PERSONAL **Newsletter**

Q3 2022 Issue 61

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First Home Savings Accounts

Overview

You may be eligible to open a new tax-free First Home Savings Account ("FHSA") with your financial institution beginning on January 1, 2023. The FHSA allows you to make tax-deductible contributions to an account for the purposes of saving for your first home. Of course, there are limits to how much you can contribute. The investment growth accumulates tax-free within the account. Qualifying withdrawals from the account to buy your first home are tax-free too. Overall, the new FHSA is a very tax-efficient way to save for a down payment on your first home.

To establish an FHSA, you must be a "qualifying individual", which means that you are resident in Canada, 18 years of age or older, and a first-time home buyer (see below for a discussion on "first-time home buyer"). The lifetime limit is $40,000 (reduced by amounts transferred from an RRSP to an FHSA).

You may have an FHSA for a "maximum participation period". It begins when you open your first FHSA, and ends at the end of the year following the year in which the earliest of the following events occur:

- the 14th anniversary of the date you first opened your FHSA,
- when you turn 70 years old, and
- you first make a qualifying withdrawal from a FHSA.

For example, if a thirty-year-old individual first opens an FHSA during 2023, their maximum participation period will end at the end of 2038. However, if that individual makes a qualifying withdrawal from their FHSA during 2028, their maximum participation period will end at the end of 2029.

The account ceases to be an FHSA at the end of the maximum participation period.

FHSA Deduction Limit

The FHSA deduction limit is the amount that you may deduct in a taxation year, from contributions to an FHSA, in computing your income until your maximum participation period has ended. You cannot deduct any contributions that occur after a qualifying withdrawal has been made.

You may contribute, or transfer from an RRSP, a combined maximum of $8,000 in a year, up to $40,000 in a lifetime. After accounting for RRSP transfers (if any) you may deduct any contributions to an FHSA made during the year up to the remaining FHSA deduction limit. You may also deduct any previous year's contributions, up to the amount of the maximum annual FHSA deduction limit, to the extent that the contributions exceeded the available maximum FHSA deduction limit in previous years.

No person other than yourself may contribute to the plan.

You can carry forward an amount of unused FHSA deduction limit for FHSA contributions (and transfers from an RRSP). You only begin to accumulate an FHSA carryforward once you have opened your first FHSA. The FHSA carryforward is also limited to $8,000, which is the equivalent of a maximum FHSA deduction limit for a single year.

The FHSA carryforward for a particular year is generally equal to:

- the amount that you could contribute (or transfer from an RRSP) under the FHSA deduction limit in the previous year ($8,000 plus the previous year FHSA carryforward less any transfers to an FHSA from an RRSP)
  less
- actual contributions (or RRSP transfers) to an FHSA during the previous year.

Overcontributions

You should monitor your contributions and limit carefully to ensure that you do not exceed your FHSA contribution room. This is because a penalty tax will apply to any excess FHSA amount. The tax is imposed on a monthly basis and is equal to 1% of the highest excess FHSA amount during each particular month. The tax applies until the excess FHSA amount is eliminated. This tax is generally sufficient to neutralize the tax benefit of overcontributions.

An excess FHSA amount is determined by a formula, which in principle, is simply the total of your actual FHSA contributions and transfers (from an RRSP) at a particular time, less your contribution limits at that time.

In contrast to other registered accounts, your FHSA contribution limits take into account the ability to carry forward a certain amount of unused contributions from previous years. As a result, it is necessary to calculate your allowable contributions by totaling the actual amounts contributed to an FHSA (including RRSP transfers) in each year, up to the annual limit of $8,000 (plus any FHSA carryforward) and the lifetime limit of $40,000.

Your excess FHSA amount is then reduced by the total of all taxable withdrawals and all designated amounts. Designated amounts allow an individual to correct an excess FHSA contribution by essentially reversing a contribution or a transfer from an RRSP.

An amount withdrawn in the year as a designated amount to correct an excess FHSA amount are removed from the FHSA deduction limit, effectively reversing an overcontribution that resulted from a contribution (excluding transfers from RRSPs) to an FHSA. A “designated amount” is an amount, not exceeding your excess FHSA amount at a particular time, that is designated by the individual in prescribed form and manner that is either

- a transfer to an RRSP, which may only be designated to the extent it does not exceed the total amount transferred from an RRSP to an FHSA prior to the particular time, or
- a withdrawal, which may only be designated to the extent that it does not exceed the total amount of direct FHSA contributions you made.

