CRA: 2 TFSA Mistakes That Could Cost You Thousands!

Description

You might have heard someone tell you that each penny you save is a penny you earn. The statement is not necessarily true. If you make a penny, you are paying taxes on it. If you *save* a penny, you get to have the whole penny.

Using your Tax-Free Savings Account (TFSA) is a fantastic way for you to genuinely save that tax, use it to earn more money, and never pay taxes on the penny or its interest payments ever again. TFSAs are investment vehicles that offer tax advantages and flexibility that nothing else does.

Once you store capital in a TFSA, it can grow without incurring any income taxes for as long as you keep it in the account. If your TFSA investments turn from $100 into $1 million, you get to keep all of it from the tax-hungry clutches of the Canada Revenue Agency (CRA). You can also withdraw from your account whenever you want without tax penalties.

Of course, the TFSA is not bulletproof. Here are the two crucial mistakes you should avoid to maximize your potential returns through the investment vehicle.

Not understanding your limits

Since its inception in 2009, the CRA has increased the contribution limit for the TFSA each year. With the latest TFSA update for 2021, the cumulative contribution room in the account is $75,500. Suppose you have been eligible to contribute to a TFSA since its inception and have yet to open an account. There is a lot of room for you to invest.

Staying within the contribution limit can help you keep your account tax-free. If you exceed your limit and overcontribute to the TFSA, the CRA will tax 1% for each excess dollar in your account each month. You should check with the CRA to see how much contribution room you have before you invest and store assets in the account.

Day trading

Many eager investors with a short-term investment horizon love to day trade. Day trading is an exceptional way to earn small profits in a short time, but that is not what the TFSA was designed for by the government. The TFSA was introduced to encourage better savings practices, and the CRA keeps a close eye on people who use their accounts to trade too frequently.

If you try to use your account's tax-advantaged status to earn tax-free day-trading income, the CRA will tax your earnings like any business income. It is better to use your TFSA for long-term investments that can grow substantially over time. A reliable income-generating asset like **Bank of Montreal** (TSX:BMO)(NYSE:BMO) can be excellent for this purpose.

BMO is a highly diversified financial services provider in Canada with over 12 million customers across North America. Its banking division is one of the oldest and strongest in Canada. BMO is one of the most reliable dividend-paying stocks trading on the TSX.

It is one of Canada's oldest dividend-paying companies. BMO has a dividend-paying streak that spans almost 200 years. In that time, the bank has seen several periods of financial stress, but it never failed to distribute its payouts to investors. Its wide economic moat allowed the bank to continue its streak through the COVID-19 crisis.

The pandemic and its economic effects caused problems for the stock, driving its valuation down. It means that investing in BMO can entitle you to returns through its capital gains in a recovering economy *and* dividend payouts that you can rely on for a long time.

Foolish takeaway

Understanding your limits and creating a portfolio of long-term dividend-paying assets can help you save a lot of money in the long run. Avoiding these two TFSA mistakes is easy if you have the right information. Consider investing in a portfolio of reliable dividend stocks in your TFSA to maximize your potential profits. BMO could be an excellent stock to begin building such a portfolio.

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