Tax-free First Home Savings Accounts: An overview

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In August 2022, the government released draft legislation to implement the new Tax-Free First Home Savings Account (FHSA). The FHSA is expected to launch at some point in 2023, so to get you prepared, here's a guide to what we know so far.

The basics

This brand new registered plan gives prospective first-time home buyers the ability to save $40,000 on a tax-free basis towards the purchase of a first home in Canada. Like a Registered Retirement Savings Plan (RRSP), contributions to an FHSA will be tax-deductible, but withdrawals to purchase a first home, including withdrawals of any investment income or growth earned in the account, would be non-taxable (so long as the rules are followed), like a Tax-Free Savings Account (TFSA).

To open an FHSA, you must be a resident of Canada and at least 18 years of age. In addition, you must be a first-time home buyer, meaning that you have not owned a home in which you lived as your principal residence at any time during the part of the calendar year before the account is opened or at any time in the preceding four calendar years.

If you make a qualifying withdrawal to buy a home, the FHSA can remain open until the end of the following year; otherwise, the FHSA can remain open for up to 15 years or until the end of the year when you turn 71 years old, whichever comes first. Any savings in the FHSA not used to buy a qualifying home before closing an FHSA could be transferred on a tax-free basis into an RRSP or Registered Retirement Income Fund (RRIF), or could be withdrawn on a taxable basis.

Contributions and deductions

Starting in the year that you open an FHSA, $8,000 is added to your FHSA deduction limit annually, and the lifetime maximum of $40,000 would be reached in five years. If you contribute less than the FHSA deduction limit for a year, then the unused portion is your FHSA carryforward, which is added to your FHSA deduction limit for the following year.

For example, if you open an FHSA in 2023, your FHSA deduction limit will be $8,000 for 2023. If you contribute $5,000 to an FHSA in 2023, your FHSA carryforward will be $3,000 ($8,000 minus $5,000). Your FHSA deduction limit will be $11,000 in 2024 (that is, $8,000 for 2024 plus $3,000 of FHSA carryforward from 2023).

You can have more than one FHSA, but the FHSA deduction limit applies for all FHSAs in total.

You will be able to claim a deduction for FHSA contributions that you make within a year that do not exceed your FHSA deduction limit for the year. Unlike RRSPs, contributions you make within the first 60 days of the subsequent year cannot be deducted in the current tax year.

Like RRSPs, you won't be required to claim the FHSA deduction in the tax year in which you make a contribution. You can claim a deduction in a later tax year, which may make sense if you expect to be in a higher tax bracket in a future year.

There's a one per cent per month penalty tax for any overcontributions (contributions that exceed the FHSA deduction limit.)

Qualified Investments

An FHSA is permitted to hold the same types of qualified investments that are currently allowed to be held in a TFSA or RRSP, including mutual funds, publicly traded securities, government and corporate bonds, and guaranteed investment certificates. The prohibited investment rules, which prevent investments in investments to which the holder is closely connected, will also apply to FHSAs.

Withdrawals

To be able to withdraw funds from an FHSA on a non-taxable basis, certain conditions must be met. First, you must be a first-time home buyer at the time of withdrawal, as discussed above. You cannot have acquired the home more than 30 days prior to the withdrawal. You must also have signed a written agreement to buy or build the home before October 1 of the year following the year of withdrawal. You must intend to occupy that home as your principal place of residence, and it must be in Canada.

If you meet the conditions, the entire balance in the FHSA can be withdrawn on a tax-free basis in a single withdrawal or a series of withdrawals. All FHSAs must be closed by the end of the year following the first qualifying withdrawal and you are not permitted to have another FHSA in your lifetime.

Transfers

You will be able to transfer funds from one FHSA to another FHSA, or to an RRSP or a RRIF, all on a tax-free basis.

If funds are transferred to an RRSP or RRIF, they will be taxed upon ultimate withdrawal. These transfers won’t affect your RRSP contribution room or the FHSA deduction limit.

You will also be permitted to transfer funds from an RRSP to an FHSA on a tax-free basis, up to your FHSA deduction limit. These transfers will not be tax deductible and will not reinstate your RRSP contribution room.

What about the Home Buyers’ Plan (HBP)?

The HBP, which allows first time home buyers to withdraw up to $35,000 from an RRSP to buy a first home, will continue to be available, however you won’t be permitted to make both an FHSA withdrawal and an HBP withdrawal for the same home purchase.

No spousal plans

Unlike an RRSP, the FHSA holder is the only taxpayer permitted to claim deductions for contributions made to their FHSA. In other words, you can’t contribute to your spouse or common- law partner’s FHSA and claim a deduction. That being said, the government will permit you to give your spouse or common-law partner the funds to make their own FHSA contribution without the normal spousal attribution rules applying .

Death

Just like with TFSAs, you’ll be able designate your spouse or common-law partner as the successor account holder, in which case the account can maintain its tax-exempt status after death. Your surviving spouse or common-law partner would then become the new holder of the FHSA following your death. Inheriting an FHSA in this way won’t affect the survivor’s own FHSA contribution limits. Funds from your FHSA can also be transferred on a tax-deferred basis to your surviving spouse’s or common-law partner’s RRSP or RRIF by the end of the year following your death, even if you have not designated that person as a successor. If the beneficiary of an FHSA is not the deceased account holder’s spouse or common-law partner, the funds would generally need to be withdrawn and paid to the beneficiary, who would be taxed on them (although different treatment may sometimes be elected).

Interest deductibility, collateralization, and bankruptcy

Like RRSPs and TFSAs, interest on money borrowed to invest in an FHSA won't be tax deductible and you won't be able to pledge FHSA assets as collateral for a loan. In addition, FHSAs will not be given creditor protection under the *Bankruptcy and Insolvency Act*.

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