The Worst Mistakes TFSA Investors Can Make Right Now

Description

Tax-Free-Savings-Accounts (TFSAs) are great and one of the best investment tools the Canadian government came out with. The TFSAs have exploded in popularity. Canadians investors embraced the facility which has overtaken the RRSP's in investor preference.

Like any investment tool, it is important to make sure you know the proper utilization of your TFSA. But in order to maximize your TFSA returns and you need to make wise investment decisions. However, it is also of supreme importance to avoid the worst mistakes of TFSA investors.

Over trading

Many investors are fickle-minded that they have acquired the habit of frequently moving from one stock to another. They trade in and out of the market with their TFSAs. You should remember the account is called a tax-free-savings-account and not a tax-free-trading-account!

If you trade more than a dozen times per year, it's possible to lose your tax-exempt status for your TFSA. If you do make profits, the CRA could treat your income as taxable since it is now business income rather than pure investment income.

By over trading, you also run the risk of paying more for trading fees and diminish your overall net returns. The amount can accumulate over time to take a significant bite out of your earnings. Further, you're prone to commit mistakes due to over trading, and in some cases, your timing is off and you'll be forced to sell high.

Another thing to keep in mind is that you can't get back the contribution room lost. You are one bad trade away from losing that room forever. There is no way to regain it.

Purchasing foreign equities

TFSA is not always tax-free. You can include foreign income-producing stocks but you'll be taxed. For example, if you own a U.S dividend-paying stock like **AT&T** (NYSE:T), you have to pay a 15% non-resident withholding tax on your dividend earnings.

The said U.S stock has a dividend of $2.04 per share at a high dividend yield of 6.3%. You'd be better off putting the stock in your RRSP instead, and the dividend income won't be subject to the 15% tax.

Holding cash

Some investors make the mistake of sitting on idle cash or limiting investments to low-interest rate bonds. Current interest rates are still very low, with the one-year treasury rate pegged at 1.73%. That is lower than the annual inflation rate average of 2%. You're not increasing the value of your investments with this strategy.

You're not taking advantage of the magic of compounding and tax-free returns by holding cash. Take **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) as an example. Had you invested $5,000 in the stock when the TFSA first came out in 2009 and reinvested the dividends by purchasing more stocks, your money would be worth over $16,000 today.

It's true that past performance is not a guarantee of future returns. The oil industry has an overall negative outlook. Hence, investors are reluctant to continue buying Enbridge. There are concerns about pipelines plus the general lack of industry support.

Building a nest egg for your retirement requires making smart investment decisions, but the crucial aspect to realizing higher gains is to avoid the common TFSA mistakes.

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