Canada Revenue Agency 101: How to Earn Tax-Free Stock Market Gains!

Description

Earning tax-free stock market gains is a dream for many.

If you're a Canadian who's at least 18 years of age or older, that dream can become a reality. That's because the Canada Revenue Agency recognizes a number of tax-deferred and tax-free accounts that can shelter your gains from taxation.

Most of the registered accounts available to Canadians have taxes applied to them on withdrawal of funds.

At least one of them, however, lets you withdraw your funds tax-free.

The Tax-Free Savings Account (TFSA) is by far the most flexible of the registered accounts available to Canadians. Although it doesn't provide the generous tax deduction you get with an RRSP, it lets you withdraw funds tax-free, making the account truly exempt from taxation (in contrast to other registered accounts, which merely defer taxes).

It pays to hold as much of your portfolio as possible in a TFSA

If you want to pay no taxes on stock market gains, you need to hold as much of your portfolio as possible in a TFSA. If you're a very high earner, having your entire portfolio in a TFSA may not be an option, but if you save less than $6,000 a year, it's entirely possible. The TFSA currently has $69,500 in accumulated contribution room, and the Canadian government typically adds between $5,000 and $10,000 a year in new room. This year, an additional $6,000 was made available. A middle-class Canadian with a mortgage could easily put all of their savings in a TFSA, and reap tax-free status on their entire portfolio.

How much tax-free income you could earn

We can illustrate the income potential of a TFSA portfolio by taking one stock as an example. Since **Toronto-Dominion Bank** offers both capital gains and dividends, it’s a good example to work with.

TD shares pay an annual dividend that yields 4% at current prices. That means that $69,500 worth of TD shares pays out $2,780 a year in cash income. Outside a TFSA, that income is grossed up and taxed, less a 15% credit on the grossed up value. The ultimate tax depends on your marginal tax rate, but if you’re a high earner, it can be quite a bit. However, if you hold the same shares in a TFSA, you pay zero taxes on the dividends.

It’s the same story with capital gains.

A healthy, growing company like TD could see its shares appreciate. If you held TD shares outside a TFSA, realized a gain, and cashed out, you’d have to pay a capital gains tax on the proceeds. And 50% of any capital gain you realize is taxable at your marginal rate, so the tax could end up being fairly high. But if you held all your stock inside a TFSA, you’d pay no tax whatsoever. So, by holding stock in a TFSA, you spare yourself two taxes: dividend tax *and* capital gains tax. Talk about a win-win situation!

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