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Revealed: How to Generate Tax-Deferred Income

Description

Many investors know that they can defer their taxes by investing in a registered retirement savings plan (RRSP).

Whatever you earn in an RRSP, whether it's interest income, foreign dividend income, Canadian dividend income, or capital gains used as income, will be tax deferred until you withdraw it when you retire. At that time, it'll be taxed at your marginal income tax rate.

The problem is, there are strict rules applied to RRSP withdrawals without the taxman going after you. In fact, investors should avoid withdrawing from an RRSP before retirement because the amount will be hit immediately with a withholding tax of 10-30% if you're outside Quebec and 5-15% if you're in Quebec. Moreover, when tax time comes around, you'll have to report the amount as income and potentially get taxed more.

There are two ways you can borrow from your RRSPs without paying the taxman. You can borrow up to $25,000 under the first-time Home Buyers' Plan and up to $20,000 (maximum of $10,000 a year) under the Lifelong Learning Plan. However, you'll have to pay those amounts back over time within 15 years and 10 years, respectively.

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A simpler way

There's a simpler way to earn tax-deferred income — income you can use now without any intervention from the taxman.

You can earn tax-deferred income conveniently in your non-registered, taxable account via return of capital (ROC).

ROC may be found in distributions from mutual funds, partnerships, and real estate investment trusts (REITs). The ROC portion reduces your adjusted cost basis and is tax deferred until you sell or your adjusted cost basis turns negative.

In other words, the ROC will be taxed as capital gains in the future, which is an advantageous way to get taxed.

The bigger the ROC portion in a distribution, the more worthwhile it is to hold the security in a taxable account. However, investors should also be aware of the other types of income that make up the distribution. Ultimately, you have to pay taxes on the received distributions sooner or later.

Two REITs which had high ROC in their distributions last year include **NorthWest Health Prop Real Est Inv Trust** (TSX:NWH.UN) and **Northview Apartment REIT** (TSX:NVU.UN).

NorthWest's distribution was 100% ROC in 2016, which meant 100% of its distribution was tax deferred. In the case of Northview, 84% of its distribution was tax deferred, while the rest were capital gains taxed at 50% of your marginal rate.

By holding a meaningful position in each of these REITs, you can earn some serious tax-deferred income in your taxable account. Both yield at least 7.6% today.

Investor takeaway

By owning securities that offer distributions with a big ROC portion is a great strategy to generate tax-deferred income that you can use right away. NorthWest and Northview are two strong candidates for tax-deferred income with large ROC in their distributions.

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1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:NWH.UN (NorthWest Healthcare Properties Real Estate Investment Trust)

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