Retirees: How to Get $2,432 Tax-Free Income While AVOIDING OAS Clawbacks!

Description

The OAS recovery tax is the bane of many a Canadian retiree. If you earn over $79,054, you're legally required to pay some of your OAS back. The amount you have to pay back depends on how far you are over the threshold. If you earn over $126,058, you have repay the entire amount!

On the surface, this reasoning makes sense. OAS is designed to help seniors in need, and high earners don't need the money as much as low earners. However, the recovery tax doesn't account for cost of living differences from city to city, or personal debt levels. In practice, it's entirely possible for a Canadian earning $100,000 to be worse off than a Canadian earning $75,000.

Fortunately, there are ways to combat the OAS recovery tax. If you're *way* over the threshold, it may be unavoidable, but if you're close to the line, you could avoid it. Particularly if a lot of your income comes from investments, you can lower your taxable income and avoid OAS clawbacks. You can even earn an extra $2,432 in tax-free income in the process. Here's how.

Hold income-producing investments in a TFSA

If you've got a lot of investments, you'd be wise hold to the ones that pay interest or dividends in a Tax-Free Savings Account (TFSA). The reason is that these investments automatically generate income. With non-dividend stocks, you can avoid taxes by not selling.

However, that's not the case with dividends and interest. Even if you automatically re-invest your dividends, they still count as taxable income. So, they push your taxable income higher.

Unless, that is, you hold them in a TFSA. By doing so, you not only avoid direct taxes, but also lower your taxable income for OAS purposes. The end result? Tax-free income and less OAS recovery tax.

How much you could save

To understand how much money you could save by holding dividend stocks in a TFSA, let's consider a hypothetical example.

Imagine an investor holding $69,500 worth of **Fortis Inc** (TSX:FTS)(NYSE:FTS) shares in a TFSA. Let's also imagine that this investor earns $79,000 in income each year–just $54 shy of the OAS clawback threshold.

Fortis is a dividend stock that yields 3.5%. That means that $69,500 worth of it produces $2,432 in dividend income each year. The actual taxes payable would depend on the investor's marginal tax rate, and would have a 15% tax credit taken off. At any rate, the taxes, outside of a TFSA, would likely be several hundred dollars.

Within a TFSA, there would be zero taxes paid.

Not only that, but the investor would avoid OAS clawbacks.

In Canada, dividend income is treated as ordinary taxable income. That means that any money you earn in dividends increases the amount your OAS is calculated on. So, for an investor earning $79,000 the dividends on a $69,500 FTS position would easily put them above the OAS recovery tax threshold.

By holding those shares in a TFSA, the tax would be avoided. So by holding dividend stocks in a TFSA, you get a double whammy of tax savings.

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