TFSA Investors: How to Generate $3,260 in Tax-Free Dividend Income This Year

Description

The TFSA (Tax-Free Savings Account) program was introduced in 2009 to encourage savings among Canadians. Any contributions towards the TFSA are not exempt from Canada Revenue Agency (CRA) taxes, but withdrawals in the form of capital gains, interests, or even dividends are tax free.

The TFSA is a registered account and is ideal to hold a portfolio of dividend-paying stocks. Investors should understand that dividend stocks allow you to benefit from a steady stream of recurring income as well as long-term capital gains. Right now, interest rates are near record lows, making blue-chip dividend stocks all the more attractive.

The contribution limit for your TFSA in 2022 is $6,000, taking the cumulative contribution room to $81,500. Let's see how you can generate over $3,250 in tax-free income each year going forward.

Invest in blue-chip stocks such as Canadian Imperial Bank of Commerce

One of the largest banks in North America, **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) is valued at a market cap of $72 billion. After adjusting for dividends, CM stock has returned close to 250% to investors in the last 10 years. Comparatively, the TSX Index has risen by just 148% since January 2012.

Canadian Imperial Bank of Commerce ended fiscal 2021 that ended in October with total assets of $837.7 billion, $621.2 billion in deposits, and $462.9 billion in loans. Its flexible balance sheet and prudent risk management allowed the company to accelerate profitable growth over the last several decades. CIBC has a diversified business with a huge presence in Canada and the U.S.

CIBC's strong fundamentals enabled the company to thrive amid economic downturns, including the ongoing pandemic. It ended Q4 of fiscal 2021 with an adjusted efficiency ratio of 57.8% and a common equity tier one ratio of 12.4%, which is higher than regulatory requirements.

Between 2007 and 2021, CIBC has increased annual dividends per share from $2.76 to $6.44, indicating annual growth rates of 4.3%. Given its current stock price, CIBC provides investors a forward yield of 4.03%.

What's next for CM stock investors?

CIBC has increased adjusted earnings per share from $11.11 in fiscal 2017 to $14.47 in fiscal 2021. It now expects earnings to grow between 5% and 10% in the medium term. An expanding bottom line will also provide the banking giant with enough room to increase dividends while maintaining a payout ratio between 40% and 50%.

Similar to peers, CIBC's capital markets division delivered strong results, and it was the second-largest player in debt and equity underwriting verticals in 2021. The company's capital markets revenue soared by 27%, and this trend is likely to continue in the near term.

CIBC's chief financial officer Hratch Panossian explained, "While we will prioritize capital deployment toward this organic growth, our strong capital position also provides us the capacity to return capital to shareholders at a higher level over the course of next year."

The Foolish takeaway

An $81,500 investment in CM stock will allow TFSA investors to generate $3,260 in annual dividend income. If the company continues to increase dividend payouts by 4.3% each year, annual dividend payments will be closer to $5,000 in the next 10 years.

However, it does not make financial sense to allocate a significant amount of your portfolio towards a single stock. You need to identify similar stocks that have robust financials, a wide economic moat, and that enjoy a leadership position, to create a diversified portfolio this year.

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