TFSA Investors: You're Likely Making This Major Mistake

Description

If you're using a TFSA, you've already made the best financial decision possible. TFSAs completely shield you from taxes on capital gains and dividends, no strings attached. That's as close at it gets to free money.

Yet millions of Canadians still make a classic TFSA mistake, one that costs them thousands today, and potentially millions down the road. It's easy to correct this mistake, but most fail to do so.

Take full advantage of your TFSA by following the advice below. The solution is stupidly simply, but its proven effects are beyond question.

Flexibility is huge

You likely know that TFSAs come with contribution maximums. If they didn't, you'd be able to shield an unlimited amount of capital from taxes. This year, the contribution maximum is $6,000, but that figure has fluctuated over the years. In 2009, the year the TFSA was first introduced, the max was set at $5,000. In 2015, it was temporarily bumped to $10,000.

If you add each year's maximum contribution together, you get $63,500. Why does that number matter? Because no matter what happens, you can never lose you lifetime contribution room. If you opened a TFSA today, for example, you could immediately contribute $63,500, even though this year's specific max is only $6,000.

Additionally, any withdrawals open up additional contribution space. Let's say you've already hit your lifetime max of $63,500, but withdraw $2,000 from your TFSA this year. That means you've opened up another $2,000 in contribution room, which can be refilled at any time after the end of this year.

The flexibility surrounding TFSA contribution maximums has clear benefits, but it also has a dark downside.

Don’t lose time

If you never lose you contribution room, what’s pushing you to hit the maximum today? Just because the contribution room rolls over, doesn’t mean *time* does the same thing.

Many investors think you need to stash away large sums of money to get rich. That’s simply not true. Your biggest weapon isn’t contributions, but time.

In finance, there’s a key principle called the *time value of money*. A dollar tomorrow isn’t worth the same as a dollar today. Here’s an example.

If you invest $5,000 per year for 10 years, earning a 10% annual rate of return, you’ll end up with $88,000. But adding up your deposits, you only contributed a total of $50,000. The $38,000 profit reflects the *time* that money was invested.

What if you invested $5,000 per year, but instead of doing it for 10 years, you did it for 20 years? Earning the same 10% rate of return, your money would balloon to $315,000. Cash contributions totaled just $100,000, so your time value profit would be $215,000. That’s more than double the amount of money you put in.

This is perhaps the most important concept in investing: you *never* get time back. That’s a tough reality considering time is your most powerful weapon.

If you have a TFSA, take advantage of the account’s contribution flexibility, but never forget that saving $1 today is worth considerably more than saving $1 in the future.

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