What retirees need to know if they plan to defer OAS until 70

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It's been five years since retirees gained the flexibility of choosing to defer receipt of Old Age Security (OAS) benefits from age 65 to as late as 70. This mirrors the option to defer Canada Pension Plan (CPP) benefits, although the "enhancement" is only 36 per cent for OAS, versus 42 per cent for CPP.

Both CPP and OAS are valuable in that they are inflation-indexed guaranteed-for-life payments. If you lack an employer defined benefit pension, the prospect of higher CPP and OAS benefits is not to be dismissed lightly. At 65, the current maximum monthly OAS pension is $600.85 or $7,210.20 per year. Wait until 70 and OAS pays $817.16 per month or $9,805.87 a year, plus any inflation increases.

Even so, as I confessed a year ago here, I chose to take OAS as soon as it was on offer last spring, although I hope to defer CPP until closer to 70. I feel the argument for deferring OAS is less compelling than for CPP. For me the real decider was that while CPP benefits are not clawed back if they exceed a certain threshold, OAS benefits begin to be clawed back once taxable income exceeds $75,910 (rising to $77,580 in 2019) and is completely clawed back at $123,386 of net income. Also, while CPP has limited survivor benefits, OAS does not.

Matthew Ardrey, a wealth advisor with Toronto-based TriDelta Financial, says if you're near the threshold a larger OAS payout could put you over the top, causing you to repay 15 per cent of the OAS deferred. Also, after age 71, you will be subject to mandatory annual and taxable withdrawals from Registered Retirement Income Funds (RRIFs). Ardrey estimates someone with $10,000 in annual CPP income and a $1.25 million RRIF would already be at the OAS threshold. This person may be better off taking OAS at 65.

Ardrey also warns the 138 per cent dividend "gross-up" on non-registered Canadian dividends can put you closer to the clawback zone.

But the real risks in deferring OAS, as described in a recent blog by Calgary-based Registered Financial Planner Aaron Hector, are a little more grim.

While deferral covers off longevity risk, life expectancy may be shorter than you imagine.

Hector cites the hypothetical case of “Mr. Smith,” who deferred OAS to 70 on the expectation he’d live till 95, his parents still being alive. But at 67 he was diagnosed with a medical condition and his doctor advised a shortened life span.

What can Smith do now? Hector says he can request an effective OAS start date that predates the original application date. Service Canada lets you go back 12 months and will send you a lump sum for the retroactive payment. If Smith applied for OAS the day he turned 67, he’d be paid a retroactive lump sum for the one year, and after that would receive monthly payments enhanced by 7.2 per cent (12 months x 0.6 per cent per month).

But what if Smith dies at 67? Then his estate/survivor can take advantage of some little-known provisions of the OAS Act. His executor can apply to begin Smith’s OAS pension with the effective starting date set as one year prior to the date of death. Keep in mind that OAS payments always end on death: our concern here is merely the opportunity to collect for the one year prior to death.

Hector — vice president of Calgary-based Doherty & Bryant Financial Strategists (a subsidiary of T.E. Wealth) — says such cases are still new but “could become an unfortunate reality for many Canadians. So, if you’re planning to postpone your OAS, you should include some precautionary measures in your financial plan.”

Ensure that your executor is aware of the post-death OAS application and option to file a Separate Rights or Things tax return. (That’s an optional tax return for specific types of income still receivable at death.) This would shift the OAS lump sum away from the final tax return, where taxable income might be high enough to result in a clawback of OAS benefits.

Estate planning for CPP has some subtle differences. With CPP, the deceased must be over age 70 before the executor can apply for retroactive payments, but since there is no benefit to deferring CPP beyond 70 people rarely do it.

Still, planning around illness is much the same for either OAS or CPP, Hector says. If you defer these benefits and then discover you are terminally ill, it’s best to apply for any retroactive amounts immediately. Matthew Ardrey agrees “there is not much else to do except to capture the one year you can.”

Adrian Mastracci, portfolio manager with Vancouver-based Lycos Asset Management Inc., says the whole OAS decision-process needs to be simplified. In the meantime, he says "Defer if you think the higher OAS receipt may come in handy in the later years."

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