WARNING: Don’t Try to Become a TFSA Millionaire!

Description

If you invest in a TFSA, you may have dreams of becoming a stock market millionaire. Certainly, the TFSA’s tax-free status would help with that. The less tax you pay to the CRA, the greater your actual take-home return. So, the TFSA is, in theory, a great account for building wealth quickly.

But it’s time for a little reality check. Actually becoming a TFSA millionaire is harder than it looks. The TFSA, in 2020, has a max contribution limit of $69,500. To get to a million starting with that much would require a 1,400% return. The odds of pulling that off are extremely low.

Not only that, but actually pulling it off could land you in hot water. As you’re about to see, the CRA doesn’t take kindly to people earning outsized returns in TFSAs. In fact, in many cases, they’ve actively pursued taxes from people who did so. Landing yourself in the CRA’s bad books could negate all the tax-saving benefits the TFSA was supposed to give you. And it’s more likely than you think.

The CRA could tax your TFSA

People generally think of TFSAs as “tax free” accounts. It’s in the name after all: TAX-FREE Savings Account. But the TFSA doesn’t spare you from all taxes. You could be taxed for overcontributing. You could be taxed for holding non-approved investments.

And, as it turns out, you could also be taxed for being too good at trading. If the CRA decides that you are running a “trading business” inside your TFSA, that will cancel all your TFSA benefits. Some signs that you’re doing this include trading too frequently, using sophisticated trading software, and trading full time. Technically, getting to a million-dollar balance isn’t against the rules. But it’s a common way that people start getting investigated in the first place.

According to a 2015 *Financial Post* article, the CRA began investigating a Canadian trader after he amassed a suspiciously large $1.25 million TFSA. Other stories have emerged where people not only gotten investigated, but actually *taxed* for trading options. This is not a boat you want to find yourself in. So, perhaps it’s best to keep your TFSA ambitions to a moderate level.

Do this instead

As shown above, getting to a $1 million TFSA can be more trouble than it's worth. If you get busted for running a trading business in your TFSA, you could not only pay taxes owning, but possibly face criminal penalties. It's not worth it at all.

The good news is that if your ambitions are more modest, the TFSA can save you a lot of money on taxes. As long as you're *investing*, not trading, your account should be left untouched. And the tax savings could be substantial.

Let's imagine, for the sake of argument, that you held $50,000 worth of **Fortis** (TSX:FTS)(NYSE:FTS) shares in a TFSA.

Fortis has a 3.7% dividend yield, which means that a $50,000 position pays out $1,850 in dividends each year. Held inside a TFSA, those dividends would not be taxable. Outside a TFSA, you could have to pay several hundred dollars on them. The same goes for capital gains.

If you realized, say, a 20% gain on your Fortis shares, you'd have a $5,000 taxable gain — that is, 50% of a $10,000 price increase. The TFSA would spare you any taxes on that as well. So, the savings could be substantial. Just remember: try to keep it to *investing*, not trading. The latter can get you in trouble down the line.

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