TFSA Investors: Want to Double Your Money? Avoid This Fatal CRA Mistake!

Description

A Tax-Free Savings Account (TFSA) is a great place to make money on quick trades.

Unlike RRSPs, however, TFSA withdrawals are tax free, so you can enjoy the proceeds of any trades you make. This makes TFSAs perfect for aggressive investments that promise to deliver quick gains. By contrast, RRSPs–which incentivize waiting until retirement–are generally seen as better for long-term investing.

Because of their flexible withdrawals, many investors like to use TFSAs for short-term trading. To certain extent, it makes sense: if you double your money on a TFSA trade, you can actually enjoy the proceeds tax-free, unlike in an RRSP.

However, as you're about to see, there's a serious limit to your TFSA's trading flexibility — a major catch which, if you ignore it, could result in your being taxed in your TFSA. This is a risk that most people don't know about, yet it could result in a tax as high as 50%–killing the benefits of even highly profitable trades.

So, what is this little-known TFSA mistake that will get the CRA on your case?

Day trading

If you're found day trading in your TFSA, you could have your trading classed as a business by the CRA. If that happens, you'll lose all the account's tax benefits. TFSA stands for Tax-Free Savings Account, not tax-free *trading* account, and the CRA doesn't let you cancel out business income by putting it in a TFSA. Basically, if you're trading full time in a TFSA, the CRA sees that as a business and will tax you accordingly.

What it can cost you

Depending on your marginal tax rate, day trading in a TFSA could cost you quite a bit. According to an article by the tax planning firm FBC, day trading income is taxed at your marginal rate just like any other business income.

In other words, you can't even take advantage of lower capital gains taxes and dividend tax credits if you're caught doing it. So, if your marginal tax rate is 50%, you'll pay a 50% tax on your trading proceeds!

What to do

If you're concerned about getting hit with huge taxes for day trading in your TFSA, your best bet is to switch to a buy and hold approach. While that may not be what you want to hear, consider this: studies show that most active traders can't beat the market, so day trading in your TFSA probably isn't a good idea anyway.

One good stock to consider for buy and hold investing is **Fortis Inc** (TSX:FTS)(NYSE:FTS). Fortis is a large Canadian utility company that has stood the test of time. It has delivered 46 consecutive years of dividend increases, making it a tried and true Dividend Aristocrat.

As a utility, Fortis enjoys unusually stable revenue in bull and bear markets. Utilities provide the most essential services that people rely on in day to day life, so they don't usually see lost sales in recessions.

Fortis actually *grew* its earnings in 2008 and 2009–the peak years of the last recession–when most companies were spiralling into the abyss.

Over the next five years, Fortis will be spending $18.3 billion to upgrade its business. While these expenditures will increase the company's debt level, they will also help drive more revenue in the years ahead.

You've therefore got a company with a solid track record of financial stability that's investing heavily in future growth–a solid TFSA pick by any standard.

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