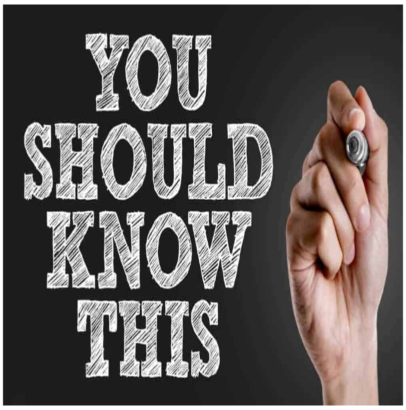

Taxed by Surprise: How Canada's TFSA Millionaires Are Getting a Rude Awakening

Description

Imagine waking up one day to find out that you were on the hook for income taxes in a "Tax-Free" Savings Account (TFSA).

It might sound like a far-fetched scenario, but it can happen.

Thanks to specific rules in the Income Tax Act, there are ways to get taxed inside your TFSA, even if you respect the contribution limits and hold approved investments.

That's not just in theory, either. It's really happening. In June of 2015, the *Financial Post* ran a story about a trader who amassed $1.25 million in his TFSA and got questioned by the CRA. Another highly publicized story involved an individual who achieved a large TFSA balance with derivatives, took the CRA to court over it, and lost. These are extreme examples, but they show that getting taxed inside a TFSA is a very real possibility.

Day trading can get you classified as a business

To understand how you can get taxed inside a TFSA, we need to understand what's considered a business under Canadian tax law.

The Excise Tax Act has a definition, which has two components:

1. "A profession, calling, trade, manufacture or undertaking of any kind whatever."
2. "Any activity engaged in on a regular or continuous basis that involves the supply of property by way of lease, licence or similar arrangement."

By this definition, passive investing isn't a business. However, active trading — especially day trading — can be. If you're day trading, that could be seen as a profession of sorts. Using special software or paid industry data to support your trades increases the chance that it is. Accordingly, the CRA may classify people trading with such special tools/resources as businesses. If that happens to you, you lose all the tax benefits of your TFSA, since business income isn't covered by TFSA protection.

How to keep yourself safe

Knowing that the CRA can classify your TFSA trading as a business, what should you do to protect yourself?

One great option is to stick to long-term positions in ETFs like **Vanguard S&P 500 Index ETF** (TSX:VFV).

VFV is a highly diversified index fund designed to replicate the average returns of the S&P 500 — the 500 largest stocks in the U.S. by market cap. Because it tracks the world's most popular stock market index, it's virtually guaranteed to give you "average" returns (minus a small fee).

Don't mistake "average" for "mediocre." Stocks as a class deliver better gains than any other type of asset, so just doing the average for the U.S. stock market is beating most types of investments you can own. Furthermore, not all stock indices are created equal: the S&P 500 is one of the best-performing indices in the world, having outperformed Canadian markets handily over the past decade. As a Canadian, you can easily buy it as "VFV" on a Canadian stock exchange, or even buy the U.S.-listed version (VOO) on a U.S. exchange. Either way, it's a solid investment that, if bought and held, will keep you a galaxy away from day trading and the taxation that can come with it.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:VFV (Vanguard S&P 500 Index ETF)

PARTNER-FEEDS

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

Category

1. Dividend Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/09/15
Date Created
2020/01/16
Author
andrewbutton