Canada Revenue Agency: Turn $6,000 to $600,000 and Pay Zero Taxes

Description

Everyday investors may not be using the available tax-saving options to the full extent. However, savvy investors not only save on the tax dollars but also earn big returns on them. Even if a few hundred dollars of tax saved every year could play a big role in generating wealth over the long term.

Start using the TFSA to its full extent

For example, if you are saving money in the Tax-Free Savings Account (TFSA), you are probably generating around a 1% return every year. Certainly, that is the least-risky way of generating tax-free wealth.

But what if you park that idle money in some safe TSX stocks for the long term? The money will grow tax-free, as it is invested via TFSA, but it will also allow to grow it so much more. TSX stocks, on average, have returned around 8% compounded annually in the long term.

For example, if one saves $6,000 in the TFSA each year for the next 10 years, they should accumulate around $63,000 at the end of the decade. However, if one invests in quality TSX stock based on historical return trends, the reserve will grow to $87,000.

Defensive versus aggressive TSX stocks

Top utility stock **Fortis** (TSX:FTS)(NYSE:FTS) is one of the safest stocks on the TSX. It has returned 10% compounded annually in the last decade, beating the TSX Index. Stocks like Fortis generate stable returns over the years and do not usually give shareholders sleepless nights.

One can also enjoy decent dividends, which will be a secondary income source. Fortis yields 4% at the moment, higher than Canadian stocks on average. A $6,000 investment per year for 10 years in Fortis would have generated $95,600 today, including dividends.

But Fortis is a low-risk, slow-growth investment option. Consider you have some years to retire and already have decent cash for your emergencies. It will allow you to take a little more risk and generate even higher returns.

For instance, tech giant **Shopify** (TSX:SHOP)(NYSE:SHOP) is a comparatively riskier stock but offers significantly greater growth potential. It has returned 95% compounded annually in the last five years, thrashing TSX stocks by a wide margin.

It might not be prudent to expect similar growth from Shopify for the next few years. But even if its growth rate halves in the next few years, that still is a way superior growth compared to broader markets. A $6,000 investment per year for a decade in Shopify would generate $617,000 at the end of the decade.

Stocks like Shopify facilitates quicker wealth generation compared to defensive stocks. This is where taking a risk will pay off!

The Foolish takeaway

Importantly, the substantial gain over the years within the TFSA will be tax-free even at withdrawal. Without the TFSA, one would lose a large chunk in taxes paid, and lesser money would be deployed for compounding.

The sensible approach would be to park money in both defensives as well as in aggressive stocks. Defensives like Fortis will provide stability to the portfolio, while aggressive stocks like Shopify will deliver growth. Importantly, the diversification should allow decent returns irrespective of where the broad market goes.

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Date
2025/08/25
Date Created
2020/11/25
Author
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