3 Huge TFSA Mistakes That Are More Common Than You Think

### Description

The Tax-Free Savings Account (TFSA) presents Canadians with several advantages. The main benefit that is fueling its popularity is the ability to experience tax-free wealth growth in the account. To make the account even better, the Canada Revenue Agency (CRA) will not collect any taxes on withdrawals, and it is a highly flexible account.



Savvy Canadians have been using their TFSAs as an investment vehicle to create substantial tax-free wealth. However, getting the most from your TFSA is not always easy if you do not understand how to maximize its benefits.

Today I will discuss three crucial mistakes that many Canadians make with their TFSAs and how you should avoid these mistakes at all costs.

## Contributing too much

With all the tax-free growth on offer, many investors become too eager to contribute to their TFSAs and go overboard. There is a contribution limit to TFSAs that the CRA increases each year. However, many people do not realize what their contribution room is and tend to invest too much using the account.

The CRA charges a tax penalty of 1% each month for every dollar above the contribution limit. To reduce the penalty, you must withdraw the extra funds or wait until sufficient contribution room is created in the account in the following year to absorb the excess contribution.

I would advise contacting the CRA before contributing to your TFSA to find out your remaining contribution room so you can avoid over contributing in the first place.

## Holding foreign income assets

The TFSA is a tax-sheltered account like the Registered Retirement Savings Plan (RRSP). However, it does not mean that both account types treat all investment income the same. According to the *Income Tax Act*

, the RRSP is a retirement savings plan. That means that if you receive dividends in your RRSP from companies domiciled in countries that share a tax treaty with Canada, the income is exempt from withholding taxes.

The TFSA does not share the tax-exempt status as an RRSP. It means that any foreign dividends paid into a TFSA are subject to a 15% withholding tax that the CRA will happily collect.

## Trading frequently

Using their TFSAs for trading too frequently is another crucial mistake Canadians make. Tax-free earnings from investments being a possibility with the TFSA might make some Canadians feel eager to make trades that can turn them a quick profit. In the current volatile market conditions, it might have benefitted some investors.

Unfortunately, too many transactions could lead the CRA to treat your TFSA earnings as business income. You can end up paying taxes on your TFSA income if the CRA catches wind of you using your account for frequent trading. The TFSA has been designed to hold investments to provide you with long-term capital growth.



Rather than using the TFSA to play the market volatility for meager short-term returns, using it to invest in a stock like the **Bank of Montreal** (TSX:BMO)(NYSE:BMO) could provide you with better returns. The Bank of Montreal has always impressed with its performance on the stock market. While it took a beating during the pandemic, its fundamentals showed sheer resilience during 2020.

The bank ended the financial year 2020 on a higher note and recently reported stellar income in Q1 2021. The bank reported an adjusted net income of $2.04 billion, up 6% from the same quarter last year. Its prolific performance on the bottom line reflects higher income and lower loan loss provisions.

## Foolish takeaway

BMO is an ideal long-term investment due to its reliable dividend payouts. Investing in the stock can provide you with virtually guaranteed dividends that can keep growing your TFSA balance without incurring any taxes for foreign income or compromising your TFSA's tax-exempt status due to frequent trading.

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