WARNING: The TFSA Risk You Need to Know About

Description

If you don't like paying taxes, then there's a good chance you're aware of the benefits of the Tax-Free Savings Account (TFSA). Offering tax-free gains and withdrawals, it has the potential to save you money come tax time. If you held a portfolio worth $69,500 in a TFSA and realized $10,000 in dividends + gains on that portfolio, you could save thousands in taxes.

But there's one TFSA risk you need to be aware of. This is a risk that's not talked about much but could cost you a lot of money. Every year, many Canadians fall into this completely avoidable trap.

So what is this TFSA mistake, and why is it such a problem?

Saving money in a TFSA

Putting cash in a TFSA is by far the worst thing you can do with the account. Negating all the tax benefits of the TFSA, it makes having the account basically pointless. You pay no taxes on cash holdings. Interest is technically taxable, but the CRA isn't going to come after you for $10 in savings account interest. To realize a tax benefit from your TFSA, you need a taxable gain in the account, which means holding investments.

You need to invest

To truly realize the tax saving benefits of a TFSA, you need to invest, which means taking your TFSA cash and investing it securities. By doing so, you realize gains that will be tax exempted in the TFSA. Some examples of investments that could achieve this benefit for you include:

- Stocks
- Bond funds
- ETFs
- GICs
- Derivatives

By holding these types of assets in a TFSA, you stand to make gains… and pay no taxes on them. This is the true power of the TFSA.

A few solid beginner investments

If you're ready to begin investing in a TFSA but aren't sure what to buy, you have several good options available.

The lowest risk of all is GICs from your bank, but be warned, they barely keep pace with inflation.

The next lowest risk after that is corporate bond funds. Corporate bond ETFs like the **BMO Mid-Term U.S. Investment Grade Corporate Bond** (TSX:ZIC) ETF pay yields in the 2-3% range, which beats inflation most years and will even give you a little gain if you re-invest. As of this writing, ZIC yielded 2.95%. That's pretty good for a fixed income investment in 2020. No, you won't get rich holding a fund like ZIC. But it's a pretty safe and low risk way to get your feet wet with investing.

If you're willing to take a little more risk, you could consider a stock fund like the **Vanguard S&P 500 Index Fund.** That's a popular stock fund based on the S&P 500–the largest index of U.S. stocks. Over the years, the S&P 500 has returned around 10% a year.

It takes about seven years to double your money at that rate, and with an ETF, you don't even need to pick individual stocks! It's a great beginner TFSA investment by any measure.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:ZIC (BMO Mid-Term US IG Corporate Bond Index ETF)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
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