TFSA Investor Alert: How the Canada Revenue Agency Can Take Your Money

Description

TFSAs are powerful, but they're not foolproof. If you don't pay attention, your tax shield could *force* you to pay money to the government. It's not difficult to avoid these traps, but the penalty for messing up is severe.

Don't let your TFSA advantages go to waste. Understand the following rules, and don't push your luck.

Too much money

Believe it or not, you can actually have too much money in your TFSA. Importantly, your money is allowed to *grow* to unlimited amounts. It's only *contributions* that matter.

If you don't know what your TFSA lifetime contribution limit is, pay close attention.

Each Canadian has a personalized contribution limit. If you contribute more than this limit, you'll be charged a 1% monthly tax on the excess amount. Ouch.

This is a simple mistake to avoid: know your limit and stay under it. How do you calculate your limit?

You likely know that each calendar year has its own contribution limit. In 2020, it's set at $6,000. But you may be able to contribute *more* than this amount. That's because unused contribution room rolls over each year, so all of your unused contribution room from past years is added to this year's limit.

You start accruing contribution room from the year you turn 18. If you turned 18 in 2009 or before, you're limit is $69,500. That's simply the sum of each year's contribution limit since the establishment of the TFSA.

If you turned 18 after 2009, you just need to do a little math. Add up each year's total since your 18th birthday to determine your personal lifetime max.

The annual limit was $5,000 from 2009 to 2012, increasing to $5,500 for 2013 and 2014. Then, it jumped to $10,000 for 2015, only to fall back to $5,500 from 2016 to 2018. The limit was $6,000 for both 2019 and 2020.

Try to contribute enough to hit your lifetime contribute maximum, but go no further until the next calendar year begins.

Don’t be a professional

This is one of the least-known mistakes in Canada: don’t day trade with your TFSA. In fact, keep transaction volumes as low as possible.

The Canadian Revenue Agency tracks how often you trade, and if you appear to be engaged in day trading, you’ll be taxed as if you’re running a business, not as an individual. That strips you of your TFSA advantages.

“If it notices that you are making several hundred trades every year, your revenue will be treated as enterprise revenue,” says Fool contributor Adam Othman. “You will be taxed accordingly by the CRA. Therefore, stick to stocks that you can hold for the long run.”

Running afoul of day trading limitations could ultimately reduce your TFSA value by a quarter or more. Yet this shouldn’t be a difficult mistake to avoid. Legendary investors like Prem Watsa and Warren Buffett have long extolled the virtues of long-term investing.

Given that both Watsa and Buffett have beaten the market for more than 30 years — putting them in the top percentile of all investors ever — I’d heed this advice. Your performance will likely improve with a long-term mindset, and you’ll maintain good standing with the Canada Revenue Authority.

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