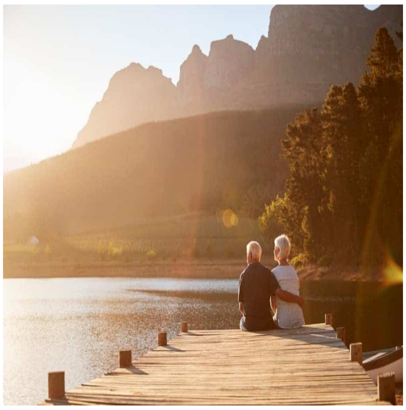

Canada Revenue Agency: How Retirees Can Earn an Extra $289 Per Month and Avoid the OAS Clawback

Description

Canadian seniors want to know how they can earn more money without being hit by the OAS pension recovery tax.

CRA clawback

The OAS clawback often comes as a surprise to new OAS recipients.

Retirees face a number of financial challenges these days, and one wouldn't expect the government to take back some of the pension money paid out under the OAS program. But that's exactly what can happen when net world income tops a minimum threshold for a given tax year.

Seniors receive taxable income from a number of sources, including company pensions, CPP payments, RRSPs, and taxable investment accounts. Earnings from a rental property or a part-time job can also helps pay the bills, but the earnings are taxed. The CRA lumps all of these income sources together when it determines the potential OAS clawback.

Every dollar of earnings above the income threshold triggers a $0.15 OAS clawback. For the 2020 tax year, the recovery tax kicks in above $79,054. At net world income of $128,137 the full OAS pension would be recovered through reductions in the next year's payouts.

It's true that $79,000 is a decent income, but it doesn't take long to top that amount, especially if someone has a good company pension. The after-tax cash left to cover bills isn't really that high, and many seniors with this level of income might find things are getting tight.

TFSA to the rescue

One perfectly legal strategy to boost income while avoiding CRA clawbacks involves earning money on investments held inside a Tax-Free Savings Account (TFSA).

The government started the TFSA in 2009 precisely to help Canadians save more money. Young people can use the TFSA to build tax-free retirement funds. Seniors can use the TFSA to generate earnings that won't trigger the OAS clawback.

The TFSA cumulative contribution space is now as high as $69,500 per person. This gives retired couples up to $139,000 in TFSA room to generate tax-free income.

Top TFSA investments

Government bonds and GICs protect the capital invested, but the returns are so low right now that many people are turning to dividend stocks.

Owning shares of companies carries risks, as we saw with the crash earlier this year. However, top firms with strong businesses and long histories of revenue and profit growth should be reliable picks for a buy-and-hold income fund.

In the current environment it makes sense to pick names with attractive dividends that should be very safe during the recession and will continue to grow as the economy recovers.

Fortis (TSX:FTS)(NYSE:FTS) would be a good example to consider today. The utility company owns power generation, electric transmission, and natural gas distribution assets in Canada, the United States, and the Caribbean. Nearly all of the revenue comes from regulated businesses, meaning cash flow should be reliable and predictable.

Growth comes from acquisitions and investments in new projects across the existing assets. The current capital program will see Fortis significantly expand the rate base over the next four years. As a result, the board intends to raise the dividend by an average annual rate of 6% through 2024.

At the time of writing, the stock trades near $53 per share and provides a respectable 3.6% yield.

The bottom line

A balanced portfolio is always recommended.

Retirees can easily put together a basket of top Canadian dividend stocks that provide an average yield of 5% today. This would generate $3,475 per year in tax-free income on a $69,500 TFSA fund. That's more than $289 per month!

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