Canada Revenue Agency: How to Retire Well With Tax-Free Dividends

Description

Relying on your CPP pension alone as a source of income is a huge mistake. With monthly CPP payments averaging just over $640, it's clear that Canadians need a heck of a lot of personal savings to finance a comfortable retirement that could span decades.

Given most Canadian retirees share the common fear of running out of money in the middle of retirement, it's vital to invest one's nest egg in income-paying securities, so one can spend only the dividends (or distributions) and never the principal — effectively making it impossible to run out of money in retirement.

Of course, to eliminate the risk of running out of money in retirement, you need to invest in high-quality, dividend-paying securities and not just the top results on a stock screener based on the highest yielders on the TSX index. Otherwise, you could be asking for a dividend cut alongside substantial capital losses that you may not have any other choice but to realize.

If you have a nice nest egg, you likely don't need to chase super-high yielders and can just settle for "middle-of-the-road" income securities that can offer you a balanced blend of upfront income and meaningful growth over time. And when you take taxation out of the equation by housing your income stream within your Tax-Free Savings Account (TFSA), you'll get more in your pocket every month (or quarter) and perhaps a little extra cash that you can reinvest to grow your TFSA nest egg further while in retirement.

When it comes to creating your TFSA income stream, look no further than the roster of one-stop-shop ETFs offered by **Bank of Montreal** like **BMO Canadian High Dividend Covered Call ETF** (TSX:ZWC).

Many of the ETFs within the BMO family are run by excellent managers who are unable to deviate from a said fund's strategy. So, what you won't have is an active manager who's flipping in and out of stocks at a whim, effectively racking up expenses that you'll pay in the form of higher fund fees.

The ZWC is a 6.9%-yielding ETF that I believe has the safest yield at around 7% that money could buy. The ETF itself owns high-yielding securities, but the sum of the dividend payments of its constituents are well below the 6.9% mark. So, where does the extra yield come from?

The premium income generated on top of the aggregated dividends and distributions paid to the fund. The “covered call” part of the ETF trades off potential upside in securities within the ZWC basket in exchange for premium income upfront. While there is “upside risk” involved with such a covered-call-implementing strategy, the downside risk is reduced by a considerable amount.

For a retiree who seeks high income and downside protection, ZWC makes a tonne of sense, and, best of all, many of the constituents within ZWC are subject to dividend (or distribution) growth over time. At the time of writing, the top constituent in the ETF is Enbridge, which is expected to raise its dividend by 10% over the foreseeable future, with a high likelihood of renewing such a dividend-growth “promise” within three years’ time.

Foolish takeaway

With a fat TFSA and a one-stop-shop income ETF like ZWC, you can score significant monthly income that the Canada Revenue Agency won’t be able to touch. Combine your income stream with your pension, and you’ve set yourself up for a retirement that’s not only comfortable but *sustainable* over a long-term time horizon.

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Date
2025/08/21
Date Created
2019/11/27

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