CRA: 1 Big TFSA Mistake Could Land You in Hot Water

Description

A much-awaited event is the Canada Revenue Agency's (CRA) official announcement of the Tax-Free Savings Account (TFSA) annual contribution limit. The big news for TFSA users in November is the new $6,000 contribution limit for 2021.

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The TFSA is a perpetual gift from the federal government to help Canadians secure their financial future and live comfortably in retirement. You can derive a host of benefits, including the non-payment of taxes on all interest, gain, and profit from the account. Funds withdrawn from a TFSA are tax-exempt too.

However, a user must abide by the governing rules and use the TFSA properly. Otherwise, the CRA will exact tax penalties to those who break the rules. One big mistake can land you in hot water.

Don't operate a business in your TFSA

The CRA will not bother you with taxes unless you over-contribute or have foreign investments in your TFSA. But the agency is unforgiving when you carry on a business. This prohibition pertains to users who are actively trading stocks within the TFSA.

You're not supposed to conduct frequent trading in the tax-advantaged account. If you do, it will constitute a business. The CRA will treat your earnings as business income and, therefore, taxable income. Don't think you can get away without penalties because the agency conducts regular audits and cracks down on violators.

Spotting red flags

Heavy traders are easy to spot or identify. Usually, the red flags are trading volume, sometimes pattern, and length or duration of ownership. Since 2011, the CRA has been conducting TFSA audits. Too much activity in a TFSA will trigger an investigation.

The CRA can file a case in court against an erring TFSA user that runs a de-facto securities trading business. It might be that professional traders are abusing the TFSA, not the average users. The targets are mostly high-value TFSAs.

Tried-and-true

If you hold a tried-and-true dividend stock like **BCE** (TSX:BCE)(NYSE:BCE) in your TFSA, you don't need to trade the stock at all. The telco stock is for keeps and a must-own asset for long-term investors or retirees. This $52.21 billion company is the largest telecommunications firm in the land.

Telco stocks are resilient, particular in the COVID world where communications services and the Internet are necessities, not luxuries. BCE trades at $57.72 per share and pays a sector-leading 5.81% dividend. A $65,000 investment today can compound to $201,116.47 in 20 years. The CRA can't touch even a dollar of your TFSA earnings.

I can give you several compelling reasons why TFSA users should invest in and hold BCE forever. The stock is recession-resistant, while the business model is predictable.As well, the dividend is juicy, and the yield could grow steadily in the years now. The rollout of the 5G network and BCE's company rural broadband project are the tailwinds.

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A grave mistake

Manage your TFSA correctly to enjoy the full perks of the unique investment vehicle. Don't attempt to purchase stocks for resale at a profit or else face the wrath of the taxman. The CRA assessed roughly $114 million in taxes in the audits between 2009 and 2017 due to one grave mistake.

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