CRA-Proof Passive Income: A 2-Stock Portfolio Averaging a 10% Yield

Description

If you follow the simple rules of using your Tax-Free Savings Account (TFSA) and steer clear of high-yield foreign dividend stocks (which are still subject to insidious withholding taxes), you can reap the rewards of a TFSA passive-income stream that can pay you an 8% yield, which can't be touched by the Canada Revenue Agency (CRA).

Depending on how much your TFSA is worth, you may have the ability to construct an income stream that can pay you more than your day job after income taxes. While a portfolio averaging a 10% yield may seem like a disaster waiting to happen, the two securities in this piece have fairly sustainable payouts with what I believe is a reasonable margin of safety.

Moreover, the two investments have capital return structures that sacrifice long-term growth to maximize the distribution to better cater to income-hungry investors. So, even given the sizeable magnitude of the yields, they're far less prone to a reduction than common stocks with similarly sized yields.

Without further ado, consider the following two securities that, when put together, average a yield of around 10%.

American Hotel Income Properties REIT: 11.9% yield

American Hotel Income Properties REIT (TSX:HOT.UN), as a real estate investment trust (REIT), is required to payout at least 90% of its taxable net income to investors in the form of a distribution (some REITs pay out over 90%), which stunts longer-term growth relative to companies that go the route of issuing common shares.

The REIT sports one of the largest yields on the TSX Index, and although the distribution payout is stretched, it's not at immediate risk of a drastic reduction — at least, not anytime soon given the more promising forward-looking trajectory to bolster future AFFO growth and encouraging recent progress with the REIT's property improvement plan.

I'd be lying to you if I told you the nearly 12% yield of HOT was completely safe, though. Over the last year, the payout ratio was just above 90%, which doesn't leave much room for further operational hiccups moving forward.

Many project renovations have come under budget, which bodes well for HOT's outlook, but all it'll take are a few cost overruns, and HOT's distribution could be at risk. As it stands now, though, HOT has a favourable risk/reward trade-off given a majority of the significant renovations are now in the rear-view mirror. If you're willing to take a bit of risk, HOT is a great way to give yourself an income jolt.

Pizza Pizza Royalty: 8.6% yield

Pizza Pizza Royalty (TSX:PZA) is a royalty play that flows profits straight into the pockets of shareholders, leaving little cash for management to spend on costly growth initiatives (which can be both a blessing and a curse).

The Canadian pizza giant behind "Pizza Pizza" flagship stores and Pizza 73 locations has taken a hit on the chin over the past few years thanks in part to belt-tightening of indebted Canadian consumers (especially with its sites in the ailing province of Alberta). To make matters even worse, competition has picked up amid a rise in food-delivery services, and Pizza Pizza's online platform, I find, is lacking in comparison to American pizza chains.

Its pizza is still tasty. And Canadians will always hold a spot in their hearts for the local pizza powerhouse. Still, of late, the broader appetite for fast food has gone down, and I suspect Pizza Pizza's royalty structure will work against it, as its peers continue to better leverage technological initiatives in their favour.

Although Pizza Pizza has been investing in technological initiatives of their own, there just isn't as much reserve for such investment with the royalty structure. Nevertheless, management continues to do its best to offset recent sales pressures, with intriguing new offerings like cauliflower crust and meatless meat topping options.

Foolish takeaway

Both HOT and Pizza Pizza have been under some pressure, but their distributions remain sustainable in spite of their respective headwinds. With encouraging plans (new products for Pizza Pizza and AFFO-boosting renovations for HOT) that aim to drive down each firm's respective payout ratio over the next few years, I think both investments are worthy of adding to your TFSA with your 2020 contribution.

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