The Secret to Getting Tax-Deferred Income Every Month

Description

For most investors, it makes sense to invest in a TFSA because whatever is earned inside, whether it's interest, dividends, or capital gains are entirely tax free. Once you use up that capacity, you could then either invest in a RRSP or a non-registered account.

If you're in a high tax bracket, it makes sense for you to contribute to a RRSP to reduce your tax bracket. What you put in the RRSP is tax deferred until you take it out in retirement, at which time it's taxed at your marginal tax rate.

However, did you know you can receive tax-deferred income in your non-registered account? Few investors know this secret, but I'm going to share it with you today.

Get juicy income from REITs

Did you know that you can invest in real estate via real estate investment trusts (REITs)? These trusts have professional teams that manage and operate the hundreds of properties owned by the company. Just like dividend stocks, you can buy shares in REITs to receive income called distributions.

Most REITs pay out distributions every month, and the ones I will talk about pay out a yield of 8-10%!

Tax-deferred income: return of capital

Distributions can consist of other income, capital gains, foreign non-business income and return of capital (ROC). The ROC portion is what I want to focus on.

The ROC reduces your adjusted cost basis (ACB). At the same time, the ROC portion of the distribution is tax deferred until you sell your shares, or until your ACB turns negative.

If you buy REIT units in a non-registered account, you'll need to track the change in the ACB. The T3 that you'll receive will help you figure out the new ACB.

Concrete example

Here’s a concrete example with **Northwest Healthcare Properties REIT** (TSX:NWH.UN). If you had bought 100 shares at the start of 2014 for $10.40 per share, and the transaction fee was $10, the ACB would have been $1,050. You would have received $80 income for the whole year.

In 2014 100% of the distribution was tax deferred. So, by the end of that year your ACB would be reduced to $970. And you pay no taxes on that income! Assuming Northwest Healthcare’s distribution amount remains the same and it continues to be entirely 100% tax deferred (which is unlikely), you won’t need to pay taxes until the 14th year of holding it in the worst-case scenario.

In the 14th year, your ACB turns -$70, implying a capital gain of $70. Half of that capital gain ($35) will be taxable. Then the ACB will be updated to zero.

At that point, if you sell the shares for $2,000, the full amount is viewed as capital gain, and $1,000 is taxable.

Other REITs with a high portion of ROC in their distributions include **Dream Office REIT** (TSX:D.UN), and **Dream Global REIT** (TSX:DRG.UN). In 2014 they made up 72.5% and 50.3% of the distribution, respectively.

In conclusion

REITs have a large portion of their distributions as ROC, which are tax-deferred investments. The return of capital portion of the distribution is not taxed until you sell the shares, or if the adjusted cost basis becomes negative.

Income investors should highly consider holding REITs with a big percentage of ROC in a non-registered account instead of a RRSP or TFSA, unless you hate math or your TFSA hasn’t been maxed out yet. Then you can receive monthly tax-deferred income without using a RRSP!

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:D.UN (Dream Office Real Estate Investment Trust)
2. TSX:NWH.UN (NorthWest Healthcare Properties Real Estate Investment Trust)

Category

1. Dividend Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/08/23
Date Created
2015/06/29
Author
kayng