Day Traders, Beware: The CRA Could Tax Your TFSA Heavily

Description

By the name alone, Tax-Free Savings Account (TFSA) users shouldn't be paying any taxes at all when maintaining the account. The Canada Revenue Agency (CRA) sets the ground rules and will not hesitate to charge a penalty tax should an account holder violate them.

Overcontribution is the common mistake of TFSA users, although the 1% penalty tax is relatively small. You can avoid it by not contributing beyond the available room or withdrawing the excess amount promptly. However, the CRA is unforgiving when you abuse your TFSA and break a cardinal rule.

TFSA objectives

The purpose of the TFSA is to help Canadians save for short-term and long-term financial goals. Your balance accumulates faster in a TFSA because money growth is tax-free. It means too that all interest, gains, or dividends inside the account are tax-exempt. You can withdraw any amount at any time without incurring a penalty whatsoever.

Furthermore, there's no age restriction on contributions, unlike the Registered Retirement Savings Account (RRSP). You can contribute eternally and not stop after age 71. You can also use your TFSA as a tax-saving tool to counter the 15% Old Age Security (OAS) clawback.

High-frequency trading

The CRA prohibits a user from carrying a business inside the TFSA. Thus, day traders, beware. High-frequency trading raises alarm bells. The CRA conducts random audits to catch anyone abusing the account and making quick profits by buying and selling stocks.

Once the CRA suspects you of generating business, not investment income, it will flag your TFSA. The tax agency will stop you in your tracks and charge heavy penalties if found guilty. Remember, income in a TFSA that is within bounds is non-taxable.

However, the CRA considers income from day trading or frequent trading as regular income, and, therefore, everything will be taxed. Don’t try your luck or risk the ire of the CRA. Some rule breakers are even brought to court.

A dividend king is enough

You don’t need to resort to frequent trading if you use your TFSA contributions to invest in a dividend king like **Keyera** (TSX:KEY). The energy stock is a top pick of TFSA investors because it pays a high 7.43% dividend. By using the Rule-of-72 formula, any investment amount will double in 9.69 years.

Assuming your available TFSA contribution room is $20,000, the annual tax-free dividend payout is $1,486. Despite the sector’s weakness, this $5.83 billion independent midstream energy company did not slash dividends. Thus far this year, Keyera is up 17.4% following a tumultuous 2020.

The company’s capital program focuses on projects that will drive organic growth. Soon, Keyera will be one of the largest gas processing and condensate handling companies in North America. Now would be a good time as any to invest in this dividend king. You’ll get value for money, and Keyera is a winner for TFSA investors.

Primary investments

Dividend stocks like Keyera are usually the primary investments in a TFSA, not cash. You can earn tax-free money 100% of the time with proper account handling. However, day traders have no place in the account. The CRA prohibits frequent trading and will exact heavy penalties, if need be, to stop users from abusing their accounts.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. TSX:KEY (Keyera Corp.)

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1. Business Insider
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