Reduce Your Income Tax by Investing in Dividend Stocks

Description

The surest thing about life is taxes. Canadians are heavily taxed on their income. Sourced from Statistics Canada, from 2009 to 2013 the median income for individuals in Canada grew from $28,840 to $32,020, an annualized rate of 2.7%. Assuming the annualized rate grows 3% in 2014 and 2015, the median income for 2015 would be $33,970.

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For this conversation, let's say that Ann is a British Columbian whose annual income is $33,970. In addition to her annual income, she will also earn $2,700 in Canadian-eligible dividends and $1,199 in capital gains this year.

For the first $37,869, Ann has to pay the following marginal tax rates to the federal and provincial government based on the income type.

2015 BC Marginal Tax Rates

Ordinary Income	Capital Gains	Canadian-Eligible Dividends
20.06%	10.03%	-6.84%

The following table lists the type of income Ann is earning in 2015 and the corresponding income tax she's paying. In total, Ann will end up paying $6,749.96 in income tax. This ends up to be roughly 17.8% of her income. Yes, you got that right, because of Ann's tax bracket, the Canadian-eligible dividends she received actually helped her reduce her income tax.

Income Type	Income Tax	Calculation
Job Income	$6,814.38	$33,970 * 20.06%
Capital Gains	$120.26	$1,199 * 10.03%
Canadian-Eligible Dividends	-$184.68	$2,700 * -6.84%

If Ann had earned all of the $37,869 from her job, she would have paid $7,596.52 in income taxes instead.

In other provinces, the situation is similar. Canadian-eligible dividends and capital gains are taxed more favourably than the ordinary income you earn from your job.

That's why it's highly beneficial for Canadians to invest in quality stocks that pay Canadian-eligible dividends.

Quality stocks that pay out Canadian-eligible dividends

There are many stocks that pay out Canadian-eligible dividends. The quality ones include the Big Three Canadian banks: **Royal Bank of Canada, Toronto-Dominion Bank**, **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS). If you ask me, Bank of Nova Scotia provides the greatest value of the three. It offers the highest yield of the group; at $62, it yields 4.5%.

Other quality stocks include these utilities: **Fortis Inc.** (TSX:FTS) and **Canadian Utilities Limited** (TSX:CU). Both offer Canadian-eligible dividends that are very safe. They have increased dividends for over 40 years in a row! If I had to buy one today, I'd choose Canadian Utilities because it's priced at a lower valuation, but I like Fortis's minimum yield of 4%, and it only yields 3.8% today.

In conclusion

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Canadians should consider investing in stocks that pay out Canadian-eligible dividends, so they can reduce the amount of taxes they pay. In doing so, you keep more money in your pocket.

If you hold on to your shares, your unrealized capital gains are essentially tax deferred. However, if you really need to sell some shares for a profit, capital gains are still taxed more favourably than the income you earn from your job.

The advice in this article is given while assuming that you're investing in a non-registered account. Once you learn the ropes of investing in a non-registered account, you should replicate your success in TFSAs for tax-free income and gains, and in RRSPs for tax-deferred growth.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. TSX:CU (Canadian Utilities Limited)
3. TSX:FTS (Fortis Inc.)

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