Yes, You Can Pay 0% Tax in Retirement

Description

In a world where gold-plated pensions are virtually nonexistent and yields from GICs and government bonds are barely positive, many investors have turned to dividend-growth stocks as an alternate income source in retirement.

Yes, there's always the risk one or more companies in a portfolio could cut their payouts. But the dividend income spun off from the other members should be increasing enough to make up for the odd cut. As long as an investor has a good, diverse portfolio, income from it each year should continue to creep up at about the pace of inflation.

Another nice thing about a dividend-growth portfolio is it's relatively hands off. Like anything, it requires some maintenance, but it doesn't require constant attention. The moat surrounding blue-chip stocks isn't something that goes away overnight.

It turns out these aren't the only advantages to investing in dividend-growth stocks. There's one more, and it's a true game changer. Here's how investors in Ontario who live on dividends can avoid paying income taxes.

How it works

For every dividend you receive, the government also gifts you a certain amount of tax credit to go with it. This is because dividends are paid out using after-tax money from a corporation.

What happens is taxpayers gross up their dividends and then apply the dividend tax credit to these amounts. If they're in the highest tax bracket in Ontario, this translates into a tax rate of approximately 25%.

Things get more interesting in the lower tax brackets. If an Ontario resident gets all of their income from dividends and stays in the lowest bracket (which means a yearly income of less than $41,536), the amount of the dividend tax credit plus the tax-free income from the basic personal amount exceeds the marginal tax rate. Since you can't pay negative taxes, there are zero taxes owing.

And remember, TFSAs are also a valuable tool investors can use to avoid taxes. By stuffing assets inside TFSAs now, investors are setting themselves up to be able to use their TFSAs for anything and everything, all while not having to pay a nickel of tax on the withdrawals.

Not just Ontario

The good news for investors is you don’t just have to live in Ontario to take advantage of this quirk in the tax system. Alberta, British Columbia, and Saskatchewan have similar oddities–up to approximately $50,000 per year in annual dividend income.

We’re not tax experts, obviously. So you’ll want to go over this strategy with your accountant or tax professional. All we know is that there are Canadian investors in each of these provinces that have positioned their portfolios accordingly and are paying virtually zero taxes as a result. You owe it to your money to at least take a look at positioning your assets this way.

Which dividend-growth stocks?

Now that we’ve determined the strategy has legs, investors just have to pick some great stocks that we know will pay through thick and thin.

One such company is **Bank of Montreal** (TSX:BMO)(NYSE:BMO), a stock that hasn’t missed a dividend since 1829. BMO is a diverse bank with holdings in the United States, and it enjoys a strong market share here at home. Earnings per share are expected to be approximately $7 per share in 2016, and the company pays out a current dividend of 4.1%.

Another high-quality company is **Canadian Utilities Limited** (TSX:CU), the owner of power and natural gas assets in Canada, Australia, and recently, Mexico. The company has a record of 41 consecutive yearly dividend increases, which is the second-longest streak in Canada. Both power and natural gas are going to be things that are in demand for a long time, and the company trades at approximately 19 times forward earnings–a reasonable valuation.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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Date
2025/08/24
Date Created
2016/05/23
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