CRA: 2 Big RRSP Mistakes to Avoid in 2021

Description

The Registered Retirement Savings Plan (RRSP) is a widely used investment account in Canada, helping individuals create a retirement nest egg. The account type has unique tax benefits that can help you enjoy the tax-deferred growth of your wealth.

Rather than paying income taxes on any growth of wealth in your RRSP, you only need to pay taxes when you withdraw from your account. If you use it properly, the RRSP can be an excellent way to secure your financial freedom for the best years of your life.

Unfortunately, many Canadians make critical mistakes with their RRSPs. I will discuss the two RRSP mistakes you need to avoid. Additionally, I will talk about how the **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) could be a valuable investment for your account.

Overcontribution

The government has allowed Canadians to enjoy phenomenal tax-deferred growth in their RRSPs. However, there are certain regulations in place to limit how much you can contribute to your account. If you contribute more to your account, you risk losing the tax-deferred status of your RRSP by incurring penalties.

The contribution limit for your RRSP is 18% of your previous year's earned income. The maximum you can contribute to your RRSP is $27,230. If 18% of your income in the previous year exceeds $27,230, you will contribute only up to the maximum limit.

The penalty for over-contribution is 1% of the excess amount per month. You can contribute up to $2,000 over the contribution limit before you start incurring the tax penalties.

Investing only cash

The second RRSP mistake you need to avoid is using it as a cash savings account. While you technically can use the RRSP as an account to hold money, it would be wasting a lot of potential. The RRSP can help you achieve a lot more growth if you use it to hold assets like dividend stocks for your contribution limit's cash equivalent amount.

The cash itself can grow through interest rates, but it can't keep pace with the growth of a dividend-paying stock like the Bank of Nova Scotia.

Using your RRSP to hold a stock like BNS can help you enjoy more rapid capital growth. The financial institution is trading for a 24% discount from its February 2020 high at writing. At a valuation of $56.66 per share, the stock is paying its shareholders at a juicy 6.35% dividend yield.

Investing in BNS and holding its shares in your RRSP can help you leverage the potential capital gains and lock-in a substantial dividend yield that can grow in your account. By the time you have to retire, the amount you invest in BNS could be worth far more than simply holding cash in your RRSP.

Foolish takeaway

While the RRSP has the term "savings" in it, the account can be more useful as an investment vehicle for Canadian investors. I would advise using the account to secure greater financial freedom through intelligent and long-term investments like BNS.

While it might not be a high-growth stock that offers explosive growth, BNS can provide you with safe and reliable growth of wealth in the long run.

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