CRA: Retired Couples Can Earn $629/Month and Avoid the 15% OAS Clawback

Description

The Canada Revenue Agency (CRA) is quite proficient in providing Canadian retirees access to pensions. However, the government agency also implements a hefty 15% pension recovery tax, or clawback, on the Old Age Security (OAS) pensions. Canadian retirees always face a unique tax challenge when the tax season comes due to this OAS clawback.

The OAS clawback

The OAS clawback is a pension recovery tax that is triggered when the world net income for a retiree reaches a minimum threshold. The minimum world net income threshold for 2021 is $79,845.

Once your retirement income hits this amount, the CRA is quick to reduce your OAS pension for the following payment year by 15% for each dollar of net world income above the threshold. The CRA keeps piling on the OAS recovery tax until it recovers the full OAS pension. The maximum threshold for the 2021 income year is $129,075.

Suppose that a retiree reported an income of $109,845 in 2021. In that case, the retiree will see their OAS payments reduced by $4,500 in the July 2022 to June 2023 period.

While $80,000 per year might seem like an adequate amount to live a comfortable lifestyle in retirement, you have to consider inflation, rising living costs, and income taxes as well. Many retirees are also facing rising rent costs or mortgage payments.

It is easy to understand why many Canadian retirees might be frustrated with the CRA, because of the OAS clawback. People who followed the right retirement planning practices while they earned active income might feel that it is unfair that a chunk of their pension is being taken away.

Use your TFSA to avoid the clawback

Fortunately, you can take advantage of your Tax-Free Savings Account (TFSA) to continue generating more retirement income without incurring the OAS clawback. The TFSA contribution room increased by $6,000 in 2021, bringing the cumulative contribution room in a TFSA to $75,000.

Between you and your common-law partner, you could have a total of $151,000 of investment room in your TFSAs to earn tax-free income that will not be used to determine OAS clawback amounts. If you can get average returns on $151,000 at 5% in your TFSA, you could potentially generate an additional $7,550 per year in passive income, translating to $629 per month. The CRA cannot tax this amount or count it as part of your net world income for the OAS clawback.

You will need to create a diversified portfolio of income-generating assets that can offer you a reliable 5% average dividend yield. **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) is an excellent stock to consider building such a portfolio.

The bank stock is an eligible investment for your TFSA, it is the fifth-largest financial institution in Canada, and it pays its investors at a juicy 5.17% dividend yield at writing. Besides its high dividend yield, CIBC returned 7% in 2020, despite the low-interest-rate environment, high loan-loss provisions, and the economic fallout from the pandemic.

CIBC also has an impressive 153-year dividend-paying streak. With virtually guaranteed dividends, CIBC could be an excellent addition to such a portfolio.

Foolish takeaway

A balanced TFSA portfolio is always recommended. I suggest diversifying your investments to get an average of 5% to earn $629 per month through your TFSA, but never allocate your entire contribution room to a single income-generating asset to reduce your risk. CIBC can be a foundation for such a TFSA portfolio, provided that you diversify and balance it.

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