CRA Pension Tax: How to Boost Retirement Income and Avoid OAS Clawbacks

Description

Canadian retirees are searching for ways to get extra income out of their savings without having to pay the Canada Revenue Agency more taxes.

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Pensioners who receive Old Age Security are at risk of being hit by the CRA with a pension recovery tax. For the 2020 tax year, every dollar of net world income that is earned above the minimum threshold of $79,054 is subject to a 15% OAS clawback.

Once net world income tops $128,137, which is the maximum income recovery threshold, all of the OAS payments are effectively wiped out.

Some people might think this would be a good problem to have, as $79,000 in annual retirement income would be enough to cover a comfortable lifestyle. Nonetheless, it is always best to keep as much money in your pocket as possible, and there is one way to generate additional income on savings without risking OAS clawbacks.

The Tax-Free Savings Account (TFSA) is a great investment tool for retirees. The TFSA contribution limit just increased by $6,000 and the cumulative maximum is now at $69,500. That gives a retired couple as much as $139,000 in investment room to generate tax-free income.

Which investments are best?

GICs are safe, but they currently offer returns that barely cover inflation. Another option would be to buy a diversified portfolio of dividend stocks. The distributions can be used to create a tax-free earnings stream and any capital gains that are realized in the account are also yours to keep.

The best stocks to buy are normally industry leaders with strong track records of dividend growth. Let's take a look at one stock that has proven to be a long-term winner for income investors and should continue to be a solid pick for a balanced TFSA dividend fund.

TD

Toronto-Dominion Bank (TSX:TD) (NYSE:TD) is Canada's second-largest bank by market capitalization with a value of $134 billion.

The bank is often cited as the safest bet among the large Canadian financial institutions due to its core focus on retail banking activities. The personal banking, commercial banking, and wealth management operations generate strong results and tend to be less volatile than other segments, such as capital markets.

TD has invested heavily in the U.S. over the past 15 years to create a significant banking presence in the country. A series of acquisitions of regional banks from Maine right down the east coast to Florida has proven to be a successful strategy. In fiscal 2019, the U.S. businesses accounted for about 40% of TD's total net income.

The bank does a good job of returning cash to investors through steady dividend growth. The distribution has increased by a compound annual rate of roughly 11% over the past 20 years. TD might not match that performance in the next two decades, but steady hikes to the payout should be in line with anticipated earnings per share growth of 7% to 10% over the medium term.

The current payout provides a yield of 4%.

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The bottom line

Canadian couples that hold a balanced portfolio of TSX Index dividend stocks in their TFSAs could reasonably generate an average 4% yield on the portfolios.

This would provide $5,560 per year of tax-free income on the combined $139,000 in investments. That's more than $460 per month that wouldn't risk triggering OAS clawbacks!

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

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1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:TD (The Toronto-Dominion Bank)

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