Canada Revenue Agency: 3 Critical TFSA Mistakes That Could Cost You Dearly

Description

A Tax-Free Savings Account (TFSA) can be your best friend when it comes to achieving your goals for financial freedom.

This account type protects your capital from the clutches of the Canada Revenue Agency (CRA) as it comes to collect its taxes. It doesn't matter how long your investments sit in the account or how much your investments grow. You get to keep all of your earnings.

Most investors do not even use their TFSAs to their full potential. Many even make critical mistakes that can lead to compromising the tax-free status of the account.

Today I'm going to discuss three critical mistakes that Canadian investors can make with their TFSAs so you can avoid making them yourself.

Not maximizing the contribution room

Each year, the CRA updates the maximum contribution limit in the TFSA. With the 2020 update, it is up to $69,500, which means that you can hold up to a total of $69,500 in cash or equivalent assets in your TFSA.

The most significant mistake that investors make is not using their TFSAs to their full potential. If you do not invest in your TFSA regularly and max out the contribution room, you can lose significant profits you could have made. If you invest correctly and max out the contribution room, your potential long-term profits can be significant.

Investing too much

While some investors don't invest enough in their TFSAs, others can get carried away. It thereforepays to know your limits when it comes to this tax-free account. Since the TFSA launched, the CRA increases the contribution room in TFSAs by $5,000 or $6,000 each year.

The contribution room update for 2020 saw it increase from $63,500 to $69,500. If you have not invested in your TFSA before, you can contribute a total of $69,500 to the account. However, exceeding the contribution limit can compromise the tax-free status of your TFSA.

Any excess amount in your TFSA will be taxed.

Storing cash

Many Canadians consider their TFSAs like regular savings accounts and use them to store cash, which can be one of the biggest ways to waste the opportunity to produce substantial income. The tax-sheltered status of your TFSA will shield any type of asset you hold in your account tax free.

It means that if any asset stored in your TFSA that produces income through appreciation, dividends, or interest can grow your wealth without affecting your contribution room. You also don't need to pay any taxes on the income you earn through assets stored in your TFSA. Simply holding cash in your account is a waste of space.

Using your TFSA contribution room to buy and hold shares of income-generating assets can help you maximize the potential of your TFSA. A stock like **Fortis Inc.** (TSX:FTS)(NYSE:FTS) can help you make the most of your contribution room and grow your wealth substantially in the long run.

Fortis is a company that operates in the utility sector in Canada. It provides electricity for homes across Canada, the US, and in the Caribbean. It is a defensive asset that can produce a stable income even during times of a recession.

Amid the COVID-19-fuelled market pullback, the **S&P/TSX Composite Index** is down by almost 11% from the start of the year. Most stocks trading on the **TSX** are experiencing double-digit losses. Fortis, on the other hand, is up by 3.50% after dipping in March 2020. It also offers investors a dividend yield of 3.49% that it can sustain through stable income.

Foolish takeaway

There are two certainties in life: death and taxes. However, if you store assets in a TFSA, taxes are the last thing you need to worry about. Make sure you avoid making these three mistakes and use the contribution room with intelligent investments.

Allocating some of the contribution room in your TFSA to an income-generating asset like Fortis can earn you substantial income in the long run.

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