CRA Warning: 3 Costly TFSA Mistakes to Avoid

Description

The Tax-Free Savings Account (TFSA) is rapidly becoming the most popular investment vehicle for Canadian investors for a wide range of short- and long-term financial goals. Perhaps the best use for the TFSA is to become a wealthy investor for all the advantages it provides.

Any income you earn through investments stored in your TFSA can grow without incurring income taxes for the Canada Revenue Agency (CRA) to take away from you. It means that any interest, capital gains, and dividends within your account are tax-free.

The simple reason for tax-free earnings inside your TFSA is that you fund your investments inside the account with after-tax dollars.

You have already paid taxes on the money. You can now watch it grow without the prying eyes of the CRA ready to collect. At least, that is what many people think. There are some things that you need to be cautious about with your TFSA portfolio. The CRA will still keep an eye on your TFSA in case you make any mistakes. If you continue making these mistakes, you could compromise the tax-free status of your account.

This post will discuss some of the most common and costly TFSA mistakes that Canadians make so you can make informed investment decisions and avoid making these errors if you're just starting investing.

Over-contribution

The most common mistake Canadian investors make is contributing too much to their TFSAs. Since the account was introduced, the CRA has been increasing the TFSA contribution limit each year. With the 2021 update, the cumulative TFSA contribution room is $75,500. However, it does not mean that you have the same limit.

Depending on when you became eligible and any TFSA contributions you have made in the past, you could have a lower TFSA contribution room. It is wise to contact the CRA to ask how much contribution room you have before making any investments in your TFSA. Contributing too much to your TFSA could result in a 1% monthly penalty on the excess amount.

Trading too frequently in your TFSA

The TFSA is called a Tax-Free *Savings* Account because it was created to encourage better savings practices through the tax-sheltered status. It is not a tax-free *trading* account, but many investors choose not to see the difference. Aggressive day trading can catch the attention of the CRA. If you use your account to trade too frequently, the government agency can consider taxing your TFSA earnings as taxable business income.

Holding foreign assets

If you like investing in American companies or any other securities registered in another country, it would be better to use a Registered Retirement Savings Plan (RRSP) to hold the asset so that you can enjoy tax-sheltered returns from the asset. The CRA charges a 15% withholding tax on foreign assets held within the TFSA.

The **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) stock is an excellent stock pick for TFSA investors who want to earn tax-free dividend income in their TFSAs. CIBC is one of the Big Five Canadian Banks, and it is a leading financial institution in North America.

CIBC provides over 10 million customers with a comprehensive range of financial products and services in Canada, the U.S., and other countries. CIBC was the only major Canadian financial institution to report over 300% earnings growth in the second quarter of fiscal 2021.

The company’s strong performance combined with its dividend streak of over 150 years makes the Canadian Dividend Aristocrat an ideal asset to create a foundation for your TFSA portfolio.

Foolish takeaway

The TFSA can serve a wide range of financial goals for you, from creating another revenue stream to supplement your income or accelerating your savings for a substantial retirement nest egg. And learning about these costly TFSA mistakes can help you understand how to get the best use out of this tax-sheltered account to achieve your financial goals.

CIBC stock could be an ideal asset to begin building such a portfolio that can grow your wealth for decades.

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