New Tax-Advantaged Account for First-Time Homebuyers

It's no secret the housing market in Canada has been overheating for years. As real estate prices continue to soar, many prospective first-time homebuyers are feeling squeezed out of the market.

While there are no instant fixes for the challenges created by insufficient affordable housing, the Canadian government introduced a measure in its 2022 Federal Budget that aims to help first-timers save money to purchase a home. The government is working with financial institutions on finalizing details of the tax-free first home savings account (FHSA), with expectations for a 2023 rollout.

What is the FHSA?

The FHSA is a registered account targeted at Canadians 18 years or older who have never owned a home or haven't owned one in the past four calendar years. While the account is a bit of a misnomer since you technically don't need to be a first-time homebuyer, nonetheless the FHSA allows eligible Canadians to contribute up to a lifetime limit of $40,000. The annual contribution limit is $8,000 and unused room cannot be carried forward to a future year (as it can with a TFSA or RRSP).

The FHSA provides two notable tax benefits:

1. Contributions are tax deductible, so your taxable income for the year in which you contribute will decrease by the amount contributed to your FHSA.

2. Any withdrawals (including investment-related gains) from the FHSA are tax free, provided that you withdraw the money to help purchase a home.

Like most other registered accounts, you may hold a wide range of investments in your FHSA, from stocks and bonds to mutual funds, ETFs and more. Keep in mind, however, that your FHSA may only remain open for up to 15 years. If you invest in risky securities prone to dramatic price movements, you might not have enough time to recover from significant losses – especially if the securities decline sharply closer to the 15-year mark. The best course is to consult with your advisor for guidance on the securities that best suit your specific timeline and capacity for risk.

If you don't use your FHSA to buy a home within 15 years, you must close the account. You can move the assets to an RRSP or RRIF tax-free or simply withdraw the funds, but in the latter case the amount will be fully taxable as income.

FHSA or HBP: What's better?

The FHSA is not the only option the government has provided for first time home buyers. The Home Buyers' Plan (HBP) allows you to withdraw up to $35,000 from your RRSP on a tax-free basis to purchase your first home. You're given 15 years to repay that amount to your RRSP, based on a prescribed schedule that includes a minimum annual repayment (you're permitted to repay a larger amount in a given year, or to repay the entire amount any time before the 15-year period ends). If you don't repay the full amount within 15 years, the outstanding balance is considered taxable income.

Each plan has benefits and drawbacks, and be aware that you cannot use both the FHSA and HBP. Which plan to choose depends on your personal circumstances – your advisor can help you decide. Many people start contributing to an RRSP before they're ready to buy a home, so the HBP lets you tap into money that you've already saved up.

It's not feasible to open an FHSA if you don't have much cash available. However, if you can contribute a meaningful amount, the FHSA might serve you better than the HBP since you have no obligation to repay any account withdrawals. The FHSA is also useful if you've maxed out annual contributions to other registered accounts and want another tax-efficient way to save for a home.

The new FHSA doesn't address the weighty issue of exorbitant real estate prices, but it does provide prospective homebuyers with an additional means of saving to purchase their first home.

To learn more about how Investia advisors can help you achieve your investment objectives, please contact us today.