3 Tax-Avoidance Tips the CRA Doesn't Want You to Know

Description

If there are Canadians who feel like they're paying too little tax, I've yet to meet them.

No, most Canadians think the exact opposite. They're tired of paying so much tax. In fact, I personally know several people who steadfastly refuse to earn any additional income because doing so would push them up into a new tax bracket.

Canadian taxpayers collectively pay thousands of accountants millions of dollars to help them avoid billions of dollars in taxes. It's a big business, and with the government dreaming up new taxes all the time, I sincerely doubt this industry is going to get any smaller.

The good news is, you can minimize your tax bill by applying a few important principles to your financial life. Let's take a closer look at three ways you can keep more of your money in your wallet. These are CRA approved, but don't kid yourself. These folks would rather see you pay much more than the minimum.

Avoid interest

I'm amazed at how many investors have large amounts of cash stashed in boring investments like high-interest savings accounts and government bonds. Low interest rates ensure these investments have paltry yields and they have no potential for growth. You won't get rich putting capital to work in these assets.

There's another major downfall to depositing your cash in the bank or lending it out. You're forced to pay full taxes on whatever you earn. That could be as high as 50% if you're in the top tax bracket and live in certain provinces.

Imagine getting a paltry 2% on a five-year GIC and then paying 50% of that gain back in taxes. Yuck.

Embrace dividends

Many seniors put their cash in GICs because they need a secure way to turn their savings into income. The good news for these folks is, the stock market can do the exact same thing, and it's likely you'll get an even better yield.

Yes, there's always the potential for a dividend cut. But that can be minimized by stuffing your portfolio full of stocks with growing dividends that offer low payout ratios. A diverse portfolio filled with steady growers could easily yield 3-4% with potential for additional annual dividend increases. This portfolio will also slowly grow over time, too.

The big advantage of embracing a dividend philosophy is in the tax savings. In fact, if you have no other income, you can earn up to approximately $50,000 in dividends tax free each year. Add in a similar portfolio for your spouse, and it's possible to earn six figures in retirement without paying any taxes on this income.

Dividends are a great tax-avoidance tool, but there's an even better way to beat the tax man.

Buy-and-hold investing

One of the biggest reasons why Warren Buffett's favourite holding period is "forever" is because he understands the value in avoiding taxes for decades.

Say you bought a stock two decades ago and it returns an average of 10% each year. That's enough to turn a $10,000 investment into something worth more than $67,000 today. If you sold that stock today, you'd be looking at a substantial tax bill. It would eat into your profits, leaving less cash left over to invest in the next opportunity.

Depending on your tax bracket, the decision to sell a long-term winner could easily create a liability worth tens of thousands of dollars. Nobody wants to cut that kind of cheque to the feds.

Once you really embrace this thinking, it'll change the way you invest. Your portfolio will be stuffed with the best companies you can find, long-term investments designed to both maximize total return and minimize taxes owed. The goal will be to never sell, lest you trigger a taxable event.

The bottom line

The nice thing about investing with taxes in mind is these strategies don't just minimize taxes. They're also good investing tips in general. You won't go wrong finding companies with a good long-term future or focusing on stocks with growing dividends. Decreasing your taxes is just a bonus.

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