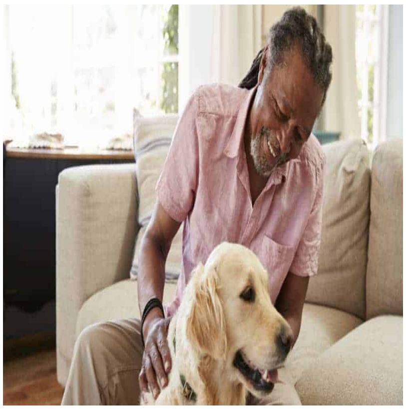

Canada Revenue Agency: How to Get $2,000 per Month Tax-Free in Retirement

Description

Canadians may be wondering how they can supplement their OAS and CPP pensions in retirement while avoiding higher taxes and OAS clawbacks.

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Taxable earnings in retirement

The CRA taxes nearly every source of retirement income.

Canada Pension Plan (CPP), Old Age Security (OAS), and company pensions, RRSP withdrawals, and RRIF payments are all taxable. In addition, earnings from side gigs, rental properties, and investments in taxable accounts also get hit. The CRA adds up these amounts to determine income taxes due.

OAS recipients face another tax. The CRA uses the total to determine the OAS pension recovery tax that kicks in when net world income tops a minimum threshold. The amount is $79,054 in 2020.

TFSA to the rescue

Canadian savers can use their Tax-Free Savings Accounts (TFSAs) to build an investment portfolio of top-quality stocks to create a steady stream of tax-free income in retirement.

The cumulative contribution space in a TFSA is currently $69,500 per person. The limit increased by $6,000 in 2020 and is expected to rise by at least that amount per year going forward. The CRA indexes the annual dollar amount to inflation and increases the limit in $500 increments.

In 20 years the TFSA limit should be at least $190,000 per person. That would give a couple $380,000 in contribution room to earn tax-free income. Some people have that much to invest. Others can build the fund over time using a powerful investing strategy.

Top investments

Investors in their working years can use their TFSA space to buy reliable dividend stocks and allocate the distributions to acquire more shares, setting off a compounding process that can turn small initial investments into a large retirement fund.

Let’s take a look at two examples that might be interesting picks to get your TFSA pension started.

Royal Bank of Canada

Royal Bank (TSX:RY) (NYSE:RY) is Canada’s largest financial institution and one of the top 15 by market capitalization in the world. The bank is extremely profitable during good economic times and is still generating solid earnings in the current downturn.

Royal Bank enjoys a balanced revenue stream coming from personal and commercial banking, capital markets, wealth management, and insurance businesses, as well as investor and treasury services.

The bank has paid out a dividend every year for more than a century, so the distribution should be very safe. Royal Bank’s share price is down from the 2020 high around $109 to $96 at the time of writing.

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A quick look at the long-term chart suggests buying the stock on dips tends to produce decent gains. A $10,000 investment in Royal Bank 20 years ago would be worth about $100,000 today with the dividends reinvested.

Investors who buy today can pick up a 4.5% dividend yield.

Enbridge

Enbridge (TSX:ENB)(NYSE:ENB) operates the planet’s largest energy infrastructure network of oil, gas liquids, and natural gas pipelines and utility assets. The company also owns renewable power facilities.

Pipelines are out of favour these days and getting large new projects built in Canada and the United States is a challenge. However, forecasters anticipate strong oil demand as the global economy expands in the coming decades. Enbridge doesn’t produce the commodity; it simply receives reliable fees for moving product from the energy companies to their customers.

The stock appears oversold right now, giving investors a great opportunity to buy shares at a cheap price while receiving a fantastic dividend. At the current price the stock provides a 7.7% dividend yield.

Long-term investors have done well with Enbridge. A $10,000 investment in the stock 20 years ago would also be worth close to $100,000 today.

The bottom line

It is quite reasonable for Canadians to build a $200,000 TFSA portfolio by the time they retire.

A diversified portfolio of top dividend stocks including Royal Bank and Enbridge would easily provide an average yield of 6% today. This would create $12,000 per year in tax-free income per person on a $200,000 TFSA or $24,000 for a retired couple with $400,000.

That's an extra $2,000 per month that is not taxed by the CRA and won't be counted to determine potential OAS clawbacks.

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