Tax-Free Income: An Oversold Canadian Dividend Stock to Help Retirees Avoid OAS Clawbacks

Description

Canadian pensioners are searching for ways to increase their income without being bumped into a higher tax bracket.

This is of particular concern for those receiving OAS pensions. The CRA implements an OAS clawback on any net world income above a specific threshold. That level is $79,054 for the 2020 tax year. Any income above this amount is subject to a 15% OAS pension recovery tax.

Retirees who are receiving decent defined-benefit employment pensions as well as full CPP and OAS pensions can quickly reach the minimum threshold. In addition, pensioners older than 71 might also be receiving RRIF payments. Finally, any earnings from other taxable sources count towards the CRA's net world income calculation.

Fortunately, there is a way to avoid OAS clawbacks. Retirees can use their TFSAs to hold income-generating investments and not worry about being hit by the CRA. Income earned inside the TFSA is not taxed, and funds taken out of the TFSA do not count toward net world income.

Let's take a look at one top Canadian dividend stock that appears oversold right now and might be an interesting pick for a diversified TFSA income fund.

CIBC

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) is Canada's fifth-largest bank. Due to CIBC's size and history of making big blunders, investors often overlook the bank when searching for a financial stock to add to their portfolios.

CIBC has a larger relative exposure to the Canadian housing market than its peers. As a result, any meltdown in house prices would certainly be negative for CIBC. Despite the perceived risks, the outlook is likely not as bad as the market might think, and the stock appears oversold.

Why?

The Bank of Canada cut rates twice in recent weeks, resulting in a full 1% reduction. This helps borrowers with variable-rate loans. In addition, mortgage rates are down significantly as a result of plunging bond yields. This provides existing homeowners with an opportunity to renew at cheaper rates. New buyers that might have been on the fringe can now enter the market.

As long as we don't see a massive wave of job losses, the housing market should hold up reasonably well.

CIBC remains very profitable. The bank earned adjusted net income of $1.48 billion in fiscal Q1 2020. This was a 9% gain over the same period last year. The adjusted return on equity was a robust 16.1%. CIBC has a strong capital position with a CET1 ratio of 11.3%. This means it can ride out some turbulence in the market.

CIBC just raised its dividend, so the board is apparently comfortable with the revenue and earnings outlook. At the time of writing, the payout provides an annualized yield of 6.9%.

The stock fell from $109 per share in February to a recent low of $71. The shares currently trade at $84.50, after a bargain-hunting bounce.

Additional volatility could be on the way, but buy-and-hold income investors might want to consider adding CIBC to their TFSA income funds.

The Canadian government is expected to launch an aggressive fiscal program to help offset the economic impact of the coronavirus outbreak. Once calm returns to the markets, CIBC's share price could quickly move back above $100.

The bottom line

Retirees can take advantage of discounted prices in the Canadian market to build a reliable high-yield TFSA portfolio. Achieving an average yield of 5-6% is possible today.

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