Retiring Soon? Here Are 2 Simple Ways to Avoid the 15% OAS Clawback

Description

Canadians approaching retirement will inevitably come face-to-face with the Old Age Security (OAS) clawback. The 15% recovery tax of the Canada Revenue Agency (CRA) is a thorn on the OAS beneficiaries' side. This notorious clawback can claim a significant portion of your pension payments if you don't watch out.

The maximum monthly OAS payment is $613.53, while the set minimum income threshold for 2020 is $79,054. If your net income exceeds the threshold, you trigger the clawback. The CRA will levy a tax equivalent to 15% of the excess income.

Assuming your income is $90,000, the excess is $10,946. You will have to pay the 15% of the amount or $1,641.90 ($136.83 per month) to the CRA. Keep in mind too of the $128,137 maximum threshold. Should your net income exceed this limit, you get zero OAS benefit. The clawback rules are clear, so it's your lookout to avoid the tax bite.

Current retirees don't like reducing the OAS benefits, so they have learned the art of minimizing the clawback's impact. You can adopt the same proven strategies that, in some instances, eliminate the nuisance.

Focus on your TFSA

Why complicate matters when you can be tax-free all the way? To make sure none of your extra income is taxable, focus on your Tax-Free Savings Account (TFSA). Investment income doesn't count as income. All earnings, gains, interest, and profits from this registered savings account are tax-exempt.

Most TFSA users hold shares of **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) in their TFSAs. The bank stock is among the buy-and-hold equities on the TSX. You can purchase BNS today at $55.40 per share, which is effectively 21% less than its 2019 year-end price. However, the dividend yield is a lucrative 6.45%.

An investment of $25,000 will generate a tax-free income of $1,612.50 ($403.13 quarterly) within your

TFSA. In 20 years, your money will compound by 349% to $87,267.66. A dividend-paying blue-chip stock like BNS is for long-term investors. Its track dividend track record is 188 years, no less, and the bank maintains a payout ratio of 50% to 60%.

Consider the delay option

Canadian seniors automatically qualify to receive the OAS benefit when they reach 65 years. However, the pension program offers an incentive for healthy seniors. If you're in the pink of health or excellent shape, delaying your OAS until 70 is a practical decision.

The defer option hits two birds with one stone. Your OAS benefit will increase by 0.6% for every month of delay. After the five-year waiting period, the total permanent increase is 36% per month. Similarly, the added advantage is that when your income between the ages of 65 and70 is high, this scheme will work to skirt the OAS.

Less fanfare

The OAS clawback will sting if you will allow it. It would help if you were savvy, not in bending the rules, but in fighting back the legitimate way. There are other useful tactics, like splitting the pension with your spouse. The two strategies, however, are the most straightforward, less fanfare and more tax savings.

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