3 of the Worst Mistakes a TFSA Investor Can Make

Description

Must Canadians open a Tax-Free Savings Account (TFSA) because it's a needful or useful thing to them? The answer is both, because it's necessary for their future financial well-being and beneficial or practical to have one. No investment account can match the TFSA's features.

Users have the opportunity to begin their journey to $1 million through a TFSA. If you're wondering why others are close to reaching the goal, it is because of proper account management. Since the investing approach is simple, managing a TFSA should be a breeze and truly rewarding for average investors.

You can only fall short of your financial objectives either by underutilizing the account or committing the three worst mistakes. Otherwise, your TFSA should be a life-long income provider.

1. Overcontribution

The Canada Revenue Agency (CRA) sets an annual contribution limit every year and keeps a tab of overcontribution by users. Money growth is tax-free, as all interest, dividends, and capital gains are tax exempt. Withdrawals are non-taxable, too. However, regardless of whether it's unintentional or deliberate, you can't overcontribute to your TFSA.

The CRA imposes a 1% penalty tax per month on the excess amount. You can rectify the mistake by withdrawing the overcontribution. You could be penalized with a tax of 1% per month on the excess until you withdraw the amount. For instance, a $10,000 overcontribution over 12 months could be subject to a $1,200 tax penalty.

2. Holding foreign assets

Most TFSA investors would stick to local investments, even if they wanted to include foreign assets in their accounts. Dividend income from, say, U.S. stocks, are subject to a 15% withholding tax. The tax implication will reduce your total return, unlike when an outsized proportion of your assets are TSX stocks. Also, the tax is unrecoverable.

3. Storing idle cash

Holding cash is fine, but keeping it idle clip the powers of your TFSA. A more meaningful approach is to include bonds, mutual funds, GICs, ETFs, and stocks. Why forego the tax-free benefits when you can accelerate your TFSA balance faster with more income-producing assets in your basket?

Mean dividend machine

Income investors often bypass **National Bank of Canada** (TSX:NA) in favour of the Big Five banks. However, Canada's sixth-largest financial institution is a mean dividend machine. The stock's 10,344.08% (11.95% CAGR) total return in 41.18 years is likewise solid proof that NA is a worthy investment in a TFSA.

National Bank's market capitalization stands at $29.71 billion, and it dominates in Quebec. The province contributes more than 60% to total revenues. Other provinces and international markets account for 25% and 15%. The current share price is $88.04 (23.9% year-to-date gain), while the dividend yield is 3.23%.

For Q1 fiscal 2021 (quarter ended January 31, 2021), National Bank reported a 16% and 25% increase in revenue and net income versus Q1 fiscal 2020. Market analysts are upbeat and forecast an 11.3% price appreciation to $98 in the next 12 months.

All mistakes are crucial

TFSA investors will not draw the attention of the CRA unless they commit mistakes number one and two. Avoiding the third mistake is equally crucial, because you undermine the power of compound interest. Risk-averse TFSA investors spread out the risks by holding a mix of assets, not only cash, in their portfolios.

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