How to Turn $15,000 Into $270,000 and Pay No Tax

Description

Canadian investors are using their TFSA to build self-directed pension funds that can generate strong long-term returns and provide tax-free passive income in retirement.

TFSA benefits

The government created the TFSA in 2009 to give Canadians an extra savings tool for building wealth. Since its inception, the TFSA contribution limit has increased annually to the current maximum level of $81,500. This is large enough for investors to build significant personal pension funds to cover their living expenses in the golden years.

The TFSA provides more flexibility than the RRSP in that money can be removed at any time without a tax holdback. TFSA contributions are made with after-tax income. In addition, any funds taken out of the TFSA will open up equivalent new TFSA contribution space in the following calendar year.

All interest, dividends, and capital gains generated inside a TFSA remain beyond the reach of the CRA. The profits are not counted as income when earned or when the cash is removed from the TFSA. That's different from the RRSP, where withdrawals are taxed as income.

Seniors who receive Old Age Security (OAS) pensions and also generate income from TFSA investments get an added benefit. The earnings are not used as part of the CRA's net world income calculation that determines the OAS clawback.

One popular strategy for building retirement wealth involves buying top dividend stocks and using the distributions to acquire new shares. This sets off a powerful compounding process that can turn small initial investments into substantial retirement funds over time.

Royal Bank

Royal Bank (TSX:RY)(NYSE:RY) is Canada's largest company with a current market capitalization of

$177 billion. The bank is very profitable, even during difficult economic conditions. Royal Bank generated $16.1 billion in profits in 2021 and is on track to top that level this year.

Royal Bank built up a large cash position over the past two years to cover potential loan defaults that never materialized. Government aid helped households and businesses make their loan and mortgage payments, saving the banks from facing a wave of bankruptcies.

Royal Bank is now using the excess funds to buy back stock, make acquisitions, and return more cash to investors through higher dividends. Royal Bank is buying a wealth management business in the United Kingdom for $2.6 billion a move that will make Royal Bank a top-three player in the wealth management sector in the U.K. and Ireland. Additional deals could be on the way.

Royal Bank appears undervalued right now near $126 per share. The stock traded as high as $149 earlier this year. At the time of writing, the dividend provides a 4% yield. Royal Bank increased the payout by 11% late in 2021 and by another 7% when the bank reported fiscal second-quarter (Q2) 2022 results. This would suggest that management isn't too concerned about the revenue and profits outlook over the near term.

Long-term investors have done well with Royal Bank stock. A $15,000 investment in the shares 25 years ago would be worth $270,000 today with the dividends reinvested.

The bottom line on using the power of compounding to build retirement wealth

Buying top dividend stocks and using the distributions to acquire new shares is a proven strategy for building retirement savings.

Royal Bank is just one example of a high-quality TSX dividend stock that investors can own to create a TFSA pension portfolio. If you have some cash to put to work right now, RY stock looks cheap and still deserves to be an anchor pick.

A number of other great Canadian dividend-growth stocks have generated similar or better returns and also trade at discounted prices today.

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