Retirees: How to Use Dividend Stocks to Boost Pension Income and Avoid OAS Clawbacks

Description

Canadian seniors want to get better returns from their savings without being bumped into a higher tax bracket or being hit by the OAS pension recovery tax.

CRA clawback

The CRA implements a clawback on OAS pension payments when net world income hits a minimum threshold. The amount to watch in 2020 is $79,054. At that point, every extra dollar of income triggers a $0.15 pension recovery tax, until net world income hits $128,137 when the full OAS pension for the year would be subject to the clawback.

While you might think $79,000 is very high, people who get pension income from a decent defined-benefit company plan along with full CPP and OAS pensions can quite easily hit the threshold. Once tax is paid on the pension income, the remaining cash available to cover living expenses might not leave much room for savings.

This is particularly true for retirees who might still have mortgage payments. Rising medical costs can also put a dent in the budget.

TFSA solution

One way to get more income while avoiding extra taxes is to generate the earnings inside a Tax-Free Savings Account (TFSA). The TFSA limit increased by $6,000 in 2020 and will likely rise by the same amount next year. The current cumulative contribution space is as high as $69,500 per person.

Putting money into GICs or government bonds won't provide the yield most people require. As a result, dividend stocks are getting more attention. Stocks carry risk, as we witnessed in the first half of 2020, but top-quality companies should recover their valuations once the economy rebounds. In the meantime, investors have an opportunity to buy great dividend stocks at cheap prices.

Top dividend picks?

It makes sense to seek out market leaders with strong balance sheets and reliable dividends. Let's take a look at one stock that might be an interesting pick to start a balanced TFSA income fund.

Royal Bank

Royal Bank (TSX:RY)(NYSE:RY) generated return on equity (ROE) of better than 17% last year, which makes it one of the most profitable large banks in the world. Even with the heavy provisions for credit losses recorded in fiscal Q2 2020, Royal Bank still had solid return on investment of 7.3%.

The bank's capital position remains strong with a CET1 ratio of 11.7%, which means Royal Bank has the ability to ride out the downturn.

The stock currently trades near $91 per share and provides a 4.75% yield. Royal Bank traded at $109 earlier this year, so there is decent upside potential once the economy gets back on track.

Risks?

A second virus wave that forces new lockdowns would be negative for Royal Bank and its peers.

The company recorded $2.8 billion to cover potential loan losses in the fiscal Q2 report. However, the actual losses could be higher if the recession drags into next year.

The bottom line

Retirees can take advantage of the TFSA to boost income without paying more tax or being hit by the OAS clawback.

Top dividend stocks on the **TSX Index** appear cheap right now and it would be easy to build a diversified portfolio that provides an average yield of 5-6% today.

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Date
2025/08/17
Date Created
2020/07/10
Author
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