CRA: How to Avoid Getting Taxed on Your TFSA

Description

The Canada Revenue Agency (CRA) loves to collect taxes on the money you earn. However, Canadians have a way to avoid having to pay taxes on the income in their accounts by using their Tax-Free Savings Accounts (TFSAs).

Any Canadian with a valid Social Insurance Number (SIN) can begin building wealth in their TFSA when they turn 18. Each year, the CRA sets a TFSA contribution limit, indexed to inflation.

A TFSA is the best way to grow your wealth fast by accumulating savings. You can save money to invest in stocks that you can hold in the account. Any profits through interests, dividends, and capital gains can grow in your account tax-free.

Ideally, the CRA cannot touch your TFSA account balance. However, making sure that the TFSA remains tax-free is entirely on the decisions you make with your account. I will tell you about a couple of mistakes you should avoid, so the CRA cannot tax your TFSA balance.

Never go over the contribution limit

With the 2020 update, the TFSA contribution limit was extended by $6,000. The total amount an individual can hold in their TFSA if they have not contributed to it since its inception is $69,500. The first way you can avoid getting taxed on your TFSA is to avoid exceeding the contribution limit.

If you exceed the TFSA contribution limit, the CRA can subject you to a 1% per month tax penalty on the excess amount. Keep track of your TFSA contributions to ensure that you stay within the limit.

Do not use the account for day trading

Over-contribution is one of the most common TFSA mistakes. Another major mistake many enthusiastic account holders make is trying to capitalize on the tax-free status of the account. The account type was introduced to encourage better savings in Canadian households. Some people try to use the account for day trading.

The CRA explicitly prohibits frequent trading in a TFSA and can audit your trading activities if it seems that you are trading too often inside your account. Under the tax rules, you cannot invest in the TFSA to turn it into a business.

If the CRA catches you using your TFSA for active trading, it can treat the income you earn as regular and taxable business income.

A long-term investment to consider

The best way to maximize your capital growth inside a TFSA is through long-term investments in reliable dividend stocks. Holding a stock like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) in your TFSA for a long time can help you make the most of the account. Toronto-Dominion is an ideal asset to consider because of its reputation for being a reliable stock.

It is a staple investment for investors with a long-term horizon. The financial institution has been paying its investors dividends for the past 164 years. It has had a tough year in 2020, like most other stocks. However, the stock is poised well to pull through the turbulence and continue providing great returns to its shareholders.

The bank is trading for a discount due to the pandemic. TD is trading for $59.43 per share at writing. At this valuation, the stock is down 19% year to date and is paying its shareholders at a juicy 5.32% dividend yield. Investing in the stock could entitle you to returns through capital gains in the future and consistent growth through its dividends.

Foolish takeaway

Avoid getting taxed by the CRA on your TFSA by sticking to the contribution limit and making investments with a long-term horizon. TD makes an ideal stock to consider for long-term investment due to its reliability when it comes to paying its shareholders their dividends.

Additionally, the stock's discounted price right now can provide you with substantial returns as the stock's valuation approaches pre-pandemic prices.

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