What is the OAS Clawback?

OAS benefits are reduced 15 cents per every dollar of net income once taxable income exceeds the threshold.

AVOIDING THE OLD AGE SECURITY CLAWBACK

Ramesh (64) and Sandra Patel (63)* are planning to retire next year and live off their pensions and other retirement savings. After spending the last years of his career as a Principal, Ramesh is expecting a pension income of $50,000 per year while Sandra's pension will be about $38,000. In addition to their home in Surrey, they have carefully built up savings in RRSPs, regular investment accounts, and instead of big vacations invested in a small condo in Whistler. Thinking about how to draw their retirement income and the potential tax involved, they came to realize that the coordination of their income streams would be important. To help with the various considerations, they engaged a professional Certified Financial Planner (CFP).

Michael Berton, CFP, RFP, CLU, CHS, FMA *is a Senior Financial Planner with Assante Financial Management Ltd. In Vancouver, (604) 678-3096. Michael has taught Financial Planning courses at BCIT and TWU. He has written for* ***Advisor's Edge***, ***Advocis FORUM***, *and* ***Advisor.ca***. *He is married to another financial planner, has three children and lives in North Vancouver. Always discuss your particular circumstances with a financial planner prior to acting on the information above.*

** Names have been changed.*

The planner assisted them in making the best choices with their defined benefit pensions. In their case, they felt most comfortable with 100% survivor benefit options. This appeared to be the safest income choice and also lowered their payments, helping to avoid the Old Age Security Pension Recovery Tax, colloquially known as the "OAS Clawback". Ramesh's retirement income was very high nonetheless, so further steps would be required. If his OAS payments could be preserved from clawback, he would be thrilled.

One consideration was deferral of the OAS or the Canada Pension Plan (CPP). Both CPP and OAS are valuable inflation-indexed guaranteed-for-life pensions. While the CPP is a contributory pension plan, the OAS is based on years of residency in Canada. If you have resided in Canada for 40 years since turning 18, you will be paid the maximum OAS pension starting at age 65. The current maximum monthly OAS pension is $613.53 or $7,362.36 per year (2020). Wait until 70, and the OAS pays $834.40 per month or $10,012.81 a year, plus any inflation increases.

Both CPP and OAS share provisions to defer receipt of income for up to 5 years. The deferral results in an enhanced pension. This is a maximum of 36 per cent for OAS, versus 42 per cent for CPP. Ramesh chose to take OAS as soon as it was on offer, as the argument for deferring OAS is less compelling than for CPP. In particular, he appreciated that while CPP benefits are not clawed back if they exceed a

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certain threshold, OAS benefits begin to be clawed back at 15 cents per every dollar of net income once taxable income exceeds $79,054 (2020) and are completely clawed back at $128,137 of net income. Also, while CPP has limited survivor benefits, OAS has none.

While Ramesh chose to start his OAS at age 65, others with sufficient financial assets to bridge their lifestyle between age 65 and 70 and less concern about the clawback might prefer to defer and enjoy the enhanced indexed income.

In addition to the preceding options, their financial planner was able to assist them with some further strategies to reduce the clawback.

MINIMIZING RRIF WITHDRAWALS

The Patels will have little wiggle room with their Defined Benefit Pension incomes, but by electing for the minimum required withdrawals from their RRIFs, taxable income and the risk of an OAS clawback can be reduced. Since age is a part of the minimum calculation, Ramesh can elect that his calculation be based on Sandra's younger age, thereby further lowering his RRIF income.

INCOME SPLITTING

Since 2007 spouses are permitted to split up to 50% of their pension income on their tax returns. This includes RRIF and annuity income after the age of 65. Splitting income from a high-income -earning spouse to a lower income earning spouse will help move some income away from OAS clawback.

In addition, splitting or sharing the Canada Pension Plan (CPP) benefit is an income splitting strategy that can help minimize or avoid OAS clawback. CPP sharing equally splits the CPP credits of both spouses earned over the period of a marriage and is normally elected for at the time of application but can be requested later. Shared pensions revert to the pre-shared indexed amounts on death of the first spouse.

For those that have time before retirement, early withdrawals from their RRSPs before age 65 can reduce the capital value of the future RRIF and, consequently, the required minimum RRIF income payment. In many cases, with OAS clawback considered, the personal tax rate prior to 65 of such withdrawals may be lower than after age 65.

ENSURING INCOME IS TAX-EFFICIENT

Their advisor recommended that they consider the tax consequences of the nonregistered portfolios. They had considered their dividend income investments to be tax efficient because they enjoy a much lower tax rate than interest and, at some levels, capital gains. The challenge with dividend income is that the calculation of a tax break includes a dividend “gross-up” before the application of the dividend tax credit. As a result, dividend income would actually move them closer to the OAS clawback threshold because the calculated grossed-up income is used. If your income is close to the OAS threshold, be careful about selecting investments that produce dividend income.

UTILIZING TAX FREE SAVINGS ACCOUNTS (TFSAS)

For the Patels’ purposes, Tax Free Savings Accounts are much more favourable than non-registered investments simply because the investment income is non-taxable inside the TFSA. Maximizing the TFSA is a great strategy to reduce OAS clawback, especially if the investment income would put you over the $79,054 threshold. Since 2009, the TFSA contribution limit has been slowly increased to $69,500 per person in 2020.

CONSIDERING TAX-DEDUCTIBLE LOANS

While borrowing to invest is considered a riskier strategy, it can also help reduce OAS clawback if the interest on the loan is tax deductible. Tax deductibility is available for loans undertaken for a bona fide business enterprise or investment. This interest deductibility reduces your net income dollar-for-dollar, thereby avoiding the clawback. At the end of the loan, you pay the principal on the loan and keep the after-tax investment income.

CONSIDERING ANY SIGNIFICANT POTENTIAL CAPITAL DISPOSITIONS AFTER AGE OF 65

Taxpayers that own rental properties, cottages, or significant unrealized capital gains from investments may be better off triggering those gains before they start receiving their OAS pension. After this they risk, at least temporarily, having OAS clawed back. The Patels’ jointly owned Whistler property is not their principal residence and has a large capital gain. As they ski very little and their children live far away, it may make tax sense to sell it now before they retire and rent if they plan to visit Whistler.

important dates

Canada Pension Plan and Old Age Security

Includes the Canada Pension Plan (CPP) retirement pension and disability, children’s and survivor benefits.

Upcoming payment dates

- March 27, 2020
- April 28, 2020
- May 27, 2020
- June 26, 2020
- July 29, 2020
- August 27, 2020
- September 28, 2020
- October 28, 2020
- November 26. 2020
- December 29, 2020

Teachers’ Pension Plan

Here are upcoming dates that pension payments are directly deposited to accounts.

2020 payment dates

- March 30, 2020
- April 29, 2020
- May 28, 2020
- June 29, 2020
- July 30, 2020
- August 28, 2020
- September 29, 2020
- October 29, 2020
- November 27, 2020
- December 23, 2020