



## Tax-free First Home Savings Accounts: An overview

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In November 2022, the government released amended draft legislation to implement the new Tax-Free First Home Savings Account (FHSA). The FHSA is proposed to launch as early as April 1, 2023, so to get you prepared, here's a brief summary of how this new registered plan will work.

### The basics

The FHSA gives prospective first-time home buyers the ability to save up to \$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 and withdrawals to purchase a first home, including withdrawals of any investment income or growth earned in the account, will be non-taxable, just like Tax-Free Savings Accounts (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 and/or your spouse or common-law partner 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 funds left in the FHSA that are not used to buy a qualifying home before closing the FHSA can be transferred on a tax-free basis to an RRSP or Registered Retirement Income Fund (RRIF), or will be included in income. Once the 15-year period has ended, you are not permitted to open another FHSA in your lifetime.

### Contributions and deductions

You can make contributions to an FHSA in cash or in-kind through the transferring of securities to your FHSA from a non-registered account. For in-kind contributions, you will be treated as if you sold the securities at fair market value upon transfer, which may trigger a capital gain. If the in-kind transfer results in a loss, however, this loss cannot be claimed. Similar to RRSP contributions, if you make FHSA contributions directly from your employment income, your employer won't have to withhold income tax on the amount of those contributions.

Another option to fund your FHSA is that you will be able to transfer funds from a pre-existing RRSP to an FHSA on a tax-free basis. These transfers will not be tax deductible (the deduction was previously available when the RRSP contribution was made) and will not reinstate your RRSP contribution room.

Starting in the year that you open an FHSA, you can contribute or transfer from RRSPs a total of \$8,000 plus any carryforward available from the previous year without incurring a penalty tax on excess contributions. Carryforward amounts will only start accumulating after you open an FHSA for the first time. You also need to make sure that you don't exceed the lifetime maximum of \$40,000 for all contributions and RRSP transfers, which could be reached in five years. There is a penalty tax of 1% per month on excess contributions.

You will have an FHSA carryforward available in a year if in the previous year you did not contribute or transfer to an FHSA the maximum amount you had available. The FHSA carryforward can never exceed \$8,000. This

means that the maximum amount that can be contributed and transferred from RRSPs in any one year will never exceed \$16,000.

You will be able to claim a deduction for FHSA contributions made during a year that do not exceed your annual limit. 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're not 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.

You can have more than one FHSA, and can transfer between FHSAs but the FHSA limits apply for all FHSAs in total.

## Example

Let's suppose Anil opens an FHSA in 2023. Anil contributes \$3,000 from a non-registered savings account in 2023. Later in 2023, he transfers \$2,000 from his RRSP to an FHSA.

Anil can claim a deduction in 2023 for the \$3,000 in contributions that he made, but not for \$2,000 that was transferred from his RRSP. He could also choose to claim a deduction in a subsequent year for any portion of the \$3,000 that is not claimed in 2023. Anil does not have an excess contribution in 2023 as he was permitted to contribute or transfer a total of \$8,000 to an FHSA that year.

In 2024, Anil's FHSA carryforward will be \$3,000 (\$8,000 minus the \$3,000 in contributions and \$2,000 transfer from RRSPs to FHSAs that was made in 2023.) In 2024, Anil could contribute/transfer a maximum of \$11,000 to an FHSA without incurring penalty taxes.

## 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 holding investments to which the holder is closely connected, also applies to FHSAs.

## Withdrawals

To be able to withdraw funds from an FHSA on a non-taxable basis, you must meet certain conditions: you cannot have lived in a home that you owned either in the four previous years, or in the year of withdrawal (other 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 no later than a year after acquisition, and it must be in Canada. You must also be resident in Canada throughout the period from the time of the withdrawal until the time when the home is acquired.

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.

## Transfers from an FHSA

If you choose not to use the FHSA to buy a first home, you always have the option (until age 71 or 15 years, whichever comes first) of transferring funds from an FHSA to your RRSP or a RRIF 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 annual FHSA limit.

## 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 and you will be permitted to make both an FHSA withdrawal and an HBP withdrawal for the same home purchase, if qualified.

## 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 holder, in which case the account can maintain its tax-exempt status after death. Provided your spouse or common-law partner qualifies to open a FHSA, 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 need to be withdrawn and paid to the beneficiary and would be taxable to them. Where no individual is entitled to the property upon your death, your estate would be considered the beneficiary.

## Interest deductibility, collateralization, and bankruptcy

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

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