Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

Heather Lagasse
Senior Portfolio Manager
& Wealth Advisor
Tel: 604-981-2340
heather.lagasse@rbc.com

Oscar Davidson
Associate
Tel: 778-338-8930
oscar.davidson@rbc.com

Lagasse Wealth Management
of RBC Dominion Securities
1300 Marine Drive, 2nd Floor
West Vancouver, BC V7T 1B5
Tel: 604-981-2340
Toll free: 1 800-375-0585
www.heatherlagasse.com

Tax-free first home savings account

A registered account to help more Canadians enter the housing market

The tax-free first home savings account (FHSA) is a new registered account to help individuals save up to $40,000 on a tax-free basis to purchase their first home. The FHSA is a mix between a registered retirement savings plan (RRSP) and a tax-free savings account (TFSA). Like an RRSP, contributions you make to a FHSA are tax-deductible; like a TFSA, withdrawals you make to purchase a first home (including the investment income earned) will not be taxable. This article provides a summary of key features of the FHSA.

While the FHSA rules will take effect on April 1, 2023, please check with your financial institution to determine when you can open a FHSA with them.

Any reference to a spouse in this article also includes a common-law partner.

Opening the FHSA

To open a FHSA, you must be a resident of Canada, at least 18 years of age and not turning age 72 or older in the year. In addition, you must be a first-time home buyer, which means you and your spouse must not have owned a home in which you lived in as your principal residence at any time during the part of the calendar year before you opened the account or at any time in the preceding four calendar years. For this purpose, home ownership includes beneficial ownership but excludes a right to acquire less than 10% of a qualifying home.

To provide more clarity, you will not be considered a first-time home buyer if you lived in a home owned by your spouse during the relevant period if that person is still your spouse when you plan to open a FHSA. On the flip side, for example, if you lived in a home owned by your spouse during the relevant period but are divorced from your spouse at the time you wish to open a FHSA, you will be considered a first-time home buyer.

Financial institutions will not be required to confirm if you are eligible to

open a FHSA. It is important for you to confirm your eligibility and ensure you meet the necessary criteria to avoid any negative tax implications associated with non-compliance.

Contributions

You will be able to contribute up to a lifetime limit of $40,000 to your FHSA, with an annual contribution limit of $8,000. The full annual limit of $8,000 would be available starting in 2023, no matter when you open the account during the year.

You are able to hold more than one FHSA, but the total amount you can contribute to all of your FHSAs cannot exceed your annual and lifetime contribution limits. To help determine your contribution room, the Canada Revenue Agency (CRA) intends to provide basic information that will state how much you can contribute to your FHSA each year.

You will be able to claim a deduction for contributions you made to a FHSA during a calendar year. However, contributions you make to a FHSA following a qualifying withdrawal (i.e., when buying a first home) will not be deductible. Also, unlike RRSPs, contributions you make within the first 60 days of a given calendar year cannot be claimed in the previous tax year.

A FHSA contribution can be claimed as a deduction against all sources of taxable income. This deduction reduces your amount of taxable income for the year and therefore your taxes payable. The actual tax savings will depend on your marginal tax rate. The following table outlines the out-of-pocket cost of a $1,000 FHSA contribution after claiming the deduction:

Marginal tax rate	Value of tax deduction	Out-of-pocket cost
25%	$250	$750
40%	$400	$600
45%	$450	$550

Carry-forward contributions

You will be allowed to carry forward your unused annual contribution limit up to a maximum of $8,000. This means that if you contribute less than $8,000 in a given year, you can contribute the unused amount in a subsequent year on top of your annual contribution limit of $8,000 (subject to your lifetime contribution limit). For example, if you contribute $5,000 to your FHSA in 2023, you'll be allowed to contribute $11,000 in 2024 (i.e., $8,000 for 2024, plus the remaining $3,000 from 2023).

Carry-forward amounts only start accumulating after you open a FHSA for the first time. As such, if you're a first-time home buyer, you could consider opening a FHSA immediately, even if you don't have the funds to contribute.

