Canada Revenue Agency Tax Tips: Make the Most Out of Your $6,000 TFSA Contributions

Description

The Canada Revenue Agency is hungry for your slice of the pie. Whether it be capital gains (which are typically taxed at 50% of that of your marginal income tax rate) or investment income from distributions or interest (which are taxed in full, although there are generous dividend tax credits for Canadian stocks held in your non-registered accounts).

TFSA: Use it or lose out on the full effects of compounding

It's vital to leverage your TFSA (Tax-Free Savings Account) to get the most out of the profound and unfathomable effects of long-term compounding, which is that much more powerful with taxes taken out of the equation. Moreover, it's also important for investors who've maxed out their TFSAs to ensure one's investments held in non-registered accounts (those held outside of TFSAs, RRSPs, and all the sort) are allocated in a tax-efficient manner.

To legally beat the taxman at his own game, you need to understand and play by the rules.

I know, a tax-efficient allocation talk is incredibly boring. While it can save you a few bucks in any given year, it can make a considerable difference over the long term, with compounding factored in. In many prior pieces, I've outlined the power of long-term tax-free compounding and how today's young investors, like millennials, are at an advantage since they have many decades to witness the true power of compounding.

Let compounding work its magic!

Warren Buffett's fortune was built through compounding. Even if you're not making much from your employment, it is possible to get ahead with your nest egg to retire early and comfortably if you stick with a disciplined investment strategy that involves consistent TFSA contributions while using the proceeds to invest in common stock, among other high-return "risky" securities. In addition,investments within non-registered accounts should be held in a tax-efficient manner.

As I described in a prior piece, there are simple ways for the young and the passive to do this, with investments such as tax-efficient ETFs (**Horizons S&P TSX 60 Index ETF**), which incorporates automatic reinvestment and domestic dividend (growth) stocks, which allow one to take advantage of generous Canadian dividend tax credits.

Of course, many millennials are likely struggling to set aside $6,000 for their annual TFSA contributions, let alone having to worry about tax-efficient allocation in their non-registered accounts, which shouldn't be invested in until one *after* maxes out their TFSA. For such millennials, any contribution can make a huge difference over the long haul. The key is to contribute as much as possible as soon as possible, all while resisting the urge to time the markets.

The Foolish bottom line on minimizing Canada Revenue Agency taxes to maximize compounding effects

It is possible to minimize extra investment taxes you'll be hit with from the Canada Revenue Agency. All it takes is a few minutes to seek knowledge on the tax-efficient allocation of investments, and you could save yourself a fortune over the long run, as you look to maximize the full effects of tax-free compounding.

Start with your TFSA and use it to invest in your best ideas. If you've maxed out your TFSA and have investments in your non-registered accounts, make sure you're doing things in a tax-efficient manner. That means having a preference for Canadian dividends to get that generous tax credit, minimizing or postponing distributions ineligible for the credit, as well as ensuring you make good use of your capital losses, which can offset gains elsewhere in your non-registered accounts.

Nobody likes talking tax or the Canada Revenue Agency. But it can pay massive dividends over the long term to understand tax-efficient allocation, especially early on in your investment career.

Stay Foolish, my friends.

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