Canada Revenue Agency: How to Pay Zero Taxes on a 12% Yield!

Description

Your Tax-Free Savings Account (TFSA) is a tool that you can use to keep the Canada Revenue Agency (CRA) at bay. Although capital gains and income payments (dividend, distributions, coupons, royalties, and all the sort) within a TFSA are free from the insidious effects of taxation, some Canadians may unknowingly still be subject to taxes as well as stiff financial penalties for breaking the simple set of rules for using a TFSA.

Given the powerful wealth-creation abilities to be had from tax-free compounding over the long haul, it's worth it stay informed about the rules of TFSA use, so you don't skate offside and get slapped with a nasty bill courtesy of the taxman.

Two of the worst TFSA crimes you could commit are overcontributing (accidentally or not) and trading securities within your TFSA for "business purposes" (I'd play it safe and avoid trading big money in your TFSA if you don't want the CRA to come knocking).

Make too much, too soon in your TFSA, and you can count on the CRA to come knocking. While racking up the capital gains via trading may lead one to commit a TFSA crime, investing in speculative super-high-yielding securities to land massive dividend payments will not.

Consider **American Hotel Income Properties REIT** (TSX:HOT.UN), a 12%-yielding real estate play that triples the "4% rule". While highly speculative, one has no choice but to invest for the long run and not trade the security to get the most value out of the name given dividends play an overwhelming role in the total returns to be offered.

As such, one could theoretically lock in a 12% yield, even as shares recover and the yield reverts toward mean levels, and the CRA can't tax you for the gains nor the dividends produced within your TFSA.

The CRA doesn't want to prevent you from getting rich with the rules placed on the TFSA. It just wants to level the playing field for all Canadians and not give an edge to those who trade for a living or wealthier individuals who can contribute more than the $6,000 limit in any given year.

That means incentivizing investing in a TFSA, as opposed to speculating or trading. For beginner investors who are tempted to try to make a quick buck, the rules may actually keep them on the right track and help them get out of their own way as they look to build their TFSA nest eggs.

Back to HOT.UN. It's a very aggressive income investment that's not at all suitable to those who depend on the income to finance their month-to-month lifestyles. But for more risk-tolerant young investors, the REIT could allow one an opportunity to build one's TFSA very quickly (through a recovery in shares, but mainly via large dividend payments) without falling under the radar of the CRA.

Of course, deep-value income investments like HOT, whose distribution is under a bit of pressure, are risky and could burn those who don't do their homework. So, just because you can "outwit" the CRA doesn't mean you should.

Unlike most other accidentally high-yielders, though, HOT has a turnaround plan, and recent progress from its property improvement plan is encouraging for those looking to go against the grain with the hopes of locking in the 12% yield in their TFSAs.

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