Why You Shouldn't Try to Get to $1 Million in Your TFSA

Description

Who wouldn't want to get to $1 million in their tax-free savings account (TFSA)?

At that level, you could generate enough dividend income to live off tax free for life.

If getting there seems like a stretch, it should be mentioned that some people have managed to accumulate pretty high TFSA balances over the years.

In 2015, the *Financial Post* ran a story on a former trader who accumulated $1.25 million in his TFSA, and many others have built up TFSA holdings in the hundreds of thousands.

Having that much money in a totally tax-exempt account could be a ticket to a lifetime of freedom. However, there's a downside to overly large TFSA holdings that most people don't know about — a massive "gotcha" that could result in you losing all the tax benefits you signed up for.

While this will never happen to 99% of TFSA holders, it could happen to you if you get an overly large account balance. In this article I'll be exploring this massive 'TFSA gotcha" and what you can do about it.

The CRA could designate your TFSA trading as a business

If the CRA decides that your trading activities are business activities, you'll be taxed on them even if you're carrying out the trades in a TFSA. And unfortunately, having a large balance is one of the best ways to raise the CRA's eyebrow.

Imagine a trader who had invested $100,000 in **Shopify Inc** (TSX:SHOP)(NYSE:SHOP) at its IPO. Shopify has delivered a greater than 1000% return since then, so the $100,000 position would have grown to over $1 million.

Although it would be hard to have $100,000 in a TFSA in 2015, it could be achieved by having made profitable trades in the past. So a trader could have gotten to $1 million in a TFSA this way.

The only problem is that doing so could easily trigger CRA scrutiny, which could lead to a number of negative consequences.

Potential consequences

The worst case scenario if you build an overly high TFSA balance is that the CRA decides you're running a trading business and taxes you accordingly. In this scenario, you'd have to pay taxes on your TFSA holdings.

Unfortunately, it's not entirely clear *how* the CRA decides what is a business. However, if your frequency of trades is extremely high or you're using advanced software to inform your trading decisions, that could tip the scale toward you being a 'business owner."

What to do instead

It wouldn't be wise to deliberately handicap your investing just to avoid having a high TFSA balance. However, it might be a good idea not to trade full time in a tax-free account. There's nothing in the rule book that says you can't hold aggressive growth stocks like Shopify in your TFSA.

In fact, the TFSA's tax-free withdrawal policy makes them perfect for owning growth stocks and cashing out the proceeds later. Just make sure to keep your trading frequency low and invest with a long time horizon in mind.

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