Hate Taxes? Here's How to Unlock Your TFSA to its Full Potential

Description

After my article on how to unlock your RRSP to its full potential, I thought I'd naturally follow up with one that focuses on the TFSA, which is also a wonderful tool to save money from the taxman.

Except for foreign withholding taxes on dividends from foreign stocks, everything earned inside a TFSA is tax free. That's why you can make tonnes of money inside your TFSA.

Because withdrawals from TFSAs are tax free, you can take out any amount in your retirement years without it affecting your OAS or CPP income.

Maximize your TFSA every year

Save consistently and regularly. If you max out your TFSA contributions every year for 30 years, you'll end up with $180,000 from your savings alone, based on the current contribution room of $6,000 per year that's set to grow over time.

Let's imagine those annual contributions of $6,000 earning a market return of 7% per year. You'll end up with a very nice nest egg of more than $606,400 in three decades.

If you're able to invest for a very reasonable return of 10% per year, that'll result in more than $1,085,000!

So, returns matter.

Maximize your TFSA returns and minimize your risks

Since TFSA contributions are limited every year, the goal is to maximize your returns. However, you need to be reasonable with your risk-taking as well.

To some extent, what you invest in your TFSA to maximize returns depends on your investment knowledge and risk tolerance.

Some investors buy a handful of carefully chosen small-cap stocks, intending to have the winners generating incredible returns that greatly eclipse the losses from the losers.

That's too risky of a strategy for most investors. Many investors are very happy with getting a total return of 10% each year, which is doable in today's market without having to take on too much risk.

Which dividend stock can deliver a 10% return?

Enbridge (TSX:ENB)(NYSE:ENB) is a safe dividend stock that is undervalued at current levels and can deliver a 10% return.

Its dividend alone provides a return of 6.3%. Moreover, its payout is set to grow over time. Not only does Enbridge have a demonstrated track record of dividend growth with a 10-year dividend-growth rate of 15%, but it also has a very safe recent payout ratio of less than 63%.

Investors only need a growth rate of 3.7% from Enbridge to get a 10% rate of return. This is asking very little of the company compared to its historical performance.

But its history isn't the future. Next year, Enbridge aims to increase the dividend by 10%. After that, it estimates its distributable cash flow will grow by roughly 5-7% per year.

So, longer term, it's more reasonable to expect a 5-7% growth rate from the stock. That would still imply an estimated total return of 11.3-13.3% per year, which exceeds our 10% target! Additionally, any multiples expansion will only increase our returns.

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