Canada Revenue Agency: 3 Ways to Avoid the 15% OAS Clawback

Description

Canadian retirees hate the 15% Old Age Security (OAS) clawback the most every tax season. The Canada Revenue Agency's (CRA) so-called recovery tax is hurtful because it reduces retirees' financial sustenance. While lower-income individuals are least affected, many still worry about triggering the notorious clawback.

The recovery period for the 2020 income year is from July 2021 to June 2022. If your net income goes beyond the minimum income recovery threshold of $79,054, you enter the clawback zone. The OAS benefit is zero if net income reaches the maximum threshold of $128,149.

Assuming your income in 2020 is $90,000, you exceed the threshold by $10,946. The CRA will charge a 15% tax on the excess, or $1,641.90. You would have to repay the amount during the recovery period. Fortunately, smart seniors have ways to fight back. There are proven strategies you can use to defang the OAS clawback.

1. Reallocate pension to spouse

Pension sharing is a popular strategy among retirees. The CRA allows Canadians over 65 to split the Canada Pension Plan (CPP), Retirement Registered Income Fund (RRIF) or pension income with their spouse or common-law partner. This approach is one of the savviest ways to lower individual income for either spouse to limit the tax bite.

2. Delay the start of OAS payments

Deferring the OAS pension by five years or until age 70 works best if your income level between 65 and 70 brings you closer to the OAS income threshold. You become eligible to receive a higher monthly pension with this option. The pension amount increases permanently by 36% (7.2% per year after 65) at age 70.

3. Create non-taxable income

Since the 15% OAS clawback applies only to taxable income, the third proven strategy is to created non-taxable income. Your vehicle to succeed with this ploy is through a Tax-Free Savings Account (TFSA).

Remember that all interest, gain, or dividends in a TFSA are 100% tax-free. Hence, it would be wise to utilize and maximize your TFSA contribution limits to produce more tax-exempt income. Withdrawals, regardless of amount, are similarly tax-free.

Defensive qualities

High-yield dividend stocks are not necessarily the best choices for TFSA investors. You must also pick assets with defensive qualities to ensure consistent dividend payouts and tax-free money growth. **Loblaw** (TSX:L) pays a 2.07% dividend, but the business model is recession-resistant and worry-free.

The $22.47 billion food and pharmacy company was resilient as ever during the 2020 health crisis and until the present. In the fiscal year 2020 (year ended January 2, 2021), total revenue increased by 9.7% to $52.7 billion versus the fiscal year 2019. Notably, Loblaw's operating income grew 4.2% to $2.3 billion. The company spent approximately $445 million in COVID-19 related costs, although e-commerce sales grew by a whopping 178%.

Customer trends are changing due to the ongoing pandemic, but you can expect Loblaw to adapt and meet them head-on. Market analysts are bullish and forecast the stock to scale new heights. The price target in the next 12 months is $91, or a 40.6% increase from its current price of $64.70.

Tax planning

The 15% OAS clawback shouldn't be a threat at all. You can incorporate the three legitimate and proven strategies in your tax planning to avoid the CRA's unpopular recovery tax.

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