3 Massive TFSA Errors to Avoid in 2021

Description

The crafter of the Tax-Free-Savings Account (TFSA) would be happy to know that overall contributions to the unique investment account are increasing. According to the **Bank of Montreal's** annual TFSA survey, the average amount held in TFSAs rose 9.5% in 2020 versus 2019. Similarly, about 68% of Canadians are now TFSA users.

The rising popularity of the TFSA is not surprising given its outstanding features. BMO's survey results are encouraging, except that many users aren't up to the task of reaping the maximum benefits. Perhaps, the narrative could change in 2021 if account holders can avoid three errors when using their TFSAs.

Cash is the primary investment

The most glaring error is that Canadians mistake the TFSA for a regular savings account. About 25% of Canadians are not aware of the eligible investments, and 12% believe you can only invest cash. While more people are turning to the TFSA, the account remains underutilized.

Nicole Ow, Head of Term Investments at BMO, said the funds invested should be working for the TFSA user. It defeats the purpose of the investment vehicle if you store idle cash. Roughly 38% of TFSA users have cash as the primary investment. Investors with a longer time horizon should capitalize on the tax-free money growth opportunities.

Unaware of the over-contribution penalty

Sometimes, the overzealousness of TFSA users gets the better of them. The Canada Revenue Agency (CRA) sets annual limits. You should follow the rule and not over-contribute. If you do, the tax agency will tax you 1% of the excess contribution monthly.

Some users forget that they can't contribute in the same year if you maxed your limit, then withdraw funds. You have to wait for the next year to re-contribute. However, the best part is that an unused contribution room carries over to the following year.

Over-trading

The CRA strictly prohibits TFSA users from over-trading to make outsized gains. Don't attempt to operate like a day-trader. Yes, earnings are tax-free, but the CRA will treat your income as taxable if you violate the rule and carry a business in your TFSA.

Transforming IPP

A wholesale power generator that's transforming is a good prospect for TFSA investors. **Capital Power Corp.** (TSX:CPX) offers an attractive 5.37% dividend. Your $6,000 contribution in 2021will produce $322.20 in tax-free income. Assuming your available room is $20,000, the windfall is $1,074.

The customer base consists of commercial, large industrial, government, and institutional clients in Canada and the United States. This $3.98 billion independent power producer (IPP) owns 28 facilities whose combined power generation capacity is more than 6,400 MW.

Capital Power's growth runway is very long. Its well-maintained facilities' average economic life is 14 years, while only 2% is due to retire over the next decade. As well as its focus on growth, the company is renewable energy-focused too. Management plans to increase Capital Power's renewable generation capacity.

As this flourishing IPP has a highly contracted and diversified portfolio of generation assets, there's no issue with cash flow stability and dividends' safety. The $37.66 share price today should be a good entry point.

Save or build wealth

A TFSA is a great — if not the best — vehicle to save for short-term goals or build wealth for the long-term. If users can avoid the errors, the tax-free earnings could be astronomical over time.

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