Any income reasonably attributable to deliberate overcontributions will be made subject to the existing advantage rules which tax the income at 100%.

The CRA maintains the discretion to waive or cancel all or part of the tax payable in appropriate circumstances.

Withdrawals

For a withdrawal to be considered a qualifying withdrawal, several criteria must be met:

- You must be resident in Canada and a first-time home buyer.
- The withdrawal must be made via a form that sets out the location of the qualifying home that you intend to occupy as a principal residence within one year of acquisition of the qualifying home. The specific form has not yet been released by the CRA.
- An agreement must be in place (before the withdrawal) to purchase or construct the qualifying home before October 1 of the year following the date of the withdrawal.
- You cannot have acquired the qualifying home more than 30 days before the withdrawal is made.

A “qualifying home” is a housing unit located in Canada. It also includes a share of the capital stock of a cooperative housing corporation, where the holder of the share is entitled to possession of a housing unit located in Canada. You are considered to be a first-time home buyer if at any time in the part of the calendar year before the account is opened or at any time in the preceding four years you did not live in a qualifying home (or what would be a qualifying home if located in Canada) that you owned.

If in the calendar year or any of the four preceding years, you lived in and had an interest in a qualifying home (or what would be a qualifying home if located in Canada), including a beneficial interest, you are not considered to be a first-time home buyer. An exception is provided where you have a right to acquire less than a ten per cent interest in the qualifying home.

Note that you cannot make a qualifying withdrawal for a particular qualifying home from an FHSA if you used the Home Buyers' Plan ("HBP") in respect of the same home purchase. Generally, the FHSA is the more advantageous choice because the HBP requires you to subsequently repay your withdrawal or else face a tax burden while the FHSA does not.

Income, losses, and gains in respect of investments held within an FHSA, as well as amounts withdrawn, will not be included in computing income for tax purposes or considered in determining eligibility for income-tested benefits or credits delivered through the income tax system (for example, the Canada Child Benefit, the Goods and Services Tax Credit, and the Age Credit). Nor will such amounts be considered in determining other benefits that are based on your income level, such as Old Age Security benefits, the Guaranteed Income Supplement, or Employment Insurance benefits.

Withdrawal of amounts that are "designated amounts" are tax-free. A "designated amount" generally means a distribution made under an FHSA in order to reduce an excess FHSA amount. It allows you to correct an overcontribution to an FHSA by returning an amount to an RRSP or reversing a direct contribution through a tax-free withdrawal.

Because the investment income within, and withdrawals from, an FHSA are not taxable, interest on money borrowed to invest in an FHSA is not deductible. Also, an FHSA may not be used as security for a loan. You must include in your income the fair market value of any property of the FHSA that is pledged as security for a loan.

If you contribute to your FHSA using funds gifted by a spouse or common-law partner, then for future income inclusion purposes (i.e., when amounts are withdrawn from the FHSA), no portion of such contribution would be attributed back to your spouse or partner who made the gift. However, the ability for amounts to be transferred on a tax-free basis from your RRSP to your FHSA is limited if spousal contributions have been made to the RRSP in the current year or two preceding years.

Transfers to/from an RRSP

You may contribute, or transfer from an RRSP, a combined maximum of $8,000 in a year. However, for deduction purposes, amounts transferred from an RRSP to an FHSA are not deductible as FHSA contributions (this is because amounts contributed to an RRSP would generally already have been deductible in accordance with RRSP rules). Accordingly, for the purpose of calculating your FHSA deduction limit, the $8,000 maximum amount is first reduced by transfers from RRSPs made during the year (or RRSP transfers from previous years to the extent that the transfers exceeded the available maximum FHSA deduction limit in previous years).

Non-Residents

You must be resident in Canada to open or hold an FHSA. Therefore, if you become non-resident, the arrangement will cease to be an FHSA and you must include the fair market value of all property in the FHSA in your income. Payments made to non-residents are subject to the non-resident withholding tax of 25%.

Qualified Investments

You can invest the funds contributed to your FHSA in a variety of qualified investments. These will generally include, among many others, the following:

- cash
- mutual funds
- securities listed on a designated stock exchange
- guaranteed investment certificates
- bonds
- certain shares of small business corporations.

However, if your FHSA holds a property that is not a qualified investment, there is a 1% monthly tax added.