Avoid These Big Mistakes in Your TFSA

Description

Interests, dividends, and capital gains you earn in a TFSA are tax free (with a small exception with regard to withholding taxes on foreign dividends that we'll discuss below). So, ultimately, you want to minimize the money you make in your TFSA.

Here are mistakes you should avoid in your TFSA to take the best advantage of the awesome tool.

Earn low interests in your TFSA

The best five-year GIC rates are going for about 3%. However, investors can make much more money by investing in low risk dividend stocks.

Investors can readily find such stocks offering safe dividend yields of 3-5% on the TSX index without taking on high risk. These stocks offer growth potential on top of secure dividend income. We'll discuss one of these safe stocks below.

Buying shares of a stock is owning a stake in a business. Why not own great businesses instead of lending your money to financial institutions for a puny 3% rate of return?

Get charged foreign withholding taxes in your TFSA

There's a tax treaty between the U.S. and Canada. However, if you earn U.S. dividends in a TFSA, there will still be a 15% U.S. withholding tax, because TFSAs aren't retirement accounts, such as RRSPs/RRIFs.

So, before buying a big-yield foreign dividend stock in a TFSA, check the withholding tax percentage on the dividend first. The withholding tax will be different for each country. For example, for U.K.-based **Unilever**, there's no foreign withholding tax (under the NYSE:UL ticker). So, it can make a good dividend holding in a TFSA as a stable consumer defensive stock.

Sell out of your quality dividend growth stocks

The biggest gains are made from long-term investments in high-quality businesses. The top Canadian banks are among the cream of the crop and are categorized as the soundest banks in the world.

This includes **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), which has a long history that stems back 164 years and has risen to become one of the most profitable companies on the TSX index.

Notably, TD Bank is consistently profitable, and it has only become a safer investment since it began focusing on the retail side of banking (which has lower risk) in both Canada and the U.S.

TD stock has paid a dividend since at least 1969, and it has increased the dividend over time. Its quarterly dividend has more than doubled from 10 years ago and is on its way to tripling. Its five-year dividend growth rate is 9.5%, which is very good for a low risk business.

The quality bank tends to increase its dividend like clockwork. In February, TD Bank increased its quarterly dividend by 10.4%. Its payout ratio for fiscal 2019 is estimated to be roughly 42%. So, there's plenty of margin of safety for the bank's dividend.

It would be a shame to sell out of quality dividend-growth stocks like TD Bank for short-term gains. Instead, I think it makes the most sense to buy such stocks when they're a good value and hold them for the growing dividends.

TD stock currently offers a decent dividend yield of about 4%. It's a good buy now and on any further dips as a long-term core TFSA holding.

Investor takeaway

If you have a long investment horizon to grow your wealth in your TFSA, it makes good sense to buy great businesses that pay you increasing dividends. That's the Foolish way anyway.

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