Should You Buy Canadian or Diversify Internationally?

Description

Deciding whether to invest in Canadian or international stocks in a taxable account is a fairly clear-cut choice, but the choice becomes less clear when considering non-dividend-payers. After all, Canadian dividends benefit from the dividend tax credit. Foreign stocks, on the other hand, carry a fairly hefty withholding tax and are fully taxable by the Canadian government.

Non-dividend stocks, on the other hand, are on a level playing field with international companies. Regardless of whether they are Canadian or from a foreign country, these stocks aren't taxable until they are sold. This accounting trick allows investors to hold these companies for a long period, compounding returns over a number of years.

As a result, it becomes unclear as to whether you should buy a Canadian company or an international company based on tax implications. The result is that Canadians are opened up to a choice of whether you should own Canadian or international stocks.

While Canada has a number of good companies, the lack of tax incentive would probably make it a wise choice for Canadians to take advantage of the ability to buy excellent international companies and save the Canadian stocks for their income generation.

Probably the easiest stocks for most Canadians to buy are American. The United States has a number of excellent, large companies Canadians in which Canadians can invest to diversify their portfolios into various sectors. Technology is one sector with some representation in Canada, but is nowhere as developed as that of the United States.

Canada does have a number of great technology companies. Take **CGI Group Inc.** (TSX:GIB.A)(NYSE:GIB) for example. This company has been an excellent performer over the years. In the fourth quarter of 2018, CGI reported increased revenues of 7.3% over Q4 of 2017. The company also increased its diluted earnings per share by a solid 47.1%. These are great numbers from a company that has performed year after year.

But you have to weigh that performance against owning a giant like **Alphabet Inc.** (NASDAQ:GOOGL). This multibillion-dollar market cap company is still growing at an incredible rate. Revenues grew at 21% year-over-year in Q3 2018, much higher than the smaller CGI. Its scale, scope, and exposure to the global economy is much larger than CGI's exposure.

Another reason to go with an international stock as opposed to a Canadian one is the true diversification you receive. When you own a Canadian company, you often gain some international exposure, with the lion's share of revenues coming from Canada. If you're at all pessimistic about Canada's economic future, it would make sense to put your money to work outside Canada as much as possible.

There are only two major caveats to owning international stocks in your taxable account. If you own more than $100,000 in foreign stocks, you need to fill out a special government tax form for foreign assets, form T1135, Foreign Income Verification Statement. While this form isn't too onerous, it is some extra work at tax time.

As much as a company like CGI has offices and business outside Canada, an international powerhouse such as Alphabet would provide far more exposure and diversification by business and currency. Like CGI, many Canadian companies are excellent businesses that have rewarded shareholders very well and should be considered. But without the tax incentive of dividends, it becomes much harder to justify owning a Canadian company without dividends over international ones.

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