Planning Matters

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Things to Consider When Deciding When to Take CPP and OAS

You've worked long and hard in Canada for years, quite possibly several decades, and now the finish line is in sight. Retirement. That Holy Grail.

Just one minor thing: How are you going to pay for it?

You may have a company-sponsored pension to support your income needs during retirement, or you may have had to sock a hefty chunk of money away in an RRSP, bit-by-bit over many years.

But if you've worked in Canada as an employee or self-employed person, you're likely entitled to receive Canada Pension Plan (CPP) retirement benefits as well as Old Age Security (OAS). These government programs form a significant component of Canadians' post-retirement income, so it makes sense to spend a bit of time understanding how they work and what to consider when deciding when to start taking them.

Canada Pension Plan (CPP)

For a little background, CPP is a contributory program where the contributor pays a percentage of their income into the plan, which is also matched by their employer. Self-employed folks get the "privilege" of paying both the "employer" and "employee" components.

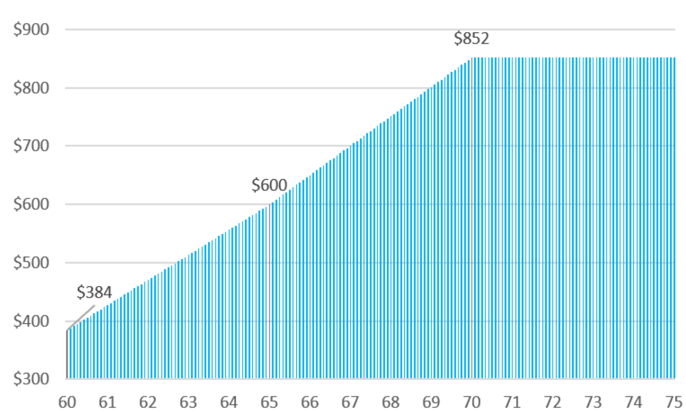
These contributions are tracked throughout your work history, and the amount you will ultimately receive as a retirement benefit depends on the amount you contributed to the program.

CPP can be taken as early as age 60, though age 65 is considered "Normal Retirement Age." The maximum CPP retirement benefit for 2021 is $1,203.75/month, or $14,445/year at age 65, though the average Canadian receives about half that.

Here's where things get interesting. For each month before your 65th birthday that you take CPP "early," your benefit is reduced by 0.6%, with a maximum 36% reduction if taken at age 60. On the other hand, for each month you wait after your 65th, you gain 0.7% or a maximum 42% increase in benefits if you wait until age 70.

Figure 1 illustrates how this locked-in monthly entitlement grows between age 60 and 65, accelerates through age 70, and plateaus thereafter (based on 2021 figures).

Figure 1: Monthly CPP Entitlement for the Average Earner, When Locked in at Various Ages



Old Age Security (OAS)

With OAS, your benefit is tied to the number of years you've been a Canadian resident after age 18. If you have lived in Canada for at least 40 years (after age 18) you're eligible for a full OAS pension, otherwise it will be prorated as long as you have lived in Canada for at least 10 years. Payments are available from age 65 but can be deferred until age 70 with a 0.6% increase per month of delay. However, if your net income exceeds $79,845 (for 2021), you will be required to repay 15 cents per dollar of your OAS due to the OAS pension recovery tax, commonly referred to as the OAS clawback. If your net income reaches $129,757, your OAS will have to be completely repaid.

Things to Consider When Deciding When to Take CPP and OAS

There are a few important factors to consider when deciding when to start receiving your CPP and OAS pensions.

1. When do you intend to (substantially) retire from work?

Although you can start receiving CPP and OAS pensions while still working full-time (as long as you otherwise qualify), most people don't since payments would be added to their taxable income – on top of their regular salary – and very likely taxed at a significantly higher rate compared to payments received after retirement. In the case of OAS, you are more likely to be forced to repay your OAS pension due to the OAS recovery tax. On top of that, you're locking in payments for life at a lower amount than what you would be entitled to by waiting.

For example, Marie is 65 and earns $100,000 per year in her job. She knows she is eligible to start receiving her CPP and OAS now, but enjoys her work and plans to work a few more years. Based on her CPP contribution history, she is entitled to receive $1000/month in CPP and a full OAS pension of $635.26. If she were to begin taking her CPP and OAS now, these amounts would be added to her income and taxed at over 40% based on her marginal tax rate. In addition, since her net income exceeds the OAS recovery threshold, she will also have to contend with a 15% OAS clawback. That hurts!

If instead Marie waits until she retires to begin her CPP and OAS pensions, depending on her other sources of retirement income she will likely be taxed at only 20%-30% and would not be subject to any OAS clawback. Both her OAS and CPP income will also get a boost due to the increase of 0.6% for OAS and 0.7% per month after age 65 that she waits.

You can also earn "post-retirement" (really, post "Normal Retirement Age") CPP benefits by choosing to continue to pay into CPP while working after age 65, which will enhance your pension.

The bottom line is that it usually makes the most sense to start these pensions only after you have substantially stopped working and your taxable income from employment has dropped.

2. ***How much retirement income are you going to get from other sources while you wait for CPP and OAS to kick in, and how much retirement income (in total) do you need to live the retirement you want?***

Do you have enough coming in to "hold out" for larger CPP and OAS payments later?

You have to be able to pay your basic bills, and you undoubtedly want to enjoy a fulfilling retirement, one for which you have likely planned your entire life. If you have a set-in-stone retirement date in mind and really need CPP and OAS payments to meet your retirement expenses, then by all means take them sooner than later.

It's important to recognize, however, that by taking payments earlier you are foregoing a significantly higher guaranteed, inflation-adjusted source of income for life. Is it possible to fund your early retirement years from another source of savings? Can you work a little longer? Are you able to trim expenses a bit? Trim "the fat" that is, not the good stuff!

If you are able to cover your retirement expenses prior to age 70 from other sources, generally it makes sense to do so and enjoy a significantly higher, stable, guaranteed-for-life, inflation-adjusted stream of income from CPP and OAS starting at (or closer to) age 70.

3. ***How is your health? What is your expected longevity?***

If only we knew how long we would live, we could make the "right" call on when to start CPP and OAS payments every time. But without a reliable crystal ball, it's useful to look at what the statistics say and play the odds.

The numbers say that if you've made it to 60, there's a better than even chance that you'll make it to 86. Therefore, almost by default most reasonably healthy people should plan to delay the start of CPP and OAS as long as is practical.

However, if you have a health condition that will likely shorten your lifespan significantly, you will want to start payments sooner than later.

As a very rough guide, aim to collect your CPP for at least 10-15 years.

For example, if you believe you'll have average or better longevity and make it to your mid-eighties, you'll likely be better off holding out until age 70. If on the other hand, you have strong reason to believe you're unlikely to live past age 70-75, by all means start your CPP at age 60 and OAS at 65.

Conclusion

CPP and OAS are two of several possible sources of retirement income that you can rely on to last, well, as long as you do! When to start receiving them depends on several factors specific to your situation, including your desired age of retirement, other sources of retirement income, and health and expected longevity.

Work with your advisor to determine how these important government programs best fit into your comprehensive retirement income plan.

Contributor

Noel D'Souza joined Money Coaches Canada in 2012 as a Money Coach, eager to help his clients develop a healthy and enlightened relationship with their money so they could live more fulfilled lives without money-related stress. His current focus as Director, Communications is educating Canadians about the choices they have when it comes to receiving financial advice, and how working with a Money Coach can be truly life-changing.

NOTE: *The contents of this article are not intended to represent legal or tax advice. Please consult your adviser before employing any strategies discussed here.*

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