The CRA Can't Tax This Handsome TFSA Income Stream!

Description

The Canada Revenue Agency always wants a piece of your income, whether it be through the labour force or passive-income investments. With a Tax-Free Savings Account (TFSA), though, you're able to legally shield your investment income from taxation, thus maximizing the profound and unfathomable wealth-creative effects of tax-free compounding over the long-term.

The TFSA is a tool that's yours to use to get ahead. The longer you don't use the account to invest, the greater the "upside risk" you'll take and the less potent the effects of compounding become. You see, there's a huge opportunity cost in sitting on the sidelines with your TFSA.

If you find yourself hoarding fixed-income securities or cash in those TFSA high-savings accounts and are fed up with the returns (or lack thereof) from your TFSA, now is as good a time as any to rotate back into "risky" assets, most notably good, old-fashioned equities.

Just because equities are considered risky assets doesn't mean you could stand to lose your shirt. Similarly, risk-free assets aren't at all free from risk if you consider the high opportunity costs they come with.

The only thing guaranteed from such low-return guaranteed assets is you'll be guaranteed to fall into hot water in the event of an unchecked uptick in the rate of inflation.

You see, central banks around the world aren't even thinking about raising interest rates at this juncture, even with a 2021 economic recovery on the horizon.

Such overly dovish monetary policy may be good news for stocks, but it's a potential risk for overly cautious investors who are overweight in cash and cash equivalents.

And once it comes time to hike rates? Bonds will fall as their yields rise, making them not as safe as they seem at a time when rates couldn't go any lower.

What's a good investment to hold for the core of your TFSA to keep the Canada Revenue Agency at bay?

Bank of Montreal has a line of covered call ETFs that implement options-writing strategies to enhance distribution yields. The strategy entails trading off capital appreciation or upside for premium income paid upfront and is for shareholders to keep, regardless of which trajectory the stock market heads next.

The added income is well worth the capped upside for cautious investors such as retirees who seek to give themselves a raise. For everybody else (especially young investors), I'd discourage using covered call ETFs and would prefer investors to go the route of their non-covered-call counterparts.

Why? The covered call strategy is quite labour intensive, and as a result, the management expense ratio (MER) is on the higher end, with names like the 8%-yielding **BMO Canadian High Dividend Covered Call ETF** (TSX:ZWC) and its 0.72% MER.

Whether the high price of admission is worthwhile depends on your need for more passive income. Personally, I wouldn't be willing to forego upside and pay a higher price to an ETF's managers for a greater yield, especially when you consider such ETFs tend to drag their feet in market rallies.

Stocks tend to go up over the long term. And with covered call ETFs that are better to own if you think the markets will be flat (or down trending like in a bear market), they're less attractive to own over an extended period unless you're keen on getting a raise and are willing to pay the price on a longer-term basis by running the risk of underperforming the broader market indices.

Foolish takeaway

Given the unprecedented times, with another hit to the economy to be expected, I certainly wouldn't be against looking to BMO's line of covered call ETFs if you've fallen on tough times and value passive income today over growth tomorrow.

The ZWC's yield is at 8% right now and is a great TFSA holding for those who want to shelter their income stream from Canada Revenue Agency taxes.

CATEGORY

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1. TSX:ZWC (Bmo Canadian High Dividend Covered Call ETF)

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