2 Ways to Reduce Your Income Tax

Description

A study from the Fraser Institute indicated that 42.1% of an average Canadian's income goes to taxes. The average household income is $79,010, and its total tax bill is a whopping $33,272! The highest tax expenses in the tax bill include income taxes (30.6%), payroll and health taxes (21.5%), sales taxes (14.4%), and property taxes (10.5%).

Payroll and health taxes are unavoidable. Sales taxes can be reduced if you buy only what's necessary and cut back on the wants. If you own a property, you'll need to pay property taxes. If you're renting, you're probably paying your landlord's property tax anyway.

Income taxes make up the biggest part of the tax bill, and there are two simple ways you can reduce it.

1. Reduce future income taxes

You can transfer after-tax dollars into a tax-free savings account (TFSA). Anything earned inside is tax-free, so you're essentially reducing your future income taxes by investing in it now, and letting your hard-earned dollars compound inside.

A TFSA is for anyone who's at least 18 years old and has a valid Canadian social insurance number.

- From 2009 to 2012, individuals had $5,000 of contribution room for each year.
- From 2013 to 2014, individuals had $5,500 of contribution room for each year.
- For 2015, individuals have $10,000 of contribution room.

So, if you were at least 18 in 2009 and didn't open a TFSA, you have $41,000 of contribution room if you opened one now.

A TFSA could earn tax-free interest from savings accounts, GICs, and bonds. Other popular investments include real estate investment trusts (REITs), which pay distributions and may include other income (that's taxed heavily), and so it's a good way to use a TFSA to shelter the income. For example, over 40% of **RioCan Real Estate Investment Trust's** (TSX:REI.UN) distribution was categorized as "other income" in 2014.

It's beneficial to invest in a TFSA instead of a non-registered account, where your investments are exposed to taxation. For example, even though **BCE Inc.** (TSX:BCE)(NYSE:BCE) pays an eligible dividend, and its dividends are taxed favourably in a non-registered account, you can hold it in a TFSA without being taxed.

2. Reduce your current income taxes

If you're in a high tax bracket, you'll want to reduce that bracket so you're paying less income taxes for the year. By transferring money into an RRSP, that amount would be deducted from your total income.

Since foreign income is taxed at your marginal tax rate, you're probably better off buying U.S. high-yield dividend stocks in an RRSP. Stocks that come to mind include **Procter & Gamble Co** (NYSE:PG), **The Coca-Cola Co** (NYSE:KO), and **Kinder Morgan Inc.** (NYSE:KMI). They pay yields of 3-6%, and they all tend to increase dividends every year.

With the strong U.S. dollar right now, it may not be a good time to buy U.S. stocks. So, for the time being, Canadian can consider buying and holding Canadian REITs in their RRSPs.

When you eventually take out money from your RRSP (after turning it or a portion of it into a RRIF), you'll need to pay taxes in full for the withdrawal. So, invest wisely and let the money compound and grow for as long as possible.

In conclusion

To reduce income taxes, your biggest tax bill, individuals can invest in a TFSA to earn tax-free income for the future. Or to reduce their taxes right now, contribute to an RRSP and compound for tax-deferred growth.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:BCE (BCE Inc.)
2. NYSE:KMI (Kinder Morgan Inc.)
3. NYSE:KO (The Coca-Cola Company)
4. NYSE:PG (The Procter & Gamble Company)

5. TSX:BCE (BCE Inc.)
6. TSX:REI.UN (RioCan Real Estate Investment Trust)

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