CRA TFSA Update: Avoid These 2 Massive Mistakes in 2021!

Description

With an extended recession looming, the announcement of the Tax-Free-Savings Account (TFSA) annual contribution limit for 2021 is welcome news. Utilization of the favourite investment account in Canada will be among the top priorities of account holders wishing to earn more tax-free income.

You can't find a savings account that's as flexible as the TFSA. However, the zeal to max out the TFSA sometimes makes users forget the rules. Committing a pair of mistakes could be costly. You run the risk of paying taxes when you shouldn't be paying any.

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No over-contribution

The Canada Revenue Agency (CRA) updates or sets an annual TFSA contribution limit yearly. A limit is a boundary, and, therefore, you shouldn't go beyond it. The CRA will impose a monthly penalty tax equivalent to 1% of the excess amount every time you over-contribute.

Responsible TFSA users will always monitor the set limits. If you lose track of your available contribution room, open a CRA My Account to find out. The portal has a dedicated section for the TFSA contribution room, although it doesn't reflect your contributions or withdrawals for this year.

You can also browse the net and save the TFSA historical and current annual contribution limits and accumulated contribution rooms for easy reference. Another way is to call the CRA Tax Information Phone Service (TIPS) directly to seek assistance.

No over-trading

The CRA strictly prohibits over-trading to make fast bucks in your TFSA. Remember that it's an investment vehicle to grow your savings over time. Money growth is tax-free, but it doesn't mean you can abuse its use by carrying on a business.

Don't trade up a storm, unless you want the CRA to take notice and be suspicious. If a user is found breaking this rule, the tax agency can slap you with heavy penalties. Likewise, the CRA will treat your earnings as business or regular income, which is therefore taxable.

Real deal

The best strategy to be problem-free when maintaining a TFSA is to pick buy-and-hold income-producing assets. A blue-chip stock like **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), or CIBC, is an eligible investment in your TFSA. The fifth-largest bank in Canada pays a relatively high 5.27% dividend.

If you have $6,000 cash available to invest and plan to max out your 2021 TFSA limit in January expeditiously, your tax-free income would be $316.20. Assuming your unused contribution room in 2020 is $14,000, you can contribute a total of $20,000 to produce a higher tax-exempt earning of $1,054.

CIBC is the real deal for TFSA users and retirees alike. This $49.51 billion bank has been rewarding loyal investors with a steady income stream for 152 years or since 1868. Don’t expect much on price appreciation, although analysts forecast the stock to climb 26% from $110.75 to $139 in the next 12 months.

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Prioritize debt repayment

A common mistake indirectly connected to the TFSA is not paying off outstanding debts first before investing. Your high-interest loans or credit card debts can negate the tax-free earnings in your TFSA. Once you get rid of your debt payables, you can free up more cash to add to your investible funds.

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