Retirees: How to Build a 2nd Pension and Avoid the 15% OAS Tax Clawback

Description

While many Canadians will be free from work-related stress when they retire, an unpleasant surprise awaits them. Income tax will remain a thorn and could be the biggest expense in retirement. The Old Age Security (OAS) becomes available at age 65, although the benefits can be smaller depending on the taxable income you generate.

The OAS recovery tax is the tax hit Canadian retirees dread the most. Your pension payment reduces when your net income goes beyond the Canada Revenue Agency's (CRA) minimum threshold income recovery. Furthermore, you get nothing when earnings breach the tax agency's maximum threshold level.

There are proven ways retirees can avoid the OAS clawback, but it would be best to build a second pension to offset its impact or fill the pension's shortfall. The important thing is to plan and minimize the sting.

3 OAS deterrents

When you receive notice from the government that you're available to receive OAS, it indicates your coming encounter with the clawback. Be a step ahead and do the following:

1. **Splitting pension income** allows a higher-income spouse to lower the tax bill by transferring up to 50% of eligible pension income to a spouse. It could eliminate the 15% tax too.
2. **Defer your OAS** until 70 to receive higher benefits. For every month you defer, your OAS payment increases by 0.6%. The permanent increase in the five-year wait is 36%. Be sure to inform Service Canada of your decision to defer your OAS before you turn 65.
3. **Topping up your Tax-Free Savings Account (TFSA)** will keep your income below the clawback threshold. The CRA doesn't treat income in the TFSA as taxable, nor does it charge tax on fund withdrawals. Monitor your available contribution room so as not to over-contribute and pay a penalty tax.

Build a second pension

Invest in a safe dividend stock like the **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) to build a second pension. The fifth-largest bank in Canada is a mean cash cow, especially for income investors and retirees. This buy-and-hold asset has been paying dividends since 1868 (152 years).

CIBC trades at $111.47 per share today, a stunning 73% rally from its COVID-low of $64.42 on March 23, 2020. Blue-chip stocks will display resiliency and rebound from market crashes every time. Thus far, the year-to-date gain is 8.27%. This bank stock currently pays a high 5.31% dividend.

If the maximum monthly OAS in 2020 is $613.53, invest $138,700 in CIBC to earn an equivalent amount per month. Assuming the dividend yield remains constant for 20 years, your nest egg would be around $390,363.06 or close to $400,000.

Analysts forecast the price to appreciate by 25% to $139 in the next 12 months, another potential upside for would-be investors. Expect CIBC's modernized banking platforms to drive strong top-line growth in the post-COVID world.

Face the reality

Apart from forward tax planning, Canadian retirees can meet lifestyle needs and live comfortably by creating a pension-like income from a safe dividend stock. Your OAS, along with the Canada Pension Plan (CPP), is guaranteed income for life. However, the pensions alone will not give you financial stability in the sunset years.

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