CRA: Are Dividends Tax-Free in TFSAs?

## Description

Canadians save and invest in their Tax-Free Savings Accounts (TFSAs), because what's earned inside is tax-free. Well, almost everything.

If you buy Canadian dividend stocks inside your TFSA, the dividends are tax-free no matter if you hold the stocks on the Canadian or U.S. exchanges. The Canada Revenue Agency (CRA) can't get taxes from your Canadian eligible dividends received in TFSAs.



For example, if you buy **BMO** shares, you'll receive the full dividend no matter if you hold it on the TSX or NYSE.

However, some foreign taxman can deduct taxes from your foreign dividends.

# Foreign dividends may not be tax-free in TFSAs

Some stocks pay cash distributions that come from a foreign country. There will probably be some tax deducted for it. The rate will be different depending on which country it's from.

However, if foreign income is a small portion of the cash distribution, it can be negligible. Estimate the total returns (take-home gains and income) of the investment to determine if it's a good idea to hold in your TFSA.

For example, **Brookfield Infrastructure Partners's** (TSX:BIP.UN)(NYSE:BIP) Q1 cash distribution was US$0.5375 per unit. However, US$0.011 and US$0.0092, respectively, was U.S. interest and dividends, which could be subject to U.S. withholding tax. That's only 3.76% of the cash distribution.

Moreover, U.S. dividends have a 15% withholding tax thanks to the tax treaty between the U.S. and Canada. So, an even smaller portion of the 3.76% will actually be lost. In other words, unitholders will receive more than 96% of the cash distribution annually.

From first-hand experience, only 0.2% of the Q1 BIP cash distribution was deducted from my TFSA, which is negligible.

## This is more important

When it comes to dividend stock investing, the tax consideration is only secondary. More importantly, investors should know what to expect from an investment.

Brookfield Infrastructure offers a yield of about 5%. It pays out its cash distribution from its diversified portfolio of quality, long-life, cash-cow infrastructure assets.

The utility expects to continue growing its distribution by 5-9% per year. There's no doubt in that target. The stock has increased its dividend every year since 2009 at a compound annual growth rate of nearly 12%.

Assuming BIP grows its dividend by 5% annually going forward, it would deliver total returns of at least 10% per year, as it is roughly 20% undervalued.

About 5% of returns will come from the dividend, 5% will come from growth, and bonus returns will come from an expansion to a more normalized valuation.

## The Foolish takeaway



It's very hard for the taxman to deduct taxes from your TFSA. If you're receiving any foreign income in the account, you should check your transactions to see if there are any deductions and make changes as needed.

Particularly, foreign dividends are subject to withholding tax from the country they originate from. There's a 15% withholding tax on U.S. dividends. That's why Canadians often hold fat U.S. dividend stocks in RRSPs instead of in TFSAs.

Focus on the take-home total returns (income and gains) you expect to get from your investments. It's more important to choose investments that deliver satisfactory returns on acceptable risks before considering the tax implications no matter if you're investing in a TFSA or not.

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2. TSX:BIP.UN (Brookfield Infrastructure Partners L.P.)

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