Retirees Beware: The CRA Will Tax Your CPP and OAS!

**Description**

For Canadian retirees, CPP and OAS are necessary financial lifelines. Providing steady income in retirement, they can go a long way toward helping cash-strapped seniors pay their bills.



Unfortunately, many Canadians are finding that they aren't getting as much from these programs as they expected. Under Canada Revenue Agency rules, CPP and OAS payments are both fully taxable. As well, OAS could be clawed back if you earn too much money. Combining both income tax and OAS clawbacks can result in a heavy tax burden.

The bad news is, there's no way to avoid paying taxes on CPP and OAS entirely. The good news is, you *can* minimize the amount you pay. By holding your other income sources in non-taxable environment, you can minimize the amount you pay on CPP and OAS.

I'll explore that in a minute. First, let's take a look at how much tax you could pay on CPP and OAS.

## How much tax you'll pay

Both CPP and OAS are taxed at your marginal rate, which means that if your highest income tax bracket is 30%, you'll pay $3,000 on $10,000 worth of CPP and OAS payments. Further, if your income is high, you could end up paying the OAS recovery tax — a portion of OAS you have to pay back. As of 2020, you need to earn $79,054 before the OAS recovery tax kicks in.

To make a long story short, you'll pay regular income taxes on CPP and OAS. You could also pay OAS recovery tax if you earn too much money. These two taxes could take a big bite out of your retirement income. Fortunately, there are ways to lower them.

## How to lower your tax bill

The best way to lower your tax bill in retirement is to hold investments in accounts that aren't taxed, including RRSPs and, better yet, Tax-Free Savings Accounts (TFSAs).

If you're already retired, you may not be able make tax-deductible RRSP contributions. However, having your money in a TFSA can lower your taxable income. It's not that you'll get a tax deduction out of it–you won't. But if you're going to be holding investments anyway, the TFSA lowers income tax payable on them.

Let's consider the case of an investor holding $50,000 worth of the **iShares S&P/TSX 60 Index Fund** ( TSX:XIU) in a TFSA. XIU is the most popular Canadian index fund, making it a practical example to work with. It also pays dividends, which is valuable for illustration purposes.

By holding XIU, our hypothetical investor would earn about $1,500 in dividends each year. Held in a TFSA, none of that would be taxable. Ditto on capital gains. A TFSA would therefore knock $1,500 at least off the person's taxable income — and possibly some capital gains too.

It would be a completely different story in a taxable account. At minimum, the $1,500 in dividends would count toward the investor's income. If they earned $77,500, that would be just enough to put them over the OAS recovery tax threshold.



And of course, the dividends themselves would be taxed at the investor's marginal rate, which could add up to a significant amount of tax–and it would all be avoided in a TFSA.

The simple truth is this: If you're a retiree with investments, you're almost always better off holding them in a TFSA. The minor negative of losing capital loss deductions is more than made up for by lowering taxable income.

**CATEGORY**

1. Dividend Stocks
2. Investing

**TICKERS GLOBAL**

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