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Jack Mintz: Want to pay more income tax? That's what the Liberals' expanded CPP could mean

By Jack M. Mintz

Jack Mintz: Canadians would end up paying billions more in personal income taxes to federal and provincial governments under an expanded CPP

The federal Liberals are about to be tested on whether they can develop a more common approach to pension policy in Canada. The Business Council of Canada and the Canadian Chamber of Commerce recently raised their concerns in these pages over the balkanization of Canada's pension system, as Ontario pushes to create its own pension plan. But even if Ottawa makes a deal that averts the creation of sundry pension schemes by expanding the Canada Pension Plan, the bargain could end up hurting savings for a lot of middle-class Canadians.

The possible expansion of the CPP will be discussed at the June meeting of the federal-provincial-territorial meeting. Any CPP expansion would require agreement from seven provinces representing two-thirds of the population. It is not clear that will happen. Some provinces are especially concerned with the state of their economies and aren't keen to see their workers and businesses sending more money to the CPP, especially since the case to force all Canadians to save more is already so thin.

As many studies have shown, about four-fifths of Canadians have adequate income at retirement from a combination of: old age security, the existing CPP/QPP, registered pension plans, RRSPs, TFSAs, business and financial assets and, most important, housing equity. Housing equity is by far the most valuable retirement asset on an after-tax basis, greater than all CPP/QPP, pension and RRSP/TFSA funds put together.

THE CPP'S TAX PREMIUM

The impact on personal income taxes: $1,000 in new CPP contributions vs. $1,000 in private registered retirement savings (Ontario only)

Annual Income	Tax credit for additional $1,000 invested in CPP	Tax savings with $1,000 invested in a pension plan or RRSP	Extra personal income tax paid: expanded CPP vs. private plan
$30,000	$201	$201	$0
$45,000	$201	$242	$41
$60,000	$201	$296	$95
$75,000	$201	$315	$114
$90,000	$201	$379	$178
$105,000	$201	$434	$233

SOURCE: EY TAX CALCULATOR NATIONAL POST

Expanding the CPP forces many employers and employees to put savings into a public fund for those workers who are already saving enough for retirement. Meanwhile, for young families facing increasingly high housing costs in Canada's bigger cities, paying more into the CPP is probably the last thing they need. Far better to let them invest that money in a house, their most important retirement asset.

Canadians with lower incomes, meanwhile, are already well protected by old age security, the guaranteed income supplement and any CPP benefits they have (plus any personal financial assets). Higher-income retirees do not need mandatory saving opportunities, especially two-income couples who own a home and have various assets to cover retirement needs. Does the state really need to guarantee that two people earning $75,000 each are able to retire in a lifestyle similar to when they earned $150,000 a year?

Of course there are notable pockets of inadequacy. Those Canadians with modest incomes (roughly $25,000 to $55,000) need the better-assured income that an expanded CPP would provide. Also, single seniors face a sharp decline in income when their spouse dies, an issue addressed by the federal budget's recent enhancement of the guaranteed income supplement for single seniors. However, surviving spouses - of which over two-thirds are women - receive only 60 per cent of their spouse's CPP benefits when their loved one passes away.

So a fully funded CPP expansion targeted for modest incomes and surviving spouses would make sense. It would not benefit existing retirees, who would not pay into the expanded system, but it would address the most glaring shortfalls in our pension system, especially for younger employees.

But there's a side effect that not everyone is aware of: Canadians would end up paying billions more in personal income taxes to federal and provincial governments under an expanded CPP. Why? Because when CPP is expanded, individuals reduce their contributions to RRSPs and pension plans, especially the latter since employers typically reduce private pension contributions to account for larger CPP contributions. And since most Canadians get a larger tax deduction from private pension and RRSP contribution than they get from their measly tax credit for CPP contributions (which is based on the lowest personal tax rate), any CPP expansion would mean many would pay higher personal income taxes. As the accompanying table illustrates, for example, an Ontario teacher or police officer earning $90,000 a year would save $379 in taxes for an extra $1,000 pension-plan contribution, but gets only a $201 tax credit for the same-sized CPP contribution, resulting in a relative tax-payment increase of $178.

Canadians would pay billions more in income taxes under an expanded CPP

This inadequate personal tax treatment of CPP contributions also reduces the after-tax rate of return on CPP savings, since future payouts are sucker-punched by high personal tax rates. An Ontario worker retiring in 2020 earning $90,000 would normally get a three per cent real return on CPP savings - without taking into account personal tax. Once personal taxation is taken into account, that's reduced to 2.25 percent, not much better than a bond.

This point is often missed by many experts who focus on the annual rate of return reported by the CPP Investment Board. A recent Fraser Institute paper argued correctly that younger Canadians stand to get a pretty poor pre-tax real rate of return from CPP, just 2.1 per cent, as they pay contributions to make up for the unfunded benefits provided to older generations. When you count the personal income-tax effects, CPP is an even worse bargain.

This problem could be fixed. It requires the federal government to enable individuals to deduct new CPP contributions from taxable income rather than offering them the less-rewarding tax credit (at least Ontario's proposed pension plan makes contributions deductible). Without that change, a CPP expansion would be very bad deal for many middle-class Canadians.

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