Canada Revenue Agency: How to Generate $7,800 in Extra Annual Pension Income and Avoid OAS Clawbacks

Description

Canada's pension programs, such as the Canada Pension Plan (CPP) and Old Age Security (OAS), aim to help retirees lead a comfortable life. The OAS is, in fact, Canada's largest pension program, and eligible Canadians over the age of 65 can apply for this payout.

The Canada Revenue Agency (CRA) states that the maximum monthly OAS payment for a 65-year-old Canadian is $613.53. This amounts to a maximum annual OAS payment of $7,362.36.

If retirees have multiple income streams with an annual income of over $79,054, the CRA will levy a 15% tax on OAS pensions. Further, if your annual net income exceeds $128,137 in retirement, the entire OAS amount will be recovered by the CRA.

However, there are ways to avoid OAS clawbacks by the CRA. One popular method is by generating income under a Tax-Free Savings Account (TFSA). The TFSA is a registered account where withdrawals are exempt from CRA taxes. These withdrawals can be in the form of dividends or capital gains, making the TFSA ideal for dividend-paying stocks.

According to the CRA, Canadians over the age of 18 with a valid social insurance number can contribute to a TFSA. The TFSA was introduced back in 2009, and the cumulative contribution room for this registered account stands at $69,500.

So, retirees can leverage the tax break features of the TFSA and avoid or limit clawbacks on their OAS payments. There are several dividend-paying Canadian companies for retirees to park their funds, and we can take a look at a few of them here.

Large Canadian banks

Retirees can hold investments in large Canadian banks that also pay tasty dividends. The recent pullback in stock prices due to rising unemployment rates and the threat of defaults has meant that Canada's largest banks are trading at cheap valuations. The dividend yields of the Big Five banks are as follows:

Royal Bank of Canada: 4.5%

Toronto-Dominion Bank: 5.1%

Bank of Nova Scotia: 6.2%

Bank of Montreal: 5.5%

Canadian Imperial Bank of Commerce: 6.1%

Canadian pipeline stocks

Another set of companies that have survived multiple recessions and generate stable cash flows across business cycles are energy pipeline companies. These firms have a contract-based business model, which makes them largely immune to commodity prices.

The dividend yields of top energy pipeline companies are as follows:

Enbridge: 7.23%

Pembina Pipeline: 7.3%

TC Energy: 5%

Recession-proof stocks

Companies in the utilities and telecom sectors are considered recession-proof, as they provide essential services. These companies are part of a regulated industry that helps them generate a predictable stream of revenue and generate cash flow to sustain and grow dividends. The dividend yields for top recession-proof companies on the TSX are as follows:

Telus: 4.8%

Canadian Utilities: 5.3%

BCE Inc: 5.9%

Fortis: 3.5%

TransAlta Renewables: 6%

Emera Inc: 4.5%

Algonquin Power & Utilities: 4.6%

The Foolish takeaway

If you allocate your TFSA contribution of $69,500 equally among the above-mentioned stocks, you can generate close to $3,800 in annual dividend payments. If these companies increase their dividends at an annual rate of 5% over the next 20 years, annual dividends will increase to $9,600.

Further, if these stocks can return 5% annually via capital gains your total annual returns for the first year will be close to $7,250. Investing in blue-chip, dividend-paying companies remains a top bet for retirees given their ability to increase dividends and create massive wealth over the long term.

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Date
2025/09/28
Date Created
2020/08/13
Author
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