



Young TFSA Investors: Don't Make This Costly Mistake

Description

Investment Executive, an industry journal that's read by more than 120,000 financial advisors and portfolio managers in Canada, recently warned about a TFSA mistake that thousands of young investors make every year: over-contributing.

"It's not uncommon for Canadians to over-contribute to their accounts," the journal noted. "Canadians would be well advised to keep track of their TFSA withdrawals and contributions themselves."

If you accidentally over-contribute to your TFSA, you will immediately be forced to pay a 1% monthly [tax](#) on any excess amount. This can quickly eat into your potential tax savings.

How to avoid over-contributions

Fortunately, it's easy to avoid this costly mistake. All you have to do is be aware of a few rules and do some basic math.

Annual limits change

The first thing you should know is that there's an annual limit to contributions. The limit can change from year to year.

From 2009 to 2012, it was set at \$5,000. The annual contribution limit was then raised to \$5,500 for 2013 and 2014, and then jumped to \$10,000 in 2015. From 2016 to 2018, it was reduced to \$5,500, only to rise to \$6,000 in 2019 and 2020.

You have a lifetime limit

There's another critical thing that you should know: it's really your *lifetime* contribution maximum that matters.

TFSA contribution room rolls over year to year, so if you didn't contribute in past years, that space is added to *this year's* maximum. Contribution space starts to accrue whether or not you've formally opened a TFSA.

So in theory, you may be eligible to open a TFSA today and immediately contribute \$69,500, the sum of each year's contribution max since the year the TFSA was first available. Notice I said *in theory*. That's because contribution space only begins to accrue on the year of your 18th birthday.

It's not uncommon for Canadian's to assume they can contribute the theoretically maximum lifetime limit of \$69,500 as soon as they open a TFSA. In reality, you need to do your own math to calculate your personal lifetime maximum.

If you turned 18 in 2016 for example, you'd sum the annual contribution maximums from 2016 to 2020 to get \$28,500. This year, you can't have accumulated lifetime contributions above that figure without incurring a tax penalty.

Watch your withdrawals

The most common over-contribution mistake, however, deals with the withdrawal rules. According to *Investment Executive*, this occurs "by withdrawing money and re-contributing within the same year in such a way as to exceed the contribution limit for the year."

What does that mean?

One of the best parts of a TFSA is the flexibility regarding withdrawals. At any time, for any reason, you can take money out of your TFSA tax-free (in contrast to an RRSP). Even better, these withdrawals add new contribution room for the following year so you can put that money back in (again, in contrast to an RRSP). It's critical to note that it *doesn't* open up new contribution room for the current year.

For example, let's say you hit your lifetime maximum in early 2020, but toward to end of the year, you take a \$1,000 withdrawal for an unexpected expense. Canadians often think they can re-contribute the money in the *current* year. However, your \$1,000 in additional contribution space doesn't occur until *next* year. If you put any more money into your TFSA in 2020, you'll be hit with penalties.

Over-contributions are only one factor you should know about with regard to your TFSA, but it pays to familiarize yourself with the rules. If you're young, spend time pinpointing stocks that can grow your capital for decades at a time. Eventually, these securities can compound your capital into millions of dollars. Just be sure to do the work to find these worthwhile investments.

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