Attention Pensioners: 2 Stocks to Add $5,842 Per Year in Tax-Free Income

Description

Canadian seniors are searching for ways to boost their pension earnings without having to share any of the income with the government.

Company pensions, CPP, OAS, and RRIF payments are all taxable, as are withdrawals from RRSP accounts. Any income you might earn from a side gig, such as a rental property, is also taxable.

One way to avoid paying tax is to receive payments from a TFSA. In 2019, each Canadian resident has as much as $63,500 in cumulative contribution room. That means a couple could earn income from $127,000 in investments.

A popular strategy involves owning high-yield dividend stocks to create a stream of tax-free distributions. Stocks carry more risk than GICs, but a GIC now only offers a yield that is little better than inflation, meaning about 2%.

Which stocks should you buy?

The best stocks to buy inside an income-focused TFSA would normally be top-quality dividend stocks that have rock-solid payouts with strong track records of raising the distributions.

Let's take a look at two stocks that might be good picks to get started.

BCE

BCE (TSX:BCE)(NYSE:BCE) is Canada's largest communications company and is one of the top stocks retirees have turned to for reliable dividends for decades.

The company is a much different beast today than it was back when everyone had a landline at home, and BCE made lots of money on long-distance calling charges.

Now, BCE is a major mobile player and a provider of high-speed internet services to homes and businesses. Management knows the value of owning the network infrastructure that connects customers to the world, and BCE is investing billions of dollars to install fibre optic lines right to the premises. This protects its wide moat and ensures customers can get the broadband they need for things like movie streaming.

BCE has other revenue avenues. It offers a portfolio of home security services, and that should increase with the expansion of the segment referred to as the Internet of Things, where any mechanical device can theoretically be connected to the internet and controlled from anywhere.

BCE's media division is also a revenue source and provides popular content. The group holds sports teams, a television network, specialty channels, a streaming service, and radio stations.

BCE raises the dividend about 5% per year. Investors who buy the stock today can pick up a 4.9% yield.

Bank of Montreal

Bank of Montreal (TSX:BMO)(NYSE:BMO) paid its first dividend in 1829 and has given its shareholders a slice of the profits every year ever since. That's a solid track record, and investors should feel comfortable that the process will continue for decades.

Bank of Montreal is good pick among the Canadian banks, as it offers a balanced revenue stream coming from strong personal and commercial banking activities, as well as capital markets and wealth management. The bank's Canadian residential mortgage portfolio isn't as large as some of its peers on a relative basis, and that should make the bank less likely to take a big hit in the event house prices tank in Canada.

South of the border, Bank of Montreal runs its BMO Harris Bank division, which has grown significantly from the first acquisition in the early 1980s to a business with roughly 500 branches. The American group provides a balance to the Canadian operations, and earnings can get a good boost when U.S. profits convert to Canadian dollars at higher exchange rates.

The stock appears cheap at 10 times earnings and offers a 4.3% dividend yield.

The bottom line

An equal investment between BCE and BMO would provide and average yield of 4.6%. This would generate $5,842 in annual tax-free income for a couple who each maxed out their TFSA today.

Diversification is always recommended, and a number of other top dividend stocks that offer similar yields would also be attractive for a dividend-focused TFSA portfolio.

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