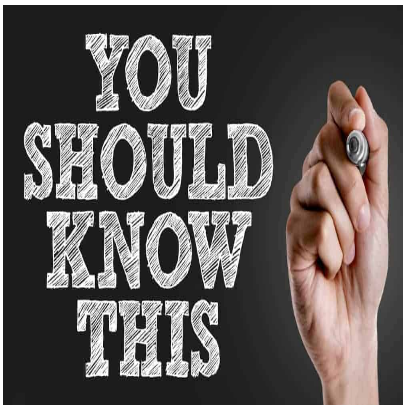

WARNING: Canada Revenue Agency Is Eyeing Your TFSA With This 1 Rule

Description

More Canadians now have a TFSA than an RRSP. Investors are realizing the potential of Tax-Free Saving Accounts and are focusing on growing their wealth with this excellent investment vehicle. But you should never put all your eggs in one basket, and you should never allocate all your assets to one investment vehicle.

TFSA is an excellent choice for growing wealth, thanks to its tax-free nature. But RRSP and even non-registered accounts have their merits, especially when it comes to tax implications.

And speaking of tax, you should know that your TFSA is not entirely impervious to the CRA's claims. This is something many TFSA holders tend to miss. Like the TFSA over-contribution penalty, there is a tax element to U.S. stocks held in your TFSA.

U.S. dividend rule

U.S. tax law enforces a 30% withholding tax on dividend income for non-U.S. investors. Under a treaty, Canadian investors are only required to pay half of it, 15% withholding tax. So if you have U.S. dividend stocks, you are liable to pay 15% on the earnings you make through dividends, even if the shares are held in a TFSA.

A lot of investors, who look to American stock exchanges for a diversified portfolio and higher dividends, end up making the same money after tax deductions. If you want to line up your TFSA with dividend stocks from across the border, understand that you will be earning 15% more than you would have from a local stock with the same yield.

For tax purposes, an RRSP is better suited for U.S. dividend stocks. Still, high dividend yields and a desire to invest in sectors that are underrepresented in the TSX (like tech, software, and health care), can make U.S. stocks look attractive, even with the 15% withholding tax.

Local investment

Instead of paying 15% to Uncle Sam, how about investing in a good, high-yield Canadian stock? **Enbridge** (TSX:ENB)(NYSE:ENB) is a dividend aristocrat and has a 19-year history of increasing dividends. It's an energy company with a diversified portfolio and a decent reach.

The company has one of the highest yields among the aristocrats, a juicy 5.78%. Your fully contributed TFSA of $63,500 in Enbridge will get you over $300 a month in passive income. If you shop around U.S. dividend aristocrats, you won't find a yield that can match the returns of Enbridge, especially after the 15% deduction.

The company's growth should be considered, as well. From the same time last year, Enbridge's market value has grown by 22%. If the company keeps it up, your capital gains in five years will be double your initial investment. It's a fantastic way to build wealth through your TFSA.

Foolish takeaway

While diversifying their investment portfolios, many investors tend to miss a vital piece – asset allocation in different investment vehicles. How you will be taxed on your income through dividends has a lot of impact on your short-term and long-term investment goals. Getting the best out of your investment doesn't just rely on your choice of stocks; it depends on your asset allocation as well.

CATEGORY

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2. Energy Stocks
3. Investing

TICKERS GLOBAL

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