CPP Pension Users: 3 Shrewd Ways to Avoid the 15% OAS Clawback

Description

The Canada Pension Plan (CPP) has no clawback provision like the Old Age Security (OAS), one of the key differences in the two pensions. But since a CPP pensioner will receive the OAS too, the 15% clawback can reduce the combined monthly payments.

When you settle into retirement (probably at age 65), the OAS clawback comes into play. You must pay the 15% recovery tax back to the Canada Revenue Agency (CRA) should your net income exceed the agency's minimum income threshold. Canadian retirees, however, have found shrewd ways to keep the claws off their OAS.

For the income year 2020, $79,054 is the minimum income recovery threshold. Assuming your income is $90,000, your repayment will be 15% of $10,946 (excess amount). Thus, the OAS clawback is $1,641,90, or $136.82 monthly. Your OAS benefit is zero if your income reaches the maximum threshold of $128,137.

Withdraw RRSP before 65

To avoid the OAS clawback threshold, some retirees withdraw their Registered Retirement Savings Plan (RRSP) funds before 65 and declare as income. This strategy brings down your taxable income, because it doesn't count in your OAS clawback amount.

Many CPP users invest in **Bank of Montreal** (TSX:BMO)(NYSE:BMO) to build their retirement fund. This investor-friendly bank stock is a qualified asset in the RRSP. You will enjoy the tax-deferral benefit, since dividend earnings from BMO are tax sheltered while growing.

If you take a position at the fourth-largest bank of Canada today, you can purchase the stock at almost a 25% discount. The recent market selloff brought down the price to $73.28. However, BMO offers a 5.62% dividend. A $100,000 RRSP fund will generate $5,620 in passive income. In a 20-year holding period, the fund will grow to $298,485.52 tax-free.

BMO is the ideal investment for retirees. Dependability is the main takeaway; the bank was the first company in Canada to pay dividends. The practice has been going on for 191 years. Likewise, the dividends are safe since BMO maintains the payout ratio between 50% and 60%.

The drawback of taking out the RRSP before 65 is that you lose out on the tax-deferral benefits. Your money can compound some more until age 71 when your RRSP expires and you withdraw the entire balance.

Split pension income

A surefire way to fight back and do away with the notorious OAS clawback is to split your pension income with your spouse or common-law partner. It makes perfect sense, especially when the spouse earns significantly less than the other. You have the liberty of splitting up to 50% of your income.

Delay your CPP

Delaying your CPP until 70 prevents triggering the OAS clawback. Also, it’s an inexpensive way to boost your CPP payments. Retirees take this deferral option because it increases the CPP pension by 8.4% (42% total) for every year of delay after 65. This shrewd way is more advantageous than the first two methods financially. However, you must be in the best of health and willing to wait.

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