How to BOGO a Single CPP Contribution

The Enhanced Canada Pension Plan Child-rearing Drop-in

FINEPOINT SOLUTIONS INC.
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While the recently enacted Enhanced Canada Pension Plan (E-CPP) no longer has a child-rearing drop-out provision, the E-CPP does provide an alternative method of relief for primary caregivers who experience a reduction in their income because of their child raising responsibilities.

In a way, it's tougher to be eligible for the new child-rearing drop-in provision, but if you do qualify for it, the value is much more than for a single CPP contribution. You get a BOGO!

The Old

For individuals who have contributed into the E-CPP, their retirement pension has three parts: (1) the Base CPP, (2) the 1st Additional CPP, and (3) the 2nd Additional CPP.

The CPP recognizes that a caregiver of children might have to earn less money than they normally would, or may not be able to work at all, because of their child raising responsibilities. To deal with this, the Base CPP has a child-rearing drop-out provision (CRDO).[1] The CRDO might allow the primary caregiver to remove, or drop-out, some of their lowest earning-years between the child's year of birth and the child's 7th birthday. Being able to drop-out low earning-years can increase an individual's CPP retirement pension because it usually increases their lifetime average earnings.

The New

The E-CPP works differently. Rather than a drop-out, the E-CPP has a child-rearing ***drop-in*** provision. A drop-in means that income that wasn't actually earned is calculated. Then that calculated pretend income amount is used to replace any real income in the 7 years after the birth of a child, if the pretend income is higher than the real income. The calculated pretend income is referred to as imputed income. The primary caregiver gets the higher amount between their real income, and the imputed income.

The Catch

What makes it tougher to be eligible for the new child-rearing drop-in is where the imputed income comes from. Imputed income is calculated based on real income that the primary caregiver earned in the 5 years prior to the birth of a child. This means if the primary caregiver didn't earn any income in the 5 years prior to the birth of a child, there will be no imputed income. To put this another way:

- Higher real income in the 5 years prior to birth will result in higher imputed income for the 7 years after birth.
- Lower real income in the 5 years prior to birth will result in lower imputed income for the 7 years after birth.

The imputed income is an average of the real income that the primary caregiver earned in the 5 years prior to the birth of a child.[2]

[1] For a 6 minute animated video that explains the CRDO, see: https://www.youtube.com/watch?v=ykg9uxIy0F4

[2] CPP Act Section 53.3(1) for the 1st Additional CPP, and 53.4(1) for the 2nd Additional CPP.

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The BOGO

With the child-rearing drop-in, a primary caregiver can get more value out of a single E-CPP contribution, because contributions on income during the 5 years prior to the birth of a child also pays for the imputed income for the 7 years after the birth of a child.

Knowing how to boost the value of a single CPP contribution will be particularly useful for incorporated, self-employed business owners who have control over how much, ***and when***, they participate in the CPP program when they determine their form of compensation from the business.

In Figure 1, we show an income profile that has 7 years of zero income for child raising, plus 8 more zero-years at the end of the hypothetical working life. For the Base CPP, the CRDO allows the 7 zero-years for child raising to be removed, on top of having access to the general dropout.[3] For the E-CPP, income is required in the 5 years prior to the year of birth of a child, in order to be eligible for the imputed income that can be dropped-in, and which replaces the 7 zero-years after the birth of a child.

