3 Hazardous TFSA Mistakes to Avoid in 2021

Description

Canadians have been using the Tax-Free Savings Account (TFSA) since 2009. The investment account has overtaken the Registered Retirement Savings Plan (RRSP) in popularity because its features are unique, if not extraordinary. Whatever interest, gain or dividends you derive from your TFSA is non-taxable income. You can also withdraw any amount at any time without incurring a penalty tax.

However, TFSA users sometimes mismanage the account and overlook the Canada Revenue Agency's (CRA) governing rules. If you do, the mistakes are hazardous and costly. You may have to pay nasty penalties when you shouldn't be paying taxes at all in a TFSA.

1. Over-contribution

Over-contribution is the most common blunder of TFSA users. The CRA sets the contribution limit every year, so ensure your contributions don't exceed the boundary. The corresponding penalty is 1% of the excess contribution per month. Correct the mistake by withdrawing the amount immediately to avoid needless tax.

2. Investing in foreign assets

The CRA is accommodating and allows users to include American and other international stocks in their TFSA portfolios. Similarly there's no cap on the amount of foreign investments for as long as the equities trade on the CRA-designated list of stock exchanges.

If you hold foreign dividend stocks in your TFSA, the CRA levies a foreign non-resident withholding tax. Since many publicly-listed companies on the TSX are cross-listed on U.S. stock exchanges, you're better off investing in the home country and pay zero taxes on dividend earnings.

3. Frequent trading

Professional or day traders are off-limits to the TFSA. The CRA conducts random checks on users that abuse or carry on a business in their tax-advantaged accounts. Frequent trading triggers alarm bells and raises suspicions. Violators of this rule face stiff sanctions or better-than-expected penalty tax.

If the CRA deems that you're using your TFSA to buy and sell stocks for quick gains, the agency will treat your earnings as business income. Hence, you remove the account's tax shelter. All your profits become taxable, and therefore, subject to taxes due from regular income.

Core holding in a TFSA

Telus (TSX:T)(NYSE:TU) is an attractive option for both Canadian and American investors because the telecom firm operates in a near-monopoly in Canada. The $34.19 billion company is also the second-largest in the telecommunications sector. If you invest today, the share price is $26.36, while the dividend offer is a juicy 4.82%.

Your $6,000 TFSA contribution for 2021 will produce $289.20 in tax-free income. Assuming you're 18 in 2009 and haven't opened an account yet, the accumulated contribution room is $75,500. Your potential investment income is $3,639.10, not a dollar is taxable by the CRA. The stock is a no-brainer choice for TFSA investors, given the nature of the business.

Telus is a Dividend Aristocrat, no less. It has raised its dividends for 17 consecutive years. Besides its core business, the telco is present in the healthcare and technology sectors. Telus Health lends support to Canada's healthcare system. **Telus International** builds and delivers next-generation digital solutions for global and disruptive brands.

Don't store cash in your TFSA

While ash is good, it's not advisable to keep it in your TFSA. While it will not incur taxes, you lose out on the tax-free money growth feature. As much as possible, don't make cash your primary investment.

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