Canada Revenue Agency OAS Clawback: How to Earn an Extra $4,170 and Avoid the Pension Recovery Tax

Description

Canadian seniors want to boost their income but have to watch out for the OAS clawback.

OAS clawback rules

The CRA takes back some of the Old Age Security pension when net world income moves above a certain level. In the 2020 income year, the OAS pension recovery tax kicks in once a person earns more than $79,054. Any taxable earnings generated above that level triggers a 15% tax that is used to reduce the OAS payments in the next year.

For example, a senior who has net world income of $89,054 in 2020 would be hit with $1,500 OAS clawback.

This might not sound fair, but that's how the OAS program is set up.

Retirees who get pension payments from a number of sources can easily hit the threshold. A person might receive a decent company pension, full CPP, and full OAS.

In addition, people who put extra money into RRSPs eventually have to roll the funds into RRIFs and remove a certain amount every year. That is also taxed as income. The government reduced the minimum RRIF withdrawal by 25% this year to help seniors cope with the pandemic, but that might not continue in 2021.

Earnings on investments held in taxable accounts also get added to the net world income total. So, it might not take long for a retiree to get into the OAS clawback scenario.

TFSA solution to avoid the OAS clawback

Aside from winning the lottery, earning money inside a TFSA is the best way to get extra income without being bumped into a higher tax bracket or being hit by the OAS clawback.

All profits earned on investments inside a TFSA are tax-free. In addition, the CRA does not count any of the gains removed from the TFSA towards net world income. In the early years of the TFSA, the contribution room was too small to make much of a difference. However, it is now as high as $69,500 per person and should increase another $6,000 in 2021.

At the current level, a retired couple has up to $139,000 in TFSA contribution space to generate tax-free income.

The best investments for a TFSA

GICs are safe, but they only pay about 1% today, and that’s if you lock the money in for few years. As a result, many retirees now own dividend stocks to boost returns. The good news is that many of Canada’s top dividend payers now trade at reasonable stock prices and offer attractive yields.

For example, **BCE** currently offers a yield of 5.9%. The stock is a long-term favourite with retirees and should continue to be a solid holding.

Bank of Nova Scotia also offers a 5.9% yield right now. The pandemic is putting pressure on earnings in the near term, but the bank remains very profitable and the dividend looks safe.

Another interesting pick would be **TC Energy**. The company’s natural gas transmission businesses generate steady profits. In addition, TC Energy’s large capital program should support decent dividend growth for years. At the time of writing, the stock offers a 6% dividend yield.

The bottom line

Retirees can easily put together a top-quality TFSA income fund that generates an average 6% yield. That would provide $4,170 in tax-free income per year on a $69,500 portfolio and not put OAS at risk of the CRA clawback.

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