Canada Pension Plan Issues to Consider When a Relationship Ends

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When a relationship ends, and the parties are negotiating how to untangle their financial lives, benefits under the Canada Pension Plan are often not given sufficient attention. Several aspects about CPP are not obvious, and there are a number of myths, that sometimes lead to decisions that end up throwing $100's of dollars a month out the window.

CPP

After age 18, employees are required to contribute to CPP, and employers make matching contributions. Someone who is self-employed is required to pay both portions. Benefits are payable at age 65 (or as early as age 60, but at a reduced amount). For 2013, the maximum CPP is $1,012.50/mo. For many Canadians, this is an important part of their retirement income and so care must be taken to make sure that it is preserved (or maximized, if possible).

Credit Splitting

CPP credits can be split between married spouses and common law partners when their relationship ends. Either party is free to apply for credit splitting after a divorce, or after 12 months separation (no agreement or court order is required for credit splitting).

If both spouses have worked throughout the relationship, credit splitting will often have only a nominal effect on benefits. But for a spouse who has been out of the workforce (or worked only part time) for any extended period, credit splitting can help a great deal.

As a very general rule of thumb, each year of maximum contributions to CPP is currently worth about $25/mo of benefits at age 65.

This means that

- if the relationship lasted 20 years, and
- one party has maximum contributions throughout their employment, and the other none

Credit splitting will provide the non-working spouse with CPP of about $250/mo, and reduce the other spouse's CPP by a similar amount. (Please note that all of the examples are simplified explanations of how CPP is determined and adjusted. This article is intended to provide an overview of basic concepts, not a detailed guide to calculating CPP entitlement.)
Future events

CPP benefits are based on years of contribution between ages 18 and 65. A contributor who has some years to go before reaching 65 can't really predict how much CPP will be payable at that age, because benefits will depend upon future years of contributions. The CPP statement everyone gets is an estimate, based upon assumptions about future events.

Drop outs

Until 2011, the lowest 7 years of contributions between age 18 and 65 could be dropped out, so benefits were based on the best 40 years of contributions. Many people, particularly in their early working lives, have an uneven contribution record. To determine a person's CPP, each year of contributions is added up (adjusted for inflation), and a percentage of this total determines the amount of CPP that will be paid. A contributor who elected to have CPP commence at age 65, and had 30 years of maximum contributions, and zero in other years, would be entitled to 3/4 of maximum CPP.

With the recent changes to CPP, this drop out of lowest years is gradually being increased and, by 2014, 8 years of low contributions can be excluded from the calculation (so CPP would be based on contributions over a 39 year period). To simplify the following discussion, the examples are based on a 40 year period of contribution, but please keep in mind the changes in the CPP rules.

How Does Credit Splitting Work?

When an application for credit splitting is made, the administrator takes each parties' contributions on a year by year basis, starting from the year the parties commenced cohabiting (which is included in the calculations) up to the year they separated (which is excluded from the calculations). The parties' contributions for each year are added up, and each party receives half of the total for that year. Each party can decide when to apply for CPP, and benefits are then determined based on the party's lifetime contributions.

It's important to understand how credit splitting works. All too often, reported decisions indicate that even some judges aren't clear about these concepts and sometimes make ineffective orders for the division of only one party's CPP, and other situations where fruitless applications are made by a spouse whose CPP has been reduced demanding to receive a half share of the other's benefits. These are examples of fundamental misconceptions about how CPP credit splitting works.

Other drop out periods

There are other adjustments made to CPP, in addition to the drop out for years of low contributions. A significant one is the child rearing drop out, which is available to a spouse who left the work force, or who worked fewer hours, to look after children under age 7. For example, if the parties had children in 1982, 1986 and 1990, the years from 1982 to 1997 can potentially be dropped out, and the spouse's benefits determined by pro-rating other, higher contribution years. (If the spouse's lowest contributions were in a 15 year period looking after children under age 7, then dropping out those years means that the spouse's CPP will be determined over a 25 year period instead of a 40 year period. If maximum contributions were made in those 25 years, then the spouse would be entitled to maximum CPP).

