3 Massive TFSA Mistakes to Avoid When Investing

Description

Editor's note: The cumulative contribution limit has been corrected.

Death and taxes are undoubtedly two certainties in life, but that does not mean you cannot reduce the amount of taxes you have to pay. Tax-free money growth is one of the biggest advantages Canadians get through the Tax-Free Savings Account (TFSA).

While you can place cash in your TFSA, using your TFSA contribution room as an investment vehicle might offer you better tax-free wealth growth. You can use the account to store various qualified investments, like bonds, mutual funds, GICs, ETFs, and stocks, for potentially greater returns than through interest rates on the cash you hold in the account.

Earnings through interests, capital gains, or dividends are tax exempt, allowing you to enjoy more rapid balance growth in your TFSA. However, you should be careful to avoid breaking some of the governing rules that could compromise the tax-advantaged status of your account.

Overcontributing to your account

The government defines a new contribution limit for the TFSA each year. After the 2022 update, the cumulative contribution room in TFSAs since the account's inception stands at $81,500. However, your contribution room might be lower based on when you became eligible to invest in a TFSA and how much you might have already contributed to your account.

Overcontributing to your TFSA means that any excess amount is subject to a 1% penalty tax per month. It is important to determine your available contribution room before making an investment in your TFSA.

Using it to hold foreign income-generating assets

There are no rules against holding foreign assets in your TFSA. However, using your TFSA to invest in and hold foreign investments comes with the drawback of compromising your account's tax-exempt status. Any dividend income paid by companies operating outside Canada will be subject to a withholding tax that can eat into your overall returns.

Day trading with your account

TFSA users can use their accounts to buy and sell stocks. However, some investors make the mistake of assuming that the tax-advantaged status of their TFSAs offers an opportunity to save costs on day trading. The TFSA has been designed to encourage better savings practices, not for active trading.

The Canada Revenue Agency (CRA) conducts audits to check whether any TFSA users are abusing their accounts. If you are caught using your account to make frequent trades, all your income in a TFSA could be treated as business income, which is taxable. A TFSA is better suited for long-term holdings that you can buy and hold in the account.

Fortis (TSX:FTS)(NYSE:FTS) is a stock you could consider investing in as a long-term Canadian investment. Fortis is a $29.86 billion market capitalization utility holdings company with regulated utility businesses in Canada, the U.S., and Central America.

The company generates most of its revenues through highly rate-regulated and long-term contracted assets. It means that its cash flows are virtually predictable and guaranteed.

The company uses its predictable cash flows to fund its capital programs and shareholder dividends comfortably. Fortis stock is a Canadian Dividend Aristocrat with a 48-year dividend-growth streak. It trades for $62.88 per share and boasts a juicy 3.40% dividend yield at writing. Fortis stock could make for a suitable long-term investment for your TFSA.

Foolish takeaway

Whether you want to achieve long-term and tax-free wealth growth or supplement your active income through tax-free passive income, TFSA investing can be useful for various financial goals. If you are careful about avoiding the above three mistakes, you can make the most of your TFSA investment returns to meet your financial goals.

Fortis stock is an income-generating asset that could serve as a core holding while using your TFSA to meet a range of short- and long-term goals.

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