Pension 101: How to Keep OAS Payments While Earning $7,300 in Tax-Free Income

Description

Canadian seniors are wondering how they can squeeze more income out of their savings without triggering clawbacks in their OAS payments.

The government implements an Old Age Security pension recovery tax of 15% on all net world income that is above the maximum threshold. In the 2019 tax year, the amount is $77,580.

This might sound like a generous level, and many people would love to have that kind of retirement income, but it doesn't take long to top the threshold if a person is still working at a part-time job, or has a healthy defined-benefit pension to go along with CPP and OAS payments.

Avoiding the OAS clawback requires finding extra income that isn't counted by the CRA towards the calculation. Aside from winning the lottery or picking up an inheritance, there isn't much a person can do, except to generate the income from a TFSA.

A Canadian retiree has as much as $63,500 in TFSA contribution room. The funds can be invested in GICs, stocks, REITs, ETFs, or bonds to generate income.

Low interest rates tend to make the fixed-income options less attractive, so many people are turning to dividend stocks to get better yield.

Let's take a look at two stocks that might be interesting picks to get the TFSA income portfolio started.

Enbridge

Enbridge (TSX:ENB)(NYSE:ENB) gets most of its revenue from regulated assets. This means the company has a predictable cash flow stream that should extend for years or decades and can support steady dividend payments.

Management has worked hard in the past couple of years to address some investor concerns. The company reached agreements to sell non-core assets to shore up the balance sheet and help fund ongoing development projects. It also streamlined operations by taking four subsidiaries in house.

In the most recent earnings report, Enbridge said the $7.8 billion in asset sales have helped fund the ongoing $19 billion capital program. New growth opportunities continue to emerge, as we saw with the addition of $2 billion in projects this year.

Enbridge raised the dividend by 10% for 2019 and is expected to bump the payout by at least 5% per year over the medium term. At the time of writing, the stock appears reasonably priced at $47 per share and provides a 6.3% dividend yield.

CIBC

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) is the baby of Canada's five largest banks.

The company's hefty mortgage portfolio relative to its size is one reason investors consider it to be a riskier bet than its larger peers. This is worth taking into consideration when evaluating the stock. Any major crash in the Canadian housing market would hit CIBC harder than the other big banks.

That said, the company has done a good job of diversifying the revenue stream, including more than US$5 billion in acquisitions in the United States.

Back at home, the Bank of Canada is expected to cut interest rates in the coming months in order to keep things in line with the downward trend by the U.S. Federal Reserve. The Canadian economy is holding up well, but a big gap in rates between the U.S. and Canada could drive the loonie higher and put pressure on exports.

With bond rates down significantly from a year ago, the banks are offering lower rates on fixed rate mortgages. This is helping existing homeowners who need to renew and is also giving demand a boost as more people can afford to enter the market.

As a result, the risk of a significant housing shock hitting the banks has dropped, and the medium-term outlook should be okay for the sector.

CIBC raised its dividend when it reported the fiscal Q3 2019 results, so the board is comfortable with the revenue and earnings outlook.

The stock is off the 2019 lows but still appears cheap. Investors who buy today can pick up a 5.2% yield.

The bottom line

Enbridge and CIBC pay attractive dividends that should continue to grow. An equal investment between the two stocks would provide an average yield of 5.75%.

These stocks, along with others in the portfolio that offer similar yields, would generate $3,651 per year in tax-free income. A couple could earn more than $7,300 and not worry about the funds pushing them over the OAS clawback threshold!

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