Canada Revenue Agency: How Retired Couples Can Earn an Extra $650 Per Month and Protect Against the OAS Clawback

Description

The Canada Revenue Agency (CRA) levies a pension-recovery tax also known as a clawback on the Old Age Security (OAS) payouts for retirees. So, Canadian retirees who receive the OAS pensions might have to look at this unique recovery tax that can be avoided.

What is the OAS clawback?

The CRA claws back your OAS if you have a net world income of over $79,054 for the 2020 tax year. Further, the maximum income threshold is $128,149, after which your entire OAS payout will experience a clawback.

The CRA will tax every dollar earned above the minimum threshold at a recovery tax rate of 15%. For example, if the net income for a retiree is $100,000 in 2020, the OAS clawback will be implemented on $20,946 ($100,000-$79,054), which means the total tax will be $3,141.9 (15% of $20,946).

It is good to have this problem of clawbacks, as it means you are generating significant income even during retirement. However, this also puts retirees in a high marginal tax bracket, which suggests that the amount left over for expenses after taxes will reduce drastically.

Hold investments in a TFSA to avoid CRA taxes and OAS clawbacks

The Canada Revenue Agency taxes pension payments such as the CPP and OAS as well as your RRSP withdrawals. However, there is one registered account where withdrawals are exempt from CRA taxes, which is the TFSA (Tax-Free Savings Account).

The TFSA was introduced back in 2009, and the cumulative contribution limit at the end of 2020 stands at $69,500. For retired couples, this amount doubles to $139,000. In retirement, you would want to have a steady source of income, which makes blue-chip dividend stocks extremely attractive instruments.

At a time when interest rates are below 2%, you can look to invest in quality dividend paying companies and create a passive-income stream. Tax-free withdrawals make the TFSA an ideal option to hold dividend stocks and generate a predictable income stream.

As retirees need to have a lower risk appetite, they require exposure to large, established Canadian companies. We'll take a look at some of the largest companies on the TSX and their respective dividend yields.

- **Royal Bank of Canada**:4.5%
- **Toronto-Dominion Bank**: 5.3%
- **Enbridge**: 8.5%
- **Bank of Nova Scotia**:6.4%
- **Bank of Montreal**: 5.2%
- **BCE Inc**: 6.3%
- **TC Energy**: 6.4%
- **Canadian Imperial Bank of Commerce**: 5.8%
- **Telus**: 5%
- **Fortis**: 3.2%
- **Canadian Natural Resources**: 8%
- **Restaurants Brands International**: 3.3%

The Foolish takeaway

If you distribute your entire TFSA amount of $139,000 in each of these stocks, you can generate $7,800 in annual dividend payments, which means a monthly payout of $650. These are just a few examples of large-cap Canadian companies that have consistently maintained and increased dividend payouts over time.

You can use this article as a starting point for your research and identify similar companies with juicy and sustainable dividend yields. Even if these companies increase dividends at an annual rate of 3%, your annual payout will increase to $13,600 at the end of two decades.

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