WARNING: The Canada Revenue Agency Could Tax Your TFSA!

Description

Did you know that one wrong move can get you taxed on your “Tax-Free” Savings Account?

It’s not common knowledge, but it’s true.

In general, investors turn to TFSAs as a flexible tax-saving account that provides the freedom to withdraw at any time. However, there’s one major caveat that you need to be aware of. This is a little-known tax rule that’s technically not a TFSA account regulation, but a part of the tax code that overrides the TFSA-specific benefits.

Running afoul of this rule is one of the biggest TFSA mistakes you can make.

Carrying out a full-time trading business in your TFSA

If the Canada Revenue Agency decides that you’re carrying out a full-time trading business in your TFSA, you’re in deep trouble.

The TFSA was designed to give investors a flexible account to earn a little bit of investment money tax-free. The small contribution limits reflect this fact.

If you’re actively trading and earning huge profits, that goes against the “spirit” of the account, and the CRA may decide that it is a business. While you might object that there is no clear blue line separating trading from a trading business, the CRA doesn’t see it that way. The Financial Post recently ran a story of a woman who ran a $5,000 TFSA balance up to $200,000 using swaps. The CRA re-assessed her and applied taxes. She appealed the decision, but lost.

What makes a business?

You might be wondering what, exactly, makes a “trading business” according to CRA rules. Unfortunately, there’s considerable ambiguity in this area. However, the following items could set off alarm bells:

- Day trading
- Using specialized, paid research services to inform your trades
- Using special software to inform your trades
- Making huge profits on derivatives
- Or even just making gains that look “too high” when the CRA reviews your account

That last item might seem particularly unfair, but it’s actually the main thing that can get your account reviewed for day trading. Then, if any of the other factors apply, you’re likely to be assessed as a business.

What to do instead

If you’re worried about getting classified as a trading business and taxed in your TFSA, there are a few things you can do to protect yourself. The most obvious is to avoid day trading – especially with derivatives.

At the opposite end of the spectrum is passive investing, in buy-and-hold index ETFs like the **iShares S&P/TSX Capped Composite Index Fund** (TSX:XIC). These funds are very popular with retail investors who want to get average returns without too much risk, and they can give you a bit of dividend income too.

XIC in particular has a lot going for it. For one thing, it has extremely low fees, with MER of just 0.05%. For another, it’s extremely diversified, with over 200 stocks. Finally, it has a fairly high dividend yield (2.8% trailing, 3.3% forward), which means any returns you get from it are boosted with income.

Overall, it’s a solid TFSA pick that’s guaranteed to ensure nobody looks askance at your account.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:XIC (iShares Core S&P/TSX Capped Composite Index ETF)

PARTNER-FEEDS

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

Category

1. Investing

Date

2025/08/15
Date Created
2019/11/28
Author
andrewbutton