2 Common TFSA Mistakes Canadians Should Avoid

Description

Tax-free savings accounts (TFSAs) continue to grow in popularity as more and more Canadians seek to take advantage of the benefits that they offer to achieve their financial goals sooner.

One key advantage is their tax-sheltered status, where essentially any capital gains, interest payments and dividends are tax-free for the life of the investment. That removes the impact of taxes on investment returns, which can be one of the greatest impediments to creating and retaining wealth.

While a **Royal Bank of Canada** poll shows that more Canadians have a TFSA than a Registered Retirement Savings Plan (RRSP), many are failing to take full advantage of the benefits and are making significant mistakes when it comes to managing their TFSAs.

Let's take a closer look at two common errors many Canadians are making regarding their TFSAs that must be avoided in order to build wealth.

Over-contributing

A common error made by many Canadians is exceeding the TFSA contribution limits. There is a cumulative contribution limit of $63,500 since the accounts were introduced in 2009, after including the $6,000 contribution for 2019, for eligible Canadians.

The problem is many Canadians treat their TFSA like a bank account, making multiple cash deposits and withdrawals which sees many inadvertently exceed their contribution limit. Any excess amounts are taxed on a punitive basis at a rate of 1% monthly for any amount in excess of the TFSA limit.

This emphasizes that it's important to keep track of withdrawals and contributions. Account holders should also remember that on January 1 of the next year, they receive more contribution room being the limit for that year and the room from all withdrawals made in the previous year.

Holding cash

According to the Royal Bank poll, nearly half of all Canadians are treating their TFSA like a savings account and only holding cash. This indicates that they're failing to take full advantage of the investment vehicles tax-sheltered status that essentially makes all capital gains, interest and dividends earned are tax-free for the life of the investment.

That slows down at the rate at which financial goals can be achieved and wealth created. It also means that account holders lose the ability to expand their contribution room.

The tax-effectiveness of TFSAs make them an ideal vehicle for building wealth by investing in high-quality income paying growth investments like utility and banking stocks that have dividend reinvestment plans (DRIP).

One candidate that stands out for all the right reasons is **Brookfield Infrastructure Partners** (TSX:BIP.UN)(NYSE:BIP).

The partnership owns a globally diversified portfolio of infrastructure assets, including ports, toll roads, utilities, data centres and communication towers which are crucial to economic activity.

Brookfield Infrastructure has a long history of growing earnings and delivering value for investors, which, when coupled with its low volatility, as illustrated by a beta of 0.81, as well as solid defensive characteristics makes it the ideal stock to hold in a TFSA.

This appeal is enhanced by its steadily growing sustainable distribution, which the partnership has hiked for the last 11 years straight to be yielding an appealing 4%.

Recent transactions including the US$5 billion purchase of railroad operator **Genesee & Wyoming Inc.**, the US$400 million investment in 130,000 India telecommunications towers and two natural gas pipelines in Mexico will drive earnings higher.

That will in turn support further distribution increases, and while giving Brookfield Infrastructure's stock a solid lift, making now the time to buy.

By reinvesting Brookfield Infrastructure's distributions through its DRIP, allowing unitholders to use distributions to acquire additional units at no extra cost, the power of compounding can be unlocked, accelerating the rate at which wealth can be created.

Over the last 10 years, Brookfield Infrastructure has delivered an annualized return of 25.5% if all distributions were used to buy additional units compared to 22% if they weren't, highlighting the considerable returns that can be generated if those payments are reinvested.

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Date
2025/08/27
Date Created
2019/11/21
Author
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