OAS 101: How Retirees Can Use the TFSA to Earn an Extra $347 Per Month and Avoid a Clawback

Description

Canadian pensioners rely on their Old Age Security (OAS) payments as part of their overall retirement earnings.

One common concern for those who have a generous company pension, CPP, and other income, such as RRIF payments, is that they risk breaking above the OAS clawback threshold with any additional income.

For the 2019 income year, any net world income that tops $77,580 would trigger a pension recovery tax of 15% of every dollar above that amount. Once the income hits the maximum threshold of $126,058, all of the OAS paid would be clawed back.

The limit increases each year, so 2020 will provide some additional breathing room, but it doesn't take much to go over the minimum. Income generated in a taxable investment account is added to the total. Earnings from a side business or a part-time job would also be included.

One option to generate more earnings without paying taxes or having the payouts count against the OAS threshold is to use the TFSA to hold the investments.

Any interest or dividends generated inside the TFSA can go right into your pocket without a concern the CRA will take a piece of the action.

Dividends stocks are an attractive option to consider. They carry some risk, but also provide a much better yield today than the fixed-income alternatives.

Let's take a look at one company that might be an interesting pick for a self-directed TFSA income portfolio.

IPL

Inter Pipeline (TSX:IPL) offers a 7.7% dividend yield.

The stock is somewhat out of favour right now due to concerns the company might take on too much debt to complete a $3.5 billion development project. There is always a threat when debt starts to weigh too heavily on the balance sheet. In the event revenue and cash flow plunge, the company could be forced to trim the distribution.

In the case of IPL, the payout should be safe. The company has a balanced revenue stream coming from oil sands pipelines, conventional oil pipelines, NGL processing facilities, and bulk liquids storage.

IPL has indicated it is considering a sale of the storage assets, which are located in Europe, to help fund the capital program. The business could fetch a nice price after the recent earnings report showed an improvement in utilization rates.

IPL didn't increase the dividend in 2019 but raised the payout in each of the 10 previous years, so there is a solid track record of distribution growth.

Once the Heartland Petrochemical Complex is completed in late 2021, investors should see average annual EBITDA increase by at least $450 million. Dividend increases could resume after the facility begins generating revenue.

At the current price of $22 per share, the stock appears cheap. IPL traded as high as $35 in the past five years, and it wouldn't be a surprise to see the company become the target of another takeover approach. Consolidation is expected to continue in the energy infrastructure sector, and IPL reportedly turned down an offer earlier this year.

The bottom line

Diversification is always recommended, and the TSX Index is home to many top dividend stocks that provide attractive yields.

The TFSA limit in 2020 will increase by $6,000 to $69,500. A balanced portfolio that provides an average yield of 6% per year would generate annual income of $4,170.

That's an extra $347.50 per month in tax-free income.

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