



How to Pay Lower Taxes on Your Income

Description

With the personal income tax reporting due at the end of April, I thought this article would be timely. We pay the marginal tax rate on the income we earn from our jobs. Interest that we earn is taxed at that rate as well.

Capital gains and Canadian dividends are taxed at lower rates. Public Canadian dividend companies tend to pay eligible dividends; investors should aim for these because eligible dividends are taxed at a lower rate than non-eligible ones.

For Canadian employees who earn an average wage of ~\$50,000, eligible Canadian dividends are taxed at a lower rate than capital gains. But it really depends on which tax bracket you're looking at and which province you reside in on December 31 of the taxation year.



Eligible dividends

TransCanada Corporation ([TSX:TRP](#))([NYSE:TRP](#)) and **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) are blue-chip stocks that offer eligible Canadian dividends.

TransCanada is undervalued and offers a rich yield of ~5.2%. The company has a strong balance sheet, indicated by an S&P credit rating of A-. The company's stock is trading at its lowest levels since late 2015.

TransCanada has increased its dividend for 17 consecutive years. In fact, management just hiked the energy infrastructure company's dividend by 10.4% in the first quarter.

Royal Bank is fairly valued, offers a safe yield of ~3.8% with an S&P credit rating of AA-. The big Canadian banks are some of the most profitable companies in Canada. Thus, they're great long-term investments, especially Royal Bank, the leader of the group.

Royal Bank generated net income of ~\$3 billion with a return on equity of ~17.4% in the first quarter. The stock is a good buy at current levels, but will be a better buy starting with any dips of 5-10%.

Capital gains

Capital gains and dividends aren't mutually exclusive. You'll collect eligible dividends from TransCanada and Royal Bank shares and pay taxes on the dividends. Simultaneously, you expect the share price to increase over time if you bought the shares at good valuations. The good news is that capital gains aren't taxed until you sell the shares.

The favourable tax rates for capital gains also apply to foreign stocks, such as **Microsoft Corporation** ([NASDAQ:MSFT](#)). Since foreign dividends are taxed at your marginal tax rate, it might make sense for investors to focus on [growth names](#) in their non-registered accounts, as growth leads to capital appreciation. Microsoft is more of a growth stock than a dividend stock. It offers a ~1.8% yield and is expected to grow north of 11% for the next few years.

Investor takeaway

Other than building your career and working hard at your job, investors can add icing on the cake by [investing for eligible dividends](#) and capital gains, which are typically taxed at lower rates than their job's income. If you consistently invest in blue-chip stocks such as TransCanada, Royal Bank, and Microsoft when they're trading at good valuations, the icing on the cake can eventually turn into a 10-course meal.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
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TICKERS GLOBAL

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2. NYSE:RY (Royal Bank of Canada)
3. NYSE:TRP (Tc Energy)
4. TSX:RY (Royal Bank of Canada)

5. TSX:TRP (TC Energy Corporation)

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