Retirees: 3 Ways to Avoid the Painful 15% OAS Clawback

Description

Canadian retirees will lock horns again with the Canada Revenue Agency (CRA) over the recovery tax in the 2021 tax season. Those who'll be subject to the 15% Old Age Security (OAS) clawback for the first time should know that it's a yearly battle. This tax that retirees dread the most is a thorn because it can reduce pension benefits or zero it out altogether.

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However, it's not a losing battle. Retirees have three proven ways to minimize the tax bite or even render it harmless. The CRA knows the ways too, but won't fault you because they're all acceptable and legal.

The 2020 monthly OAS benefit stands at $613.53. You won't trigger the clawback if your income doesn't exceed the minimum threshold ($79,054). The CRA charges you a 15% tax on the excess amount. Moreover, if your income touches the maximum threshold of $128,137, you get nothing. These are the salient figures you must remember when you file your 2020 taxes.

1. Defer OAS until 70

The first way to contend with the OAS clawback is to delay your benefit payments by five years. Your OAS payments start at 65, but if you were to take it at age 70, the amount increases by 7.2% per year of delay. This strategy works best when you finally stop working and income is smaller. You're unlikely to enter the clawback zone.

2. Split the pension

The CRA is lenient or won't mind if spouses split the pension. While this approach is simple, it works to draw income further away from the threshold. A higher-income spouse can transfer up to 50% of eligible pension income to a spouse. Pension splitting between spouses is legitimate and doesn't violate any tax laws.

3. Top up your TFSA

Top up your Tax-Free Savings Account (TFSA) if you have one. Canadian retirees who use or maximize their TFSA contribution limits create non-taxable income. The CRA will not impose taxes on interest, gain, or dividends inside a TFSA. Don't fear taking out funds because TFSA withdrawals are tax-exempt too. You have funds to address your financial needs and not pay taxes at all.

Defense against the clawback

TFSA investors can consider a Dividend Aristocrat like **Emera** (TSX:EMA). This utility stock is a recession-proof asset and pays a 4.5% dividend. If your available TFSA contribution room is $15,000 and you have the funds, tax-free income is $675. It could compensate for your tax payables or negate the OAS clawback's impact.

Emera is a $14.3 billion regulated electric utility company based in Halifax, Canada. Its electricity and gas generation, transmission, and distribution operations cover North America. Performance-wise, the stock is up 6.41% year to date. Income investors find the dividend growth history impressive.

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The dividend per share growth over the decade stands at a compound annual growth rate (CAGR) of 8%. Over the past three years, Meanwhile, earnings per share (EPS) increased at a 17% CAGR clip over the past three years. Furthermore, the business model is low risk.

Emera derives almost 100% of earnings from a regulated asset portfolio. It means that cash flows are stable, recurring, and visible. If you're dealing with the OAS clawback, you must be armed to the teeth. You need the tax-free income stream to be recurring and stable too.

Avoidable nuisance

The 15% OAS clawback is a nuisance. However, Canadian retirees have proven ways to minimize the painful tax.

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