

The Tax-free First Home Savings Account

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In Budget 2022, the federal government proposed the Tax-Free First Home Savings Account (FHSA). The most recent draft legislation has proposed April 1, 2023 as an effective date. Here is a summary of this new registered plan which is based upon the draft legislation to date:

- The FHSA gives prospective first-time home buyers the ability to save \$40,000 on a tax-free basis. It's a bit of a hybrid between a Registered Retirement Savings Plan (RRSP) and a Tax-Free Savings Account (TFSA). Contributions would be tax-deductible like an RRSP, and withdrawals to purchase a first home - including the investment income earned in the plan - would be non-taxable, like a TFSA.
- To open a FHSA, you must be a Canadian resident who is 18 years of age or older. In addition, you must be a first-time home buyer. This means neither you nor your spouse has owned a home in which you lived in the year the account is opened or in the preceding four calendar years.
- The lifetime limit on contributions would be \$40,000, with an annual contribution limit of \$8,000. You can claim an income tax deduction for contributions made in a given year. Unlike RRSPs, contributions made within the first 60 days of a given year could not be attributed to the previous tax year. However, like RRSPs, you aren't required to claim the deduction right away. Instead, you can carryforward non-deducted contributions and claim them in a later year if you are expecting to be in a higher tax bracket in the future.
- You are allowed to carry forward unused portions of your annual contribution limit but only up to a maximum of \$8,000. For example, if you contributed \$5,000 to a FHSA in 2023 you would be allowed to contribute \$11,000 in 2024 (i.e., \$8,000 plus the remaining \$3,000 from 2023). So, unlike a RRSP and a TFSA, unused contribution room of prior years doesn't carryforward except for a maximum amount of \$8 000.
- The FHSA can remain open for up to 15 years. So there needs to be some consideration as to when the FHSA should be opened to start saving. Starting too young may mean the account has to be closed before a home is purchased. However, any savings in the FHSA not used to buy a qualifying home can be transferred on a tax-free basis into an RRSP. It can also be withdrawn on a taxable basis. If transferred to a RRSP, it would not reduce the RRSP contribution room.



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The Tax-free First Home Savings Account (continued)

- One of the more recent changes made to the draft legislation is that you can now use both the FHSA and the Home Buyer's Plan (HBP). The HBP provides for a tax-free withdrawal from your RRSP, up to \$35 000, but the amount must be repaid into the RRSP in equal annual instalments over 15 years. Otherwise, the unpaid instalment amount is included in your taxable income for that year. The goal is to provide some cashflow for first time home buyers and eventually replenish the RRSP to continue the non-taxed investment growth to save for retirement. With the FHSA, you can preserve your RRSP contribution room and contribute to the FHSA instead. Plus, unlike the HBP, the FHSA withdrawals don't need to be repaid to avoid taxation, so that's more tax advantageous.
- Using both the HBP and the FHSA will provide a total of \$75 000 of capital, plus the growth on the funds contributed to the FHSA.
- It's also possible to transfer money from the RRSP on a tax-free basis to the FHSA subject to the annual contribution limits. Since those RRSP contributions were deducted for tax savings when contributed, you won't get a deduction on the transfer to the FHSA. The advantage is that the withdrawal will be tax free, but without the requirement to repay it as with the HBP. That's good on cashflow, but not great for saving for retirement as the RRSP doesn't get replenished and the RRSP contribution room isn't reinstated for the amount transferred to the FHSA.

Bottom line, the FHSA provides some additional tax advantages and flexibility, but some tax planning relative to your specific case may be needed.

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