Credit splitting and the child rearing drop out

Although the policy underlying credit splitting, and the policy underlying the child rearing drop out, are both clearly good ideas and usually work well separately, there are sometimes unfortunate consequences when they apply at the same time.
In the previous example, suppose that

- one spouse has maximum contributions between 1982 and 1997,
- the other spouse was out of the work force looking after their children under age 7 and has zero contributions in that period, but worked full time before and after it,
- an application for credit splitting is made when the relationship ends, and
- when the decision is made to have CPP benefits start, a child rearing drop out application is made by the spouse who looked after the children.

In a case like this, the spouse with higher contributions ends up with half of maximum for each of the years being split. Using the ballpark value of about $25/mo (based on current rates) for those years, this represents a reduction of about $185/mo to that spouse.

If the other spouse ends up receiving an equivalent amount, then the trade-off makes sense. But, in the example, since that spouse has higher contributions in other years, the child rearing drop out results in credits between 1982 and 1997 being excluded from the calculation. This process ends up with the spouse receiving a higher monthly CPP benefit. But the $185/mo taken from the other spouse is ignored in determining the benefits. The $185/mo is effectively money thrown out the window.

In a case like this, an agreement to not credit split can end up increasing the parties' overall financial resources. For retired spouses, $185/mo can be an appreciable amount. (Obviously, this can be a lesser or greater amount, depending on the circumstances.)

If savings can be achieved by waiving credit splitting, it's not necessary for all of these savings to be allocated to one party. It's often possible to adjust other benefits, so that each can share in the savings.

**More complicated cases**

In any case where both parties have worked throughout, except for periods looking after children under 7, the advantages of not credit splitting discussed in the last example are pretty obvious (once pointed out).

In a traditional relationship, where one spouse has been out of the workforce throughout, the child rearing drop out may end up being of little use. Where other years represent lower CPP contributions, the entitlement received through credit splitting will be important to the spouse in calculating CPP benefits, and there will be no overall loss of CPP to the parties.

In other cases, without access to CPP's computers, it can be difficult to determine whether credit splitting will hurt or help the parties, particularly where they are some years from becoming eligible for CPP to start. In those cases, it often makes sense for the parties to agree to review the question at a later time, closer to when they are about to apply for CPP and their history of contributions is known.

If the gain to one party from credit splitting is roughly equivalent to the loss to the other, credit splitting makes sense. But there are many unfortunate cases where the loss to one spouse will be substantially more than the gain to the other, with the result that credit splitting reduces the overall financial resources available to the parties for their retirement. In these cases, a reasonable arrangement is for the parties to not credit split, and for the spouse who retains CPP to compensate the other (through a lump sum payment, representing, for example, the commuted value of the lost benefits, or monthly support, or increasing the entitlement to other benefits).

**Timing the credit splitting application**

Another case in which CPP benefits are often wasted is where the spouse with higher CPP is already receiving benefits, or likely to receive them before the other spouse. This could be the case where there is a difference in
ages, or where one spouse is receiving long term disability benefits and not planning on taking CPP until the LTD benefits end at age 65.

For example, suppose

- one spouse is currently receiving maximum CPP of $1012.50/mo,
- credit splitting will reduce this to $700/mo., and
- the other spouse is not eligible to apply for CPP for 5 more years.

If an immediate application for credit splitting is made, the CPP reduction is immediate to the spouse receiving CPP, with no benefit to the other spouse.

If the application is deferred until shortly before the other spouse plans on receiving CPP (5 years later in the example), this preserves for the first spouse $3600/yr for 5 years, or benefits totalling $18,000.

**CPP Disability Benefits and Long Term Disability Benefits**

Under the CPP Act, a contributor with disabilities that make it impossible to work at any job on a regular basis may be entitled to CPP disability benefits. These are payable until the contributor reaches 65, at which time regular CPP would be paid.

A common mistake is for a spouse who is receiving long term disability benefits to not bother applying for CPP disability. Typically, LTD benefits are coordinated with CPP benefits. In those cases, any CPP disability payments that are received end up simply reducing the LTD benefits dollar for dollar, so there is no obvious benefit from going through the hoops to qualify for CPP disability.

However, there is another facet to the issue: years that a person is receiving CPP disability represent another drop out when calculating the CPP benefits payable at 65.

So,

- if a contributor has 30 years of maximum contributions, and
- the contributor receives CPP disability benefits for the last 10 years before 65,

CPP benefits will be pro-rated over the 30 years, resulting in maximum CPP.

