The CRA Taxes Your $2,000 CERB — but Not THIS!

Description

One of the biggest drawbacks of the CRA's $2,000 monthly CERB benefit is that you have to pay taxes on it. The benefit is considered ordinary income, so if your marginal tax rate is 33%, then you have to pay $660 on every $2,000 in CERB money you receive.

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Making matters worse is the fact that it's hard to know exactly how much taxes you'll owe on the benefit. You probably don't know exactly how long you'll be out of work for, so your marginal tax rate for the year is to-be-determined.

The obvious answer to this dilemma is to save more CERB money than you could possibly need for taxes. For example, if your marginal tax rate would have been 33% *without* you having been laid off, then putting aside half of your CERB money will cover your taxes and then some.

However, that leaves you with another problem: not enough money to spend. If you're not a tax expert, you need to err on the side of caution with your CERB money until you can speak with one. This leaves you with less money to spend–at least if you can't access professional tax help.

Fortunately, there is one passive cash benefit you can get that doesn't have this disadvantage. And the best part is, you can build it yourself.

A well-diversified TFSA dividend portfolio

If you want to build up tax-free passive income, a Tax-Free Savings Account (TFSA) is the perfect vehicle. TFSAs let you hold investments without paying any taxes on them. RRSPs also have this advantage temporarily, but you have to pay taxes when you withdraw your proceeds. With TFSAs, your investments stay tax-free in the account and on withdrawal.

How it works

To illustrate the tax-saving power of a TFSA, let's imagine you had a 30% marginal tax rate, and held

$69,500 worth of **Fortis Inc** (TSX:FTS)(NYSE:FTS) shares.

If you held those Fortis shares in a TFSA, you'd pay no taxes on the dividends, which would add up to about $2,432 per year. Further, if you realized a $10,000 capital gain on the shares, you'd pay no taxes on that either.

Now let's imagine that you held the shares in a taxable environment. First, the dividends would be taxed no matter what. Dividends are taxable after they're received, even if you automatically re-invest them. The $2,432 you'd receive would be "grossed up" to $3,356, and you'd be taxed on that amount less a 15% credit.

Similarly, you'd pay a 30% tax on half of your $10,000 gain. That's a $5,000 *taxable* gain that you'd pay $1,500 in taxes on.

So you're looking at several thousand dollars in tax savings just by holding FTS shares in a TFSA. Of course, the TFSA has a strict contribution limit–in 2020, the absolute max you can contribute is $69,500.

Nevertheless, it's a great place to tax-shelter at least a portion of your portfolio. In the long run, it's a much better source of passive income than the CERB.

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