Canada Revenue Agency: Stop Repeating This 1 TFSA Mistake!

Description

Canadians find the Tax-Free Savings Account (TFSA) so important because no other investment account can provide a tax-free benefit for life. Unlike the Registered Retirement Savings Plan (RRSP), TFSA users can keep contributing past age 71 and not close the account.

The Canada Revenue Agency (CRA) determines the contribution room limit each tax year and announces it every November. Thus, all TFSA users can contribute again at the beginning of the year. For 2021, the new TFSA limit is $6,000, the same as in 2019 and 2020.

However, some TFSA users are unable to take advantage of the tax-free benefits fully. They commit one mistake over and over again that prompts the CRA to charge taxes. Your TFSA should be tax-exempt 100% of the time if you can avoid repeating this common infraction.

Overcontribution

The CRA's rules on TFSAs are clear and straightforward. If you have $6,000 in contribution room in 2021 and you make a $6,000 deposit, you can't make further contributions to your TFSA this year. Another rule states that even if you make a withdrawal, your contribution room will not free up or increase. You must wait until the next year to make contributions or redeposit the withdrawn amount.

The third rule is the penalty for overcontribution. Every time you exceed the contribution limit, the CRA will charge 1% of the excess contribution as a penalty tax per month. To avoid paying the tax, you must withdraw the amount promptly. Hence, timing is essential when you're managing a TFSA. Here are two examples to illustrate:

Example 1: The contribution room at the beginning of 2020 is $6,000.

- Deposit $5,000 on February 4
- Made another $4,000 deposit on February 15
- Overcontribution is $3,000
- Withdraw the excess or else the CRA will charge a penalty tax (1% x $3,000, or $30)

Example 2: The contribution room at the beginning of 2020 is $6,000.

- Deposit $5,000 on March 3
- Withdraw $5,000 on June 4
- Deposit $4,000 on July 10
- Overcontribution is $3,000
- If the excess is not withdrawn, the tax payable is $3,000 x 1% x six months (inclusive of the months from July to December), or $180

Eligible investment

Most TFSA users hold dividend stocks in their accounts, although bonds, mutual funds, ETFs, GICs, and cash are also eligible investments. **Pembina Pipeline** (TSX:PPL)(NYSE:PBA) belongs in the volatile energy sector, but income investors still pick the stock for its high dividend yield.

The $19.8 billion pipeline operator offers a hefty 7.04% dividend. If you plan to max out your $6,000 TFSA contribution limit this year, Pembina Pipeline will pay you $422.40 in tax-free money per year. But since the payouts are monthly, you'll have an income stream of $35.20 per month.

Pembina isn't entirely risky as the business model can quell or endure the industry headwinds. The company provides essential transportation and midstream services for North America's energy industry. Because it offers a full spectrum of midstream and marketing services, Pembina generates stable and predictable cash flows.

For 2021, management expects further growth with the reactivation of two growth projects. Likewise, analysts forecast a price appreciation of 16.6% (from $36.01 to $42) in the next 12 months.

Needless tax expense

A TFSA requires proper management and strict compliance with CRA rules. You can avoid needless tax expense if you toe the line and don't overcontribute.

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Date
2025/08/24
Date Created
2021/02/11
Author
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