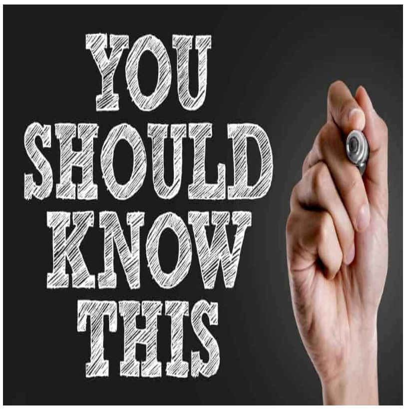

TFSA Investors: 3 Common Mistakes to Avoid in 2020

Description

The Tax-free Savings Account (TFSA) was introduced in 2009 and has quickly gained popularity among Canadians. According to the annual BMO TFSA study, 66% of Canadians hold a TFSA account as of 2019.

The average annual contribution is up 10% year over year at $5,332 in 2019, up from $4,826 in 2018. The total contribution has increased by 4% from $27,053 in 2018 to $28,214, according to the report.

As more people are investing in their TFSA, investors need to know the common mistakes that impact Canadians and may attract fine from the Canada Revenue Agency.

Overcontributing in your TFSA

In 2020, Canadians can invest $6,000 in their TFSA. The total contribution limit for an eligible investor who has never invested in the TFSA since its 2009 inception stands at $69,500.

However, several investors still tend to overcontribute in their TFSA, which attracts a 1% penalty tax per month on the excess amount. If a TFSA investor over contributes by $1,000 this year, the monthly CRA fine will amount to $10.

Understanding the nature of market gains and losses

Another mistake by investors is the lack of understanding in cases of capital gains and losses and the resulting impact on their TFSA contribution limit. If an investor’s contribution of $5,000 has ballooned to $7,000 in 2020 and if he or she wishes to withdraw the entire amount this year, that investor can contribute an additional $7,000 in 2021.

However, the opposite holds true in case of losses. If the investment amount falls to $4,000 the excess contribution room for 2021 will be $4,000. TFSA investors need to calculate the exact investment amount available after accounting for the profit and losses in case of a withdrawal.

Holding cash in your TFSA

This is a common mistake that investors make. The withdrawals are tax free, which means you need to allocate investments with high returns to this account. If investors hold cash in the TFSA, the return is a measly 0.25% on an annual basis.

Instead, TFSA investors can look to add undervalued dividend stocks like **Toronto-Dominion Bank** (TSX:TO)(NYSE:TO) in this account. Shares of the banking giant are trading at $57.38. The stock is trading 26.4% below its 52-week high and is down almost 13% in the last year.

TD shares fell 12.3% yesterday after the oil price war escalated between Saudi Arabia and Russia. The stock is trading 20% lower year to date, as investors are also concerned over lower consumer demand driven by the spread of coronavirus coupled with the bank's rise in provisions for credit losses.

This offers an opportunity for investors to buy a company with strong fundamentals and a cheap valuation. TD is Canada's second-largest bank and a huge player across the personal banking, commercial banking and wealth management segments.

Over the last few years, it is also increasing presence in the retail banking sector south of the border. In 2019, the United States accounted for 26.3% of total sales, up from 25.9% in 2018.

While Canadian banks have huge exposure to the energy sector, TD's market penetration in the U.S. will help diversify its portfolio and loan book.

The drop in interest rates will help the banking giant offer mortgage loans at a lower rate, which will also reduce the chance of default.

The recent drop in stock price has increased TD's dividend yield to 4.7%, and with a payout ratio of 45%, it can continue to increase payouts in 2020.

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