Canada Revenue Agency 101: How Retirees Can Earn an Extra $4,170 and Avoid the OAS Clawback

Description

Canadian seniors face some serious challenges when it comes to boosting income without paying more taxes.

CRA taxes on pensions

Canadian retirees get pension income from a number of sources. These include company pensions, CPP, and OAS.

Income can also come from a Registered Retirement Income Fund (RRIF). This is created by the mandatory transfer of RRSP funds before December 31 in the year a person turns 71. The government sets minimum withdrawals from the RRIF each year. The investments inside the RRIF grow tax free, but the payments are taxed as income.

Other income sources include earnings from investments in taxable accounts. Earnings from part-time jobs or rental properties also get taxed.

CRA clawback

To make matters worse, income above a minimum threshold is subject to an Old Age Security pension recovery tax. The CRA has a system in place where it implements 15% OAS clawback for every dollar of net world income above a certain amount. In the 2020 tax year, the number is $79,054.

Retirees with decent company pensions and full CPP and OAS pensions can quite easily top that amount. Those who own dividend stocks in taxable accounts also have to watch out for the dividend gross-up, as it boosts the net world income total even higher.

TFSA solution

Aside from hitting it big at the casino or winning the lottery, it is difficult for Canadian pensioners to boost income without potentially being bumped into a higher tax bracket or being hit with the OAS clawback.

One solution, however, involves holding income-generating investments inside a Tax-Free Savings Account (TFSA). The beauty of the TFSA is that all income earned inside the account is protected from the tax authorities. In addition, any funds removed are not counted toward the net world income calculation.

The TFSA cumulative contribution space is at $69,500 in 2020. That's enough room to build a solid income fund.

Where to invest?

GICs are safe, but they offer terrible returns. This is why many retirees are turning to top dividend stocks to boost yield on their savings. Stocks come with risk, but the pullback in 2020 now has many high-quality companies trading at very attractive prices.

The result is dividend yields of 5-8% from industry leaders with strong track records of dividend growth supported by decades of rising revenue and higher profits.

For example, BCE looks attractive right now for an income portfolio. The communications giant trades near $56 at the time of writing compared to $65 in February. Investors who buy at this level can pick up a dividend yield of close to 6%.

The company just ended its free extension on extra internet usage. This could trigger a surge in plan upgrades in the next few months. People are still working from home and need the extra broadband capacity for video conferences. Kids, teens, and university students are also looking at more study time from home in the fall.

BCE generates enough free cash flow to cover the dividend and has the power to raise prices when it needs extra cash. Low interest rates appear here to stay, and a plunge in bond yields this year means BCE can borrow at lower costs to fund big network expansions. This means more cash should be available for payouts in the coming years.

The bottom line

BCE is just one stock among many top dividend picks in the **TSX Index**.

A balanced TFSA portfolio of top companies could easily provide an average 6% dividend yield today. That would generate an extra $4,170 per year in tax-free income that won't put the OAS pension at risk of a clawback.

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aswalker