2 Massive TFSA Mistakes to Avoid When Buying Stocks

Description

Canadian residents age 18 or older and have a valid Social Insurance Number (SIN) can open a Tax-Free Savings Account (TFSA). Non-residents of the same age and who hold a valid SIN are allowed, except that the Canada Revenue Agency (CRA) taxes contributions. The tax is 1% per month as long as the funds remain in the account.

The registered investment account was introduced in 2009 to help Canadians meet their short- and long-term goals. Many misconstrue the one-of-a-kind account as an ordinary savings account because of the words *savings* and *account*. You can hold cash, bonds, mutual funds, GICs, ETFs, and stocks in your TFSA.

Since most users want higher returns, dividend stocks are the preferred eligible investments. However, there are massive mistakes you must avoid when buying stocks to hold in your TFSA.

1. Investing in foreign stocks

Some TFSA investors desire international diversification, so they look to stocks abroad, mainly American. However, dividends earned from foreign investments are subject to a 15% withholding tax. A cross-over decision reduces the overall return.

2. Frequent trading

The CRA stresses that TFSAs are for investing and growing your savings over time. However, the tax agency prohibits frequent or day trading. It means you can’t run an investment business or carry on a business in your TFSA. If the CRA confirms a violation, any realized income or gains due to frequent trading convert to business income and, therefore, are taxable.

Ideal holding

Big bank stocks are considered blue-chip assets. Also, the more than 100 years of dividend payments make them ideal for TFSA investors. However, **Bank of Montreal** (TSX:BMO)(NYSE:BMO) is often the first choice. Canada's oldest bank is the pioneer in sharing a portion of profits with shareholders.

The practice started in 1829 and continues to this day. BMO's record would be 200 years in 2029. As of October 22, 2021, the quality stock trades at $135.47 per share and pays a 3.13% dividend. You can use your 2021 TFSA annual contribution limit ($6,000) to purchase BMO shares to generate $187.80 in tax-free income every year.

BMO has endured the worst recessions, and economic downturns yet didn't stop dividend payments. The dividends are safe and sustainable, given the less than 40% payout ratio. Hence, you can buy BMO shares and hold them in your TFSA forever.

Build a nest egg

Your TFSA is the ideal vehicle to save for retirement or build a nest egg. Moreover, your balance would compound and grow faster by reinvesting the dividends and not touching the principal. For example, **Rogers Sugar** (TSX:RSI) engages in sugar and maple production.

While sugar is a low-growth business, sugar is a consumer staple. Hence, you'd be investing in a consumer-defensive stock. The share price is considerably lower ($5.65) than other dividend stocks, but the dividend yield is a lucrative 6.41%. In 2021, the TFSA's cumulative contribution room is $75,500.

You'd have the same available contribution room if you've been eligible to own a TFSA in 2009 but haven't opened one yet. A $75,500 invested in Rogers Sugar and held in a TFSA will generate $4,839.55 in non-taxable income. If your investment window is 20 years, the money will compound to $261,574.75.

Be tax-free all the way

Avoid investing in foreign assets if possible and resist frequent trading for quick gains. Generally, TFSA users must be free of needless taxes.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
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