CRA: 53% of Canadians Are Using the TFSA Wrong

Description

The Tax-Free Savings Account (TFSA) has been a valuable account type introduced by the Canadian government to encourage citizens to improve their savings practices. The TFSA has become popular since its inception. However, many Canadian savers are making a crucial TFSA mistake.

I will discuss the TFSA mistake that over half of Canadian TFSA users are making and what you should do instead.

Half of Canadians are making this TFSA mistake

The TFSA is a popular account type. While it has "savings" as part of its name, the account is far more than a mere savings account. Unfortunately, 53% of Canadians are using the contribution room in their TFSAs to hold cash. The Pollara Strategic Insights survey that found this alarming mistake observed that the number of Canadians using their TFSAs for cash is down from 58% last year.

However, less than half of TFSA users said that they knew they could use their account as an investment vehicle. Another alarming statistic revealed by the poll indicates that almost 40% of the total national TFSA amount is held as cash.

Using your TFSA as a mere cash savings account is a mistake for two reasons: taxes and interest.

Interest rates have been low ever since the market crash of 2008 came along. The rates declined to historic lows. The best high-interest savings accounts offer a 2% interest. That rate is too low to generate significant returns through interests over time.

Another reason that keeping cash in your TFSA is the lack of tax benefits. Any assets you own and hold in your TFSA can provide you with completely tax-free returns. It means that the 2% you earn through the cash you hold is free from the clutches of the Canada Revenue Agency (CRA). However, you could use its tax-advantaged status to earn much more.

Better way to use the contribution room

A better way to leverage the tax-advantaged status of your TFSA is by using the contribution room to invest in and hold onto a portfolio of dividend-paying stocks. Consider using it as an investment vehicle rather than a savings account, and you could be sitting on a goldmine with the right portfolio of stocks.

Your investments can grow in the TFSA tax-free, including dividends and capital gains. Investing in a portfolio of stocks like **Hydro One** (TSX:H) could help you leverage the full potential of your account. Hydro One is trading for $28.59 per share at writing, and it pays its shareholders at a juicy 3.55% dividend yield.

Buying and holding shares of Hydro One in your TFSA can get you paid for doing nothing. Hydro One is a utility company that delivers power to customers across Ontario. Its power transmission lines cover most of Ontario, and it operates in a highly regulated market.

It means that Hydro One generates predictable cash flows, without any surprises from the economic environment. A recession is not going to hurt the company's revenue and, in turn, your dividend payouts.

Foolish takeaway

Ideally, an entire portfolio of dividend-paying stocks that provide consistent payouts to shareholders is a much better way to use the contribution room in your TFSA. You can rely on interest rates, dividend payouts, and any capital gains on your investments held in the account. Hydro One could be an excellent stock to begin building such a portfolio to see substantial growth of wealth in the long run.

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