TFSA Investors: Avoid These CRA Fines in 2020!

Description

Tax-Free Savings Accounts (TFSAs) are one of the most popular investment vehicles in Canada. As the name suggests, withdrawals (capital gains, interest or dividends) from this account are tax free. However, TFSA investors need to wary of certain rules in order to avoid fines from the Canada Revenue Agency.

Do not over contribute

The contribution limit for someone who has never invested in the TFSA since its introduction in 2009 stands at $69,500. Comparatively, the standalone investment figure for TFSA investors in 2020 is $6,000.

In case you overcontribute in the TFSA, the CRA levies a 1% penalty tax per month on the excess amount. So, in case a TFSA investor over contributes by $1,000 in 2020, he will have to shell out $10 a month in CRA fines.

Understand market gains and losses

Investors need to understand how capital gains and losses impact their contribution limit in case of withdrawals and deposits. For example, an investor contributes $5,000 in the TFSA and this investment has risen to $7,000 over the years.

Now, if the investor wishes to withdraw this amount, he or she can contribute an additional $7,000 (instead of the original investment of $5,000) at the start of the next calendar year.

However, the opposite is also true in the case of losses. In case the $5,000 investment drops to $4,000 and the investor is keen on withdrawal, the additional contribution room available will be the latter figure for the next calendar year.

Investors need to calculate the exact amount available for deposits in the TFSA, after accounting for a profit or gain on the withdrawal.

Avoid non-qualified investments

The Canada Revenue Agency keeps a close watch on the type of investments that are eligible for TFSAs. In case a TFSA holds non-qualified investments, CRA taxes any income or capital gains earned on the investment.

The responsibility of compliance lies with the TFSA account holder and the penalty for non-qualified investments is severe. Investors will have to pay a tax of 50% of the investment value in addition to other penalties depending on the scenario.

Given the tax-free withdrawals, the TFSA continues to remain an ideal investment vehicle for equity investors. TFSA holders can look to invest in high dividend yield Canadian stocks such as **Exco Technologies** (TSX:XTC).

Exco designs and manufactures dies, molds, components and equipment for automotive industries. Exco has a market presence in the United States, Canada, Mexico, Europe, Asia, and South America. It's a small-cap company with a market cap of $327.55 million.

In the last 12-month period, Exco stock has fallen 18.2%, grossly underperforming the broader markets. The pullback in Exco shares has meant the company's forward dividend yield stands at a healthy 4.7%.

The stock is trading at a cheap valuation. It has a forward price-to-earnings ratio of 9.2, while the price-to-sales and price-to-book ratios stand at 0.67 and 1 respectively.

The slowdown in global automotive sales has contributed to the stock's decline over the years. Exco stands to benefit when the auto industry stages a comeback which will also boost profit margins higher.

At the current valuation, Exco stock seems like an attractive buy for contrarian investors.

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Date
2025/08/18
Date Created
2020/02/10
Author
araghunath