TFSA Investors: 3 Mistakes to Avoid With Your Enhanced $6,000 Limit in 2021

Description

The Tax-Free Savings Account (TFSA) has become quite popular since its introduction in 2009. The phenomenal tax-advantaged account type offers Canadians a unique way to save money. You can open a TFSA and contribute money to it each year to achieve long-term or short-term financial goals.

The TFSA is a fantastic way to meet your financial goals, and it would be a great idea to learn how to benefit the most from this account. Unfortunately, many Canadians keep making TFSA mistakes that do not let them get the best out of this amazing investment vehicle.

With the 2021 TFSA contribution limit update announced, I will discuss three TFSA mistakes you should avoid to reap massive benefits in the long run.

Using it to store just cash

The first mistake you should avoid with the $6,000 additional limit is to allocate only cash. Many Canadians treat their TFSAs like typical savings accounts because of the “savings” in its name. Doing so means you will downplay an exceptional advantage that the tax-free account offers.

Yes, you can earn tax-free income through the interest on the money you hold. However, you could earn far better returns if you use it to store income-generating assets. Earnings from your assets, including capital gains and dividends, can grow in your TFSA tax-free.

Contributing and withdrawing the same year

There are no withdrawal charges or tax penalties in the TFSA. However, many investors overlook a crucial withdrawal rule. Suppose that you maxed out the contribution limit and withdrew $1,000 today. You should never invest the same amount in your account right away.

The withdrawal rule with your TFSA is that you cannot withdraw and contribute in the same year. If you make the deposit before the start of the new year, you are overcontributing to your TFSA. Over contribution entails a 1% tax penalty on the excess amount.

Investing without paying down debts

The third TFSA mistake is more about your financial discipline. Suppose you have significant debts or credit card balances that are due. It would be ideal to pay down your debts before investing in your TFSA. If you let the debt grow, it can pose problems in the future and offset your gains in the TFSA.

The idea is to become debt-free, so you can enjoy true financial freedom. Ideally, you should focus on paying down your debts before you invest in your TFSA. This way, you can begin growing your account balance with returns on your investments. You will not have to worry about the sword of debt dangling over your head.

An ideal investment for your TFSA

I would advise investing the dollar amount of the enhanced TFSA contribution limit in a stock like **Hydro One Ltd.** (TSX:H).

There are several reasons you could consider allocating the contribution room to Hydro One. It is a power transmission and distribution company with a vast network of high-voltage transmission lines and distribution lines.

The company provides its services to over 1.4 million customers. Almost the entire revenue for this utility operator comes through rate-regulated assets, making its income virtually guaranteed. Hydro One can use its predictable and stable income to finance its growth and investor payouts.

Foolish takeaway

Investing in reliable dividend stocks is the best way to use the contribution room in your TFSA. Hydro One is trading for $29.34 per share at writing. It has a juicy 3.46% dividend yield at its current valuation. The stock provides an essential service to its customers, and its business model allows the company's valuation to grow consistently.

Hydro One could be an excellent stock to consider adding to your TFSA portfolio.

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Author
adamothman