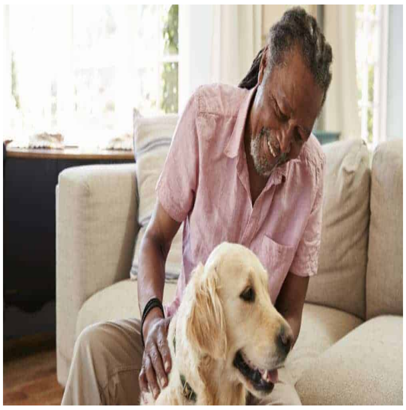

Retirees: How to STOP the CRA From Taxing Your CPP and OAS!

Description

Did you know that the CRA considers your CPP and OAS payments to be taxable income?

Under Canadian tax laws, your CPP and OAS can be taxed just like any other income. Although these taxes may be offset somewhat by deductions and credits, you'll still pay a portion of your old age pension benefits to the CRA. While it might seem unfair to pay even more tax on program benefits that you've been paying for your entire working life, the CRA doesn't see it that way.

Fortunately, there are a few ways to *reduce* the amount of tax you pay on CPP and OAS. Though you can't stop the CRA from taxing the payments entirely, you can pay much less by eliminating benefit repayments, which are effectively like a kind of tax, and tax-sheltering your investments at the same time. Here's how.

Invest as much as possible in a TFSA

By law, TFSA earnings and withdrawals aren't considered taxable income. That means that you can earn as much in dividends and capital gains as you like and withdraw it tax-free, with no effect on your CPP and OAS payments. This is different from investing outside a TFSA, where your investment income could force you to repay some of your pension benefits.

How much you could save on taxes and repayment

By investing in a TFSA, you can save big on taxes and on the benefit repayments you'd have to make otherwise.

On the Canada Revenue Agency website, there's an example given of how much a person would save if they earned $500 in a TFSA. If that person earned $66,200 in total income, of which $48,250 was pension income (including $12,017 in CPP and $5,933 in OAS), that person would repay no benefits if they invested in a TFSA.

However, if that person earned $500 *outside* a TFSA, he or she would have to repay $67.50 in benefits, which is effectively like an additional tax.

Here’s the crazy part: you can actually earn a lot *more* than $500 a year tax-free in a TFSA. So, the “tax” savings you could enjoy could be far greater than $67.50.

Consider the case of an investor holding $69,500 worth of **iShares S&P/TSX 60 Index Fund** (TSX:XIU) in a TFSA. This is purely a hypothetical example to make the math simpler, as you should always diversify your TFSA or any other investment portfolio you own.

XIU yields about 2.8%, so you could earn $1,946 in dividends a year by holding it.

Held inside a TFSA, those dividends would be completely tax free. Outside a TFSA, they would be taxable at your marginal rate less a tax credit. Not only that, but remember the scenario above, where the investor earning $500 in interest gets out of re-paying $67.50 in CPP/OAS benefits. If you earn $1,946 a year in a TFSA, you can save even more than that, which just goes to show how much investing in a TFSA can save you in taxes.

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