TFSA Investors: 3 Top Mistakes to Avoid in 2020

Description

The Tax-Free Savings Account (TFSA) is one of the most flexible investment options for Canadians. This program began back in 2009 and is one of the top savings options for individuals over the age of 18. The contributions to your TFSA are not tax deductible, while the withdrawals (investments, dividends, or capital gains) are tax-free.

Like other investment options, Canadians need to ensure they comply with the relevant terms and conditions to circumvent penalties from the Canada Revenue Agency. Here are the top three mistakes that can be easily avoided.

Over contributing to your TFSA

The maximum TFSA contribution limit for a Canadian individual who was over the age of 18 in 2009 currently stands at $69,500. This limit for 2020 is $6,000. The TFSA contribution room between 2009 and 2012 was $5,000/year. It was raised to $5,500 for 2013 and 2014, while in 2015 it increased by $10,000. The CRA then reduced TFSA contribution limits to $5,500 for the next three years. In 2019, it was increased to $6,000.

If you have withdrawn any amount in 2020, you can re-contribute that amount in 2021. In case individuals overcontribute, they will be subject to a 1% tax for every month of the excess amount, which amounts to a 12% tax annually.

Paying a foreign withholding tax charge

Individuals can contribute foreign funds to a TFSA. If you get paid a dividend income from a foreign country, it could be subject to a foreign withholding tax. We know that in times of volatility, investors like to have a passive-income stream and find top-quality dividend-paying stocks attractive.

However, they need to check foreign withholding tax rules for each country to avoid paying these taxes.

Avoiding growth stocks

As TFSA withdrawals are tax-free, investors need to allocate funds to buy growth stocks in this account. Shares of Canadian growth companies, such as **Shopify** and **Constellation Software**, have generated massive returns in the last few years, and such companies need to be part of your TFSA portfolio.

For example, if you had invested $5,000 in Constellation Software back in 2009, the investment would have ballooned to a staggering $240,000.

Where do you invest right now?

We have seen that the broader markets have lost over 25% in less than two months. This is an attractive opportunity for investors to buy top-quality stocks at cheap valuations. However, it is pretty difficult to identify winners in a market that is increasingly volatile.

For investors who do not have the time and expertise required to pick stocks, investing in ETFs is the best bet. Most ETFs provide diversified exposure to stocks and are wealth creators for long-term investors.

The **iShares S&P/TSX 60 Index ETF** is currently trading at $20, which is 26% below record highs. It is the most liquid index fund in Canada and has exposure to the largest companies in the country.

The top five holdings of the ETF include **Royal Bank of Canada** at 8% followed by **Toronto-Dominion Bank**, **Enbridge**, **Canadian National Railway**, and **Bank of Nova Scotia** at 7%, 5.3%, 5.2%, and 4.5%, respectively.

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Date

2025/07/03
Date Created
2020/04/07
Author
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