TFSA Demystified: 3 Huge Mistakes to Avoid

Description

The introduction of the Tax-Free Savings Account (TFSA) has allowed Canadians to create wealth. You can also use your TFSA to shelter investments that would typically be subject to tax. But since you won't be paying taxes on your earnings, the money in your TFSA could accumulate faster.

Unfortunately, if you don't know the basic concepts of the TFSA, you could commit mistakes that could lessen your earnings. Free yourself of the nuisances by avoiding the slip-ups.

Do not focus on short-term gains

Some TFSA users are not happy with the money growth in their accounts because of a wrong investment strategy. Your primary goal should be to find high-quality stocks that pay decent dividends. The largest bank in Canada, **Royal Bank of Canada**, is an example of a good investment.

RBC is not the kind of stock you will hold in your TFSA for short-term gains. This $152.5 billion financial giant can be your partner in prosperity for a lifetime. A scant investment of $10,000 could yield an overall return of 1,318.40% for 20 years.

Although the stock is not the highest dividend payer, it's bankable because of the more than 100-year history of non-stop dividend payments. RBC is financially strong to endure cyclical markets, market disruptions, and even a recession.

Retirees will not make the mistake of dumping high-quality assets in exchange for short-term gains. Keep it in your TFSA for as long you need continuous income.

Do not use your TFSA to overtrade stocks

It is tempting to trade stocks in the utility sector within the TFSA because of the tax-free features. **Superior Plus** is a reasonably priced utility stock. For $12.20 per share, you'll receive an annual dividend of 6%.

This $2.13 billion company engages in the energy distribution and specialty chemicals businesses in Canada as well as Chile and the United States. Since its energy distribution and specialty chemicals business segments generate steady cash flows, the stock offers capital appreciation.

You could fall into the trap of frequently trading the stock to ride on the price momentum and gain from the spikes. If you continue the practice, the Canada Revenue Agency (CRA) can audit your TFSA. Once the CRA detects your frequent trading, your earnings would be treated as a business income and be subject to tax.

A dividend-paying stock like Superior Plus with a growth rate history of 16.4% in the past five years is an exciting option. However, you shouldn't put the stock in your TFSA for the wrong reasons.

Do not over contribute

The TFSA is a flexible savings plan because you can forward any unused contribution room to future years. But to reap the maximum benefits, do not over contribute. You will pay 1% monthly as penalty tax for as long as the excess amount remains in your TFSA.

Over contribution is the most common mistake when managing a TFSA. But a good TFSA user will not exceed the yearly contribution limits. Likewise, there is strict monitoring of withdrawal and deposit to avoid incurring unnecessary penalties.

Invest every year

Save a little every year and use the money to purchase dividend stocks such as RBC and Superior Plus. Your money will grow over time the tax-free way.

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