3 TFSA Mistakes That Could Destroy Your Returns

Description

The Tax-Free Savings Account (TFSA) has been a blessing for Canadian investors by allowing them the opportunity to protect the returns from their investments from taxes. TFSA investing happens with after-tax dollars. Once you contribute to your account, any earnings or returns generated from assets held in your TFSA are tax free.

However, the TFSA comes with rules and regulations that you should follow. Failing to ensure that you are abiding by the rules when using your TFSA can compromise your account's tax-sheltered status. Today, we will look at two of the most common TFSA mistakes people make, how they can destroy your investment returns, and how you can avoid them.

Overcontributing to your TFSA

TFSAs come with a contribution limit for each year, and the Canada Revenue Agency (CRA) increases it by an inflation-adjusted amount each year. Many investors tend to get carried away and invest more than their available contribution room. The CRA charges a 1% penalty tax for the excess contributions held in your account until you remove them.

Holding foreign assets

The TFSA can be used to store stocks listed on international stock exchanges. However, buying and holding foreign assets carries tax implications that supersede the tax-free status of the TFSA. You are liable to pay a 15% withholding tax on any income earned through securities listed in another country, effectively compromising your TFSA's tax-advantaged status.

Frequently trading in a TFSA

The TFSA is a tax-free *savings* account, not an investment account for day traders. The account was designed to encourage better savings practices among Canadians. The CRA keeps a close eye on

TFSAs being used to make frequent trades. If caught, the government agency will treat your TFSA income as regular business revenue and tax your earnings in that account accordingly.

Do not use the TFSA to make frequent trades. Use the available contribution to buy and hold assets for the long term. **Fortis** (TSX:FTS)(NYSE:FTS) is a $28.56 billion market capitalization utility holdings company that could be ideal for this purpose.

Fortis owns and operates several utility businesses in Canada, the U.S., Central America, and the Caribbean. Fortis generates almost its entire revenue through highly rate-regulated and contracted assets. It means that the company generates predictable and stable cash flows. Fortis stock is also a Canadian Dividend Aristocrat with a 48-year dividend-growth streak.

Fortis stock trades for $60.14 per share at writing, and it boasts a juicy 3.56% dividend yield.

Foolish takeaway

The TFSA is a wonderful investment tool that you can use to achieve various short- and long-term financial goals. It is an excellent vehicle to create substantial wealth growth, provided you find and invest in the right assets and avoid making TFSA mistakes.

Using the TFSA to store income-generating assets that can keep lining your account balance with additional cash through dividends can be a great approach.

You can consider using the payouts to supplement your active income to help with your monthly expenses. You could also consider reinvesting the payouts to unlock the power of compounding and accelerate your wealth growth.

Fortis stock could be an ideal core holding for a TFSA portfolio, regardless of your goals with the tax-free account.

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