2 Common TFSA and RRSP Mistakes to Avoid

Description

The Tax-Free Savings Accounts (TFSA) and the Registered Retirement Savings Plan (RRSP) are the widely used investment accounts in Canada. Each one has unique characteristics, although the objective is the same. You can use either to build wealth or secure your financial future.

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Both accounts are tax shelters on investment returns. The TFSA is tax-free, such that there are no taxes whatsoever on earnings, gains, or interest when you withdraw. In contrast, the RRSP is a tax-deferred account where there is tax-free money growth, but you will pay taxes when you withdraw.

However, utilization can be perfect if users of these investment vehicles can avoid two common mistakes.

Using the TFSA and RRSP as savings account

The term *savings* is deceiving because the TFSA and RRSP are far from being savings accounts. You can save or hoard cash in either, but you limit the earnings potential or get none at all if you do.

It would defeat the purpose of using your TFSA and RRSP as simple savings accounts and withdrawing money when you need it. The primary goal when you open either account is for long-term retirement savings.

Overcontribution

Rules are governing the management of the TFSA and RRSP. The shared one is a direct contribution with set limits. You pay penalty tax when you overcontribute to the accounts.

For the TFSA, the annual maximum limit changes from year to year. The contribution for the TFSA in 2020 is $6,000, while the cumulative lifetime maximum is $69,500. But for your RRSP, you can contribute 18% of your previous year's earned income to $27,230, or whatever is lower.

The penalty tax for overcontribution is 1% of the excess contribution per month. Your remedy is to withdraw the excess so as not to pay an unnecessary penalty. There is a $2,000 grace amount for overcontribution in the RRSP, but the TFSA offers none.

Top pick

You can choose your investments, whether you're a TFSA or RRSP user. Your investments can be in bonds, ETFs, GICs, mutual funds, and stocks.

Since stocks offer higher returns than most, they are the usual choices. If you want high tax-free earnings and tax-free money growth, **Enbridge** (TSX:ENB)(NYSE:ENB) is the logical choice.

Income investors will never bypass this top-notch energy stock. This $85.56 billion energy infrastructure company is the best you'll ever find. Some are staying away from Enbridge, because it belongs to the highly volatile energy sector. You're mistaken if that is your perception.

There was collateral damage from the recent oil price war but it was not material enough to impact on the business or operations. You're investing in the titan of pipelines and Canada's top exporting company. Enbridge transports 20% of America's natural gas requirements. Its extensive pipeline network functions like a toll road, which means cash is forever flowing.

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As of this writing, the stock is trading at $42.25 per share. If you invest today, the dividend offer is 7.8%. The income on a $25,000 investment is $1,950. The dividends are safe and could be your everlasting income.

No nonsense

TFSA and RRSP are practical investment tools. Use them well, and you will see how fast your money can grow.

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