THE SMALLBIZ BUILDER

PADGETT THE SMALL BIZ PROS

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The Tax-free Home Savings Account

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In Budget 2022, the federal government proposed the Tax-Free First Home Savings Account (FHSA), which is to be effective at some point in 2023. Here is a summary of this new registered plan which is based upon the draft legislation to date. There may be some minor changes before the legislation is finalized.

- 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 from investment income - 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 you have not 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 could claim an income tax deduction for contributions made in a 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. That's not too bad however, as 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 It can also be withdrawn on a taxable basis.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.

The Tax-free Home Savings Account (continued)

- You can't 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. The goal was 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, the FHSA withdrawals aren't taxable so that's more tax advantageous. However, for some people who'll be buying a home in the next few years, they might need to use the plan that extracts the maximum cash for the down payment. This requires some consideration, also taking the TFSA into account. In some cases it might be better to use the HBP if more funds are available in the RRSP. Alternatively, you could transfer money from the RRSP on a tax-free basis to the FHSA. 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.