3 Giant TFSA Mistakes to Avoid When Buying Stocks!

Description

The Tax-Free Savings Account (TFSA) is easily one of the most popular financial tools available for Canadians. The government introduced this account type in 2009 to encourage better savings practices. While the people were slow in adopting the new account type, its popularity has exploded in recent years.

It is an excellent investment vehicle that can maximize your returns due to its tax-exempt status and tax-free withdrawals. All its great features do come with some limitations. I will discuss three giant TFSA mistakes that you should avoid making while buying stocks for your TFSA.

Overtrading

Realizing its remarkable benefits has made some Canadian investors too eager about the TFSA's tax-free status. One crucial thing to remember about the TFSA is that it is a tax-free *savings* account, not a trading account. If you begin using this account to make several trades per year, the Canada Revenue Agency (CRA) can compromise its tax-exempt status.

The CRA will keep a close eye on trading activity in TFSAs. If you trade too much using the account and earn significant profits from the trades, the CRA can treat it as taxable business income.

The account was designed for long-term holding and offers better returns by staying invested instead of making short-term trades for small profits.

Overcontributing

Another critical mistake Canadians make with their TFSAs is investing too much into the account. There is a contribution limit to the TFSA that the government increases each year. After the 2021 update, the cumulative contribution room in TFSAs is $75,500.

Contact the CRA to request the information on your contribution limit if you are not sure about how much available contribution room you have.

Overcontributing to your TFSA entails a 1% per month tax penalty on each excess dollar in your account.

Holding U.S. dividend stocks

Any earnings within your TFSA can grow your account balance without incurring income tax. If you are a Canadian investor with a few favourite foreign dividend stocks, you might feel tempted to use your TFSA to store the stock. While it is possible to use your TFSA to hold foreign dividend-paying stocks, it comes with a catch.

Revenue generated by foreign dividend stocks in your TFSA is subject to a non-resident withholding tax. The CRA will happily collect the 15% tax from your dividend income if you hold a foreign dividend stock in your TFSA. You can store the foreign dividend stocks in a Registered Retirement Savings Plan (RRSP) to enjoy tax-sheltered returns. It is better to consider Canadian dividend-paying stocks for your TFSA portfolio.

Telus (TSX:T)(NYSE:TU) could be an excellent dividend stock to add to your TFSA portfolio instead of a foreign dividend stock. The telecom giant is a reliable dividend-paying stock that can provide you with wealth growth through capital gains and dividend payouts.

Telus is a top Canadian telecom operator that is banking on the 5G boom to substantially increase its cash flows in the near future. The Vancouver-based Canadian company generated more than 50% of its revenues through its wireless segment last year. The onset of the pandemic grew its sales, and it could see greater profits this year, as 5G technology goes mainstream.

Foolish takeaway

Do not overtrade, overcontribute, or hold foreign dividend-paying stocks in your TFSA to avoid compromising its tax-free status. Seek high-quality and reliable stocks on the TSX that you can buy and hold for the long run to maximize tax-free wealth growth in your TFSA. Telus could be an excellent stock to begin building such a TFSA portfolio.

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