Canadian Investors: 3 Huge TFSA Mistakes to Avoid

Description

A positive outcome from the health crisis is the shift in focus among Canadians. Suddenly, building rainy day funds or saving for the future is the preoccupation. Rather than spending their pandemic money, people increased their overall Tax-Free Savings Account (TFSA) contributions.

According to the results of **BMO's** annual TFSA survey released in December 2020, about 68% of Canadians have TFSAs. The same survey also reveals that about 72% of millennials and Canadians over 55 maintain a TFSA. The TFSA is an investment gem for investors because money growth could be 100% tax-free.

All interest, gains, or dividends earned inside the account are untouchable by the Canada Revenue Agency (CRA). The tax agency will only impose tax penalties or withholding taxes when TFSA users themselves commit three costly mistakes.

1. Exceeding the contribution limit

The CRA appoints a legislative dollar maximum per year for the TFSA. It means a user can contribute up to the annual contribution limit only. While maximizing the limit is ideal, there's no pressure to contribute the full amount. Your unused amount will carry forward to the following year. Also, you can carry forward unused contribution rooms indefinitely.

If the 2021 TFSA annual contribution limit is $6,000, don't over-contribute. Otherwise, the CRA will impose a 1% penalty tax per month on the surplus contribution. The solution is to withdraw the excess amount immediately.

2. Holding foreign assets

International diversification is allowed, although account holders risk paying a 15% withholding tax on foreign dividends. Most TFSA investors hold Canadian dividend stocks so that all dividend earnings are tax-free. If you want to include U.S. stocks in your portfolio, the alternative is to hold them in a

Registered Retirement Savings Plan (RRSP) instead.

3. Day trading

Tax penalties are harsher if you carry on a business inside your TFSA. Never engage in day trading. High frequency or aggressive buying and selling of stocks raise alarm bells. The CRA could swoop down on your earnings and treat them as business or regular income. If you violate this rule, your TFSA loses its tax-free status as all your income becomes taxable.

Over-the-top dividend yield

TFSA investors want nothing more but over-the-top dividends. If high yield is your primary consideration, the perennial choice is none other than **Enbridge** (TSX:ENB)(NYSE:ENB). North America's largest energy infrastructure company pays a mouth-watering 7.18% dividend.

The $94.27 billion energy giant's natural gas and active crude pipelines stretch 216,000 kilometers. This extensive network traverses across North America and the Gulf of Mexico. Apart from the high-quality liquids and natural gas infrastructure assets, Enbridge has more than 30 renewable power facilities, including an offshore wind farm in Europe.

Enbridge's revenues hinge on transport volumes and tolls from transportation services. The long-term contracts with investment-grade customers provide strong cash flow visibility. Furthermore, volume and price risks are non-existent because of the regulated assets.

The current threat to the business is possible business litigation. Enbridge did not shut down its Line 5 despite the May 12, 2021 deadline by the Governor of Michigan. The company will continue to operate the pipeline until it receives a court order to stop.

Crystal-clear rules

TFSA investors shouldn't be paying taxes at all if they follow the CRA's rules. Also, account holders with cash as their primary investments are losing out on the tax-free benefits.

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