TFSA Investors: How to Truly Pay ZERO Taxes in Retirement

Description

You're probably aware of how powerful a wealth-creator your Tax-Free Savings Account (TFSA) can be with the effects of long-term tax-free compounding.

What you may not know, however, is that the Canada Revenue Agency can still tax your TFSA if you break a TFSA crime and that any sources of foreign income are still subject to taxation from a foreign tax authority.

If you're a retiree who uses your TFSA as a passive income stream, it's worthwhile to ensure a tax-efficient allocation to make sure that you are in fact paying zero taxes with your an account that's supposed to be 100% free from taxation, both domestic and foreign.

Watch out for foreign income withholding taxes

In a prior piece, I noted that Canadians would be better served by investing in domestic dividend stocks rather than their U.S. complements to avoid seeing their dividends get trimmed by 15% off the top.

With no Canadian tax credits applicable for withheld dividends within a TFSA, Canadian retirees should consider using their TFSA for **TSX**-traded income-paying securities or foreign securities that don't pay dividends or distributions to shareholders.

While it may indeed make sense to stash foreign securities with small dividend yields, one must also consider the long-term rate of dividend growth and the intended holding period, as even the smallest dividend (or distribution) has the potential to grow by leaps and bounds. A 15-30% withholding tax could make a world of difference over prolonged periods.

Never overcontribute

I admit that the rules of the TFSA are a bit strange and inconvenient for those who contribute and withdraw cash from their TFSAs on a regular basis.

The CRA portal is updated annually, and if you take out income payments from your TFSA, it's vital that wait until the next calendar year before recontributing if you're up against the limit to avoid easily-avoided overcontribution penalties.

Consider shares of popular retiree pick **H&R REIT** (TSX:HR.UN), which sports a 6.5% distribution yield that's paid on a monthly basis.

The diversified Canadian real estate kingpin helps many retirees construct their own mini real estate empire, and with one of the best-supported monthly distributions in the business (the payout ratio currently sits at 79%), H&R is the epitome of a retiree investment with excellent marks on the safety, income, and valuation fronts.

The REIT has a good mix of office (contributing 43% of the property portfolio); retail (30%); residential (20%); and industrial (7%). Like many other office-focused REITs, H&R is looking to dilute its less favourable office exposure with some promising residential expansion projects.

Management is pursuing development in the U.S. market, which bodes well not only for the potential capital gains (shares have flatlined on a longer-term basis), but also for possible distribution hikes moving forward, as the payout ratio looks to be driven down.

While REITs are less likely to reward investors with handsome distribution hikes given their growth-stunting capital structures, one can't help but think that H&R's will have a distribution raise up its sleeves as it continues to expand and better-diversify its portfolio.

As a Canadian REIT, H&R can be held with your TFSA, and the rich distribution can't be touched by any foreign tax authority. And while you can feel free to collect and spend the monthly income payments, be sure not to recontribute an amount if you've already made the maximum contribution for any given year.

For monthly income-payers like H&R, it's easy to lose track, so take tabs on cash movements in and out of your TFSA, so your tax-free account is actually tax free!

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joefrenette