2 Huge TFSA Mistakes to Avoid Before You Buy Stocks

Description

According to a **BMO** study of Tax-Free Savings Accounts (TFSAs), about two-thirds of the Canadians have a TFSA, and the average holding in the TFSAs is over $30,900. The number might seem low, but many people using TFSAs don't have the whole contribution room because they turned 18 sometime after 2009. People who turned 18 in 2017 only have $29,000 in total contribution room in 2021 (assuming they haven't contributed anything yet).

And even though opening your TFSA and starting to make contributions to it *is* a mistake, it's not as massive as the ones I will discuss below. That's because, despite the lost "time" opportunity, you don't lose any of the contribution room and carry it with you whenever you are able to take advantage of it.

First mistake: Contributing too much

The CRA is very particular about contribution limits. And if you contribute more than the allowed amount, you will end up paying back 1% a month until it's used up by your next year's contribution room. Let's say you have taken advantage of all of your contribution room and added $4,000 extra to your TFSA in January.

You will keep paying $40 each month until the beginning of the following year, and then you will not be able to use your full contribution room for the year after that because it will have to swallow the previous year's over-contribution first, leaving you with a fraction of the total allowed contribution room.

And you don't *need* to over contribute to meet your growth goals if you invest in the right stocks. For example, if you had invested just $5,000 in **FirstService** (TSX:FSV)(NASDAQ:FSV) exactly five years ago, you would now be sitting on over $23,000. That's more than four times the growth of capital in just five years and effectively negates any need to over contribute.

FirstService is still an outstanding growth stock to consider and a Dividend Aristocrat, but the valuation is too high for most investors' taste. And thanks to its amazing growth, the yield has been pushed too low to even compete with the low-interest rates offered by the banks.

Second mistake: Buying and selling stocks too frequently

The TFSA is an *investment* tool, not an account for *trading*. Even if you don't understand or care about the distinction, the CRA does, and if you break this rule, the CRA can revoke your TFSA's tax-free status and tax whatever you have accumulated and contributed to your TFSA over the year. That's because the CRA classified the frequently buying and selling of stocks (i.e., day trading) as a business and the income is treated as such.

Buying stocks you can hold long-term for their growth or dividend potential is a wise idea. One contender here is **Thomson Reuters** (TSX:TRI)(NYSE:TRI). One of the oldest Aristocrats currently trading on the **TSX** is offering a yield of 1.35% with decent capital appreciation potential. The 21% 10-year compound annual growth is both powerful and sustainable.

The best part about considering Thomson Reuters right now is its attractive valuation. As an information company, it has fantastic growth opportunities ahead, and it's the type of stock that you can keep in your TFSA for decades.

Foolish takeaway

Your TFSA can be a powerful investment tool if you use it the right way. That includes not making the two mistakes mentioned above (or any other significant mistakes, like using the TFSA just for cash) and choosing the suitable securities to put into this account.

CATEGORY

1. Dividend Stocks
2. Investing

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