CRA: Delay Your CPP Pension to Reduce the 15% OAS Clawback for 5 Years

Description

Canadians retiring at age 65 are eligible to receive Old Age Security (OAS) benefits. The government pension doesn’t relate to employment history, so whether you’ve never worked before or were not employed, you still get the monthly payments. However, OAS benefits count as taxable income and, therefore, retirees are not free of taxes.

The Canada Revenue Agency (CRA) sets the minimum and maximum income thresholds every year. If your income exceeds the minimum threshold, you trigger the recovery tax or the notorious OAS clawback. The tax-equivalent is 15% of the excess amount, which the CRA will deduct from the benefits. Your OAS reduces to zero if your income exceeds the maximum threshold.

Since the Canada Pension Plan (CPP) pension payments are taxable income, CPP users also dread the OAS clawback. Taxes are thorns, especially to retirees, because it lessens retirement income. However, if you want to minimize, if not avoid, the recovery tax, a simple way is to delay your CPP until 70.

Hit two birds with one stone

The deferral option is a proven strategy of Canadian retirees. More importantly, you benefit in two ways. Delaying your CPP until age 70 increases your pension and reduces your net income at the same time. To further boost your retirement income, consider delaying your CPP and OAS.

If you delay both until 70, the permanent increases are 42% for the CPP and 36% for the OAS. In 2020, the average annual CPP pension at age 65 was $8,524.92. Thus, the amount bumps up to $12,105.39. For the OAS, instead of $7,362.36, it becomes $10,012.81.

Combine the pensions, and your annual income for life is $22,118.20 or $6.230.92 more than if you were to start CPP and OAS payments at 65. Consider splitting your pension if your spouse’s income is significantly lower than yours. Split up to 50% with your spouse or common-law-partner to bring down your tax bill.

Second fallback

The next best option to be rid of the 15% OAS clawback is to produce non-taxable income. Your vehicle to keep the CRA off your back is the Tax-Free Savings Account (TFSA). If you have savings or non-registered investments, move them to your TFSA if there's an available contribution room for tax-free income.

Pure dividend play

Most TFSA investors hold a pure-dividend play like **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) in their accounts. The energy stock is a top choice for the high yield and its dividend growth streak.

This $36.86 billion crude oil, natural gas, and natural gas liquids (NGLs) producer have raised its dividends for 19 consecutive years. Although the renowned dividend payer underperformed in 2020 (-27%), investors enjoyed a 5.48% dividend. However, CNQ should rebound in 2021 now that oil prices are picking up.

Canadian Natural Resources plays a vital role in the oil and gas industry, particularly in Western Canada, the North Sea close to the U.K. and Offshore Africa. Analysts are bullish and recommend a buy rating. The next 12 months' price target is $45, or a 44% jump from the current price of $31.21.

Minimize the tax bite

The 15% recovery tax will bite if CPP users won't do anything. Delaying your CPP will work wonders in reducing taxes and avoiding the OAS clawback.

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Date
2025/08/01
Date Created
2021/01/07
Author
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