Hate Taxes? Then Avoid These 3 TFSA Mistakes

Description

One of the biggest advantages presented by the Tax-Free Savings Account (TFSA) is the promise of tax-free wealth growth. The flexibility that comes with TFSA investing allows accountholders to use it for various short- and long-term financial goals. Since all earnings from holdings in your account through interests, capital gains, or dividend income are exempted from taxes, your TFSA balance can grow faster, and you get to keep more of it.

Unfortunately, many investors tend to get carried away and ignore the governing rules of the account that allow them to retain its tax-free status. If you hate taxes and you want to enjoy tax-free growth, here are the crucial TFSA mistakes you need to avoid.

1. Contributing too much

Each year, the government adds more contribution room to the TFSA. After the 2022 update, the cumulative TFSA contribution room since the account's inception in 2009 stands at $81,500. It means that Canadians who were eligible to invest in a TFSA since the account's introduction have a total contribution room of $81,500.

It is important to check with the Canada Revenue Agency (CRA) to determine how much available contribution room you have before you decide on buying and holding investments in your TFSA. Any excessive contributions to your TFSA result in a 1% tax penalty per month for the additional amount held in your account.

2. Day trading

The idea of tax-free returns might make many investors think that it's the perfect opportunity to minimize their trading costs when day trading with a TFSA. It is called a Tax-Free *Savings* Account and not a trading account for a reason. The account was designed to encourage better savings practices in Canadian households.

The government keeps track of investments you make in a TFSA, because it's a registered account. If the government determines that you've been using the account for active trading, your income generated in a TFSA will be considered as taxable business income, compromising its tax-free status entirely.

3. Holding foreign securities

It is possible for you to hold foreign assets in a TFSA. However, the account does not provide tax exemptions for dividend income through such investments and subjects your earnings to a 15% withholding tax. Investing in a long-term buy-and-hold asset like **Fortis** (TSX:FTS)(NYSE:FTS) stock could be a far better way for you to use the contribution room in your TFSA without incurring taxes.

The Canadian Dividend Aristocrat is a $27.94 billion market capitalization utility holdings company. Fortis owns and operates several utility businesses across Canada, the U.S., Central America, and the Caribbean. The company generates most of its revenues through highly rate-regulated and long-term contracted assets, virtually guaranteeing predictable cash flows.

Fortis stock boasts a 48-year dividend-growth streak that it can comfortably fund through its stable and reliable cash flows.

Foolish takeaway

TFSA investing can be incredibly beneficial if you max out the contribution room and avoid making these critical TFSA mistakes, resulting in tax penalties. Fortis stock trades for $59.28 per share at writing, and it boasts a juicy 3.61% dividend yield. Allocating a portion of your contribution room to Fortis stock could help you generate significant tax-free returns.

You can choose to withdraw the amount from its dividend payouts at any time without worrying about incurring tax penalties. Choosing to reinvest your dividend income can help you accelerate your wealth growth through the power of compounding.

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