Canada Revenue Agency: How to Turn $5,000 Into $120,000 and Pay No Tax!

Description

Canadians pay tax to the Canada Revenue Agency on nearly all of their earnings. There is one way, however, to grow investments and not pay the CRA a penny in income tax.

Canada Revenue Agency: TFSA 101

The government created the TFSA in 2009 to provide Canadians with a new way to save. The first fours years gave Canadian residents who were at least 18 years old a TFSA contribution limit of $5,000. The dollar limit rose to $5,500 in 2013 and 2014. It jumped to $10,000 in 2015 then came back to $5,500 for 2016-2018. The last two years saw it move up to $6,000. In the current program, the government intends to raise the TFSA limit in line with inflation in $500 increments.

The cumulative TFSA contribution space in 2020 is $69,500. The 2021 TFSA increase will probably be $6,000.

The TFSA provides flexibility in how the funds are contributed and withdrawn. A person can carry forward unused space. When a withdrawal is made, the amount taken out gets added to the contribution room at the beginning of the next year.

Any earnings on investments held inside the TFSA remain beyond the reach of the CRA. In addition, you do not pay taxes on the profits you decided to withdraw. This is great for retirees who want to create a tax-free income stream.

It is also helpful for younger investors who prefer to tax advantage of the TFSA to build large retirement portfolios. In this situation, investors can use dividends to buy new shares to harness the power of compounding.

Most online brokers let you set the process up automatically to take advantage of a dividend-reinvestment plan (DRIP). The DRIP allows the stock to be purchased without a service charge, and some companies even offer a discount on their share prices under the DRIP.

Over time, the strategy can turn small initial investments into large portfolios.

Best stocks for a TFSA fund

It is possible to get big returns over a short period of time if you catch new trends early. Tech stocks are a good example. However, the risk of these bets going bust is also high.

As such, a popular buy-and-hold strategy for a TFSA involves owning top dividend stocks. In tough times, you still get paid and can take advantage of market dips to buy more shares at lower prices.

The best stocks to own normally have long histories of revenue and profit growth. They are often industry leaders and enjoy a sustainable competitive advantages.

Let's take a look at **Canadian National Railway** (TSX:CNR)(NYSE:CNI) to see why it might be a good pick to get started.

CN is the only rail operator in North America with tracks that connect to three coasts. The company serves a key role in the efficient operation of the Canadian and U.S. economies. It transports everything from cars and coal to grain and finished goods.

CN has a great track record of increasing the dividend with a compound annual dividend-growth rate of about 15% over the past 25 years. That helped investors who use the power of compounding to boost their returns.

A $5,000 investment in CN just 20 years ago would be worth $120,000 today with the dividends reinvested.

The bottom line for not paying tax to the Canada Revenue Agency on investment profits

Investors can use the TFSA to build substantial tax-free portfolios for retirement. When the time comes to spend the money, all the profits are yours to keep!

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