Thinking About Actively Trading in Your TFSA? Think Again…

Description

A tax-free savings account (TFSA) is an investor's best friend. Providing the ability to shelter your holdings from taxes and withdraw proceeds tax-free, TFSAs can dramatically improve your tax efficiency.

In Canada, dividends are taxed at your marginal rate minus a 15.02% credit (for Canadian stocks), and at your full marginal rate for foreign stocks. Capital gains, on the other hand, are 50% taxable at your marginal rate.

Whether you're trading actively for big capital gains or buying and holding dividend stocks, you can pay a hefty fee in taxes on investments–especially if you're a high earner.

For this reason, it's natural to want to shelter your returns in a TFSA. Providing much more flexible withdrawals than RRSPs, TFSAs are simply the ideal accounts for short-term plays that you want to cash out early.

However, there's a huge risk when it comes to TFSA trading that most investors don't know about–for which many are paying a hefty price.

The huge risk of active TFSA trading that most investors don't know about

In a recent article, I wrote that if you earn too much money in your TFSA, you can trigger the attention of the CRA. Basically, it may get the tax collector to class your trading as a business — and deny your exemptions.

Enormous balances are one way to get CRA's attention. However, whether you ultimately will be forced to *pay* taxes depends on what you're doing. Simply having a high TFSA balance is not enough to get your TFSA classified as a business.

The real problem is the level of trading activity. If you spend so much time trading that it could constitute a job, then the CRA will likely see that as a business. If an audit reveals as such, then you could end up getting taxed on TFSA holdings even if your returns weren't unusually high.

Why it's such a big mistake

In Canada, capital gains are 50% taxable at your marginal rate. In other words, when you earn a capital gain, you cut the amount in half and pay your highest tax level on that.

If you earn a lot of money and make profitable trades, that can end up being quite a heavy tax.

Consider somebody earning $250,000 from a job who made $90,000 trading **Lightspeed POS Inc** (TSX:LSPD) this year. Such a feat wouldn't have been hard to pull off, as LSPD has risen over 100% this year.

However, $50,000 out of a $100,000 position in Lightspeed would end up being taxable at 53% (combined provincial and federal) in Ontario, if the holder were earning over $220,000. This would leave our hypothetical trader on the hook for $26,500 in taxes! And if he or she had been actively trading, holding the shares in a TFSA may prove to have been irrelevant.

Lightspeed is exactly the type of stock that traders love to hold in TFSAs. Boasting 36% year-over-year revenue growth, it's been rising in the market with the sales growth to back it up. But with every success story like this comes the potential for high capital gains taxes.

And as we've seen, if you're actively trading, there's a risk those taxes will affect you even if you trade in a TFSA.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. TSX:LSPD (Lightspeed Commerce)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Investing
2. Tech Stocks

Date
2025/09/18
Date Created
2019/09/10
Author
andrewbutton