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Undeducted contributions

If you make a contribution to your FHSA, you do not have to claim a deduction for that year. Like RRSP deductions, you'll be able to carry forward undeducted contributions indefinitely and deduct them in a later year. For example, if you contribute $5,000 to your FHSA in 2023, you can carry forward some or all of your deduction to 2024 or subsequent tax years. You may want to consider this approach if you want access to tax-free growth immediately, but you expect to be in a higher tax bracket in a future tax year and would benefit more from a deduction in that year.

Income earned

Income as well as capital gains (and capital losses) earned in a FHSA are not included in your annual income (or deductible) for tax purposes. This means income and capital gains can continue to grow and compound in the FHSA on a tax-free basis. Income, capital gains and capital losses will also not be taken into account in determining your eligibility for income-tested benefits or credits delivered through the income tax system such as the Canada child benefit and the goods and services tax (GST) credit.

Withdrawals

There are qualifying withdrawals (non-taxable) as well as non-qualifying withdrawals (taxable). When any withdrawals are made, you will receive an information slip from your financial institution stating the amount of the withdrawal and, for non-qualifying withdrawals, the amount of income tax withheld.

Qualifying withdrawals

In order for a FHSA withdrawal to be a qualifying withdrawal (i.e., non-taxable), the following conditions must be met:

- You must be a first-time home buyer at the time you make a withdrawal. Specifically, you could not have owned a home in which you lived at any time during the calendar year before the withdrawal is made or at any time in the preceding four calendar years. If you make a withdrawal within 30 days of moving into your home, it will still be considered a qualifying withdrawal; and
- You must have a written agreement to buy or build a qualifying home before October 1 of the year following the year of withdrawal and intend to occupy the qualifying home as your principal residence within one year after buying or building it. A qualifying home is a housing unit located in Canada.

If a FHSA withdrawal is qualifying, you may withdraw the entire amount of available FHSA funds on a tax-free basis either as a single withdrawal or a series of withdrawals. No taxes will be withheld on qualifying withdrawals.

Qualifying withdrawals will also not be taken into account in determining your eligibility for income-tested benefits or credits such as the Canada child benefit and the GST credit.

Non-qualifying withdrawals

If you make a withdrawal that's not qualifying, the withdrawal will be included in your income. Taxes will be withheld on non-qualifying withdrawals, in a manner consistent with taxable RRSP withdrawals. Non-qualifying withdrawals will not re-instate either your annual or lifetime contribution limit.

Transfers

You can transfer funds from an FHSA to another FHSA, an RRSP or a registered retirement income fund (RRIF) on a tax-free basis.

If you transfer funds from an FHSA to an RRSP or a RRIF, the transfer will not reduce, or be limited by, your available RRSP contribution room, nor would the transfer reinstate your FHSA annual or lifetime contribution limit. Once transferred, the funds will be subject to the rules applicable to RRSPs and RRIFs, including that the funds will be taxable when you withdraw them from the account.

You're also allowed to transfer funds from your RRSP to your FHSA on a tax-free basis, subject to the FHSA annual and lifetime contribution limits. This transfer would not be deductible (since your original RRSP contribution was previously deductible) and would also not reinstate your RRSP contribution room.

Interaction with the home buyers' plan (HBP)

Under the HBP it is possible to withdraw up to $35,000 from your RRSP to buy or build a home without triggering immediate tax consequences. Generally, you must repay

If you transfer funds from an FHSA to an RRSP or a RRIF, the transfer will not reduce, or be limited by, your available RRSP contribution room, nor would the transfer reinstate your FHSA annual or lifetime contribution limit.

any amounts withdrawn to your RRSP within 15 years, starting the second calendar year following the year in which you made the withdrawal. The funds must be repaid but as there is no interest charged, it is like an interest-free loan to yourself.

