# WHAT IS THE NEW TAX-FREE FIRST HOME SAVINGS ACCOUNT AND HOW MAY I BENEFIT FROM IT?

With the soaring prices of real estate and amid the rapid decrease in home affordability, the Canadian government has decided to create a new savings mechanism, designed with first-time homebuyers in mind. Although the details have not been finalized yet, the expectation is that the new tax-free First Home Savings Account (FHSA) will be implemented in 2023. Canadians may then be able to save for a home purchase in a new and fiscally advantageous way. This article will provide you with basic knowledge of the FHSA and demonstrate how you could save for your upcoming home purchase.

## FHSA at First Glance

| Description | Tax-free First Home Savings Account (FHSA) |
|---|---|
| Lifetime Limit | $40,000 (account can remain open for 15 years) |
| Annual Contribution Limit | $8,000/year (contributions are tax-deductible) |
| Minimum Requirements | • Must be a Canadian resident;<br>• Must be 18 years old or more;<br>• Must not have owned a home for a minimum of four years prior to opening the account. |
| Withdrawals | • Tax-free (including the growth portion) when used to purchase a home;<br>• Taxable when withdrawn for other purposes;<br>• Can be transferred to an RRSP if not used without affecting contribution room. |

## A detailed overview

The tax-free First Home Savings Account will be, at its core, a cross between a Tax-Free Savings Account (TFSA), which provides for the tax-free growth of your investments, and a Registered Retirement Savings Plan (RRSP), which allows for tax-deductible contributions. The account will have a lifetime contribution limit of $40,000 and an annual contribution limit of $8,000. This means accountholders could contribute a maximum of $8,000 per year over a span of five years or $4,000 a year over a span of 10 years for example. This allows for flexibility in their cash flow, while having their funds grow tax free and reducing their taxable income in doing so. Be advised, however, that the account must be closed within 15 years of its opening (whether you purchased a home or not).

As with other investment vehicles, the FHSA will allow the accountholder to decide which type of investments are held and for how long. Because the funds inside the FHSA will not be guaranteed when invested in stocks, mutual funds, ETFs or similar products, it would be reasonable to prefer investing in fixed income and cash assets over equity assets should the home purchase be a short-term goal (i.e., within five years). If, however, the goal appears to be more long term, an individual may decide to prioritize equity assets and divest or reduce the portfolio risk over time, as the purchase nears.

The table below demonstrates the year-end value of maximum contributions made at the beginning of the year over a five-year period.

| | | YEAR-END VALUE BASED ON THE RATE OF RETURN | | |
|---|---|---|---|---|
| YEAR | CONTRIBUTION | 1% | 3% | 5% |
| 2023 | $8,000 | $8,080 | $8,240 | $8,400 |
| 2024 | $8,000 | $16,241 | $16,727 | $17,220 |
| 2025 | $8,000 | $24,483 | $25,469 | $26,481 |
| 2026 | $8,000 | $32,808 | $34,473 | $36,205 |
| 2027 | $8,000 | $41,216 | $43,747 | $46,415 |

| | | | | |
|---|---|---|---|---|
| 2028 | | $41,628 | $45,060 | $48,736 |
| 2029 | | $42,045 | $46,411 | $51,173 |
| 2030 | | $42,465 | $47,804 | $53,732 |
| 2031 | | $42,890 | $49,238 | $56,418 |
| 2032 | | $43,319 | $50,715 | $59,239 |
| 2033 | | $43,752 | $52,237 | $62,201 |
| 2034 | | $44,189 | $53,804 | $65,311 |
| 2035 | | $44,631 | $55,418 | $68,577 |
| 2036 | | $45,077 | $57,080 | $72,005 |
| 2037 | | $45,528 | $58,793 | $75,606 |
| **TAX-FREE GROWTH** | | **$5,528** | **$18,793** | **$35,606** |

The FHSA's purpose will be to help first-time homebuyers accumulate a greater down payment; however, those who have not owned a home within the previous four years may open an account as well. Additional requirements include being a Canadian resident and at least 18 years of age. For example, a 25-year-old who is currently renting or living with their parents could open an account with the hopes of purchasing a home in the future. However, a similar 25-year-old who already owns a home cannot open an FHSA with the hopes of using the funds to purchase a second residence or help their children buy their first home.

## How to optimize savings when cash flow is limited

It is generally recommended that Canadians maximize savings into registered accounts (TFSA's and RRSP's) before investing in non-registered or cash accounts. The investment income earned in those accounts is not taxed, which would result in a greater amount of savings in the long term. This would also be applicable to the new FHSA when it becomes available. Unfortunately, with a limited cash flow, especially at a younger age, most individuals will not be able to maximize all those accounts at once. With this in mind, how should they prioritize their savings?

An effective strategy that can allow those with limited dollars to save with the main goal of purchasing a home will be to prioritize contributions into an FHSA account. These contributions will decrease their taxable income, which in many cases will result in receiving a tax refund. Individuals could subsequently invest the tax refund into their TFSA. This would result in the multiplication of tax-free sources of a potential down payment. RRSP contributions could then be made in later years when a person is more advanced in their profession, earning a higher income and with saving for retirement as their new main financial goal. Furthermore, if the accountholder decides not to purchase a home, they could transfer the accumulated funds in their FHSA into their RRSP without affecting their overall contribution room.

The table below demonstrates the year-end value of $4,000 contributions made at the beginning of the year over a 10-year period.

| | | YEAR-END VALUE BASED ON THE RATE OF RETURN | | |
|---|---|---|---|---|
| **YEAR** | **CONTRIBUTION** | **1%** | **3%** | **5%** |
| 2023 | $4,000 | $4,040 | $4,120 | $4,200 |
| 2024 | $4,000 | $8,120 | $8,364 | $8,610 |
| 2025 | $4,000 | $12,242 | $12,735 | $13,241 |
| 2026 | $4,000 | $16,404 | $17,237 | $18,103 |
| 2027 | $4,000 | $20,608 | $21,874 | $23,208 |
| 2028 | $4,000 | $24,854 | $26,650 | $28,568 |
| 2029 | $4,000 | $29,143 | $31,569 | $34,196 |
| 2030 | $4,000 | $33,474 | $36,636 | $40,106 |
| 2031 | $4,000 | $37,849 | $41,856 | $46,312 |
| 2032 | $4,000 | $42,267 | $47,231 | $52,827 |
| 2033 | | $42,690 | $48,648 | $55,469 |
| 2034 | | $43,117 | $50,108 | $58,242 |
| 2035 | | $43,548 | $51,611 | $61,154 |
| 2036 | | $43,984 | $53,159 | $64,212 |
| 2037 | | $44,423 | $54,754 | $67,422 |
| **TAX-FREE GROWTH** | | **$4,423** | **$14,754** | **$27,422** |

## FHSA vs. HBP

The tax-free First Home Savings Account (FHSA) appears to be a more effective tool when compared to the Home Buyers' Plan (HBP) within an individual's RRSP, as it would allow for a higher amount to be withdrawn tax free with no repayment requirements. The table below compares both strategies.

| Description | FHSA | HBP |
|---|---|---|
| Annual Contribution Limit | $8,000/year | 18% of earned income (RRSP) |
| Maximum Withdrawal | $40,000 plus accumulated growth | $35,000 |
| Tax-free Status | Yes, if used for home purchase | Yes, if yearly repayments are made |
| Repayment | None | 6.67% (or 1/15) of the amount withdrawn on an annual basis, over 15 years |

***Contact your Raymond James advisor if you wish to learn more about the new tax-free First Home Savings Account.***

RAYMOND JAMES®