CRA Warning: Avoid These 5 Costly TFSA Mistakes

Description

The Tax-Free Savings Account (TFSA) is perhaps the most travelled road to wealth in Canada today. Users can make money without worrying about taxes. All interest, dividends, and capital gains you earn inside the account are tax-free. Unlike the Registered Retirement Savings Plan (RRSP), you can keep contributing to your TFSA past age 71.

Unfortunately, some account holders will have to reckon with the Canada Revenue Agency (CRA) because of five costly mistakes. If you can avoid them, building wealth over time should be a breeze.

1. Over-contribution

The most common TFSA mistake is over-contribution, whether by accident or on purpose. Keep a close tab of the annual contribution limits or your available contribution room. The CRA issues an “excess amount letter” to users who exceed the limit. Withdraw the excess immediately or else pay a 1% penalty tax per month on the amount.

2. Transferring funds between TFSAs

The CRA allows multiple TFSA accounts in different institutions, although it will not increase your contribution limit. Hence, if you withdraw from one TFSA to contribute to another, it constitutes a contribution. You might be over-contributing, and therefore, you pay the penalty tax on the excess.

3. Holding foreign assets

Resist holding foreign assets like U.S. stocks in your TFSA. All foreign dividends are subject to a 15% withholding tax. The IRS exempt taxes only on investments placed in a retirement plan like the RRSP. Stick to Canadian stocks so you won’t pay taxes on dividends at all and keep returns intact.

4. Carrying a business

High-frequency or aggressive day trading may trigger alarm bells. The CRA prohibits users from carrying on a business in their TFSAs. Don't attempt this practice because the tax agency will treat all your earnings as taxable business income.

5. More cash or low-yield assets

The CRA will not dictate on any TFSA user what to hold in the investment account. However, holding more cash than income-producing assets reduce the TFSA to an ordinary savings account. The secret to accumulating or growing TFSA balances faster is to take advantage of the power of compounding. Idle cash doesn't have such power.

Anchor stock for your TFSA

The **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) is a non-nonsense choice because it's a blue-chip asset. Canada's fifth-largest bank made waves recently and bested its bigger industry peers. CIBC was the only one among the Big Five banks to report more than 300% earnings growth in Q2 fiscal 2021 (quarter ended April 30, 2020) versus the same period last year.

In Q1 fiscal 2020, CIBC increased its provision for credit losses (PCL) to $1.41 billion for fear of massive loan defaults due to the global pandemic. But in the most recent quarter, the PCL level is down to $32 million. Regarding the stock's performance, CIBC is up 33% year-to-date.

At $141.57 per share, the $63.48 billion bank pays a generous 4.06% dividend. The extensive dividend sequence of 152 years should give you the confidence to invest in this Dividend Aristocrat and make it the anchor stock in your TFSA.

Unfailing strategy

Savvy TFSA investors will not commit costly mistakes that would set back their timetables. Their unfailing strategy is to follow the CRA rules and maximize the account the best way possible. The last task is to pick dividend stocks they could buy today and own forever.

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