Canada Revenue Agency: How to Avoid the OAS Clawback

Description

Canadian seniors who collect Old Age Security (OAS) have to keep and eye on their earnings. When income is too high, the CRA implements the OAS clawback, also known as the OAS pension recovery tax.

OAS clawback rules

The CRA's pension recovery tax on OAS payments kicks in when a person's net world income tops a minimum threshold. The number to watch in 2020 is $79,054. Once net world income hits this level, every extra dollar of earnings triggers a 15 cent OAS clawback.

The pension recovery tax continues to increase until the full OAS for the year is accounted for and would be recovered through a reduction in the OAS in the next payment year. According to the CRA chart, the maximum threshold is $126,058 for the 2020 income year — at which point the full OAS gets clawed back.

To calculate your OAS repayment amount, you just have to determine how much your income is above the threshold and multiply the amount by 15%. For example, if you have net world income of $109,054 in the 2020 income year, you would have to repay $30,000 X 0.15 = $4,500.

What counts as net world income?

The CRA considers most retirement income sources toward the total. This includes company pensions, CPP, OAS, RRSP withdrawals, and RRIF payments. In addition, earnings from a part-time job, an income property, or investments held in taxable accounts also get added to the pot.

So, it doesn't take long for a person who worked hard their entire life to build a stream of retirement income to hit the $79,000 mark.

Aside from a good day at the casino or a lucky win on a lottery ticket, it is difficult to get more money as a senior without handing some over to the CRA. Fortunately, the government provides one attractive and legal option.

TFSA advantage to avoid the OAS clawback

The Tax-Free Savings Account (TFSA) gives retirees a chance to earn investment income that isn't counted toward the net world income calculation.

In 2020, the cumulative contribution space inside the TFSA is $69,500. This will increase to at least $75,500 in 2021, as the next limit hike is expected to be $6,000. That means a retired couple will have as much as $151,000 in TFSA contribution space next year.

At this level, retirees can earn significant dividends that can go right into their pockets.

Where to invest the TFSA funds

Seek out reliable dividend stocks that have long track records of distribution growth. Industry leaders with wide competitive moats tend to be solid picks. In the current environment, it makes sense to find companies that provide essential services and products.

For example, **BCE** and **Royal Bank of Canada** might be good stocks to start the fund.

BCE is Canada's largest player in the Canadian communications market. The company's world-class wireless and wireline networks deliver mobile, internet and TV services to millions of customers across the country. The nature of the Canadian market allows the large players to make decent money and have the funds necessary to invest in essential upgrades while paying investors a solid dividend.

At the time of writing, BCE stock offers a 5.9% yield.

Royal Bank is Canada's largest financial institution by market capitalization. Like BCE, the bank operates in a profitable market. Royal Bank generated more than $12 billion in adjusted net profit last year and continues to earn large profits in the pandemic.

While the stock isn't as cheap as it was a few months ago, it still looks attractive. Investors who buy today can get a 4.1% yield.

The bottom line

BCE and Royal Bank are just two examples of top dividend stock in the **TSX Index** that should be solid picks for a TFSA income fund. It is quite easy to build a portfolio that provides an average yield of 5% today. This would pay a retired couple $7,550 in tax-free dividends on $151,000 in TFSA investments.

That's $629 per month in tax-free income that won't trigger the OAS clawback!

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Date
2025/08/24
Date Created
2020/11/20
Author
aswalker