2020 Tax-Reduction Strategies the Canada Revenue Agency Doesn't Want You to Know

Description

We have a marginal tax system in Canada, so the higher the income a person makes, the higher their tax rate is. Canadians must pay both federal taxes and provincial taxes. The province you reside in will change the effective tax rate you will pay on your income.

The highest integrated marginal tax rate in Canada is 54%; reducing the income reported on your investments can significantly increase your discretionary net income. Here are some tax-reduction strategies that CRA is not going to tell you.

Max out your TFSA

TFSA contribution limits have a yearly max of $6,000 in 2020 and a max lifetime limit of $69,500. The biggest tax advantage of a TFSA is that any realized income inside is tax-sheltered and realized income on a withdraw is tax-free. This strategy allows an investor to both reallocate their portfolio and draw income from a TFSA with no tax consequences.

For example, if you generate $10,000 in realized taxable investment income, the usual taxes you would pay at a 54% tax rate would be $5,400. That same investment inside a TFSA would yield you zero taxes, saving you $5,400.

Take full advantage of RRSP contributions

RRSP contribution limits in 2020 are 18% of your previous year's earned income to a max of $27,230 plus any carry-forward contribution room. The biggest advantages of RRSP contributions are that they are tax deductible. Depositing $20,000 into an RRSP will reduce your taxable income by an equivalent amount. At a 54% marginal tax rate, you will reduce your taxes by $10,800.

Like a TFSA, any income earned inside an RRSP is tax-sheltered, and you can reallocate your portfolio with no tax outlays. However, the amount withdrawn is fully taxed, and not just on the income earned on the investment. The best RRSP tax-reduction strategy is to deposit as much as possible, get a tax return, deposit more, and keep all the money in there till retirement.

Avoid interest and look for capital gains outside of registered funds

Most investors think that when you invest in guaranteed funds such as GICs or Treasury Bills that the only opportunity cost is a lower rate of return than a capital market investment. However, you are also taxed significantly more on interest income compared to capital gains income. If you make $10,000 in interest income and your tax rate is 54%, you will be taxed $5,400 and left with only $4,600 net.

The capital gains income-inclusion rate is only 50%, meaning that only half the income will be fully taxed. If you make $10,000 in capital gains, only $5,000 of it will be taxed. At a 54% tax rate, you will only be taxed $2,700 and left at $7,300. With the same $10,000 earned, you will have $7,300 to spend with capital gains income compare to $4,600 with interest income.

This is my recommendation for the best stock to help reduce taxes

A stock that has huge capital gains potential inside registered or non-registered funds is ideal for an investor that wants to make money and reduce taxes at the same time.

Any investor that owns **Dollarama** (TSX:DOL) should count themselves lucky, as it has been a reliable growth stock for the past decade. It has a 10-year return of 1,101% with no signs of slowing down.

It recently exercised its option to acquire a large 50.1% stake in Dollar City, giving DOL access to the growing Latin American markets. This acquisition gives Dollarama a new long-term growth avenue. I fully predict that DOL will buy out all of Dollar City in the future, further increasing the revenue potential.

Also, in 2019, Dollarama rolled out a robust digital store, selling thousands of products to retail clients and wholesaling to smaller businesses. DOL has differentiated itself with direct sourcing from manufacturers to get exclusive products at a lower price for its consumers.

Dollarama's recent great moves have created opportunities for growth well into the future, making this a great buy now.

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