TFSA Pension: How a Retired Couple Can Earn $8,300 in Tax-Free Income and Avoid OAS Clawback

Description

Canadian retirees need to ensure they keep an eye on the income they generate in order to avoid clawbacks by the Canada Revenue Agency (CRA) on their Old Age Security (OAS) pension.

The OAS is Canada's largest pension program, and if your net annual income exceeds the threshold amount of $77,580 for the income year of 2019, the CRA will claw back part of your OAS. The threshold amount will increase to $79,054 in 2020 or for the recovery tax period between July 2021 and June 2022.

For example, if your income for 2019 was $90,000, then the repayment will be the 15% difference between $90,000 and $77,580, which is $1,863 (15% of $12,420). So, you would have to repay $1,863 for the period between July 2020 and June 2021 to the CRA.

If your net annual income exceeds the maximum threshold amount of $128,137 the CRA will claw back the entire OAS pension amount. However, you can reduce or eliminate the clawback by holding investments in a TFSA (Tax-Free Savings Account).

The TFSA is a Canadian registered account that can be used to hold investments such as equities, bonds, ETFs, or mutual funds. Any withdrawals in the form of dividends, capital gains, or interest are exempt from CRA taxes, and they are not counted as part of your annual income.

So, the TFSA is an ideal account to hold quality dividend stocks that will ensure a steady stream of income. Further, you can also benefit from capital gains over the long term.

Retirees may have a cumulative contribution room of $139,000 in their TFSA

The TFSA was introduced in 2009, and the maximum cumulative contribution room available for Canadians is $69,500. So, for retired couples, this TFSA amount will double to $139,000. The recent weakness in energy stocks provides investors an opportunity to buy blue-chip stocks such as **Enbridge** (TSX:ENB)(NYSE:ENB) at a depressed valuation.

Enbridge stock is trading at $38.6 and has a forward dividend yield of 8.5%. It is a diversified energy infrastructure company that generates the majority of its EBITDA via long-term contracts.

This robust business model has made it relatively immune to volatile changes in commodity prices and allowed Enbridge to increase dividends at an annual rate of 11% in the last 25 years.

Despite falling crude oil prices, the company's EBITDA was up 3% in Q2, and its payout ratio was less than 65% in the first six months of 2020. Enbridge continues to invest heavily in expansion projects, which will bring in cash flows in the upcoming decade and help it increase dividend payouts over time.

The Foolish takeaway

It is not prudent to invest such a massive amount into one stock, and you need to identify a portfolio of quality companies with attractive dividend yields for your TFSA. If stocks in your portfolio have an average forward yield of 6%, you can generate over $8,300 in annual dividend payouts.

Further, blue-chip companies tend to increase dividend payouts over time. So, if the companies increase dividends by an average of 6% every year, your annual dividend income can easily double in 12 years.

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Date
2025/09/16

Date Created
2020/10/18
Author
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