5 TFSA Mistakes You Don't Know You're Making

Description

Tax free saving accounts (TFSAs) are supposed to be simple, but many people are still getting tripped up by the rules.

In 2014 the Canadian Revenue Agency (CRA) sent out warnings to thousands of taxpayers for over-contributing to their TFSAs. Even worse, most savers don't even know how to take full advantage of these wonderful products.

Given that more than 10 million of us have opened these tax-sheltered accounts, it's about time we got the facts straight. Here are the top five TFSA mistakes that you might not even realize you're making.

1. Don't over-contribute

The chart below outlines the maximum amount you're allowed to contribute to a TFSA since they were launched. This applies to people who were at least 18 years old in 2009.

Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Limit	$5,000	$5,000	$5,000	$5,000	$5,500	$5,500	$10,000

So, if you were born before 1992 and have not made a contribution, you can add up to $41,000 to your TFSA this year. Once your money is in the account, you don't have to pay any taxes on earned interest, dividends, or capital gains.

What happens if you go over this limit? The CRA will impose a tax of 1% per month on every dollar you have contributed over the ceiling. Moral of the story—track your contribution limits closely!

2. Replacing withdraws within one calendar year

This is where a lot of people get confused. Withdrawals from your TFSA don't reduce the total amount of contributions you've already made for the year. Let me give you an example.

Let's say in January 2015 you have already contributed your maximum $41,000 to your TFSA. Then in

July 2015 you decide to withdraw $7,000. You have to wait until at least January 1, 2016 to replace the $7,000 or you will be penalized by the CRA.

3. Be careful when transferring accounts

Be careful when moving your TFSA from one institution to another. Do not simply take out all your money from one TFSA, close the account, and place it in a new TFSA during the same year. This will be considered an over-contribution.

Instead, make sure to go through the proper transfer procedures. There is paperwork you can fill out to transfer TFSA money in a way that doesn't trigger an accidental withdrawal. It's the same paperwork needed to transfer RRSPs from one institution to another.

4) Don't use your TFSA as a savings account

TFSAs were misnamed. They should've never been called tax-free *savings* accounts. Because of this misnomer, most Canadians believe they can only keep cash and guaranteed investment certificates inside their TFSA. However, you can shelter a variety of investments—including stocks, bonds, and REITs.

It's only when you combine the higher returns that these other investments provide with tax-free growth that you really unlock the wealth-building power of TFSAs. So, if you have a long-term investment horizon, you should not treat these vehicles as a glorified savings account.

5) Do hold dividend stocks

Financial experts will argue that you should always keep your fixed-income investments inside your TFSA. After all, because interest is taxed at a higher rate than dividends and capital gains, it follows that fixed-income securities rather than stocks that should be kept in registered accounts. The problem with this argument is that it ignores the rate of return.

Most fixed-income investments, like the **iShares Canadian Universe Bond Index ETF** (TSX:XBB), currently yield less than 2%. Equity securities like the **iShares S&P/TSX Capped Composite Index Fund** (TSX:XIC), in contrast, have historically generated annual returns around 8%. In that case, owning stocks outside your TFSA could generate a bigger tax bill than interest-paying bonds would.

Of course, this will depend on your personal financial situation. Always consult a tax professional to determine what's best for you.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:XBB (iShares Core Canadian Universe Bond Index ETF)
2. TSX:XIC (iShares Core S&P/TSX Capped Composite Index ETF)

Category

1. Investing

Date
2025/08/22
Date Created
2015/04/22
Author
rbaillieul