Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

Helping your child buy their first home

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As the cost of owning a home generally continues to rise, many are finding it more and more difficult to save up enough funds to purchase a home. As a parent, you may be willing to help your child buy a home and wondering which options are available to you. This article explores making use of your child's registered accounts such as the tax-free first home savings account (FHSA), the registered retirement saving plan (RRSP) and the tax-free savings account (TFSA). It also discusses other options and strategies you may consider, such as gifting or loaning funds to your child to assist them in purchasing a home.

This article assumes your child is a tax resident of Canada.

Using registered accounts

The FHSA

The government recently introduced a tax-free first home savings account, also known as the FHSA. The FHSA is a new registered account designed to help individuals save up to $40,000 on a tax-free basis to purchase their first home. The FHSA is a mix between an RRSP and a TFSA. What this means is, like an RRSP, contributions you make to an FHSA are tax-deductible. And like a TFSA, withdrawals you make to purchase a first home (including the investment income earned in the FHSA) will not be taxable.

You can help your child purchase a home by gifting them funds to contribute to their own FHSA. To open an FHSA, your child must be age 18 or older (age 19 in provinces where the age of majority is 19); they must also be considered a first-time home buyer as defined by the Canada Revenue Agency (CRA) for this plan.

There would be no tax implications to you if you're gifting them cash. However, if you must liquidate securities to come up with the cash, you may realize a capital gain or loss.

Once your child contributes the funds to their FHSA, they can claim a deduction against any income source they may have. This will reduce your child's taxes payable for the year.

If your child has relatively low income this year and expects to have higher income in the next few years (perhaps they're just starting out in their career), they can contribute to their FHSA this year and wait to claim the tax deduction in a future year when they have higher income. This way, they gain access to tax-free growth immediately and get to benefit more from a tax deduction in a later year when they're paying tax at a higher marginal income tax rate.

If your child withdraws those gifted funds from their FHSA to buy or build a qualifying home, the entire amount can be withdrawn tax-free. If instead your child makes a non-qualifying withdrawal (meaning, a withdrawal not for the purpose of buying or building a home), they will have a taxable income inclusion. You wouldn't be taxed on your child's non-qualifying withdrawal.

If your child doesn't end up buying a home within 15 years (which is the longest you can keep an FHSA open), they have the flexibility of transferring the funds accumulated in their FHSA to their RRSP, where they can later make a withdrawal under the Home Buyers' Plan (HBP) — another government initiative to help first-time home buyers own a home. The transfer from your child's FHSA to their RRSP will not reduce their available RRSP room, so they can essentially create more RRSP room through this transfer.

The RRSP (and the HBP)

If your child has unused RRSP contribution room, you can also consider gifting funds to your child for them to contribute to their RRSP, in order to take advantage of the HBP. Under the HBP, it may be possible for your child to withdraw up to $35,000 from their RRSP to buy or build a home without triggering immediate tax consequences.

To participate in the HBP, your child must be a first-time home buyer as defined by the CRA for this plan.

Depending on your child's marginal tax bracket and their available RRSP contribution room, gifting them funds to contribute to their RRSP may afford them a larger annual tax deduction than an FHSA. It would also allow them to withdraw more funds ($35,000) than they could from an FHSA, in the early years of the FHSA program.

Your child can make both an FHSA withdrawal and an HBP withdrawal for the same home purchase. If they maximize withdrawals from both programs, they will be able to access $75,000 in capital plus any growth in the FHSA to use towards the purchase of a home.

The TFSA

If your child is not considered a first-time home buyer and therefore isn't eligible to open an FHSA or participate in the HBP program, you can gift them funds to contribute to their TFSA to help them save for a home.

If your child doesn't end up buying a home within 15 years (which is the longest you can keep an FHSA open), they have the flexibility of transferring the funds accumulated in their FHSA to their RRSP, where they can later make a withdrawal under the Home Buyers' Plan (HBP) — another government initiative to help first-time home buyers own a home.

