



## TFSA Investors: 3 Big Mistakes to Avoid With Your TFSA

### Description

Since its creation in 2009, the TFSA is growing in popularity among Canadians. According to a study by **BMO**, 66% of Canadians held a TFSA in 2019. The average annual contribution is up 10% year over year at an average of \$5,332 — up from \$4,826 in 2018.

To take full [advantage](#) of your TFSA, you must avoid certain mistakes. Here are three mistakes that you should avoid if you want to get the most out of your TFSA.

### Overcontributing

Be careful not to exceed your TFSA contribution limit, as it can be very expensive. Many people exceed their TFSA contribution limits without being aware of it.

If you exceed the limit, the Canada Revenue Agency (CRA) will charge you a penalty of 1% per month for any amount exceeding your total TFSA limit (\$69,500 in 2020) until you withdraw the excess funds. You may receive a letter from the CRA to notify you, but it could take a few months.

It is important to track your contributions carefully and to take note of any withdrawal from your TFSA. A TFSA is not like a regular bank account. If you withdraw money from your TFSA, the amount you withdraw will be added to your contribution limit, but only the year after the withdrawal.

### Parking only cash in your TFSA

Although it is called a “Tax-Free Savings Account,” you shouldn’t just have cash in your TFSA. In a TFSA, you will never have to pay tax on the money you contribute and on all the money you make in it. It is therefore not optimal to hold cash in a TFSA since interest paid on saving accounts is very low.

Although the name may be misleading, you can hold many different kinds of investments in a TFSA, such as guaranteed investment certificates (GICs), bonds, stocks, ETFs, mutual funds, and options.

Although you only gain about 1% of interest in a savings account, you can get a lot more by investing your TFSA in stocks. There are many great stocks that will give you a strong share price appreciation

and dividends.

For example, **National Bank of Canada** ([TSX:NA](#)) stock has soared by more than 20% over one year. The bank pays a quarterly dividend of \$0.71 per share for a dividend yield close to 4%.

This means that by buying National Bank stock, you'll get a dividend of \$2.84 per year for each share you buy, and this dividend will be entirely tax-free. So, with just the dividend, you'll get a much higher return than the interest you can earn on a savings account.

You can sleep peacefully at night, since National Bank is a very [solid bank](#) and its dividend is safe. The bank also increases its dividend regularly. Plus, when you sell your shares, the gain you have made on the stock will be entirely yours. The stock is cheap now with a forward P/E of just 10.5.

By contributing the maximum, you can and choosing the right investments, your TFSA could grow to a very interesting amount in the long term.

## Buying U.S. dividend stocks in your TFSA

If you want to buy U.S. stocks that pay dividends, you should buy them in your RRSP rather than your TFSA. The reason is that you'll have to pay a 15% withholding tax for non-residents on U.S. dividends if you receive them in a TFSA.

Plus, as opposed to a non-registered account, you cannot claim a foreign dividend tax credit on U.S. dividends on your Canadian income tax return. In an RRSP, you won't have to pay a withholding tax on your U.S. dividends, so it's better to buy them there.

For example, if you're looking to buy a U.S. stock like **AT&T**, which pays a quarterly dividend of US\$0.51 per share, it's best to buy it in an RRSP, so you're not taxed on the dividend. If you don't have room in your RRSP to buy the stock, you can buy it in a non-registered account to receive a foreign dividend tax credit.

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1. TSX:NA (National Bank of Canada)

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sbchateauneuf

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