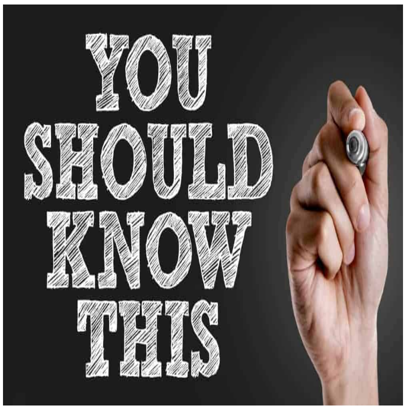

Warning: 3 TFSA Mistakes to Avoid

Description

The Canadian TFSA reached its 10-year anniversary on January 1, 2019.

In late 2018, the Canadian government announced that it would increase the annual TFSA contribution room to $6,000. This brings the cumulative total contribution room to $63,5000. The increase in annual contribution still falls short of the $10,000 mark set by the Conservative government in 2015, but this increase should still make investors happy.

In previous articles, I have discussed the benefits of a TFSA and the potential strategies that investors can adopt to soak up tax-free gains. Today, we are going to go over three mistakes that investors can make in managing their TFSAs. It is worth it to identify these common mistakes and discuss the best way to avoid them.

Over-contributions

Investors can easily make the mistake of over-contributing to their TFSA, although this is an issue that gets more coverage when we talk about RRSPs. All excess contributions in a TFSA attract a 1% per month penalty.

In most cases, investors who over-contribute do so because they forgot their contribution room, or they elected to re-contribute after a withdrawal in the same year. For example, if you contributed $63,500 to your TFSA in February 2019, and withdrew $5,000 in April 2019, you need to wait until 2020 before you can max out your contribution room again.

Fortunately, there is an easy fix to this mistake. Remove your excess contribution room and pay whatever penalty you have accrued to the Canada Revenue Agency (CRA). In some cases, you can appeal the penalty and seek to waive the fee.

Using your TFSA solely as a savings account

Motley Fool readers tend to manage their own portfolios and trade equities, but there are many Canadians who use their TFSAs as an account to hold only cash and GICs. The low rate of return on GICs and cash accounts in 2019 is reason enough to look for other options. However, it is a particularly unfortunate mistake as the TFSA is such a fantastic vehicle for growth and income.

There are those who use the TFSA primarily as an emergency fund. However, those who are using it as an investment vehicle are wasting its potential if they limit themselves to a base savings account.

An overly cautious investment strategy

This mistake draws upon the previous point. An investor with a long-time horizon should seek a large blend of equities in their TFSA portfolio.

Royal Bank (TSX:RY)(NYSE:RY) and its peers are considered relatively conservative equities. Shares of Royal Bank have climbed 172% over the past decade, in addition to offer a dividend yield in the 3-4% range over this period. Those represent massive tax-free gains over a 10-year span, and with a balanced equity holding that offers a nice blend of growth and income.

More aggressive investors who want to maximize the potential of the TFSA will want to target growth stocks. **Canopy Growth** (TSX:WEED)(NYSE:CGC) has emerged as a top cannabis producer in the years since the Liberals announced they were pursuing recreational legalization in 2015. Shares have soared over 1,300% over the past five years. Even a modest holding in your TFSA back in 2015 would have resulted in massive tax-free gains in 2019.

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