Canada Revenue Agency: Avoid These 2 TFSA Tax Errors

Description

The Tax-Free Savings Account (TFSA) is becoming increasingly popular among Canadian families. There's plenty of reason for that. The tax-free account allows a significant number of Canadians to save money and secure a better financial future for themselves.

One of the key advantages of the account is its tax-sheltered status. With assets stored in the TFSA, your earnings – interest payments, capital gains, and dividends – will be tax-free for the duration of the investment. It ensures that Canadians can save a significant amount of money through protection from taxes on their investment returns.

Many Canadians think the tax-sheltered status of their TFSAs protects them from the hands of the Canada Revenue Agency (CRA) entirely just by keeping within the contribution limit. The TFSA was made to help Canadians save more money by dampening the effects of taxes. It was not intended to be a free ticket for professional day traders who trade stocks to make a lot of money already.

I am going to discuss a couple of crucial tax errors many Canadians are making that effectively nullify the tax-free status of the TFSA.

Storing stocks with U.S. dividends

The TFSA is an ideal financial vehicle for storing stocks from dividend-paying companies. Any capital gains you earn are free of tax, and dividend payments from the company accumulate in the form of cash in your TFSA as well. A lot of Canadians make the mistake of holding dividend-paying stocks from U.S. companies in their TFSAs.

The TFSA is not a retirement account. Despite a tax treaty between the U.S. and Canada, if you earn U.S. dividends in your TFSA, you are liable to pay 15% U.S. withholding tax. If you are looking for a high-yield foreign stock, it is better to consider storing it in your Registered Retirement Savings Plan instead of your TFSA.

Overtrading

Remember that the TFSA is a tax-free *savings* account and not a tax-free *trading* account. A lot of Canadian investors are making the mistake of assuming it for the latter. Many Canadians are utilizing TFSAs for day trading, switching between stocks frequently to earn a lot of money. They are enjoying all the benefits of full-time trading free of the taxes they would have to pay with regular trading activities.

The CRA will keep an eye on the activity of your TFSA. If you are found to be trading more than a dozen times in a year, it is possible that you can lose your tax-exempt status in your TFSA. If you make any profits using your TFSA as a day trading account, the CRA can treat the income as taxable since it is more like business income than purely investment income.

What to do instead

Holding foreign dividend-paying stocks and overtrading in your TFSA will both make you lose the tax-free status in your TFSA. I can tell you that there is a better way to leverage the advantages of your TFSA, and it can be a more straightforward affair. Look for high-quality dividend-paying stocks traded on the TSX like **Sun Life Financial Inc** (TSX:SLF)(NYSE:SLF).

SLF is an exciting pick for investors who want to earn dividend income and enjoy healthy capital gains to accrue substantial wealth in the long term. Sun Life is a financial services company that gets the bulk of its earnings through Canadian and U.S. insurance and wealth management operations. The company also holds the potential for immense growth moving forward.

SLF has established subsidiaries in major Asian market segments like Vietnam, China, India, Indonesia, Malaysia, and the Philippines. As the middle class expands in these markets, the demand for wealth management services and insurance will increase. The large population in all these segments opens up doors for Sun Life to see immense growth in revenue.

Foolish takeaway

Avoiding the two mistakes and supplementing your TFSA with stocks from Sun Life Financial can allow you to grow your wealth and enjoy all the benefits of the account type. The share prices for SLF gained more than 32% in 2019 alone. Additionally, the company is paying shareholders a dividend yield of 3.69% at the time of this writing. I think it could be a stock worth looking at closely.

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