Canada Revenue Agency: Are You at Risk of the OAS Clawback?

Description

Canadian seniors have to watch their income carefully to avoid the Canada Revenue Agency's (CRA) OAS clawback.

What is the OAS clawback?

The CRA implements a pension recovery tax on Old Age Security (OAS) payments when net world income in a calendar year moves above a minimum threshold. The tax is widely known as the OAS clawback.

Retirees feel they are being punished for making smart decisions through their working lives. They maxed-out contributions to defined-contribution pension plans, RRSPs, and invested extra cash to build the reserve. The government encourages Canadians to put money aside for the golden years but then takes some away if the retirement plan is too successful.

Seniors collect retirement income from several sources, all of which are deemed as taxable earnings. The list includes defined-benefit and defined-contribution pension plans, CPP, OAS, RRSP withdrawals, or RRIF payments. Earnings from investments held in taxable accounts or other assets, such as rental properties, also go into the mix.

The CRA adds all the income sources together to determine annual net world income. It then measures the amount against the OAS clawback threshold. The income level is $79,054 for 2020. Based on increases over the past two years, the 2021 OAS clawback threshold could be close to $80,500.

The CRA applies a 15% OAS pension recovery tax on every dollar of net world income above the threshold. It deducts the amount from the OAS payments due in the next fiscal year of the program.

For example, a senior with net world income of $89,054 in 2020 is hit with a 15% OAS clawback on $10,000. That means a $1,500 reduction in the OAS pension paid for the July 2021 to June 2022 OAS payment term.

How can you avoid the OAS clawback?

Taxable income sources in retirement are often fixed amounts. So, retirees have to look at options that provide tax-free earnings. One strategy involves moving all money held in taxable investment accounts to a TFSA, if the room is available. The TFSA came into effect in 2009 and the limit grows each year. The cumulative amount of contribution space in 2021 will increase by $6,000, bringing the total as high as $75,500 per person.

This gives a retired couple $151,000 in TFSA investment room to earn income that isn't taxed and won't be used to determine the OAS clawback.

Retirees at the OAS clawback threshold can save a lot of money. Earnings on investments held in taxable accounts not only put you at risk of the recovery tax; they can also bump you into a higher marginal tax bracket, so it can be a double hit!

Best investments for a TFSA

GICs don't pay much these days. As a result, retirees use dividend stocks to boost returns. Top companies enjoy reliable and predictable revenue streams and offer attractive dividends that grow steadily over time.

For example, **Fortis** might be an interesting pick right now for a TFSA income fund. The company raised its dividend in each of the past 47 years and the board intends to boost the payout by an average annual rate of 6% through 2025. That's great news for TFSA income investors. Fortis offers a solid 4% yield at the current share price, so you get paid well during tough times.

The bottom line

Short of winning the lottery, it is tough for retirees to boost income and avoid the OAS clawback. However, the CRA at least gives seniors the TFSA as an option to earn tax-free income. At the existing TFSA limit levels, retired couples can generate decent tax-protected earnings.

Fortis is just one of the top dividend stocks in the **TSX Index**. Several appear oversold and offer fantastic yields right now.

CATEGORY

1. Dividend Stocks
2. Investing

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Yahoo CA

Category

1. Dividend Stocks
2. Investing

Date
2025/09/11
Date Created
2020/12/03
Author
aswalker