RBC Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Old Age Security and other government income sources

Please contact us for more information about the topics discussed in this article.

As you approach age 65, you may have questions about the Old Age Security (OAS) program. This article discusses the OAS pension and related benefits you may be entitled to receive. It also covers when these benefits may be reduced and strategies that may help you minimize the reduction. Please note that any reference to a "spouse" in this article also refers to a common-law partner.

What is OAS?

OAS is a monthly federal retirement benefit payable for life to individuals who are 65 and over. You don't have to make contributions to receive OAS retirement benefits; this program is funded through general tax revenues paid to the Government of Canada.

Eligibility for OAS

If you are living in Canada, you must:

- be 65 years old or older;
- be a Canadian citizen or a legal resident at the time your application is approved; and
- have lived in Canada for at least 10 years since the age of 18.

If you are living outside Canada, you must:

- be 65 years old or older;
- have been a Canadian citizen or a legal resident of Canada on the day before you left Canada; and
- have lived in Canada for at least 20 years since the age of 18.

If neither of the above scenarios applies to you, you may still qualify for an OAS pension, a pension from another country or from both countries if you have:

- lived in one of the countries with which Canada has established a social security agreement; or
- contributed to the social security system of one of the countries with which Canada has established a social security agreement.

Applying for your OAS pension

Many Canadians are automatically enrolled for OAS. If you've been automatically enrolled, you'll receive a notification letter from Service Canada the month after you turn 64. Provided that the information in the letter is accurate and you don't want to defer your pension, no action is required. If you don't receive this notification you have to apply.

The earliest you can apply for OAS is 11 months before your 65th birthday (i.e., the month after you turn 64). If you've already reached 65 and you want your OAS pension to start immediately, you should apply as soon as possible. Service Canada can only provide retroactive payments for up to a maximum of 11 months from the date they receive your application.

To apply, complete, sign and mail the *Application for the Old Age Security Pension and the Guaranteed Income Supplement* form as well as any necessary documents to the Service Canada location nearest you. You can obtain the application form on Service Canada's website.

Receiving a full or partial OAS pension

The amount of your OAS pension depends on how long you've lived in Canada after age 18.

Full pension

You're eligible to receive a full OAS pension if you fall into one of the following two categories:

1) You've lived in Canada for at least 40 years after turning 18; or
2) You were born on or before July 1, 1952, **and**:
   a. on July 1, 1977 you lived in Canada; or
   b. after you turned 18, you resided in Canada for a period of time prior to but not on July 1, 1977 or
   c. on July 1, 1977, you were in possession of a valid Canadian Immigration Visa.

You must also have lived in Canada for the 10 years immediately before the approval of your OAS application. If you didn't live in Canada during that 10-year period, you may still qualify for a full OAS pension if:

1) you lived in Canada for at least one year immediately before your OAS was approved; **and**
2) since you turned 18, you lived in Canada for at least three years for every one year of absence from Canada during those last 10 years. For example, if you lived outside of Canada for two of the last 10 years before your OAS pension was approved, you must then have lived in Canada for at least six years after the age of 18.

Partial pension

If you don't qualify for the full OAS pension, and do not wish to wait until you do, you may still qualify for a partial

You must also have lived in Canada for the 10 years immediately before the approval of your OAS application. If you didn't live in Canada during that 10-year period, you may still qualify for a full OAS pension.

OAS pension. To qualify for a partial OAS pension, you must have lived in Canada for at least 10 years after you turned 18 and you must be living in Canada when you receive your OAS pension.

A partial OAS pension is calculated as 1/40th of the full OAS pension for each complete year you lived in Canada after age 18. For example, if you lived in Canada for 20 years after your 18th birthday, you may qualify to receive 20/40ths or half of the full OAS pension.

Understanding the OAS pension recovery tax

Generally, if your net income before adjustments (on line 23400 of your personal income tax return) exceeds a certain minimum threshold for the year, you may have to repay all or part of your OAS pension. This is referred to as the OAS pension recovery tax, more commonly known as OAS clawback. The repayment amount is based on the difference between your income and a threshold amount for the year. You must repay 15% of your income that exceeds the minimum threshold amount for the year, up to a maximum threshold for the year. Once your income reaches the maximum threshold, your OAS will be fully clawed back. To determine these annual income thresholds, please visit the Service Canada website.

Each year, you will generally need to complete an *Old Age Security Return of Income* form, in which you will report the amount of OAS paid to you in the previous tax year and the amounts deducted for taxes. You will also calculate your OAS repayment amount and include it on this form. You must submit this form to the Canada Revenue Agency (CRA) by April 30.

Once your Old Age Security Return of Income form is received, the net income you reported on your tax return is used to estimate your OAS repayment amount for the following tax year. The repayment amount is divided over 12 months and is deducted from your future OAS pension payments as a recovery tax. This starts with your July OAS payment.

If you expect your net income for the current year to be substantially lower than your income for the previous year, you can submit a request to the CRA to have Service Canada reduce the recovery tax withheld on your OAS pension payments.

