SAVE TAXES

REDUCE THE OLD AGE SECURITY CLAWBACK

Meet Rob and Hannah

Rob and Hannah are 65 and 60, respectively, and they are transitioning into retirement. Rob, a senior management executive, will officially retire now but will continue working part-time in a consulting capacity for at least five years.

THE GOAL

Rob is wondering how he can minimize the Old Age Security (OAS) clawback.

Rob married Hannah two years ago following the death of his first wife, Jody. He has always maximized his contributions to the company's group Registered Retirement Savings Plan (RRSP). Jody's RRSP assets rolled over into his RRSP upon her death. As a result, Rob has RRSP assets of $600,000. He also has $200,000 in non-registered mutual funds.

Hannah will also retire now with an employment pension of about $20,000 per year. She has little in the way of her own savings. Rob and Hannah plan to start their Canada Pension Plan (CPP) benefits now at about $11,500 and $4,200 annually, respectively.

Rob is now eligible for the Old Age Security pension. He's heard that if a retiree's annual income is between $67,688 and $110,038 (2011 limits), the OAS benefit is reduced at a rate set by the government. This rate is 15%. 2011 rules also eliminate the entire benefit if income is $110,038. This penalty is often called the "OAS clawback."

OAS benefits are also taxable, so the clawback is like paying another 15%, on top of your marginal tax rate! Fortunately, there are ways for Rob to reduce or avoid this clawback.

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THE CHALLENGE

Rob wants to avoid the OAS clawback. Currently, based on his anticipated income of $80,904, $1,982.40[1] of Rob's OAS benefits will be clawed back.

Income Source (in 2011 dollars)	Annual Amount (before tax)
Consulting employment income	$60,000
Canada Pension Plan	$11,500
Taxable income from mutual funds	$3,000
OAS benefit (before clawback)	$6,404
Total income for clawback calculation	**$80,904**

Rob's income exceeds the clawback threshold of $67,688 and his OAS will be reduced by 15% of the excess income or $1,982.40 annually. How can Rob minimize this clawback?

THE OPTIONS

There are several strategies Rob can use to reduce or even eliminate the OAS clawback.

Rob's advisor tells him about a number of ways to minimize the clawback:

1. He could reduce his income when he retires by delaying withdrawals from his RRSP savings as long as he can, until the year he turns 72.
2. He could continue making RRSP contributions based on his consulting income until he turns 71. Based on his consulting income, Rob should have RRSP contribution room of $10,800 per year, not counting any carry-forward room. If Rob puts that income into an RRSP, his taxable income is less and his OAS clawback will decrease from $1,982.40 to $362.40[2]. He would also defer about $3,888 in income taxes. Rob could consider making that contribution to a spousal RRSP for Hannah to shift income to her later in retirement.
3. If Rob does need to draw on his RRSP before age 72, he should consider buying a Registered Retirement Income Fund (RRIF) term certain or life annuity. The withdrawals of the RRIF are considered eligible pension income and the entire payment from a registered annuity is eligible for pension tax credits.

   He could then split that eligible pension income with Hannah for tax purposes, reducing both his OAS clawback and their combined income taxes.
4. Rob could reduce his taxable income by purchasing a non-registered GIC or a non-registered life annuity.

THE SOLUTION

Rob chooses a solution that uses his non-registered savings to reduce his taxable income.

Rob uses $100,000 of his non-registered savings to either buy a GIC or life annuity.

If he invests in a GIC at 3%, he will earn $3,000 in interest which is fully taxable and, at his marginal tax rate, will result in a total increase in income tax and OAS clawback of $1,530.00.

If Rob purchases a life annuity instead, the full income payment is considered eligible pension income and qualifies for the pension tax credit. If he splits that with Hannah, the taxable amount is very low and the OAS clawback is reduced. They will end up with a combined income tax and OAS clawback of only $224.19.

	Investment / Income option	
	$100,000 in GICs	$100,000 Life Annuity
Taxable investment income (Rob)	$3,000.00	$640.53[3]
Taxable investment income (Hannah)[4]	$0.00	$640.53
Income tax (Rob)[5]	$1,080.00	$0.00[6]
Income tax (Hannah)	$0.00	$128.11[7]
OAS clawback resulting from that income[8]	$450.00	$96.08
Total: Income tax and clawback	$1,530.00	$224.19
TOTAL TAX AND CLAWBACK SAVINGS WITH LIFE ANNUITY		**$1,305.81**

THE RESULT

Rob reduces his OAS clawback and also saves income tax.

By purchasing a non-registered life annuity, Rob not only reduces his OAS clawback, he also saves on income tax. His total savings are $1,305.81

[1] Calculated as [($80,904 - $67,688) × 15%]

[2]Calculated as [($70, 104 - $67,688) × 15%]

[3]Assumes the annuity's interest income is split with Hannah for tax purposes

[4]Assumes Hannah's marginal tax rate is 20%

[5]Assumes Rob's marginal tax rate is 36%

[6]Because this is Rob's only eligible pension income, it will be tax sheltered by the $2,000 pension tax credit amount.

[7]Hannah has other pension income, so she will not be able to shelter this with the $2,000 pension amount.

[8]Calculated as 15% of taxable income because Rob's total income is above the OAS threshold.

Talk to your advisor today to see how retirement income solutions from Sun Life Financial can help you achieve your retirement goals, or visit www.MyRetirementCafe.ca.

Advisor information:

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810-3735-09-11