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

If you don't have enough funds to contribute to both a FHSA and an RRSP, here are some points to consider:

- With the HBP, you're essentially borrowing money (interest-free) from your own RRSP, as you have to repay the funds to your RRSP within 15 years. With the FHSA, you can make a qualifying withdrawal (tax-free) and you don't have to repay the funds.
- If you don't buy a home within 15 years, you can transfer the funds accumulated in your FHSA to your RRSP, where you can then withdraw under the HBP.
- If you start contributing to an RRSP and then transfer the funds into your FHSA, you will have lost that RRSP room. On the other hand, if you start contributing to a FHSA and then transfer the funds to your RRSP, the transfer will not reduce your RRSP room. Since a transfer of funds from a FHSA to an RRSP will not reduce your available RRSP contribution room, you can effectively create more RRSP room by starting to contribute to your FHSA.

Spousal considerations for the FHSA

Spousal contributions

As the FHSA holder, only you can claim a deduction for contributions made to your own FHSA. You will not be able to contribute to your spouse's FHSA and claim a deduction. You can, however, gift funds to your spouse and have them contribute those funds to their own FHSA. Normally, if you gift funds to your spouse, the attribution rules apply so that all of the income earned and capital gains realized on those funds will be attributed back to you and taxed in your hands. However, there is an exception and the attribution rules will not apply to income earned and capital gains generated within a FHSA that is derived from such contributions.

An example

You and your spouse each contribute $8,000 per year (the annual maximum) to a FHSA starting in 2023. Both of you can deduct the contribution from your taxable income each year. The tax savings on your federal tax return each year will be based on your marginal tax rate. For example, if each of you makes between $50,000 and $100,000 per year, the contributions to your FHSAs allow each of you to receive an annual federal tax refund of $1,640 (i.e., $8,000 x 20.5%). At the end of 2027, when you're ready to buy your first home, your combined FHSAs amount to $90,000, which includes $10,000 of tax-free investment income earned in the plans. You can withdraw the entire amount tax-free for a down-payment on your first home.

Relationship breakdown

If you experience a breakdown of your marriage or common-law partnership, you may transfer funds directly from your FHSA to your former spouse's FHSA, RRSP or RRIF. These transfers would not re-instate any FHSA contribution room for you and would not use any contribution room of your former spouse.

Over-contributions

Over-contributions occur when you contribute more than your FHSA contribution room. You will be subject to a tax of 1% on the highest excess amount in the month, for each month (or part of a month) that you're in an over-contribution position.

The 1% tax will continue to apply for each month the excess amount remains in your FHSA. The tax will stop accruing when:

1. You withdraw the excess amount from your FHSA; or
2. You receive new contribution room to absorb the over-contribution, which occurs on January 1 of the following year.

You will be allowed to deduct an over-contributed amount in the year in which it ceases to be an over-contribution but not earlier. However, if a qualifying withdrawal is made before an over-contribution ceases to be an over-contribution, no deduction would be provided for the over-contributed amount.

An example

Zoey contributes $10,000 on November 15, 2023, and keeps the full amount of the funds in her FHSA. This contribution exceeds Zoey's annual FHSA contribution limit by $2,000. Zoey will be subject to an over-contribution tax of $40 (1% × $2,000 × 2 months) when filing her 2023 tax return. The $2,000 amount would cease to be an over-contribution on January 1, 2024, as a new annual limit of $8,000 would be available.

If you weren't able to use the funds in your FHSA to purchase a qualifying home, you can transfer any savings in the account on a tax-free basis into an RRSP or a RRIF. You may also withdraw these savings, but the withdrawal will be taxable.

Zoey will be allowed to deduct $8,000 from her 2023 net income. Presuming Zoey did not make a qualifying withdrawal between November 15, 2023, and January 1, 2024, she would be allowed to deduct the additional $2,000 from her 2024 taxable income.

Closing the FHSA

You will need to close your FHSA by December 31 of the year you turn age 71. You will also need to close your FHSA by December 31 of the 15th anniversary of first opening the account, if you have not used the funds to purchase a qualifying home. The CRA will issue a reminder to you when your FHSA ceases to have tax-advantaged status.

After the date it loses its FHSA status, the FHSA will become a taxable trust and will have to pay tax on any income earned. You will have to include in income the fair market value (FMV) of the FHSA immediately before it lost its status as a FHSA.

If you weren't able to use the funds in your FHSA to purchase a qualifying home, you can transfer any savings in the account on a tax-free basis into an RRSP or a RRIF. You may also withdraw these savings, but the withdrawal will be taxable.

