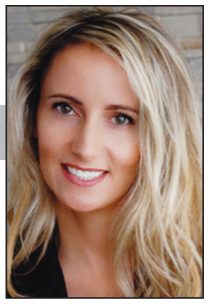
The Newest 'Tax-Free Saving Account' – How young adults (and even their parents) can take advantage

Managing Your Money

LYNN MacNEIL



Many Canadians are anxiously awaiting the availability of the newest 'Tax-Free Saving Account', slated to be available in the coming months. The First-Home Savings Account (FHSA) was first proposed in the 2022 Federal Budget to support those trying to save for their first home. Who should consider this plan? How can parents help their children by using this plan? I'll explain what it is, how it compares to other plans, and how it can best be used.

It's been a difficult time for some first-time homebuyers. With interest rates at their highest point in decades and home prices out of the reach for many, the government is providing a new alternative and incentive for saving for a down payment. And it has some very attractive features!

Over the years, the government has introduced ways to encourage people to save – in general, for retirement, and now, to buy their first home. Up until now, the Tax-free savings account (TFSA) was a good option to save for a home, as well as the RRSP Home Buyers Plan (HBP), which allowed first-time home buyers to withdraw funds from their RRSP tax-free to make a down payment. The catch with the HBP is that the amount needs to be paid back, otherwise it's taxed!

The beauty of the new Tax-Free First Home Savings Account (FHSA) is that not only can you deduct your contributions from your income, thereby reducing your taxes, but the amount in the plan can be withdrawn for a first home purchase with no taxes and doesn't have to be repaid. And, at the end of the plan life, if you haven't purchased a home, you can either withdraw the funds on a taxable basis or transfer the plan to your RRSP or RRIF without affecting your RRSP room. This is like getting "bonus" RRSP room!

Here's an example of how it would work in practice. I received an email last week from one of my most money-savvy millennial clients wanting to set up an FHSA as soon as they are available. She is the third generation in her family working with us and she is a model saver. At 24 years old, she is earning over $60,000 as a Junior Lawyer, paying about $17,000 in taxes. She is saving diligently both for a first home and for retirement. By maximizing both the new FHSA and her RRSP, she will recoup tax savings of about $7,000, which can additionally be saved towards her goal of buying a house. Over the next 5 years, her savings towards a downpayment (not including RRSPs) will grow to over $80,000, with today's interest rates.

Many of our clients want to help their children with a first home purchase and have put aside, or earmarked money for this goal. Now parents can take advantage of the FHSA through their children to shelter these savings from taxes and create additional tax savings (either immediately or in the future) for their child. As an example, I have clients who set up an investment account for their daughter when she was quite young. This account, which is currently in the parents' name, is now worth over $25,000. The purpose of the money is to help their daughter with the purchase of a first home. Soon, their daughter could open an FHSA and this $25,000 could be transferred into the account over a number of years (respecting annual limits). This creates a tax deduction for the daughter, which can be used in the future when she's out of school and her income is higher, and it eliminates annual taxation on the investment income which the parents have been paying. In this particular case, there will be a capital gain each time money is moved but negligible compared to the benefits of the FHSA.

This FHSA opens up new opportunities for tax saving strategies as long as you have never purchased a home, and even if you don't plan to. They also create opportunities to pull money out of RRSPs tax-free without the need to repay the withdrawals as in the case of the HBP, assuming you do buy a home.

So, what's your best bet between the FHSA, TFSA, or RRSP/HBP? Unfortunately, there's no straight answer to this question. It depends on your tax situation, income, cash flow availability, and most importantly, your goals. Financial advisors will soon become more familiar with the rules and strategies that can be used and will be able to provide guidance on how to best take advantage of the plans available to you. In the meantime, just save! …figure out where to put it later.

For a link to the Canada Revenue Agency (CRA) page on First Home Savings Accounts (FHSA), and a more detailed breakdown comparison of the three plans available for new homebuyers, please visit our Facebook page or contact us below.

	FHSA	TFSA	RRSP
TAX BENEFITS			
Can be used for the purchase of a first home without taxes	Yes	Yes	Yes
Can be withdrawn for any reason without taxes	No	Yes	No
When used for a first home, amount must be repaid to avoid being taxed in future	No	No	Yes – over 15 years
Contributions are tax-deductible	Yes	No	Yes
Investment income and gains are non-taxable	Yes	Yes	Yes
PLAN RULES			
Maximum lifetime contribution	$40,000	N/A	N/A
Minimum age requirement	18 years old	18 years old	none (must have earned income and file a tax return)
Maximum age limit	71 yrs old	none	71 yrs old
Maximum annual contribution for 2023	$8,000	$6,500	$30,780 (depends on income)
Non-used contribution room can be carried forward to future years	Yes (up to $8,000)	Yes	Yes
Penalties apply to overcontributions	Yes	Yes	Yes (after $2,000)
Un-deducted contributions can be carried forward to future years	Yes	N/A	Yes
Can hold most types of public investments	Yes	Yes	Yes
How long can the plan stay open	15 years, or age 71	indefinitely	age 71
Contributions can continue after withdrawal for first home purchase	No	Yes	Yes
Can you contribute to a spouse's plan and benefit from tax savings	No	No	Yes

Information source: Canada Revenue Agency

*Note: U.S. citizens should seek specific tax advice before opening a TFSA or FHSA, as they may be subject to tax under U.S. rules.

Lynn MacNeil, F.PL., CIM®, is an Associate Portfolio Manager and Financial Planner with Richardson Wealth Limited in Montreal, with over 27 years of experience working with retirees and pre-retirees. For a second opinion, private financial consultation, or more information on this topic or on any other investment or financial matter, please contact Lynn MacNeil at 514.981.5796 or Lynn.MacNeil@RichardsonWealth.com. Or visit our website at www.EphtimiosMacNeil.com.