Investors: Does This Event Mean (Much) Higher Taxes?

Description

Something happened this week, an event that many Canadian investors might not even remember. But it could be the reason why we have higher taxes down the road.

Fitch Agencies — which is North America's third-largest debt rating organization — downgraded Canadian government debt from AAA, which is the highest level. Government of Canada debt is now rated AA+. That's still an outstanding rating, but investors were troubled by the downgrade.

The rating agency had a few reasons for downgrading Canada. Its analysts think Canada won't recover from the current recession for a little while. Fitch expects poor economic numbers to be the norm until the end of the year or potentially longer.

Fitch is also concerned with the government's spending spree. This year's deficit should be in the $250 billion range, a massive number pushed higher by the many stimulus plans put forward by Justin Trudeau and his ruling Liberal party. This should increase the nation's debt-to-GDP ratio to well above 100% of GDP, which isn't something any ratings agency wants to see.

Canada's debt likely won't stabilize until 2022 to 2024, when it should settle in at approximately 120% of GDP.

Some folks, including government officials, aren't particularly concerned about Fitch's downgrade. They point out Canada's borrowing costs are still incredibly low, and there's still plenty of investor demand for our bonds. Our credit rating with all three agencies is still quite high as well.

Others are more concerned about what this might mean in the future. Will Canada have to raise taxes to pay for this spending binge?

What higher taxes might mean

I’m hardly a macroeconomic expert, but I can easily envision a future where the burden put on Canadian taxpayers will increase.

The government is lucky to be issuing all this new debt in an era when even longer-term borrowing costs are less than 1%. But it will still cause strain on government finances to service this debt. That burden will be even higher when interest rates rise once again, whenever that might be.

Like any business, the government essentially has two choices. It can balance the books by either increasing revenue or decreasing expenses. It seems unlikely a Liberal government will choose austerity, so there’s really only one option left. Taxes will increase, especially for wealthier folks.

An easy target will be capital gains taxes and dividend taxes, two kinds of income that have advantageous income tax rates associated with them. Many activists have been pushing to increase these taxes for years as a way to help wealth inequality. They may very well get their wish in the next few years.

How will this impact your portfolio?

If the dividend tax credit is eliminated or reduced, I can easily see a rotation out of dividend-paying securities into companies that don’t pay dividends. The most effective way to reduce taxes will be to buy and hold high-quality companies forever.

I can also envision a future when many companies simply eliminate dividends all together. That cash will either be used to buy back shares — which would become a much more attractive way to return capital to shareholders — or used to expand the company.

Many high dividend stocks would take such news particularly hard. When you pay out close to all of your earnings as dividends — like **TransAlta Renewables**, for example — a higher tax on dividends would eliminate much of the reason to invest in such a stock. That income stream is suddenly less valuable.

The bottom line on higher taxes

Higher taxes could be a reality down the road. We must pay for this stimulus program somehow.

These tax increases could easily target wealthy investors. Although I wouldn’t start to get too excited yet, I can certainly envision a world where investors will see their tax burden increase. Maybe investors need to start paying a little more attention to politics, just so they can protect their portfolios.

CATEGORY

1. Dividend Stocks
2. Investing

PARTNER-FEEDS

1. Business Insider

2. Koyfin
3. Msn
4. Newscred
5. Sharewise
6. Yahoo CA

Category

1. Dividend Stocks
2. Investing

Date
2025/08/14
Date Created
2020/06/28
Author
nelsonpsmith