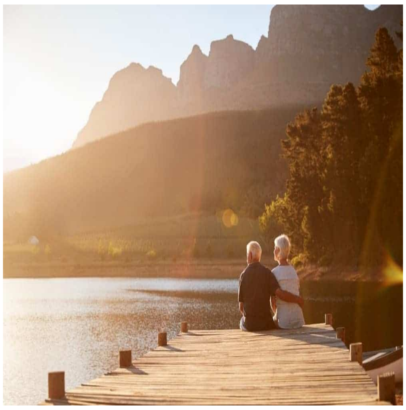

Canada Revenue Agency: How Retired Couples Can Earn an Extra $660 Per Month and Avoid OAS Clawbacks

Description

The Old Age Security pension (OAS) provides Canadian seniors with important income to meet monthly expenses, but it can be taken away by the CRA.

OAS clawback rules

Retirees must keep an eye on their income levels to make sure they minimize, or ideally avoid, the OAS pension recovery tax, otherwise known as the OAS clawback.

The CRA has OAS rules that say anyone who receives OAS and reports net world income above a certain level is subject to a reduction in the next year's OAS payments. The recovery tax in 2020 kicks in at net world income of $79,054.

Every dollar of income earned above this amount triggers a $0.15 OAS clawback. So, a senior with net world income of $109,054 in 2020 would see their OAS in the next payment year reduced by $30,000 X 0.15 = $4,500. That's a meaningful hit.

Now, you might think that anyone who earns retirement income of $79,000 or higher can afford to take a reduced OAS payment. That might be the case for some people. Others, however, could be just scraping by depending on where they live and what kind of expenses they incur each month.

Remember to consider taxes. For example, a person earning $80,000 in Ontario in 2020 would be at a combined provincial and federal marginal income tax rate of 31.48%.

TFSA solution

The CRA counts earnings from most sources when it determines net world income. Company pensions, CPP, OAS, RRSP withdrawals, and RRIF payments all go into the pot. The government reduced the minimum RRIF withdrawal rate by 25% for 2020 to help seniors cope with the pandemic. It is uncertain if the change will extend through 2021.

Retirees also get income from side gigs, rental properties and investments held in taxable accounts. These earnings also get added to the CRA's net world income calculation. So, it is easy to see how a person could quickly move above the $79,000 threshold.

Casino buffs can pick up some tax-free cash if they have a lucky day, but that's not a reliable way to generate steady retirement income. The odds of winning lotto 649 are roughly one in 14 million, so that's not much help either.

One strategy that *does* exist to create a steady stream of tax-free income involves taking advantage of the full TFSA contribution space. All interest, dividends, and capital gains earned inside the TFSA can be paid out tax-free without the CRA using the amount to boost net world income.

In 2021, the maximum cumulative TFSA contribution room per person is $75,500. This means a retired couple could earn income on a combined portfolio of $151,000.

A popular TFSA strategy involves owning top dividend stocks that pay reliable and growing distributions. Many of Canada's leading companies offer attractive yields right now that could generate significant tax-free income.

Equal investments in **Royal Bank**, **Fortis**, **BCE**, **Enbridge**, and **Manulife** would generate an average dividend yield of 5.25% at the time of writing. This would provide annual tax-free dividend income of $7,927.50. That's $660 per month!

The bottom line

The CRA encourages Canadians to take full advantage of their TFSA contribution space. In the case of seniors, getting investment income from the TFSA rather than from taxable investment accounts can help reduce, or avoid, the OAS clawback.

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