CPP Pension User: 3 Easy Tips to Reduce or Even Eliminate OAS Clawback

Description

CPP pension users are enjoying their golden years. It'd be such a drag to find out that you have to pay back the Old Age Security (OAS) pension in part or in its entirety.

If your net income exceeds the threshold amount of $79,054 in 2020, you'll be subject to the OAS clawback, which means you'll have to pay a part or all of the OAS pension that you receive in 2020 between July 2021 and June 2022 every month.

Notably, this is based on your global net income. So, any foreign income or capital gains from properties, stocks, or other investments also count towards that net income.

Here are three top tips to reduce your OAS clawback.

Split the income

Although the CPP and OAS pension income cannot be split, Canadians at age 65 or older can split eligible income from RRSP, RRIF, or life annuity with a lower-income spouse. This act will increase tax savings between the couple.

Use the TFSA

The earlier you start using the Tax-Free Savings Account (TFSA), the better, because gains and income earned inside TFSAs are not taxable. As long as you generate reasonable returns of, say, 7-20% per year in the account, you should not get chased down by the Canada Revenue Agency (CRA). (Only those folks who run their accounts up to $1,000,000 in a short time will get into trouble with the CRA.)

The lower your taxable income, the less OAS clawback you'll get (possibly none)!

The important thing to note is that it may be tricky to contribute in kind to your TFSA when you're retired. For example, you want to shelter the dividends from your **TD** stock that currently resides in your non-registered, taxable account. However, you're sitting on huge capital gains for holding the quality shares for 20 years.

If you transfer $6,000 worth of the shares in kind into your TFSA, it'll be as if you sold $6,000 worth of TD stock in your non-registered account, and the capital gains are added to the taxable income amount for the year.

Realize capital gains in low-income years

Some people do not sell stocks in their non-registered, taxable accounts because they don't want to realize capital gains and pay taxes on them. However, they could end up selling and paying hefty taxes on those long-term capital gains during retirement, which will increase their taxable income and potentially trigger OAS clawback.

The matter gets way worse if they sell real estate properties, including rental or vacation properties, which they've held on to for a long time.

By realizing capital gains early on, especially during low-income years, (or you can also think of it as spreading the realization of your capital gains over multiple years) investors should be able to pay lower taxes overall.

Besides, sometimes the stock market gives awesome opportunities to sell stocks at unreasonably high valuations. You can sell these overvalued stocks and buy better-valued stocks. The idea is to opportunistically trade a pool of stocks you're familiar with for capital gains that are taxed at a lower rate than your job's income.

However, I wouldn't recommend trading in and out of core positions, because the best businesses generate long-term value, and you can only benefit by holding and investing for the long haul.

Investor takeaway

There you have it. Three easy tips to reduce or even eliminate OAS clawback include splitting the income between you and your lower-income spouse, using the TFSA, and realizing capital gains in low-income years before you retire.

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