CPP: Canadians will soon pay more and get more

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New contribution obligations required by CPP and QPP "enhancements" will mean bigger employer and employee payroll contributions and bigger payments for retired Canadian workers.

In 2016, the federal Finance Minister and nine provincial counterparts agreed to change the Canada Pension Plan ("CPP"). The changes became law in December 2016.

The Québec government recently followed suit by introducing legislation that will make changes to the Quebec Pension Plan ("QPP") to mirror the CPP changes.

Increased payout

The changes are described by both governments as "enhancements." Benefit amounts will increase as will payroll contribution obligations of employers and employees.

Retired Canadian workers will receive bigger payments from the CPP and QPP. The maximum amount of the payout from the CPP to a retired Canadian has been estimated by the federal Department of Finance to rise from $13,110 a year to nearly $20,000 when the CPP enhancements are fully implemented.

Implementation

The Department has estimated that full implementation will occur after approximately 40 years of making contributions. So, the sad reality is that older Canadian workers will never enjoy the fruits of the CPP higher benefits. However, they will be required to start contributing more to fund them in a few months.

This article describes the higher contributions to the CPP that will be required commencing January 1, 2019, and several strategies that Canadian employers are considering in response. For simplicity, it will describe the details of the CPP changes.

Employers and employees contribute equal amounts to the CPP by payroll deductions. That will not change. Every employer and employee pays a percentage of the employee's income, subject to certain portions of income being exempt.

Exemptions

The first $3,500 of income is currently exempt from CPP contributions. In addition, income in excess of an amount set by the Government of Canada, called the Year's Maximum Pension Earnings or "YMPE" amount, is exempt.

In 2018 that YMPE cap amount is $55,900. In 1996, the rate that each employer and employee had to pay was 2.8% of applicable income. It increased gradually to 4.95% in 2003 and has remained constant since then.

New contributions

There are two parts to the new contribution obligations required by the CPP "enhancements."

First, the contribution rate will increase from the current 4.95% to 5.95%. The increase will be applied gradually, over a seven-year phase-in period, commencing January 1, 2019.

Second, an entirely new, second tier of contribution obligations will be imposed on higher-income earners, commencing in 2024. Employees who earn more than the YMPE amount at that time will be required to contribute an additional percentage (currently projected to be 4%) of those above-the-YMPE earnings.

Employers will have to match that. Note that there will be a cap on the earnings that will be subject to this new tier of contribution obligations.

Public response

There has been no noticeable public outcry by employers and employees regarding these increased contribution obligations. The increases are being implemented so very gradually for the first few years that they may not be noticed.

Impact

The federal Department of Finance has estimated that an individual with an annual salary of $54,900 will contribute only an additional $6 per month in 2019. By the end of the seven-year phase-in, contributions for that individual would be approximately $43 per month higher.

The significant impact will likely not be felt until 2024, when higher-income earners will notice a much bigger bite taken out of their earnings. Some consultants and employers have been mulling over options to react to these new obligations.

Plan adjustments

The higher contributions cannot be avoided, but changes can be made to compensation and benefit plans to reduce or entirely negate the impact. The following describes some options.

Employers who sponsor defined contribution pension plans and group registered retirement savings plans could reduce the required contributions to those plans by the same amount of the higher CPP contributions, so that the net effect on employer costs and employee take-home pay is nil.

Mandatory employee contributions to defined benefit pension plans could be reduced so that employees would not suffer a reduction in take-home pay. The defined benefit promise in such plans would have to be reduced for there to be a financial advantage for employers.

Employers who sponsor defined benefit pension plans should seek advice as to whether the CPP and QPP changes have any relevance to the computation of benefits, or contributions, in the defined benefit plans.

Some pension plans require employee contributions based on how much they contribute to the CPP. And,

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some plans have "integration" with benefits payable from the CPP, such as an offset to the amount of the benefit to take account of the CPP benefit payable.

It is notable that reducing benefits and contributions to employer-sponsored pension plans in response to CPP and QPP changes will result in the shift of pension responsibilities from employers to governments.

Salary and bonus

Other elements of compensation could be reviewed, including salary and bonus plans, to determine whether the increased costs to employers and employees of higher CPP and QPP contributions could be offset by changing payments to employees from such plans.

Restrictions

Any changes to compensation and benefit plans to minimize the impact of the CPP and QPP enhancements will be subject to restrictions in collective agreements, fixed-term employment contracts, and the obligation to provide reasonable notice of significant changes to terms of employment.

Significance

The details of the changes to Canada's state-sponsored pension plans are complicated, and the higher contribution obligations may not be noticed for a few years.

Employers should nevertheless consider whether there is a financial (or other) benefit to considering changes to the terms of their compensation and benefit plans in order to manage the impact of the CPP and QPP changes.

REFERENCES: *Canada Pension Plan*, R.S.C. 1985, c. C-8, amended by S.C. 2016, c. 14; Bill No. 149, *An Act to enhance the Quebec Pension Plan and to amend various retirement-related legislative provisions* (introduced in the Quebec legislature on November 2, 2017, currently before the Committee on Labour and the Economy), proposing to amend the *Act Respecting the Quebec Pension Plan*, C.Q.L.R. c. R-9; Department of Finance Canada, *Backgrounder: Canada Pension Plan (CPP) Enhancement*, online: https://www.fin.gc.ca/n16/data/16-113_3-eng.asp.

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THOMSON REUTERS®

Legal Alert is published 12 times a year.

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One Corporate Plaza, 2075 Kennedy Rd.
Toronto, Ontario M1T 3V4

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Content Editor: Susannah Buehler
ISSN 0712-841X

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Publications Mail Agreement No. 40065782
PAP Registration #8577

We acknowledge the financial support of the Government of Canada, through the Publications Assistance Program (PAP), toward our mailing costs.

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