But, if the same contributor instead decided not to apply for CPP disability benefits, then CPP at 65 will be determined over 30 years of maximum contributions and 10 years of zero contributions, with the result that CPP will be 3/4 of maximum (in today's dollars about $750/mo instead of $1012/mo).

**Timing the credit splitting application where CPP disability benefits are being paid**

Another situation in which delaying an application for credit splitting will preserve financial resources is where the spouse with greater contributions is currently receiving CPP disability benefits. Part of the CPP disability benefit is based on the spouse's CPP contributions. If an immediate application for credit splitting is made which reduces those contributions, this will reduce the CPP disability benefits.

In these cases, it makes sense for the credit splitting application to be postponed until the other spouse chooses to have his or her own CPP benefits commence. (If the spouse receiving CPP disability benefits is also receiving LTD benefits under an employment plan, however, there is often no advantage to deferring credit splitting, because the coordination rules will result in any reduction to the CPP disability benefits being made up by an increase in the LTD benefits).
Waiving Credit Splitting

The CPP Act provides that credit splitting is mandatory and an agreement waiving credit splitting is enforceable only in provinces that enact legislation allowing waiver. Only B.C., Alberta, Saskatchewan and Quebec (for the similar Quebec Pension Plan) have enacted legislation that permits the parties to waive credit splitting.

However, that does not prevent parties in other provinces from agreeing not to apply, or agreeing on when they will apply, for credit splitting. It only means that, if such an agreement is made, and one party decides to break it by making an application for credit splitting, the agreement would be ineffective to prevent the credit splitting. But the parties may be prepared to abide by the agreement. There are many cases where parties will not insist on their full legal rights, in exchange for other considerations.

Obviously, trying to set up effective retirement planning that requires the cooperation of the parties is not going to be something that should be pursued in cases of high conflict. But, in many files, the parties are both motivated to agree to arrangements that protect their income in old age. Agreeing not to apply for credit splitting for a period of years that benefits one spouse may very well be the key to securing agreement on another issue that benefits the other.

And agreements can be structured to provide for an indemnity or compensation to encourage both parties to keep their bargain.

Of course, a lawyer assisting parties with questions of this nature must make sure that the parties are advised, in writing, of the parties' legal rights, and the enforceability of these types of agreements.

Credit Splitting after the Death of a Party

Even in provinces where waivers are legally enforceable, there are factors that may suggest that the parties should not make a formal waiver, but instead agree to defer credit splitting.

For example, if the parties were legally married, an application for credit splitting can be made by one party for up to 3 years after the death of the other. In a case where credit splitting would benefit one spouse, but not as much as it hurts the other (as described above), arrangements can be made so that

- no application is made for credit splitting during the parties' joint lives,
- instead, compensation is paid to the spouse who would have benefited from credit splitting, and
- if that spouse is the survivor, an application for credit splitting can be made on the death of the other.

But, if the parties have made an agreement waiving credit splitting in a province where the waiver is effective, then it would prevent an application in any case, even after the death of the other spouse. So, if the parties want to structure things in this way, their agreement must provide for a deferred application, not a waiver.

Limitation Periods

The CPP Act sets out different limitation periods for married spouses and common-law partners applying for credit splitting. The limitation period for common-law partners is 4 years from separation. This limits the amount of fine tuning that can be done to maximize CPP for common-law partners, (although even in this case there is some scope, because the parties can waive limitation periods under the Act).
Other resources

The information provided in this article is at a very high level of generality. A great deal of useful information is provided by Service Canada on its website. Another useful resource is “Canada Pension Plan Credit Splitting – A Guide for the Legal Profession”.

CPP and CPP credit splitting both appear to be fairly simple and straightforward but, as the discussion above indicates, there are many nuances, and the policies do not apply as fairly as one might expect. My hope, over the years, and through various submissions to the CPP administrators, is that the legislation would be revised so that there is never any risk that one or both spouses may end up being prejudiced by this government program which is, after all, designed to provide income security in old age. In the meantime, it is important to be aware that there are options to protect the parties’ benefits from the less satisfactory aspects of the CPP Act.

Tom is a B.C. lawyer who specializes in pension and employment benefits and provides consulting services to family lawyers and plan administrators on issues that arise with respect to these assets when a relationship ends.

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