If you did make a withdrawal to purchase a qualifying home, you can transfer any unwithdrawn savings on a tax-free basis to an RRSP or a RRIF until December 31 of the year following the year of your first qualifying withdrawal.

Treatment upon death

You may be able to designate your spouse as the successor account holder on your FHSA. If named as the successor holder, your surviving spouse would become the new holder of the FHSA immediately upon your death, provided your surviving spouse meets the eligibility criteria to open a FHSA. The FHSA in this case can maintain its tax-exempt status.

Inheriting a FHSA in this way would not impact your surviving spouse's contribution limits. Inherited FHSAs would assume your surviving spouse's closure deadlines. If your surviving spouse is not eligible to open a FHSA, amounts in the FHSA could instead be transferred on a tax-deferred basis to your surviving spouse's RRSP or RRIF, or withdrawn on a taxable basis.

If you name anyone other than your spouse as the beneficiary of your FHSA, the funds will need to be withdrawn following your death and paid to your named beneficiary. Amounts paid to your beneficiary will be included in your beneficiary's income for tax purposes and subject to withholding tax. If you did not name a beneficiary, your estate will have the income inclusion. The income will not be included in your final tax return.

The FHSA will cease to be a FHSA at the end of the year following the year of death.

Non-resident issues

If you move from Canada, you will be allowed to contribute to your existing FHSA after becoming a non-resident, but you will not be able to make a qualifying withdrawal as a non-resident. In order to withdraw funds from an FHSA, you must be a resident of Canada at the time of withdrawal and up to the time a qualifying home is bought or built. If you make a non-qualifying withdrawal as a non-resident, the withdrawal will be subject to withholding tax.

Qualified investments

You will be able to hold a broad range of investments, including mutual funds, publicly traded securities, government and corporate bonds, and GICs in your FHSA. Essentially, any investment that's allowed to be held in an RRSP or a TFSA can be held in your FHSA.

Prohibited investment, non-qualified investment and advantage tax rules

There are prohibited investment, non-qualified investment and advantage tax rules that are applicable to other registered plans, and these rules will also apply to FHSAs. These rules are intended to disallow investments in entities or transactions with parties that you do not deal at arm's length with. Further, these rules prevent investments in certain other assets such as land, shares of private corporations and general partnership units.

Carrying on a business

FHSAs are generally intended to hold passive investments. If the CRA determines that a FHSA is "carrying on a business" of trading securities, the income from that business may be taxable. Whether the FHSA is carrying on a business depends on many different factors, including how frequently the securities are traded, the length of time the securities are owned, the holder's knowledge or experience in the securities markets and whether the securities are considered speculative in nature.

If the CRA determines that a FHSA is carrying on a business of trading in securities, taxes are imposed on the income earned by the FHSA. The FHSA holder and the trustee of the FHSA are jointly and severally liable with the FHSA for any tax payable on income earned from carrying on a business in the FHSA.

If you pledge the assets in the FHSA as collateral for a loan, you will have to include the full value of those assets in your income.

Other features

Interest deductibility

Like RRSPs and TFSAs, interest on money borrowed to invest in an FHSA would not be deductible for tax purposes.

Income splitting

You can gift money to your adult children to contribute to their own FHSA. Income earned on that gift is not subject to attribution, but keep in mind that the gift becomes your child's property.

Collateralization

If you pledge the assets in the FHSA as collateral for a loan, you will have to include the full value of those assets in your income.

Bankruptcy

FHSAs would not be creditor protected under the *Bankruptcy and Insolvency Act*.

Conclusion

Once available, first-time home buyers can consider opening an FHSA and taking advantage of the tax-deductible contributions, plus the tax-free compounding growth on any income earned and capital gains realized within the account. This account may help you save tax-efficiently towards the purchase of a home. And if you don't end up buying or building a qualifying home, you can direct the funds towards your retirement by transferring any unwithdrawn savings on a tax-free basis to an RRSP or a RRIF. Speak with your RBC advisor and a qualified tax advisor to see how the FHSA may help you meet your financial goals.

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