CRA: 3 Ways to Avoid the 15% OAS Clawback Taxes Legally

Description

Financial hardship is the worry of most retirees, so it hurts if their pensions reduce because of taxes. In Canada, the Old Age Security (OAS) charges a recovery tax similar to withholding taxes on salaries. Thus, Canadian retirees hate the so-called 15% OAS clawback the most for obvious reasons.

There are times every tax season that seniors overlook, if not forget, the income threshold that triggers the clawback. For current and would-be retirees, it's important to know how the clawback works.

For the 2020 income taxes, the OAS benefit reduces if net income exceeds the minimum income threshold of $79,054. The clawback is 15 cents for every dollar above the threshold. However, if your income reaches the maximum threshold of $128,137, the CRA claws back the entire OAS benefit.

However, there are ways you can avoid the recovery tax to receive the maximum $613.53 OAS monthly benefit. All three are legal in the eyes of the Canada Revenue Agency (CRA).

1. Split pension income

The CRA allows pension splitting between spouses. A higher income spouse can transfer up to 50% of eligible pension income to a spouse to lower tax bills or eliminate the OAS clawback.

2. Defer OAS

A good strategy for Canadians working past 65 is to defer taking the OAS until age 70. The payment increases by 0.6% every month you delay until you turn 70. Once you stop working and income declines, the benefit is more considerable but less likely to bring you to the clawback zone.

3. Create non-taxable income

Canadian retirees can keep the CRA off their backs by topping up or maximizing the Tax-Free Savings

Account (TFSA) contribution limits. The CRA doesn't consider income derived from the TFSA as taxable income. TFSA withdrawals are likewise tax-exempt, so you can still cover your financial needs without incurring needless tax expenses.

Solid dividend growth stock

Dividend Aristocrats are ideal investments in a TFSA. Apart from avoiding the 15% OAS clawback, income streams are lasting. **Emera** (TSX:EMA) is an attractive option because it operates a strong regulated asset base. Nearly 100% of its earnings come from a regulated asset portfolio.

The $13.97 billion regulated utility company from Halifax, Canada, has a solid history of growing dividends. Emera has recorded a dividend per share growth of more than 8% compound annual growth rate (CAGR) in the last decade. Over the past three years, earnings per share (EPS) increased at a rate of 17% CAGR.

If you were to invest in Emera today, the share price is less than $60 ($55.59), while the dividend yield is a decent 4.59%. A $20,000 TFSA investment will produce $918 in tax-free passive income.

Emera engages in the generation, transmission, and distribution of electricity and gas in North America. The company also provides other utility energy services. Growth is likewise visible, given management's continuing investments in renewable energy, infrastructure modernization, and customer-focused technologies.

Protect your healthy income

Retirement planning should include tax projections to ensure the CRA can't claw back any amount from the pension or retirement income. Remember that Canadian retirees with healthy income have to deal with taxes, especially the 15% recovery tax. If you don't want to forego some or all of your OAS benefits, see which of the three ways work best for you this tax season.

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