2 Giant TFSA Mistakes to Avoid if You Want to Keep it Tax-Free

Description

The Tax-Free Savings Account (TFSA) has become an amazing tool for Canadians. It is a gift that the Canadian government introduced in 2009 to encourage Canadians to improve their savings practices. While people were slow to begin using the TFSA, its popularity has exploded in recent years.

Financially savvy Canadians have started using it as an investment vehicle that maximizes their returns. The tax-free status of the account and zero withdrawal penalties make it an excellent investment vehicle to consider. However, the flexible and convenient account comes with its limitations.

It is crucial to avoid making some of the worst mistakes to retain its tax-free status. I will discuss two of the most common mistakes that Canadians make that can end up compromising their TFSA's tax-free status.

Overtrading

Many investors have become too eager about the prospects of investing with tax-free returns through their TFSAs. It is important to note that it is called the Tax-Free *Savings* Account and not the Tax-Free *Trading* Account. If you use the account to make multiple trades per year, it is possible that you can lose your TFSA's tax-exempt status.

The Canada Revenue Agency (CRA) loves collecting taxes, and it will keep a close eye on your trading activity. If you trade too much using your account and earn a significant profit from your investments, the government agency can treat your income as taxable business income. By overtrading, you also run the risk of paying more trading fees and diminish your overall net returns.

The TFSA has been designed for investing long term, and there are better ways to find more substantial returns by staying invested in high-quality assets for the long run.

Holding U.S. dividend stocks

Another critical mistake that Canadians make is allocating the contribution room in their TFSAs to foreign dividend stocks. While it is possible to use your account to hold foreign income-producing stocks, you are also adding the hassle of paying taxes on your earnings. For instance, if you own a U.S. dividend stock like **AT&T** because you like its returns, you will have to pay a 15% non-resident withholding tax on your dividend income from the stock.

The U.S. stock could provide you with tax-sheltered returns if you store it in a Registered Retirement Savings Plan (RRSP) instead. The non-resident withholding tax does not apply to foreign income-generating assets in RRSPs.

A Canadian bet to consider

Telus (TSX:T)(NYSE:TU) could be an excellent stock to consider adding to your TFSA investment portfolio. It is a reliable dividend-paying stock that you can store in your TFSA. Since it is a Canadian income-generating asset, there is no fear of having to pay a 15% non-resident withholding tax. Additionally, it can make for an exceptional long-term investment due to its reliable returns.

Telus is one of the top Canadian telecom sector operators. With the possibility of the 5G boom sending telecom stocks skyrocketing in the near future, Telus could be an excellent addition to your TFSA. The Vancouver-based Canadian telecom giant is continuously raising its bets on the 5G technology. More than half of the company's revenue came from its wireless segment last year.

The onset of COVID-19 grew its sales twofold, and the company reported $15.5 billion in revenues throughout 2020 — up 5.5% from 2019. The company's revenue growth rate was just 2% last year, but it could see much greater cash flows, as 5G technology goes mainstream.

Foolish takeaway

Avoiding overtrading using the account and ensuring that you are investing in Canadian income-generating assets can help you make the most of your TFSA. Telus could be an excellent asset to consider adding to your TFSA portfolio for this purpose.

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