Investing in Your TFSA? Avoid These 3 Massive Mistakes

Description

The Tax-Free Savings Account (TFSA) is an excellent tax shelter available to Canadians 18 years old and above. Apart from its one-of-a-kind features, you should integrate it with your financial plan. If you're saving to meet short-term goals or retirement needs, the funds are tax-free when you decide to use or withdraw the money.

Every TFSA user can preserve the tax-free status of the account by following the governing rules strictly. However, some account holders commit massive mistakes that prompt the Canada Revenue Agency (CRA) to intervene. It would be best if you avoided these miscues. Similarly, you'd be paying taxes in your TFSA when there shouldn't be any.

1. Exceeding the contribution limit

Over-contribution, whether consciously or unconsciously, is a common mistake. The CRA rule is simple. Don't pack your account in a way that would exceed the annual limit or available contribution room. The penalty tax per month is 1% of the excess contribution.

Assuming you contribute more than the $6,000 TFSA contribution limit in 2021, the CRA will send an over-contribution notice. Act fast and don't let the excess amount sit in the account. Fix the error by withdrawing the funds promptly.

2. Foreign dividends paid to a TFSA

The *Income Tax Act* no longer imposes limits on foreign content in a TFSA or Registered Retirement Savings Plan (RRSP). Canadians are free to hold assets from abroad. However, tax exemptions on dividend earnings from international stocks apply only to the RRSP.

Your TFSA loses its tax-free status when you hold U.S. dividend stocks, for example. The U.S.-Canada tax treaty covers accounts equivalent to a pension plan like the RRSP or Registered Retirement Income Fund (RRIF). Thus, all U.S.-based dividends paid to a TFSA are subject to a 15%

withholding tax.

3. Day trading

The CRA is strict on TFSA users who break the “no trading” or “overly frequent trading” rule. Don’t participate or attempt to buy and sell stocks using your TFSA because the consequence is harsh. If the tax agency confirms a violation after an audit, it will treat all earnings as business income. Thus, you must pay income taxes.

Green energy giant

While you can include bonds, mutual funds, GICs, and ETFs, the preferred assets of most TFSA users are dividend stocks. Among the profitable options today are renewable energy companies.

TransAlta Renewables (TSX:RNW) trades at a discount ($20.12 per share) and pays a 4.67% dividend. Besides the lucrative yield, the payout of this $5.4 billion green energy giant is monthly, not quarterly. Your TFSA balance should compound faster because you can reinvest the dividends 12 times in a year.

Suppose you maximize your $6,000 TFSA annual contribution limit, you’ll have $23.25 tax-free income monthly. Assume further that you max out the limit every year, and the yield remains constant. Your TFSA balance could swell to around $200,000 in 20 years.

The utility stock is ready for take-off following the company’s solid results in Q1 2021 (quarter March 31, 2021). TransAlta President Todd Stack credits the strong EBITDA contribution from its portfolio. TransAlta’s competitive advantages are the highly diversified, highly contracted facilities in various geographical locations.

Stay problem-free

TFSA users should be problem-free eternally with proper account handling. Avoid the three mistakes so that the CRA won’t bother you with pointless taxes.

CATEGORY

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TICKERS GLOBAL

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