TFSA Investors: the Right Way to Use Your RRSP

Description

Canadian investors are sometimes inclined to invest in foreign stocks, particularly those in the U.S. stock exchange. The reasons may vary but more often, the higher dividend is one of the major considerations. However, there are things that shouldn't be ignored especially the tax implications when you have an RRSP.

The RRSP was created for the purpose of providing employees and the self-employed Canadian citizens with retirement savings and investing vehicle. The RRSP is actually a part of the *Income Tax Act.* Hence, it's important to understand in depth the tax components in the RRSP as well as the TFSA.

Mandatory tax reporting

Canadian residents intending to purchase or invest in high-dividend-paying U.S. stocks like **Alliance Resource Partners** or **Macy's Inc.** should find out first the tax consequences. Both U.S. stocks are preferred because of the consistent, high-dividend payouts.

By law, any income, dividends or capital gains derived or earned from foreign investments including stocks outside of Canada must be reported to the Canada Revenue Agency (CRA). Likewise, you are required to pay the corresponding taxes.

If foreign shares are held in a registered account such as an RRSP, taxes due on all earnings or income are taxed as regular income upon withdrawal. Even when a Canadian taxpayer declares foreign investment income, a case of double taxation may arise. This problem may be cumbersome to resolve.

There may be instances when a foreign country may impose taxes on the income earned. In such an event, the Canadian resident can claim a foreign tax credit during the filing of the tax return through the Federal Foreign Tax Credit, which is designed to protect Canadians against double taxation when earnings are from sources abroad.

Generally, an RRSP and a TFSA account are exempt from any Canadian income taxes on income generated. Hence, if a U.S. stock or any foreign stock is subject to income tax, the investor's final or net return will be diminished. Further, the tax is not recoverable through a foreign tax credit or deduction when computing the taxable income.

Proper use with the right stock

AltaGas Ltd. (TSX:ALA) is one the top energy stocks on the TSX that pays higher-than-average dividends. Assuming you're choosing Alliance Resource because the stock pays an annual average dividend of 10.47% compared to AltaGas' lower dividend of 6.90%. The total tax due on the U.S. stock might come out to be more than the 3.57% difference.

The operations of the Canadian oil and gas midstream company are 100% regulated and supported by long-term contracts. Over the next five years, AltaGas has about $300 million worth of low risk growth opportunities. The business is able to create unique, stable, and predictable dividend payouts that a foreign stock might be able to deliver.

In the end, the total gains from AltaGas versus Alliance Resource, with the tax component, can be greater. Investors should take note that for the current year, the growth estimate for AltaGas is 13.6% with a higher growth estimate of 14.0% in 2020.

There is no limit on the foreign stocks or securities placed in RRSPs or TFSAs. Investors can diversify their portfolios but should be conscious of the maximum contribution limits.

However, if you still want to own U.S. stocks, make sure the stocks are held in your RRSP. The taxes due upon withdrawal will be treated as regular income tax. But stocks with predictable earnings and sustainable dividends like AltaGas are better placed in a TFSA account.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. TSX:ALA (AltaGas Ltd.)

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