

# THE IMPACT OF PENSION SPLITTING LEGISLATION ON OAS CLAWBACK

## OVERVIEW

Canadian taxpayers who are age 65 and over and eligible for Old Age Security (OAS), must repay part of their OAS when their income exceeds a certain level. In 2008, a taxpayer with "net income" (as defined in Income Tax Act; basically calculated on the tax return as total income less deductions) over \$64,718 will have to repay OAS at the rate of 15 cents per dollar of excess income. For a taxpayer with 2008 net income of \$105,043 or more, (s)he will repay the entire OAS, because 15 cents X (\$105,043 minus \$64,718 equals \$40,325) represents a "social benefits repayment" of \$6,049 or the full estimated OAS entitlement for 2008. We call this repayment the "OAS clawback".

## CLAWBACK MECHANICS

Let's assume that individual taxpayer Bob will have 2008 net income of \$74,718. When he files his 2008 taxes, he will have to repay \$1500 of his OAS, due to the calculation explained above.

If Bob only turned 65 in late December 2007, so 2008 becomes the first year that Service Canada pays him OAS, he'll receive the full OAS entitlement of about \$6K, if his 2007 net income filed with CRA was under \$63,511 (the OAS clawback threshold that year). However, once he files his 2008 tax return, the Canada Revenue Agency (CRA) will learn that he had to repay \$1500 of his OAS, so a month or two after reviewing his tax return they will inform Service Canada of this situation, and Service Canada will begin to reduce his monthly OAS payments – expecting that his 2008 income situation will repeat in 2009. The reductions they make are accounted for as taxes withheld at source, and will be reported to him on his year-end T4-OAS information slip, that he will report at tax time.

When Bob subsequently files his 2009 taxes, if he demonstrates that his net income is below the OAS clawback threshold (estimated to be \$66,000 in 2009), the tax form will indicate that no social benefits repayment is required. The taxes withheld from his OAS in 2009 are simply considered along with other taxes that were remitted to CRA, and he gets the full benefit of those prepaid taxes when finalizing his tax calculations. After CRA processes Bob's 2009 tax return, they note he was not required to repay any OAS, so again inform Service Canada – who will now restore the full monthly OAS, typically as of June or July, and then cease withholding tax at source. Bob's T4-OAS slip for that year will again show full OAS as revenue, and the tax withheld for part of the year.

## OAS UNDER PENSION SPLITTING LEGISLATION

Let's re-visit the 2009 scenario just discussed, and assume Bob receives \$62.5K pension, \$6K OAS, and \$5K CPP, for total taxable income of \$73.5K, which is \$7,500 into the new \$63.5K claw back zone. Accordingly, he would normally have to re-pay  $0.15 \times \$7,500 = \$1,125$  of his OAS.

But let's now assume Bob isn't single, and his spouse Barb earns \$12K pension + \$5K CPP, for total income of \$17K. Given her lower tax bracket (in Ontario, 21% marginal rate versus Bob's 33% rate plus clawback cost), it is clear that the couple will want to take advantage of the new pension splitting legislation that will permit Bob to allocate up to half of his employer pension to his wife when they complete their 2009 tax returns in April 2010. Suppose that he deducts \$20K from his \$73.5K of income, and she adds that \$20K to her \$11K base income. They will then pay taxes based on net incomes of \$53.5K and \$37K, respectively, for a total tax bill of about \$16,200 versus about \$18,600 before pension splitting, including the OAS repayment. Thanks to pension splitting, the couple in this situation anticipates savings of about \$2,400 or 13% of what the household would otherwise have paid (figures used in the situation just described are for an Ontario couple).

## TIME LAG BEFORE FULL OAS IS RESTORED

You will recall from the “clawback mechanics” discussion that Service Canada will reduce single taxpayer Bob’s OAS for 2009 based on his 2008 tax filing. Once they process his 2009 return, that demonstrates he need not repay any OAS, they will so inform Service Canada, who will stop withholding tax as of the middle of 2010. Although there’s a lag before he recovers his full OAS, full restoration does occur; the withholdings that were made in early 2010 were simply tax pre-payments, not a permanent reduction of the taxpayer’s OAS.

## **REFERENCES**

<http://www1.servicecanada.gc.ca/en/isp/oas/oasrates.shtml> = current OAS information

<http://www.hrsdc.gc.ca/en/isp/oas/oastoc.shtml> = “OAS Recovery Tax” mechanics, as applied based on 2006 and 2007 figures

<http://www.cra-arc.gc.ca/tx/ndvdl/tpcs/ncm-tx/rtrn/cmpltnq/ddctns/lns206-236/235/menu-eng.html> = shows tax return repayment calculation