



Canada Revenue Agency: How to Use the TFSA to Build Substantial Wealth

Description

The TFSA is a valuable tool to help Canadians build a retirement portfolio.

TFSA 101

The Canada Revenue Agency sets the rules for the Tax-Free Savings Account. Since its inception 10 years ago, the cumulative TFSA contribution limit has grown to \$69,500 for 2020. The CRA recently announced the 2021 TFSA limit increase will be \$6,000. This brings the maximum total TFSA room to \$75,500.

Younger investors who have the full space available might not have this kind of cash sitting around to max out their TFSA room. That's fine, as the TFSA limit can be carried forward and used whenever a person has the cash to invest. In addition, the TFSA provides great flexibility.

Retirees take advantage of the TFSA space to hold extra savings that can generate a tax-free income stream. Seniors also use the TFSA to invest money that must be removed from RRIFs. The government reduced the minimum [RRIF withdrawal](#) amount by 25% in 2020, but that likely won't become a permanent cut.

Investors in the middle or later part of their careers often try to ramp up savings for retirement. Those with generous pension plans, for example, could quickly max out their RRSP space. In this case, they can take advantage of the TFSA to create a tax-free investment fund that can be used to complement retirement earnings or purchase a vacation property.

For all TFSA investors, any money pulled from the TFSA opens up new contribution space in the following year. Some people tap the TFSA to cover emergency expenses and then top it back up when cash flow improves.

All profits created on investments inside the TFSA remain beyond the reach of the Canada Revenue Agency. This means interest, dividends, and capital gains can be withdrawn without the income pushing you into a higher tax bracket. For retirees, the TFSA earnings also remain outside the CRA's

calculation for a potential [OAS clawback](#).

Best investments for a TFSA portfolio

Financial advisors recommend a balanced portfolio. One popular strategy that serves investors well at all career stages involves owning top-quality [dividend stocks](#).

Retirees can use the distributions to create a steady tax-free income stream. Younger investors reinvest the dividends to harness the power of compounding. Over time, a small initial investment can grow to become a significant fund. In fact, many people might not ever need to use the TFSA limit space.

Let's take a look at **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) to see why it might be a good example for a TFSA investment.

Royal Bank is Canada's largest financial institution by market capitalization. It also ranks among the top 15 in the world on that metric. The pandemic hit the share price earlier this year, but investors are realizing that Royal Bank has the means to ride out the downturn and continues to generate strong profits.

The stock currently trades near \$107 per share, roughly where it was before the pandemic hammered the market. Despite the rally off the 2020 lows, Royal Bank still offers a solid 4% yield.

Long-term investors have done well with the stock. A \$10,000 investment in Royal Bank 25 years ago would be worth about \$330,000 today with the dividends reinvested. At the current yield, this would generate \$13,200 per year in dividends!

The bottom line

The CRA wants Canadians to take full advantage of the TFSA to save extra money. Owning top dividend stocks such as Royal Bank is one strategy to build a significant fund that can ultimately provide a steady tax-free income stream.

The **TSX Index** is home to many high-quality dividend stocks, and some still appear oversold right now.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:RY (Royal Bank of Canada)
2. TSX:RY (Royal Bank of Canada)

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