How to minimize OAS pension recovery tax

The following strategies may help you minimize OAS pension recovery tax:

- **Consider earning capital gains instead of dividends**
  50% of capital gains are included in your taxable income while public company dividends are generally grossed-up by 38%. This gross-up increases your taxable income and consequently may also increase your OAS pension recovery tax. Earning capital gains instead of dividends may help keep your taxable income to a minimum and minimize your OAS pension recovery tax. However, you should consider the investment merits of the securities that will generate capital gains versus dividends before looking at the tax benefit. Securities that generate capital gains may have a higher level of risk than securities that generate dividends. Speak to an RBC advisor about the suitability of the investments in your portfolio.

- **Consider mutual funds that have Return of Capital (ROC) distributions**
  Mutual funds that have high ROC distributions may provide a steady payment stream. ROC distributions are not considered taxable income. Instead, they reduce the adjusted cost base (ACB) of your investment. As a result, the ROC distributions will not immediately increase your income and potentially trigger OAS pension recovery tax. However, the ACB reduction can increase the capital gain you realize when you eventually sell the investment. Therefore this type of investment may be ideal for individuals with high income now that is expected to decrease in the future. Please note that mutual funds may also distribute taxable income (e.g. interest or dividends), which may have an impact on the OAS pension recovery tax.

- **Consider making Registered Retirement Saving Plan (RRSP) contributions**
  If you have unused RRSP contribution room and will be age 71 or younger at year-end, consider making an RRSP contribution. This contribution will provide a deduction against your taxable income and may help you reduce your OAS pension recovery tax.

- **Consider making spousal RRSP contributions**
  If you have unused RRSP contribution room, and your spouse will be age 71 or younger at year-end, consider making a spousal RRSP contribution. Even if you are over the age of 71, you can still make a spousal RRSP contribution if you have a younger spouse and unused RRSP contribution room. Spousal RRSP contributions will provide a deduction against your taxable income and minimize OAS pension recovery tax. They may also help equalize the taxable retirement income for both you and your spouse in the future.

> If you have unused RRSP contribution room and will be age 71 or younger at year-end, consider making an RRSP contribution.

- **Consider pension income splitting with your spouse**
  The pension income splitting rules provide an opportunity to reallocate eligible pension income from one spouse to another. This reallocation of income may help you reduce or eliminate OAS pension recovery tax for the higher-income spouse. Eligible pension income includes payments from a registered pension plan, and if you are age 65 or over, payments from a Registered Retirement Income Fund (RRIF). For more information on pension income splitting, ask an RBC advisor for an article on this topic.

- **Consider Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) pension sharing with your spouse**
  If you and your spouse are both at least age 60, you can elect to share your Canada Pension Plan (CPP) or Québec Pension Plan (QPP) retirement pensions. This may make sense where one spouse is receiving more CPP/QPP and is in a higher tax bracket than the other spouse. By electing to share the pension, a portion of the higher-income spouse's retirement pension may be received by the lower-income spouse and taxed in the lower-income spouse's hands. This may result in an overall family tax savings. As well, it may reduce the higher-income spouse's income for purposes of OAS pension recovery tax.

- **Consider earning investment income through an investment holding company**
  If you're a shareholder of a holding company, consider holding investments in your corporation. This way, income earned on the investments can be taxed in the corporation instead of on your personal tax return. This may enable you to keep your personal net income below the OAS pension recovery tax threshold. However, corporate investment tax rates may be higher than your marginal tax rate, so there may be a tax cost to earning investment income in the corporation.

- **Consider investing in a Tax-Free Savings Account (TFSA)**
  Income you earn in a TFSA or withdrawals from a TFSA are not taxable income and are not included in determining OAS pension recovery tax.

- **Consider withdrawing from your RRSP before age 65**
  If you're retiring early or have low income in the years before you turn 65, consider withdrawing from your RRSP before age 65 to minimize your OAS pension recovery tax in future years when you'll be required to convert your RRSP to a RRIF and begin withdrawing from your RRIF.

- **Consider realizing capital gains before age 65**
  If you're planning to sell an asset that could trigger large capital gains (i.e. a rental property, a business, a cottage or investments with large accrued gains), consider realizing these capital gains before you turn 65. Triggering these gains after age 65 may result in OAS pension recovery tax.

- **Consider deferring the receipt of OAS**
  If you choose to continue working beyond the age of 65, earn more than the annual maximum income threshold for OAS pension recovery tax, and don't need your OAS pension, you may want to consider deferring your OAS. By deferring your OAS until a time when you have lower income, you may be able to reduce your OAS recovery tax and keep more of your pension. Deferring OAS is discussed in more detail in the next section.

Prior to implementing any strategy, obtain professional advice from a qualified advisor to ensure you have considered your own circumstances.

Deferring OAS

You can postpone receiving your OAS pension for up to five years after the date you become eligible for OAS in exchange for a higher monthly amount. Your monthly OAS pension payment increases by 0.6% for every month you delay receiving it, up to a maximum of 36% at age 70. There is no financial advantage to deferring OAS after age 70.

