BY MAUREEN GLENN

CPP and the wealthy client

Tax implications of pension plan are still relevant for the rich


GLENN

Pension reform is a hot topic these days. In reaction to demographic and investment pressure, changes already made to the CPP will be phased in over the next few years.

Since corporations are moving away from providing generous defined-benefit pensions, individual retirement savings are critical to the retiree's future well-being.

But government pension plans should not be overlooked. All working Canadians contribute to CPP and expect to receive benefits in return. This can have financial-planning implications, even for wealthy clients who have contributed to CPP throughout their working years.

By definition, high-net-worth (HNW) clients have significant savings now and can expect to enjoy a comfortable retirement lifestyle. Yet these clients want to know that they will not outlive their retirement savings. They're asking for guidance on the best approach to funding their retirement while minimizing taxes.

Clients' questions include:

- How much can I spend on vacations each year?
- Should I use non-registered funds for lifestyle expenses or begin withdrawing income from my registered plans now?
- How long will my retirement nest egg last?
- When should I apply for CPP?

This last question can be the hardest to answer — especially for the HNW client.

CPP retirement benefits are based on a person's average earnings during their working years and the age at which they apply for benefits (benefits can begin anytime between ages 60 and 70).

CPP will provide an estimate of a client's retirement pension based on benefits at age 65. Under the new rules, after 2016, if someone chooses to take CPP early, her pension payment will be reduced by 0.6% for each month she is under age 65. If she waits until after age 65, her monthly pension payment will be increased by 0.7% for each month she is over age 65.

The recent changes to CPP have increased the incentive to apply for retirement benefits after age 65. From a financial standpoint, people who live past age 80 will be better off postponing their CPP application to age 70. But is this really the best choice?

HNW clients have options

Low-income retirees will likely apply for CPP when they need the income — when they stop working. However, HNW clients often have several sources of retirement funding, so they can choose when to apply for CPP benefits. This presents tax-planning opportunities.

For clients who are 65 in 2012, the maximum CPP retirement benefit is $11,840 per year. This may seem like a drop in the bucket for the HNW client, but with Canada's graduated tax system, each drop can make a difference come tax time.

Delaying application for CPP retirement benefits could present an opportunity to reduce the OAS clawback for these clients, especially if they expect to be in a lower tax bracket later in life.

Further, the increased monthly payout as a result of the delayed application could mean an extra 42% CPP benefit. Just don't wait too long: applications after age 70 provide no additional benefit and CPP will only backdate late applications to a maximum of 12 months once clients are over 70.

HNW clients often have several sources of retirement funding, so they can choose when to apply for CPP benefits. This presents tax-planning opportunities.

The reality is, as a result of taxable investment income, many HNW clients will remain at the highest marginal tax rate throughout retirement. These clients are more concerned about having their pension benefits in their own hands, rather than in the hands of the government.

Control over their investments and the opportunity to find tax-preferred investment vehicles are critical for these clients. This also removes the risk of future government changes to the CPP program and the potential loss of benefits to which many Canadians feel entitled.

Once the full CPP redesign is in place in 2016, applying for CPP at age 60 will mean a 36% reduction in monthly retirement payments. In today's dollars, assuming 100% eligibility for benefits, the annual pension payment would fall to $7,578.

A HNW client in the highest marginal tax bracket could invest this income, and with a rate of return of 4% (before tax), it would take close to 15 years to break even, compared to waiting and taking CPP at age 65.

The longevity factor

What if the client doesn't live long enough to receive CPP benefits? CPP provides a death benefit to a maximum of $2,500 for eligible pensioners — not even three months' worth of retirement payments. Clients who choose to delay application for CPP take the risk of premature death and the loss of any future payouts.

In 2012, the required annual CPP employee contribution limit for high-income earners is $2,306 — double that amount for self-employed individuals. Applying for CPP as early as possible is the only way to guarantee that at least some of those contributions will be returned to you.

Longevity is the biggest unknown. Perhaps your client has a family history of centenarians, in which case your HNW client could feel comfortable delaying their CPP application to receive the maximum payout.

For most of us, this would be a gamble. Any current health issues may sway the decision to apply early. One other caution: CPP also offers disability benefits and eligibility for disability benefits may be impacted by the decision to apply for retirement benefits early.

Non-traditional careers

One good news item for those workaholic HNW clients: you no longer have to provide proof that you have stopped working in order to apply for CPP benefits. This is particularly helpful for those who, either by choice or circumstance, continue working in their retirement; many entrepreneurs and consultants move in and out of the workforce over time.

The new Post-Retirement Benefit will also be helpful for those clients who work longer, allowing CPP recipients over the age of 65 the option to continue contributing and topping up their retirement income.

Retiring early and living longer are two of the biggest pressures on any retirement plan, even for the wealthy client. While CPP is only a small piece of the retirement planning puzzle, it should not be ignored as the plan provides some flexibility in choices available. AER

MAUREEN GLENN, B.A. CFP, FLMI, is Manager of Tax & Estate Planning at Richardson GMP Limited.

This team of in-house experts collaborates with investment advisors to deliver customized wealth management solutions designed to address tax, estate, insurance, philanthropic and succession needs.

CPP ANNUAL BENEFITS

Age at application	Old CPP Rules (Pre 2011)	New CPP Rules (Post 2016)
60	70%	64%
61	76%	71.2%
62	82%	78.4%
63	88%	85.6%
64	94%	92.8%
65	100%	100%
66	106%	108.4%
67	112%	116.8%
68	118%	125.2%
69	124%	133.6%
70	130%	142%

Reprinted with permission by Advisor's Edge Report

RICHARDSON GMP