Canadians: Top 3 Common TFSA Mistakes to Avoid in 2021

Description

Every good thing can be a bane if not used wisely. The Tax-Free Savings Account (TFSA) is no exception. It offers numerous benefits to Canadian investors. Along with the tax-free gains, whether it's a capital gain, interest, or dividends, the TFSA forces you to save and invest regularly.

TFSA contribution in 2021

The TFSA contribution limit for 2021 is being kept at $6,000. Many people think that they lose the contribution room if they do not put the specified amount in their TFSAs in that particular year. However, the fact is that the contribution room gets accrued every year, and one can still use it if it is not maxed out. If you have never contributed to it, the limit for 2021 extends to $75,500.

Convenient, tax-free withdrawal is one of the major advantages of the TFSA. However, this can be troublesome at times. For example, suppose you have contributed $6,000 this year in the TFSA and maxed out on all previous years as well. Even if you withdraw $5,000 and put it back in a few weeks, the tax rules consider it as an overcontribution.

Mistake #1: Overcontribution

The Canada Revenue Agency will levy of 1% per month penalty on the overcontributed amount. So, investors should note that the TFSA contribution room does not change with withdrawals. With markets at record highs, many of us will be sitting at huge unrealized gains. But beware! If you want to withdraw from the TFSA, putting the money back in can attract some penalty.

Mistake #2: Frequent trading

It would be best if you also avoid frequent trading in the TFSA. It is evident that markets have been rallying for the last few months now. Some might have benefitted from the immense volatility. However, too many transactions could lead the CRA to think of this as a business income and might charge even higher taxes.

Mistake #3: Holding cash

Holding cash in your TFSA is the biggest blunder of all. Even if it is a savings account, you can hold various high-return investments in it. It is advisable to set aside cash for emergencies, but you should also not over-contribute to it and lose the potential for higher returns.

For example, a $6,000 investment in the TFSA in the form of cash could fetch you around 0.25% interest annually. But putting it in stocks can earn 10%, 50% or even 100% returns over the long-term. If you invested $6,000 in the tech titan **Shopify** stock back in May 2015, you would be sitting on a tax-free reserve of $264,146 today!

It's certainly true that stocks and rallies like Shopify are very, very rare. But TFSA investors can at least consider putting a portion of the contribution to stocks instead of just saving in cash.

Top TSX stocks in your TFSA

Consider a safe stock like **Fortis** (TSX:FTS)(NYSE:FTS). A top utility stock earns stable cash flows and thus pays stable dividends. It yields almost 4% at the moment. One might not generate significantly large returns with Fortis, but one can certainly expect stable dividends for the long term.

If you invested $6,000 in FTS stock in 2009, the first year of the TFSA, your money would have almost tripled today. Utility stocks like Fortis generally outperform in bearish markets and are considered recession-proof.

Investing in stocks via TFSA will not only offer you higher potential returns but will also create a decent tax-free passive income for your sunset years.

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Date
2025/09/12
Date Created
2021/01/11
Author
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