TFSA Investors: Don't Get Taxed in Your TFSA by Avoiding These Mistakes

Description

The Tax-Free Savings Account (TFSA) is one of the best tools for Canadians who want to maximize the returns on their investments. TFSA investing with the right income-generating assets and utilizing dividend reinvesting can help you get the most out of your investment by unlocking the power of compounding and accelerating your wealth growth.

Any Canadian with a valid Social Insurance Number can begin investing in a TFSA when they turn 18. Earnings from investments held in a TFSA can grow your account balance without you incurring any income tax on them. It means you can enjoy wealth growth through capital gains and dividend income without worrying about moving to a higher tax bracket.

However, making sure that the TFSA remains entirely tax free is based on how you use your account. Today, I will discuss a few crucial TFSA mistakes to avoid and how to maximize your returns by investing in a Canadian Dividend Aristocrat.

Never go over the contribution limit

The government increases the TFSA contribution room each year, indexed to inflation. After the 2022 update, the cumulative TFSA contribution room since the account's inception in 2009 stands at $81,500. But that does not mean that your total contribution room is the same.

Your cumulative contribution room would be $81,500 if you were eligible to start TFSA investing in 2009. The amount could be different right now if you turned 18 after the account was introduced or if you have been contributing to your TFSA. Check with the Canada Revenue Agency (CRA) to determine your available contribution room.

Overcontributing to your TFSA could result in a tax penalty of 1% of the excess amount in your TFSA each month until you remove the additional account from your TFSA.

Avoid day trading within your TFSA

Some investors who love day trading might have gotten the brilliant idea of using the tax-advantaged status of the TFSA to save some costs while day trading using their accounts. The account type was introduced to encourage better savings practices in Canadian households, not as a free pass for day traders to leverage the tax advantages for trading activities.

The government keeps track of investments you're making in a TFSA, and if it finds that you have been using it for day trading, you could end up compromising the tax-free status of the account. Under the tax rules, using the TFSA to generate trading revenue could result in those earnings counting as taxable business income.

A long-term investment to consider

The best way to maximize your returns in a TFSA is to invest in assets you can hold for the long run. A Canadian Dividend Aristocrat like **Fortis** (TSX:FTS)(NYSE:FTS) could be perfect for this purpose.

Fortis is a $28.55 billion market capitalization utility holding company that owns and operates several natural gas and electric utility businesses across Canada, the U.S., Central America, and the Caribbean. It serves over 3.4 million customers, providing them with an essential service. Fortis generates most of its revenues through highly rate-regulated and long-term, contracted assets.

It means that the company generates predictable cash flows that allow it to pay its investors virtually guaranteed shareholder dividends. Fortis stock also boasts a 48-year dividend-growth streak that makes it a reliable income-generating asset that can help you keep pace with rising inflation rates.

Foolish takeaway

At writing, Fortis stock trades for $60.38 per share, and it boasts a juicy 3.54% dividend yield. Buying Fortis stock and holding it in your TFSA could allow you to generate significant tax-free returns over the years. Reinvesting your shareholder dividends can help you use compounding to accelerate your wealth growth.

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adamothman