OAS Clawback 2020: How Retirees Can Earn an Extra $521.25 Per Month and Avoid the CRA Pension Recovery Tax

Description

Canadian seniors who collect Old Ages Security (OAS) have to watch their net world income very carefully.

The Canada Revenue Agency (CRA) implements a pension recovery tax on OAS payments once income breaks through a minimum threshold. In 2020, the magic number is $79,054. The OAS clawback, as it is commonly known, equals 15% of every dollar earned above that level until the full OAS payment is recovered. That occurs once net world income tops $128,137.

Hitting the minimum income recovery threshold isn't that difficult for Canadians who have generous employment pensions and are collecting OAS, CPP, and RRIF payments.

As living costs continue to increase, retirees are searching for ways to increase their cash flow without being hit by higher taxes or the OAS clawback. One way to achieve the goal is to take advantage of the full contribution space available in a Tax-Free Savings Account (TFSA).

Investments held inside the TFSA can generate income that isn't taxed and won't count towards the CRA's calculation of the potential OAS recovery tax.

Where should you invest?

The maximum cumulative TFSA contribution space is currently $69,500 per person. That means a couple could invest up to $139,000 and collect tax-free income on the returns. GICs are the safest bet, but they only offer returns of about 2% right now. That is barely adequate to cover inflation, according to changes in the Consumer Price Index.

A popular alternative is to own high-quality dividend stocks. These come with some risk as the share prices can fall, but the top companies tend to raise their payouts every year and deliver solid capital appreciation over the long term.

Let's take a look at one top stock that has a proven track record of rewarding shareholders with solid dividend growth and should be an attractive pick to start a diversified TFSA income portfolio.

Telus

Telus (TSX:T)(NYSE:TU) is a leading player in the Canadian communications industry with world-class wireless and wireline network infrastructure delivering quality services to mobile, TV, and internet customers across the country. The company is known for its customer service initiatives, and the low postpaid mobile churn rates indicate the efforts are bearing fruit.

Telus continues to add new subscribers at a steady rate and generates adequate profits to fund its capital programs while returning cash to investors. Telus just raised the dividend by nearly 7% and announced a share split.

Free cash flow should double in 2020 to as high as $1.7 billion and the dividend payout is targeted at 60-75% of free cash flow for the year.

The current distribution provides a yield of 4.3%.

Telus is driving growth through its investments in new technology and upgraded networks. The evolution of the smart home and demand for remote monitoring and security services can boost revenue from existing customers. Telus has also invested heavily in its Telus Health division, which is already Canada's leading supplier of digital solutions to the Canadian health sector. In the coming years, Telus Health could be a meaningful contributor to revenue growth.

Long-term investors have done well with the stock. A $10,000 investment in Telus just 10 years ago would be worth $48,000 today with the dividends reinvested.

The bottom line

Telus pays an attractive dividend that should continue to grow. The stock might not generate the same overall returns in the next decade, but Telus still deserves to be a core holding in balanced TFSA income fund.

The **TSX Index** is home to many top stocks that offer similar or higher dividend yields. Getting an average yield of 4.5% should be very easy, and that would generate $3,127.50 per year on a $69,500 TFSA portfolio.

A couple could earn an extra $6,255 annually, or $521.25 per month, tax-free and not put their OAS at risk!

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