DANGER: This Mistake Could Get Your TFSA Taxed at 50%!

Description

All it takes is one big mistake to get you taxed in your “tax-free” savings account. The scary part is that not everybody is even aware that such mistakes exist.

Although most investors are aware of the doozy that is over-contributing to a TFSA, not everyone knows about two other big killers.

In a recent article, I explored the dangers of day trading in your TFSA–a big mistake that could negate all the tax benefits you opened the account to enjoy.

In this article I’ll be taking a deep look at another TFSA mistake that could get you hit with a stunning 50% tax.

Holding prohibited investments

If you really want to get taxed heavily in your TFSA, holding prohibited investments would be the way to go.

If you hold investments that the TFSA wasn’t designed to hold, you’ll get a 50% tax *even if* your marginal tax rate is much lower. This is in contrast to the day trading mistake, where the tax penalty depends on how much income you’re earning.

Another factor that makes prohibited investments particularly bad is that there’s no ambiguity about what they are, so if you do get caught holding them, it’ll be hard to come up with excuses that the Canada Revenue Agency will buy.

What to buy instead

If you’re looking to keep your TFSA safe, there are two types of investments you should consider:

Common stocks in publicly traded companies and ETFs.

Unless you're a corporate insider, holding stocks in a TFSA is always allowed. ETFs, being based on stocks, are therefore also allowed.

One stock you could consider holding in your TFSA is **Royal Bank of Canada** (TSX:RY)(NYSE:RY). RBC is Canada's largest bank by market cap. It's also historically been one of the safest.

With a strong focus on the highly regulated Canadian financial services industry, it's facing fewer risk factors than the more international Canadian banks.

The Royal Bank has many features that make it a solid TFSA pick. With a 4% dividend yield, it's a solid income producer. With a 12 P/E ratio, it's fairly inexpensive.

Finally, thanks to its Canadian focus, it's less susceptible to risks in foreign countries compared to, for example, **Bank of Nova Scotia**. Over the years, RY has delivered steady but not amazing results to investors, which should continue for the foreseeable future.

If you want an even safer bet than RY, you could always consider a diversified index ETF like the **iShares TSX 60 Index Fund.** This index fund gives you nice exposure to RY itself (it's heavily weighted in banks), along with the rest of the Big Six and miscellaneous other sectors such as energy and utilities.

One of the most popular Canadian index funds in the world, it's an approved investment that allows you enjoy the benefits of a TFSA without a surprise call from the CRA.

CATEGORY

1. Bank Stocks
2. Dividend Stocks

TICKERS GLOBAL

1. NYSE:RY (Royal Bank of Canada)
2. TSX:RY (Royal Bank of Canada)
3. TSX:XIU (iShares S&P/TSX 60 Index ETF)

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Date
2025/08/26
Date Created
2019/12/10
Author
andrewbutton