How to Earn Big TFSA Income That the Canada Revenue Agency Can't Tax

Description

Unless you're one of the lucky ones to land major multi-baggers that swelled your TFSA past the million-dollar mark, I think it's safe to say that any TFSA income stream you make for yourself today will be free from taxation.

The TFSA is a gift to Canadians courtesy of the federal government.

Unfortunately, many Canadians aren't using the gift to build their wealth and are just using it as a store for cash and bonds. Hoarding such "risk-free" instruments in your TFSA comes with unfathomable and astronomical opportunity costs.

Gone are the days where you can score an over 7% yield on your fixed-income securities without having to risk your shirt. So, if you're young and letting your cash collect dust in your TFSA, it's time to make some changes so you can put your TFSA proceeds to work for you.

How high are the opportunity costs of leaving your cash in TFSA "high" interest savings accounts?

Consider an extreme example with a high-yield security such as **American Hotel Income Properties REIT** (TSX:HOT.UN), a relatively small hotel REIT with a $510 million market cap that currently sports a massive 13.2% yield.

Shares of AHIP have been in a world of pain over the last few years, and the distribution payout is now undoubtedly stretched. If you've got what it takes to be a contrarian and think that AHIP can turn its ship around, you could lock-in the 13.2% yield, which would be yours to keep (based on your invested principal), even if shares were to recover in a turnaround scenario.

Come 2020, Canadians should have $69,500 (not including interest) in their TFSAs if they just made regular contributions and sat it in a savings account. If invested entirely in AHIP, one would stand to collect $9,174 per year, not a penny of which is subject to taxation.

Who couldn't use such a boost to their annual income?

This HOT property could burn a hole in your wallet

Unfortunately, a super-high-yielder like AHIP comes with its fair share of baggage — and isn't without its risks. The company has been treading water for awhile, and investors must understand the situation so they're not left holding the bag in the event that AHIP slashes its distribution.

The REIT's strategic pivot away from economy hotels toward premium branded hotels is encouraging for longer-term AFFO growth, but in its current state, there is apparent financial pressure.

The AFFO payout ratio is over 100%, and AFFOs growth has been in the red of late (AFFOs fell around 4% in the last quarter), both of which don't bode well for the health of the distribution.

Fortunately, the REIT can easily avoid a distribution reduction as it continues to make changes for the better. AHIP's property improvement plan (PIP) is going quite well, with many projects coming under budget (good news given AHIP's "tight" financial position).

Whether AHIP will be a rebound candidate in the new year remains to be seen, but if you're willing to take on a bit of risk, the potential rewards could be massive.

Continued successful execution of the PIP could bolster AFFOs and relieve a bit of financial pressure caused by the now colossal distribution.

Foolish takeaway

AHIP is a high-risk/high-reward bet, but it's just one extreme example of what you could do with the funds sitting in your TFSA. If all goes well with a super-high-yielder like AHIP, you could enjoy more than $9,000 per year in tax-free income alongside potential capital gains.

Given the progress with AHIP's PIP, I'd say the distribution is safer than most would think in spite of its ominous triple-digit payout ratio.

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