Retirees: Grab This $7,637 Credit and Earn $189/Month Tax-Free

Description

When you’re retired, every penny counts. The minute you stop working, you need to start paying that much more attention to your taxes, because pension income isn’t likely to replace your employment income.

In 2020, CPP and OAS *combined* only pay about $1,286 a month on average. That’s far below the poverty line. In fact, it’s not even enough to pay rent in many Canadian cities.

The implication is this: In order to offset lower taxes in retirement, you need to pay close attention to your income and claim every possible tax break you’re entitled to. In this article, I’ll explore one such $7,637 tax break that can save you big come tax time.

The age amount

The age amount is a $7,637 portion of your income that has a 15% tax credit applied to it. The maximum tax savings from the credit is $1,146.

You don’t necessarily get the full credit from the age amount. The amount is clawed back by 15% for earnings in excess of $38,508. The website Taxtips.ca gives an example of an individual earning $50,000 who saves only $849 from the age amount due to clawbacks. However, even $849 is a great savings. And, as you’re about to see, there’s a great way to put any tax refunds you receive to work for you, so the money grows over time.

How to get even more tax savings

If you get a tax refund from claiming the age amount, you can put the money to work for you, to generate more income and further tax breaks.

The way you do that is by investing in a Tax-Free Savings Account (TFSA). A TFSA is a special tax-sheltered account that spares you the taxes you'd normally pay on dividends and capital gains.

By investing money you save from the age amount in a TFSA, you can earn income and boost your tax savings.

Let's imagine that you held $75,500 worth of **BMO Mid-Term U.S. Investment Grade Corporate Bond Index ETF** (TSX:ZIC) in a TFSA. According to **BMO's** website, this ETF yields about 3%. That's enough to generate $2,265 in annual income on $75,500. It works out to $189 on a monthly basis. ZIC is a very conservative bond fund — backed by safe interest income. This type of "defensive" investment is ideally suited to retirees. And with a TFSA, you can shelter 100% of the income from taxation.

Of course, if you're saving $1,146 a year from the age amount, it will take a long time to get to $75,500. But you're not limited to investing just your tax refunds. By depositing $10,000 a year from various sources, you'd get up to $75,500 in just over seven years. At that point, you'd be able to generate thousands of dollars a year in tax free income — even with defensive ETFs like ZIC. And if you got into more enterprising investments, like stocks, you could boost your returns even further.

It's simply a great way to put your tax savings to work for you. And remember: when you're retired, every penny counts.

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