Uh-Oh! The CRA Could Tax Your TFSA if You Make These 3 Mistakes

Description

Taxes have no place in a Tax-Free Savings Account (TFSA) in Canada. The investment vehicle was created in 2009 primarily to encourage Canadians to secure their financial well-being.

A TFSA user can set aside money to contribute to the account every year to build wealth or grow a retirement fund. If you hold income-producing assets inside it, you can witness tax-free money growth for years or even throughout your lifetime. No savings account can match this unique feature. However, some users make mistakes that could be costly or defeat the TFSA's real purpose.

1. Abide by the golden rule

The golden rule when managing a TFSA is to abide by the Canada Revenue Agency's (CRA) annual contribution limit. The tax agency usually announces the new limit every November. Don't overcontribute to prevent the CRA from imposing a penalty tax.

When you go beyond the set contribution limit, the penalty is 1% per month of the excess amount. You can avoid incurring the needless tax by withdrawing the entire overcontribution amount. If not, the charge will only stop until the new TFSA contribution room absorbs the overcontribution amount in the following years.

2. Stick to TSX stocks

Many TFSA users don't invest in top American stocks, even if the CRA allows them. There are tax consequences if you plan to diversify and include U.S. stocks in your TFSA portfolio. All dividends or income derived from foreign assets are subject to a 15% withholding tax.

Should you insist on buying American stocks, hold them in your Registered Retirement Savings Plan (RRSP) instead. The IRS considers the RRSP as a registered plan but not the TFSA.

3. Storing cash isn’t the right way

The CRA will not prohibit you from storing cash in your TFSA. However, you defeat the very purpose of this unique account if hard cash is your primary holding. Cash is king, but in a TFSA, it’s not. Your TFSA isn’t a traditional savings account. Leave some cash but put in more income-producing assets to earn better returns.

Super-regional bank

If I were to fortify my TFSA and ensure long-term, tax-free money growth, I would use my cash to invest in **National Bank of Canada** (TSX:NA). The sixth-largest bank in Canada is a reliable income stock, like the Big Five banks.

At $86.64 per share, the dividend yield is a decent 3.28%. The quarterly dividends should be safe, given the less than 50% payout ratio. Management has raised its dividends for 10 consecutive calendar years at more than 6% annually. The feat makes National Bank a true-blue Dividend Aristocrat.

National Bank rules in Quebec. The province accounts for more than 60% of the bank’s is total revenues. Other provinces contribute 25%, while the international markets deliver the remaining 15%. Investors consider this $29.18 billion integrated financial service provider as a super-regional bank.

More cash flows

Other eligible investments in your TFSA are bonds, mutual funds, ETFs, and GICs. You can mix them all in one basket along with your dividend stocks. There are risks in each one, although they can produce more cash flows than cash itself.

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Date
2025/07/19
Date Created
2021/04/17
Author
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