benefits arises from the fact that the financial and tax effects of a decision on each source of retirement income may affect the others. As well, most Canadians will have to take into account other retirement savings which they may have, or, in a smaller number of cases, any employer pension which may be payable. It would be helpful if there were some financial or actuarial formulas which could be applied to determine the optimal date for receiving federal government retirement benefits or for determining how to create a retirement income stream. No formula could, however, take account of individual circumstances.

Taxpayers who are trying to plan for retirement and, in particular, trying to structure their various sources of retirement income, are best advised to start by gathering together information on each potential source of retirement income, the tax treatment of each, and the age at which such income may be accessed. Doing so will allow each individual or couple to organize a retirement income stream (including CPP retirement benefits) which will maximize after-tax income to provide for a comfortable standard of living in retirement. Assistance in that process can be had in the form of a retirement income calculator available on the Service Canada website or by meeting with a qualified Financial Advisor.

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