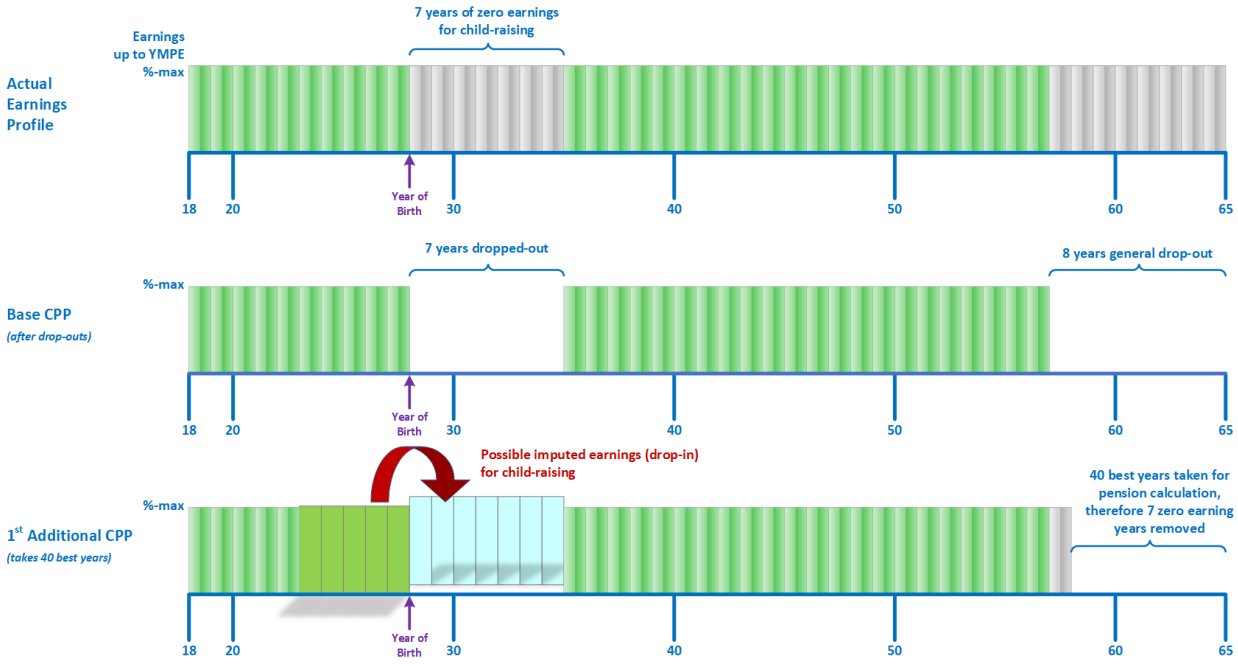

Figure 1. Child-rearing provisions with income in the 5 years prior to birth of a child.

[3] The general dropout, which all CPP beneficiaries are entitled to receive, is 17% of the lowest earnings in the beneficiaries' contributory period.

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In Figure 2, we show an income profile that has 7 years of zero income for child raising, but also no income in the 5 years prior to birth of the child. For the Base CPP, the lack of income in the 5 years prior to birth doesn't impact the ability to use the child-rearing drop-out provision. On the other hand, for the E-CPP with the same income profile, the lack of income in the 5 years prior to birth results in no imputed income. Ultimately, far more zero-years would be included in the 40 best years that are taken for the 1st Additional portion of the total CPP retirement pension calculation.

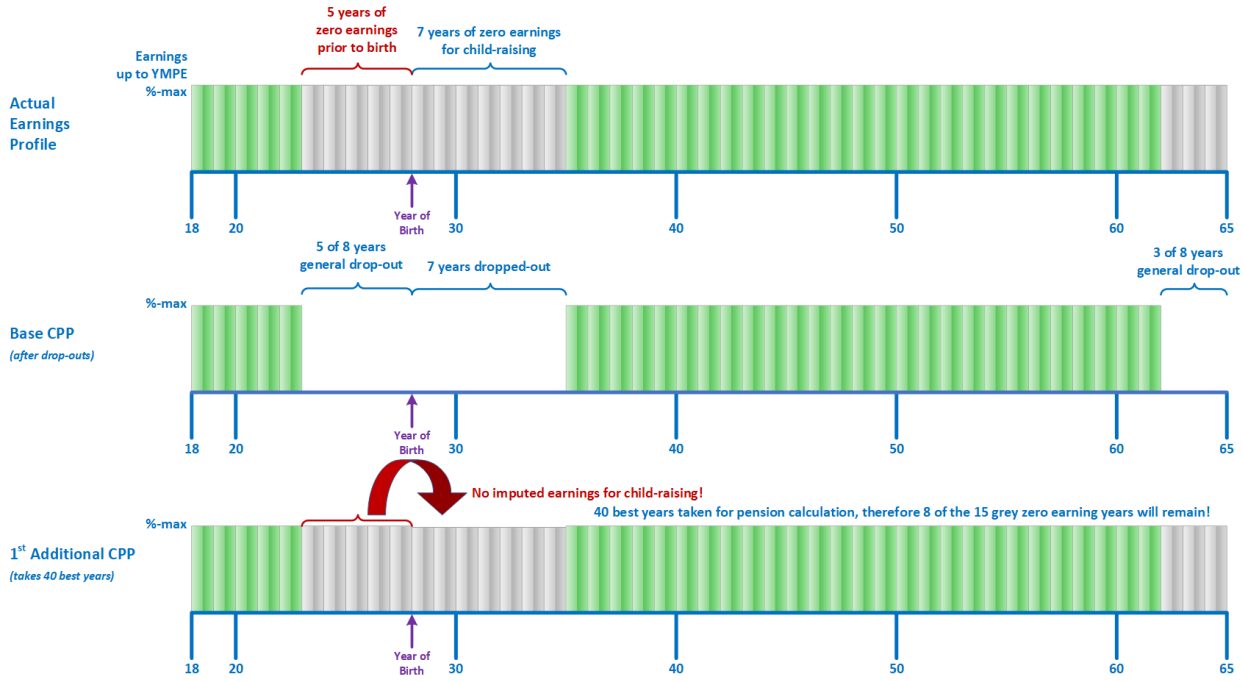

Figure 2. Child-rearing provisions without income in the 5 years prior to birth of a child.

Conclusion

Conceptually, the Enhanced CPP requires having income prior to the birth of a child, and then a decrease in income, in order to get the relief available for child-rearing.

On the other hand, the Base CPP doesn't require income in the 5 years prior to birth, if the math happens to work out.

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Jason Yee is the principal investment analyst and financial planner at FINEPOINT SOLUTIONS INC.

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- Personal Canada Pension Plan (CPP) analysis and estimates.
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- Analytical methods for CPP calculations.

Prior to this role, Jason had a 16-year career as a Professional Engineer, where he held a number of technical and leadership roles managing operations at a variety of industrial facilities.

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