CRA: 2 Massive TFSA Mistakes That Have Tax Pitfalls

Description

The Tax-Free Savings Account (TFSA) is one of two smart savings and investment vehicles in Canada. It came later than the Registered Retirement Savings Plan (RRSP) but has become more popular than its elder sibling. Unlike the RRSP, you can keep contributing to your TFSA past age 71.

You can invest your TFSA contributions or funds in bonds, ETFs, GICs, mutual funds, and stocks. All gains, profits, and dividends from these eligible investments are tax-free. You can withdraw at any time and not pay taxes at all. However, there are set rules to follow if you want to be free of the Canada Revenue Agency (CRA).

Some TFSA users, however, commit two mistakes that result in tax penalties. Avoid them as much as possible, because you shouldn't be paying needless taxes in a tax-free investment account.

1. Over-contribution

The CRA's rule is simple: do not contribute more than your contribution limit or available contribution room. When you overcontribute, the tax agency will charge you 1% of the excess amount per month as penalty tax. In case you overlook this rule or fail to monitor your limit, withdraw the over-contribution amount soon.

Related to this mistake is when you withdraw from your TFSA and redeposit in the same calendar year. You might be over-contributing and risk paying penalties. Instead, wait until the next calendar year when you have a new contribution room.

2. Investing in foreign assets

A TFSA is the ultimate tax shelter, because the tax-exempt status is forever. However, you can losethe status by making the mistake of investing in foreign assets. The CRA accepts foreign dividendstocks in a TFSA provided the company trades in the agency's approved list of designated stockexchanges.

Dividend income from a foreign land or country is subject to a 15% withholding tax. Also, your TFSA contribution can be in foreign funds. However, the CRA will convert the currency to Canadian dollars. It might happen that after conversion, your contribution is more than limit. Thus, the CRA can penalize you.

Dividend heavyweight

There are dividend heavyweights on the TSX that are established wealth builders. The most prominent one is **Royal Bank of Canada** (TSX:RY)(NYSE:RY), a Dividend Aristocrat, no less. This $154.11 billion bank pays a 3.99% dividend.

Purchase the blue-chip asset at $108.30 per share today and hold it in your TFSA forever. RBC has been paying dividends since 1870 and could pay dividends for centuries more. Your $6,000 TFSA contribution in 2021 will generate $239.40 in tax-free income.

For fiscal 2020 (year ended October 31, 2020), RBC reported a 2.6% revenue growth versus fiscal 2019, despite the 133.4% increase in credit loss provision. Net income fell by only 11.1% to $11.4 billion compared to the previous year. RBC, along with the its industry peers, are confident that economic recovery is on the horizon.

Dave McKay, RBC's CEO, said Canada can really get back to reopening the economy if 4.5 million high-risk Canadians are vaccinated in 100 days. He adds that people sitting on idle cash will spend again on past times like entertainment and travel when it's safe to do so.

Stay free of the CRA

Put your money to work and optimize your TFSA every year. Most importantly, stay free of the CRA by avoiding the two mistakes that could trigger tax payments.

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