TAX MATTERS

Five ideas to reduce the clawback of OAS benefits

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66 COMMENTS

You gotta love computer spell-checks. As a personal finance specialist, I use the term “clawback” quite often in my work. My spell-checker never fails to flag this term and suggests “call back” or “clambake." Here’s where the story gets weird. Some friends of ours have been talking about having a “clambake party” (yes, there’s such a thing) where we’ll enjoy some laughter, lobster, crab and other seafood.

My wife, Carolyn, has been trying to co-ordinate dates with these friends, and she e-mailed me a couple of days ago to announce that she got a “call-back about the clambake." I immediately thought about the clawback of Old Age Security (OAS) benefits. That’s how my mind works. And that, folks, is how I was inspired this week to write about minimizing the clawback of OAS benefits (people often ask how I think of things to write about; now you know how it works).

THE BASICS

You can start collecting OAS benefits once you’re 65, are a Canadian citizen or legal resident, and have lived in Canada for at least 10 years since the age of 18 (if you’re living outside of Canada, you may still be able to collect if you meet certain tests).

How much can you collect? It can change quarterly, but is currently $613.53 a month. For 2019, it will be a total of $7,272. These benefits are clawed back at the rate of 15 cents for every dollar of income over $77,580 and will disappear entirely once your income reaches $126,058 for 2019.

There may be some simple ideas you can implement to reduce the clawback of your OAS benefits – which will give you more money to spend on a clambake, or some other gifts for yourself.

THE IDEAS

Consider these five ideas to reduce the OAS clawback.

Split pension income. If you're collecting eligible pension income (most pension income other than OAS and Canada Pension Plan/Quebec Pension Plan), you may be able to have your spouse pay tax on up to half of this income. This reduces your taxable income – and could reduce the clawback. You can make this election on your tax return for 2019 by filing Form T1032 (both spouses should file it).

Use your TFSA. If your investment income is sufficient to create a clawback problem, it will make sense to invest as much as you can inside a tax-free savings account where the income from your portfolio inside the TFSA won't show up on your tax return.

Control your asset location. Not all income is taxed equally. Interest and foreign dividends are taxed at your full marginal tax rate, while capital gains are taxed at half these rates. Canadian dividends are taxed somewhere in-between. You'll want to hold your interest-bearing investments in your registered plans, where there is no tax annually, to the extent you can. You might even consider holding some of your Canadian dividend-paying equities in these plans since these dividends are "grossed-up" and can make your clawback problem worse (some math should be done here to see if this is worthwhile). Ideally, assets held outside registered plans should be more tax-efficient – such as equities that are held for growth.

Defer your RRSP deduction. If you're still contributing to your registered retirement savings plan, but expect to run into a clawback problem later when you start collecting OAS benefits, consider deferring your RRSP deduction (for perhaps a few years) and claim it in those years when you want to reduce your income to minimize clawbacks.

Use your holding company. If you have a corporation, you might consider transferring some of your investments to the corporation (you may need to complete a "tax-deferred rollover" to avoid tax here) and take back an interest-free promissory note in exchange. This will remove investment income from your personal tax return, minimizing your annual clawback. Your corporation will now earn investment income and can declare (but doesn't need to pay) a dividend to you each year equal to the amount of its after-tax earnings. This dividend won't be taxable to you until it's actually paid. If you need cash to live on, your company can pay out those investment earnings as a tax-free repayment of the note it owes to you – which can go on for many years. You'll also save tax upon death because the dividends payable to you are a liability of the company and will reduce its value, which will reduce the tax that will otherwise be owing on your company shares at that time. Also, any dividends still owing to you upon your demise may be subject to preferential tax treatment on a separate "rights or things" tax return. Complex? Sure. So, speak to a tax pro about the pros and cons for you.

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