3 Huge TFSA Mistakes to Avoid

Description

The Tax-Free Savings Account (TFSA) has grown into a favourite for Canadian investors since its inception in January 2009. It is not hard to see why. The TFSA offers investors flexibility and the mouth-watering boon of tax-free gains. Today, I want to look at three big TFSA mistakes that Canadians need to avoid in 2020 and beyond.

Using your TFSA as a cash account

In late 2019, I'd discussed why investors should avoid using their TFSA solely as a savings account. Canadians who use this as a basic cash account are failing to take advantage of its best qualifies. That is especially true in the current environment. Interest rates are at historic lows, which means savings accounts typically fail to keep up with inflation. For example, most daily interest savings accounts offer a meagre 0.25%.

Any capital growth or income derived in a TFSA is not subject to a capital gains tax. Because of this, investors should be making the most out of this opportunity. More risk-averse Canadians can still get much more out of safe stocks like **Emera** or **Fortis** than they will in a daily interest account. Younger investors should pursue long-term growth with stocks like **Shopify** or **WELL Health Technologies**.

Whatever strategy you adopt, keeping only cash in your TFSA will prove to be a waste in the near term and particularly in the long term.

Over-contributions and transfer errors

Last year, I'd discussed why over-contributions can be a pain for investors. Canadians who contribute beyond their cumulative room will be subject to a monthly withholding tax. This will be multiplied in each month the account is over the limit. As it stands today, the cumulative contribution room in a TFSA is $69,500. However, younger investors need to calculate this limit from when they were eligible to open the account.

Another avoidable misstep involves transferring between TFSAs at different institution. For example, let's say our hypothetical investor wants to transfer from their TFSA at **Royal Bank** to their new account at **Scotiabank**. Some Canadian make the mistake of initiating a withdrawal from the first institution and contributing to the other. If this is not done correctly, this will count as a withdrawal and a subsequent contribution.

Instead, Canadians should use the direct transfer form (T2033) that will allow them to make the transfer between institutions.

TFSA: Investing in U.S. dividend stocks

I'd already mentioned top Canadian dividend stocks like Emera and Fortis in the first tip. Many Canadians are interested and invested in United States markets. However, they should be careful when investing in U.S. dividend stocks. U.S. assets that generate income in a Canadian TFSA are subject to a 15% withholding tax. Because of this, it makes more sense for Canadians to stash domestic dividend stocks.

The **TSX** does not possess a large stable of dividend kings like the **S&P 500 Composite Index,** but there are still some great options. Fortis, for example, has achieved 47 consecutive years of dividend growth. It currently offers a quarterly dividend of $0.4775 per share.

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