The TFSA offers tax-free growth and enhanced flexibility. Your child can contribute to a TFSA at any time, as long as they have contribution room. They will have started to accrue contribution room in the year they turn age 18, regardless of whether they file a tax return or have opened a TFSA. Your child can also withdraw from a TFSA at any time, for whatever purpose, and the amount of the withdrawal is added back to their contribution room for the following year.

Using other strategies

In addition to making use of your child's registered accounts, there are other options or strategies you can consider to help your child buy a home. However, it's important you consider the tax, estate planning, and family law implications associated with each option. For example, for family law purposes, if your child is currently married, in a common-law relationship, or may get married or enter a common-law relationship in the future, you would want to consider which option provides suitable protection should your child's relationship break down.

With that said, although matrimonial property regimes differ between provinces and territories, often the best way to protect any asset is through a valid domestic contract such as a prenuptial or postnuptial agreement, or cohabitation agreement in the case of common-law partners. In most provinces, a domestic contract can specifically state that the home will not be included in property division calculations in the event of a relationship breakdown.

You buy the home and remain on title

If you don't feel your child is ready for home ownership or you wish to retain control over the property during your lifetime, you could buy a home for your child and remain on title. Aside from a domestic contract, this option may provide the most protection for family law purposes on relationship breakdown, in the event your child is currently in a relationship or entering one.

The main consideration with this strategy is that when you eventually sell the home, or are deemed to dispose of it, you may be subject to tax if the home has appreciated in value. Any capital gain will be reported on your income tax return for the year and taxed at your marginal tax rate.

Since you own the home and your child would be living in the home, it may be possible to reduce or eliminate the capital gain using your principal residence exemption. However, to designate a property as your principal residence for a tax year, you must not designate any other property as your principal residence for that same tax year. As such, if you already own a home which you would designate as your principal residence, you won't be able to claim the principal residence exemption with respect to this property. Your child would also not be able to claim the principal residence exemption since they would not own the home.

Since you own the home in sole name, on your death, the property will form part of your estate and be distributed as per your Will, or if you have no Will, provincial or territorial intestacy laws. This means probate taxes will likely be payable on the value of the home. To make sure the home passes to your child, you'll want to specifically bequeath it or address it in your Will. It's important to note that if there are insufficient assets in your estate to satisfy other bequests and the payment of taxes and/or debts, the property may need to be sold.

You gift cash to your child who purchases the home

To help your child build equity in their own home, you can gift cash to your child, who would then purchase the home outright. If you gift cash, there would be no tax implications associated with the gift. If you have to liquidate investments to come up with the cash, you may realize capital gains or losses on the sale of those investments. On the eventual sale of the home, your child may be able to claim the principal residence exemption to eliminate some or all of the capital gains that have accrued on the property.

As a cautionary note, since the home would be in your child's name, it could be exposed to any potential creditor claims. It could also be exposed to a potential marital claim on relationship breakdown, if there was no domestic contract.

Since you wouldn't own the home, the property won't be subject to probate fees on your death. In fact, since you gifted assets prior to your death, you would have reduced the value of your estate potentially subject to probate.

You lend funds to your child to purchase the home

You can loan funds to your child, who would then purchase a home with the borrowed funds. To evidence a loan, you can require the execution of a promissory note and/or a loan or mortgage agreement.

To help your child build equity in their own home, you can gift cash to your child, who would then purchase the home outright. If you gift cash, there would be no tax implications associated with the gift. If you have to liquidate investments to come up with the cash, you may realize capital gains or losses on the sale of those investments.

This strategy requires involvement of a qualified legal advisor, as it's often implemented for the purpose of protecting the funds from your child's marital or creditor claims. The characterization of an advance to your child as a loan rather than a gift can have a significant impact with respect to the division of property on relationship breakdown. Some factors that may be considered by a court in determining whether an advance to a child is a gift or a loan include documentation evidencing the loan (particularly documentation executed contemporaneously at the time the funds were transferred); the repayment terms of the loan; security provided for the loan; any repayment by the borrower; and the expectation and likelihood of repayment.

