How to Make Passive Income and Owe Zilch to the CRA

Description

If you generate investment income held in a non-registered account, you've got to set aside a portion for the CRA.

Unlike capital gains, only half of which are subject to taxation, investment income is taxed in full, just like your employment income is. Although there are perks to investing in Canadian dividend-paying stocks in non-registered accounts (assuming your TFSA is already full), with Canadian dividend tax credits, most Canadians would be best served by stashing the most bountiful income investments in their TFSA portfolios.

Retail and office REITs: Down but not out

REITs, which tend to sport colossal yields, are favourites of many income-oriented investors who live off monthly distributions. If you're retired or are soon to be, REITs are magnificent asset classes to stash in a TFSA. Not only will your distributions be free from CRA taxes, but any outsized gains will also be entirely yours to keep.

Following the coronavirus crash, which decimated the REIT space, many harder-hit REITs are still in the doghouse. While some, which have greater exposure to the harder-hit office and retail real estate sub-industries, are riskier than others, it's these such REITs that can provide risk-taking investors with a good chance to "lock in" a swollen dividend yield alongside a shot at potentially outsized gains, as the economy looks to normalize on the other side of this pandemic.

Battered REITs may be worth stashing in your TFSA if you hate CRA taxes!

Some diversified REITs that have felt the full force of the COVID-19 impact, like **H&R REIT** and **RioCan REIT**, had to reduce their distributions amid the turmoil. While nobody likes being on the receiving end of a distribution cut, I think that income investors have a lot to gain over the long term by going against the grain with such distressed REITs. It all comes down to a REIT's valuation and its recovery expectations.

With retail or office REITs, a common thesis on the Street is that the pandemic will cause a permanent reduction in the demand for such property types. The death of the office and shopping mall theses seem pretty realistic amid the latest surging wave of coronavirus cases.

But once COVID-19 is conquered, and it's safe to return to the realm of the physical, will we witness a reversion to the mean when it comes to the way we work and shop? Or will the acceleration of remote working and e-commerce cause firms to walk away once leases expire?

That's the million-dollar question.

With such gloomy expectations of investors in the heat of the moment, I'd argue that the risk/reward to be had on many of today's battered retail- and office-exposed REITs looks pretty attractive when you consider the possibility that we'll witness *some* reversion in demand for such properties in a post-pandemic world.

While the demand for office and retail space probably won't return to 2019 levels over the near to medium term, I think that a modest recovery in demand will be a major needle mover on hard-hit REITs within the retail and office REIT space.

Moreover, if post-pandemic recovery expectations turn out better than expected, we could witness pandemic-era distribution-cutters reinstate their distributions, and that would likely cause a huge inflow of income investors who had previously ditched their shares.

Foolish takeaway

While the pandemic will permanently alter the landscape for various forms of real estate, I'm just not buying that consumer habits will profoundly change after the pandemic is over such that the demand for office and retail REITs will remain as depressed as they are right now.

While it may take months or years for workforces to return to the office or for people to ditch e-commerce for the shopping mall, I think we'll be in for a robust multi-year recovery for the most hard-hit of Canadian REITs. As such, I think many bruised REITs are worth stashing in your TFSA today for those who hate CRA taxes!

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