3 Massive TFSA Mistakes to Avoid With Your New $75,500 Limit

Description

Canadians can amass a fortune and retire wealthy through a Tax-Free Savings Account (TFSA). The federal government introduced the one-of-a-kind investment vehicle in 2009. If you were 18 then and haven't opened a TFSA yet, the accumulated contribution room has grown to $75,500.

The TFSA doesn't require an account holder to be a taxpayer. You can open a TFSA, even if you don't file an income tax and benefit return. A user's task is simple — make contributions yearly, withdraw funds at any time, and determine where to invest the funds.

However, there are instances when a TFSA user mismanages the account. If you were to maximize the new $75,500 accumulated contribution limit, avoid three mistakes. All of them could prevent you from deriving the full tax-free benefits of the unique investment account.

1. Making cash the primary investment

Cash is king but not necessarily in a TFSA. You can invest in income-producing assets such as bonds, ETFs, GICs, mutual funds, and stocks and hold them in your TFSA. You squander the opportunity to see the tax-free growth of your money. The Canada Revenue Agency (CRA) will not tax any gains, profits, and dividends from these eligible investments.

2. Overcontributing

The CRA sets a contribution limit every year. The annual contribution limit in 2021 is $6,000 — the same as it was in 2019 and 2020. You can contribute at any time in the year, as long as you don't exceed the allowable TFSA contribution room. The CRA will fault you for overcontribution and exact a tax equal to 1% of the excess amount per month.

Note too that an unused contribution room in a year carries over to the next year. Assuming you use only $5,000 in 2021, your annual contribution limit in 2022 is $1,000 plus the new TFSA limit.

3. Investing in foreign assets

A TFSA's tax-exempt status is for eternity. As much as possible, limit or don't insist on investing in foreign assets. It's a costly mistake, because you lose your tax shelter. The CRA allows foreign dividend stocks in a TFSA, provided the shares trade in the list of duly designated stock exchanges. There's a tax bite if your holding is from a country outside Canada. Your dividend income is subject to a 15% withholding tax.

Ultimate TFSA investment

There are dividend stocks that are cross-listed in the Canada and U.S. stock exchanges. **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), for example, attracts retail and institutional investors from both countries because of its reliability as an income provider.

Canada's second-largest bank is the only company that reported top- and bottom-line growth during the 2008 financial crisis. This $133.55 billion bank showed its class once more in the 2020 pandemic. Despite the massive headwinds, TD delivered a total return of 7.2% last year. The dividend yield is also a respectable 4.26%.

In 2021, TD will have a more diverse set of business customers. The acquisition of **Wells Fargo's** Canadian Direct Equipment Finance business will add scale and capabilities to TD's current Canadian Equipment Financing business. Aside from expanding its presence in core markets, TD can offer competitive equipment loans, leases, and customized financing services.

Tax-free all the way

The mistakes discussed here are all avoidable. A TFSA user needs to stick to the ground rules and Canadian investments to experience tax-free money growth 100% of the way.

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