From a tax perspective, consider whether the loan should be interest-free. Any interest your child pays to you would be taxed in your hands. As well, your child wouldn't be able to claim a tax deduction for interest paid since the purpose of the loan is not to earn income. If your child is using this home for personal use, there are no income attribution concerns, as capital gains earned on funds that are loaned interest-free by you can be taxed in your child's hands.

Since the home would be owned by your child, they may use their principal residence exemption on the eventual sale of the property to eliminate the tax on the capital gain.

You should consider what would happen to the loan if you were to pass away while the loan is outstanding. If you were to pass away and no specific instructions are given to the executor/liquidator of your estate with respect to the loan, your child may need to repay the loan to your estate. You may consider forgiving the loan in your Will. Be sure to address the loan to your child in your estate plans.

One last consideration with this option is that the outstanding loan balance would be an asset of your estate on your death and would be subject to probate fees, if you have only one Will and that Will needs to be probated (even if your Will forgives the loan). Speak to a qualified legal advisor about any strategies you could employ in your province or territory of residence, such as the use of a secondary non-probatable Will, to minimize probate fees on this asset on death.

You gift funds to an inter-vivos trust which purchases the home

Another common option available to help your child purchase a home would be to establish an inter-vivos trust. You could gift funds to the trust, have the trust purchase the home, and name your child as a beneficiary of the trust. The trust allows for the separation of legal and beneficial ownership, which enables you to retain legal control over the home that has been set aside for the benefit of your child (the beneficiary).

This option adds complexity to your affairs and will increase costs to you, as you'll need to engage legal and accounting practitioners in order to help establish and maintain the trust. In addition, the trustee will need to ensure the trust meets its tax reporting and filing obligations.

To ensure the trust is properly structured for tax purposes, so that any future capital gains can potentially be taxed in your child's hands, you may not wish to be the sole trustee of this trust. You can either appoint someone else as the sole trustee (such as your spouse) or, if you wish to be a trustee, name two additional trustees.

Since 2017, most types of trusts cannot make use of the principal residence exemption upon the sale or disposition of a property. Only limited types of trusts (i.e. alter ego trust, spousal trust, qualified disability trust) can now make use of a beneficiary's principal residence exemption. As such, if the home is owned by a trust established during your lifetime, then a capital gain realized on the eventual sale may be taxable. The taxation of the gain would depend on how the trust is structured, as well as the terms of the trust.

If the trust is able to roll out the home on a tax-deferred basis to your child (the beneficiary) prior to selling the property, and your child has been living in the property while it's been held by the trust, it's possible for your child to use their principal residence exemption to shelter the gain from tax on the sale or disposition of the property. This is assuming your child hasn't designated any other property as their principal residence for those same tax years. This would also mean your child would receive the sale proceeds outright, which may or may not be what you intend.

If the home remains in the trust upon your passing, there would be no probate fees on the home since it's legally owned by the trust and does not form part of your estate. If you're not the sole trustee, or if you name an alternate trustee in the trust agreement, they could then continue to manage the trust and/or distribute the home in accordance with the terms of the trust after your passing.

In certain jurisdictions, holding a home in a trust may offer some protection from division on relationship breakdown.

To ensure the trust is properly structured for tax purposes, so that any future capital gains can potentially be taxed in your child's hands, you may not wish to be the sole trustee of this trust. You can either appoint someone else as the sole trustee (such as your spouse) or, if you wish to be a trustee, name two additional trustees.

Please consult with a qualified legal advisor in your province or territory about whether a trust offers the level of protection you may need.

Conclusion

There are a number of avenues available to assist your child in purchasing a home. It's always recommended that you speak with a qualified accountant and lawyer to review your options and ensure they're most appropriate for your and your child's situations from a tax, legal and estate planning perspective.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.