WARNING: 3 Costly Mistakes That Could Destroy Your TFSA's Earnings

Description

A Tax-Free Savings Account (TFSA) can be an excellent way to grow your savings over the long term. But investors need to be careful using it because if you don't follow the rules, you could end up with fees and penalties that can wipe out a large chunk of your savings. Here are three things *not* to do with your TFSA:

Buying stocks that aren't on eligible exchanges

If you're buying and selling stocks that are on large exchanges like the **NASDAQ, NYSE, and TSX**, then this isn't something you'll need to worry about. There are dozens of exchanges that the Canadian government considers "Designated Stock Exchanges," including the TSX Venture Exchange.

And if a stock doesn't trade on any designated exchange, then it's not a qualified investment and therefore can't be put inside a TFSA. Doing so could result in penalties from the Canada Revenue Agency (CRA).

Trading too often

A TFSA is intended for investments, not for trading. The danger here is that if you're day-trading stocks, the CRA could consider the income that you earn inside a TFSA to be business income since it could argue that you're carrying on a business rather than investing, which typically involves long-term holds.

But the problem goes beyond just day trading, as there's no definitive rule as to how long you should hold on to an investment for to avoid running into trouble with the CRA.

Generally, this likely won't become a big issue for you unless you've got a TFSA that's grown significantly (e.g., hundreds of thousands of dollars or more) to the point where it attracts the CRA's attention and the agency wants to make sure it isn't missing out on possible tax revenue.

Over-contributing

This is another easy mistake to make, but it's much more clearer.

The danger with over-contributing isn't normally that you invest $100,000 into your TFSA where your cumulative limit is only $69,500. Rather, the more likely mistake is withdrawing from your TFSA and then re-contributing before the contribution room is replenished.

Suppose your TFSA limit was $69,500 and you contributed the full $69,500 on January 1. Even if you were to withdraw that amount on January 2, you wouldn't be able to re-contribute back into your TFSA until the following year.

The reason is that the funds you withdrew on January 2 wouldn't replenish the contribution room in your TFSA until the next calendar year. And so even if you contributed another $1 into your TFSA before the year ended, you will have over-contributed to your TFSA. The larger the over-contribution amount, the larger the penalty.

Here's what you should do with your TFSA

If you're not sure what to put into your TFSA, a good option is an exchange-traded fund like the **BMO Canadian Dividend ETF** (TSX:ZDV). With the ETF, you'll effectively be holding a basket of stocks in your TFSA with just one investment, and so you can minimize the temptation to do too much trading since it'll already hold many top **TSX** stocks in there.

And since the ETF trades on the TSX, it's an investment that's eligible to put in your TFSA. It's also a good investment if you wanted to make a big buy. For instance, a $69,500 investment in the ETF could earn you more than $3,800 in dividend income every year at its current yield of around 5.5%.

With top stocks like **Bank of Nova Scotia**, **BCE**, **Telus**, and many other big-name Canadian companies inside the ETF, you'd be getting a balanced investment with just one purchase.

Investing in a top ETF can be an easy way to grow your TFSA without worrying about having to actively manage it.

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