Canada Revenue Agency: 1 Common RRSP and TFSA Mistake That Trigger Costly Penalties

Description

The Registered Retirement Savings Plan (RRSP) and Tax-Free Savings Account (TFSA) are both tax shelters for Canadians to take advantage of and maximize. As much as possible, the Canada Revenue Agency (CRA) shouldn't be in the picture. However, due to a common oversight, the taxman will come knocking.

The CRA will charge users of RRSPS as well as TFSAs penalties for excess contribution. If you have one or both, you should know the contribution limits of each to avoid paying costly taxes.

RRSP penalty tax

RRSP contributions are not subject to tax. In 2020, the contribution limit is 18% of the earned income an individual taxpayer reported in the 2019 tax return. The maximum, as per the CRA, is $27.230. However, any contribution over that in excess of $2,000 means a 1% tax per month. For late tax return filing, add a 5% penalty.

The only time you pay taxes is when you withdraw from the RRSP. Meanwhile, you can invest in high-yield stocks like **Inter Pipeline** (TSX:IPL) to allow your money to grow tax-free. This $9.09 billion yields a better-than-market average of 7.97% dividend.

Assuming the dividend remains constant and your holding period is 10 years, the future worth of a $100,000 investment is $215,293.55. The advantages of holding an income-producing asset like IPL in your RRSP are tax-sheltered earnings and tax-deferral. For as long as your money stays in the plan, earnings are non-taxable.

Inter Pipeline has a record of raising dividends for 11 consecutive years. Hence, you're deferring the tax liability due to your contribution and investment income from this oil and gas midstream company. The tax kicks come withdrawal time.

TFSA penalty tax

Dividend monsters like **Morguard** (TSX:MRT.UN) are ideal for the TFSA. Since this $752.96 million real estate investment trust (REIT) is listed on the TSX, it's an acceptable asset to place in your TFSA. Currently, this real estate stock yields a hefty 7.72%.

Like the RRSP, there is a TFSA contribution. However, whatever interest, dividends, or gains you collect from this REIT stock are all tax-free. Assuming you have $6,000 to invest and your 2020 TFSA limit is available, your tax-free earnings from Morguard are $463.20. Do the math and see how much tax-free money you'll have if the TFSA accumulated contribution room of $69,500 is free.

Morguard is an attractive real estate stock,q because the portfolio consists of high-quality office properties and large enclosed full-scale regional shopping malls. You can find the properties in major urban centres with a high traffic count. These high-quality assets are mainly responsible for growing revenue and free cash.

Rules are rules

The CRA is clear that whenever you overcontribute to the RRSP or TFSA, there are tax consequences. The 1% penalty tax per month for excess contribution appears insignificant. But you're diminishing total returns from investment just the same.

Show the CRA that you're a disciplined RRSP and TFSA user. By following the contribution rules, your earnings from dividend machines like Inter Pipeline and Morguard should remain intact. Above all, there's no sense paying taxes that are avoidable in the first place.

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1. TSX:MRT.UN (Morguard Real Estate Investment Trust)

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