How to Earn Tax-Free 7.5% Dividends Forever

Description

Few people want to pay taxes, yet every year, most Canadians pay *thousands* of dollars to the Canada Revenue Agency. It's an important act of patriotic solidarity, but the government has provided some easy ways to lower the tax burden on everyday citizens. In fact, you could build a tax-free dividend stream that supports you with regular passive income.

How is it possible to build a tax-free income stream? It's all about which stocks you pick and how you buy the stock. If you follow a few easy steps, you can accumulate a 7.5% dividend every year without paying a cent to the CRA.

Pick your accounts wisely

To earn a tax-free dividend, you'll need to pick the right stocks. But before you do that, you must ensure that these investments are held in a tax-advantaged account. In Canada, your top options are a TFSA or an RRSP.

A TFSA is a Tax-Free Savings Account, which was introduced in 2009. You can use this account to invest in anything you'd like. The money you deposit into a TFSA is considered *post-tax*. That's money you've already paid taxes on. So if you earn a $1,000 paycheque, and pay $250 in taxes, you're allowed to contribute the remaining $750 to a TFSA.

In return for paying taxes now, your money grows tax free forever. That includes dividends and capital gains. Even withdrawals are tax free.

An RRSP, on the other hand, uses *pre-tax* money. The first version of the Registered Retirement Savings Plan was launched in 1957, making it much older than a TFSA. When you contribute money, you get a near-term tax break. That's because all contributions are deductible. If you earn $50,000 this year, but contributed $1,000 to an RRSP, your taxable income is reduced to $49,000.

Which account is superior to create a tax-free dividend stream? For most people, it's a TFSA. Withdrawals in these accounts can occur at any time for any reason, so you can take advantage of your passive income stream at-will. RRSPs, meanwhile, have more complex withdrawal rules. Because you pay taxes on TFSA contributions in advance, the future flexibility is much greater.

Earn tax-free dividends

Armed with a TFSA, you now need to find a stock that can deliver on your passive income dreams. **Enbridge Inc** (TSX:ENB)(NYSE:ENB) is a top pick.

Enbridge is the largest pipeline operator in North America. It's essentially a toll-road owner, but instead of cars and trucks, it transports crude oil and natural gas.

Like highways, pipelines are expensive to build. Some segments can cost $5 million per mile to construct, not to mention years of planning and regulatory approvals. These barriers reduce industry supply, to the direct benefit of Enbridge. Fossil fuel producers need pipelines to survive, and there aren't many options.

In return, Enbridge generates consistent cash flow through pricing power. In some instances, it's forced customers to commit to decade-long agreements. Customers are charged on volumes, not commodity prices, insulating the company from market gyrations. All of this results in a rock-solid dividend.

The COVID-19 correction has pushed Enbridge's stock lower, causing the dividend yield to hit 7.5%. As long as North America continues to pump oil, Enbridge will remain strong.

With a TFSA, you can lock in a 7.5% dividend and pay *zero* taxes on your gains for life.

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