Retirees: How to Prevent the CRA From Taxing Your OAS and CPP Pension!

Description

Retirees must be aware that under Canada's tax laws, the country's lead tax agency can tax the Old Age Security (OAS) and Canada Pension Plan (CPP). While both are guaranteed lifetime incomes of seniors, they aren't tax-free. The Canada Revenue Agency (CRA) will treat your pension payments as taxable income.

Pension taxation

Most Canadian retirees will rely on the OAS and CPP to fund their retirement. As such, any tax bite on either pension will reduce the benefit amount, which is worrying. The maximum OAS benefit is $615.37 (January to March 2021), although usually, it's net of any pension recovery tax in the year that you receive it.

For the CPP, the maximum monthly amount is $1,203.75 (as of October 2020), yet most users will receive $689.17 per month, on average. Tax deductions on your CPP are not automatic. You can sign in to your My Service Canada account or complete the request for voluntary Federal Income tax Deductions form.

If there's no request for monthly tax deductions, you may have to pay your income tax every quarter. Many retirees worry about outliving their retirement fund such that taxes become thorns. However, there's a proven and effective solution to minimize your tax payables during tax seasons.

Create non-taxable income

The Tax-Free Savings Account (TFSA) is popular among Canadians because it clips the CRA's power to collect taxes. By law, all interest, earnings, gains or dividends in a TFSA are tax-free. Withdrawals, regardless of the amount, are also tax exempt. Furthermore, withdrawals have no impact whatsoever on your OAS and CPP payments.

By creating non-taxable income through a TFSA, retirees can save big on taxes. Canada's tax system is progressive, which means taxes are higher for high-income earners, depending on the federal income tax brackets. Thus, if your annual income in 2020 is $58,436 and $10,000 is TFSA income, the tax rate is only 15%, not 20.5% if taxable income is between $48,536 and $97,069.

Top TFSA holding

Assuming you haven't opened a TFSA and have been eligible since 2009, your available contribution room in 2021 is $75,500. The potential tax-free income from a dividend king like **Keyera** (TSX:KEY) is $5,526.60. The energy stock pays a high 7.32% dividend, so it's the best fit for your TFSA.

Despite the massive headwinds from the oil price slump and the global pandemic, it didn't severely affect Keyera's core business. This $5.79 billion energy infrastructure company plays a vital role in Canada's oil and gas midstream industry. The average oil price in 2020 was $41.29 per barrel, but the IMF forecast it to rise by 20% to $50 per barrel this year.

One notable trait of Keyera's business is its sensitivity to volumes, not so much on the oil price. Meanwhile, demand for natural gas is rebounding to all-time highs. The share price is lower by 20% compared to a year ago, so it should be a good entry point.

No love lost

The CRA will forever hound Canadians earning pensions or retirement incomes. There's no love lost between both, although retirees can reduce the tax bite by creating non-taxable income. A new tax season is coming, so another bout with the taxman is at hand.

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Date
2025/07/30
Date Created
2021/02/24
Author
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