If you receive a letter from Service Canada informing you that you've been automatically enrolled to receive OAS but you would like to defer it, inform Service Canada of your decision to defer either by:

- accessing your "My Service Canada" account and indicating your choice on the Service Canada website; or
- sending a letter to Service Canada by mail stating your choice to defer OAS.

How to benefit from deferring OAS

If you currently earn more than the annual maximum income threshold for OAS recovery tax, you may want to consider taking OAS at a later date (e.g. when you stop working). By deferring OAS until a time when you have lower income, you may be able to reduce OAS pension recovery tax and keep more of your pension. Your monthly OAS pension will potentially be higher because you have deferred. In deciding whether to defer OAS, consider your current and future sources of income, your health and your plans for retirement.

> By electing to share the pension, a portion of the higher-income spouse's retirement pension may be received by the lower-income spouse and taxed in the lower-income spouse's hands.

Cancelling OAS to benefit from deferral

You can request to cancel your OAS pension if you have been receiving it for less than six months. To cancel your OAS pension, provide a written request to Service Canada within six months of receiving your first payment. You must repay, within six months from the day your cancellation request is granted, the amount of OAS pension you received and any related benefits you and/or your spouse received during this time. You can re-apply for OAS at a later date and receive an increased OAS pension.

The Guaranteed Income Supplement (GIS)

The GIS is a monthly benefit paid to low-income OAS recipients living in Canada. To receive this benefit, you must be receiving an OAS pension. Your annual income or, in the case of a couple, your combined annual income, cannot exceed a maximum annual threshold. To determine the annual threshold and possible GIS payments available, please visit the Service Canada website.

The Allowance

The Allowance is a monthly benefit for low-income seniors whose spouse is currently receiving OAS and is eligible for GIS.

To qualify for these benefits, you must:

1. be 60 to 64 years old (this includes the month of your 65th birthday);
2. have a spouse who receives OAS and is eligible for GIS;
3. be a Canadian citizen or legal resident when your benefit is approved;
4. currently live and have lived in Canada for at least 10 years after turning 18 (or you may qualify if you lived or worked in a country that has a social security agreement with Canada); and
5. have an annual income combined with your spouse's income that is below a maximum annual threshold.

The Allowance will stop the month after your 65th birthday, when you may become eligible for the OAS pension and possibly the GIS. For additional information on the Allowance, please visit the Service Canada website.

The Allowance for the Survivor

The Allowance for the Survivor is a monthly benefit available for low-income seniors living in Canada whose spouse has passed away.

To qualify for these benefits, you must:

1. be 60 to 64 years old (this includes the month of your 65th birthday);
2. be a Canadian citizen or legal resident when your benefit is approved;
3. currently live and have lived in Canada for at least 10 years after turning 18 (or you may qualify if you lived or worked in a country that has a social security agreement with Canada);
4. have a spouse who has died and have not remarried or entered into a common-law relationship; and
5. your annual income is less than the maximum annual threshold.

The Allowance for the Survivor will stop the month after your 65th birthday, when you may become eligible for the OAS pension and possibly the GIS. For additional information on the Allowance for Survivor programs, please visit the Service Canada website.

Taxation of OAS, GIS and Allowance payments

Your basic OAS pension is taxable. Other OAS benefits (i.e. GIS, Allowance and Allowance for the Survivor) are not taxable; however, you must still report these benefits on your income tax return.

Living outside Canada

Receiving an OAS pension as a non-resident of Canada

If you qualify for an OAS pension, you can still receive it if you leave Canada, provided you lived in Canada for at least 20 years after turning 18 or you lived and worked in a country that has a social security agreement with Canada and you meet the 20 year residence requirement under the provisions of that agreement.

If you don't meet one of these requirements, you can receive the OAS pension only for the month you leave Canada and six additional months after that. GIS, the Allowance and Allowance for the Survivor can only be paid outside Canada for six months after the month you leave Canada.

> You can postpone receiving your OAS pension for up to five years after the date you become eligible for OAS in exchange for a higher monthly amount.

If you return to Canada after an absence of more than six months, every additional year you live in Canada will count in calculating your 20 years of residence necessary to receive your OAS pension outside the country. If you plan to live outside Canada for more than six months, you'll need to notify Service Canada of your departure and your return, so your OAS pension payments can restart in the month you return to Canada.

You may be able to receive your payment in the local currency of the country where you live and, in some countries, by direct deposit into your bank account. See Service Canada's website for a list of countries where this is possible.

OAS and non-resident withholding tax

If you are a non-resident of Canada and receive OAS, non-resident withholding tax of 25% will be applied to your monthly payment, unless the rate is reduced under a tax treaty between Canada and your country of residence. For example, under the Canada-U.S. Tax Treaty, no withholding tax is applied to OAS pension payments made to U.S. residents.

Conclusion

OAS and its related benefits can be an important element of your overall retirement income. It's important to understand the rules governing these government income sources so you can maximize your entitlement and minimize the recovery tax that may apply to this kind of pension and benefits. Consider these pension sources in the light of your overall financial position to ensure you take into account all relevant factors and be sure to obtain advice from your tax professional in setting up appropriate tax planning strategies.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.