CRA: Want to Retire Rich? Avoid These 2 Tricky Tax Traps

Description

Your Tax-Free Savings Account (TFSA) and Registered Retirement Savings Plan (RRSP) are excellent tools to save for your retirement. Both account types allow for better savings due to the tax advantages you can get from them. However, there are a couple of tricky tax mistakes that people tend to make.

Today I will discuss how you can avoid two tax traps with these accounts so you can make the most of your investments to retire as a wealthy investor.

Withdrawing early from your RRSP

One of the major mistakes people make with their RRSP is withdrawing from the account before retirement. This is generally considered a significant mistake that people make when they find themselves in hard times.

The RRSP allows you to grow your funds tax-free within the account. However, the funds are taxable when you withdraw. If you are still earning an income, the tax can be significant because it is based on your marginal rate. If you are earning a substantial annual salary figure, you could lose a major chunk of your RRSP balance between federal and provincial taxes.

Remaining invested in the RRSP until you retire can provide you with more substantial returns in the long run.

Not investing in the TFSA

According to a poll from the **Royal Bank of Canada**, 42% of Canadians have a substantial amount of cash sitting in their TFSAs. Using your TFSA to hold cash rather than using the contribution to invest is the second big mistake you need to avoid. You don’t have to pay taxes on the money in your TFSA, and you can let it grow tax-free. However, it creates a considerable opportunity cost.

No matter the interest rates, holding cash won't allow you to take full advantage of the TFSA's tax-sheltered status. All interest payments, capital gains, and dividends received in a TFSA are tax-free as long as you remain invested.

If you use the contribution room to hold an income-generating asset, you can get far greater returns than relying on interest returns for the cash equivalent amount.

A stock to consider

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) is an excellent stock that you can consider adding to your TFSA portfolio to leverage its tax-sheltered status. BNS is Canada's third-largest bank in terms of its market capitalization. The company has invested billions of dollars in the last decade to expand its exposure to international markets.

It focused much of its growth in Peru, Mexico, Chile, and Columbia. All four countries took massive hits amid the pandemic, like most countries worldwide. While it may have impacted short-term earnings for the bank, BNS has a promising long-term outlook. Despite the short-term troubles, BNS remains a profitable investment for its shareholders.

Foolish takeaway

The stock is trading for $61.48 per share, and is paying its investors at a juicy 5.86% dividend yield at writing. It is still at a 16.54% discount on a year-to-date basis. Scotiabank could make an excellent investment for investors who are looking to capitalize on the tax-sheltered status of their TFSA.

Try to avoid making the RRSP and TFSA mistakes that can result in significant losses for you in the long run. Additionally, you should consider using reliable dividend stocks like BNS to take full advantage of the tax-sheltered accounts.

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