Canada's Income Tax Act has provided several tax deductions in the past. The most significant and beneficial to date has been the well-known Registered Retirement Savings Plan (RRSP) which was introduced in 1957. With contribution limits calculated based on earned income and carried forward to age 71 the RRSP provides a tax deduction upon deposit as well as tax sheltered income inside the plan. All withdrawals from an RRSP are 100% taxable with the exception of the Home Buyer and Lifelong Learning plans. In the case of the Home Buyer Plan (HBP) a maximum of $35,000 can be withdrawn from the RRSP tax free by a Canadian resident to purchase a qualifying home as a first-time home buyer. The HBP is to be repaid back to the RRSP within 15 years. Any annual payment that is not deposited back to the RRSP is considered taxable income. In the case of the Lifelong Learning Plan (LLP) a maximum of $10,000 can be withdrawn from the RRSP tax free by a Canadian resident who is enrolled in a full time qualifying educational program. The LLP is to be repaid back to the RRSP within 10 years. Any annual payment that is not deposited back to the RRSP is considered taxable income. For planning purpose's, the best fit for an RRSP contribution is to deposit when your marginal tax rate is higher and is expected to be lower when the RRSP is withdrawn.

In 2009 the Tax Free Savings Account (TFSA) was introduced. Every Canadian resident age 18 or older is eligible to deposit based on a set annual limit which accumulates. In 2022 the annual limit is $6,000 and the accumulated limit since 2009 is $81,500. Although there is no tax deduction for deposits, all funds inside of a TFSA are tax sheltered and are withdrawn tax free. For planning purpose's it is most ideal to deposit when your marginal tax rate is lower and is expected to be higher when the TFSA is withdrawn. This is the exact opposite as the RRSP.

And now coming in 2023 the Income Tax Act will have a new addition called the Tax-Free First Home Savings Account (FHSA) which will allow first-time home buyers to save for a down payment on a tax-free basis. Like an RRSP, contributions would be tax deductible, and withdrawals to purchase a first home would be non-taxable, like a TFSA. There is an annual contribution limit of $8,000 and a lifetime contribution limit of $40,000.

The draft legislation was released Tuesday August 9, 2022.

Here are the key details about the proposed FHSA:

Timing:

Finance said it expects people will be able to open and contribute to an FHSA "at some point in 2023," but did not specify a date. Regardless, accountholders would be allowed to contribute the full $8,000 annual limit in that year. Any financial institution (including Canadian trust companies, life insurance companies, banks and credit unions) able to issue RRSPs and TFSAs would be able to issue FHSAs.

Eligibility:

An individual who is resident in Canada, at least 18 and is a first-time home buyer can open an FHSA. A first-time home buyer is defined as someone who has not owned a home in which they lived at any time during the part of the calendar year before the account is opened or at any time in the preceding four calendar years.

Home ownership is defined broadly and includes beneficial ownership, but excludes a right to acquire less than 10% of a qualifying home.

Closing an FHSA:

An FHSA can only be open for 15 years, and an accountholder must be younger than 71.

Per the legislation, an individual's account would cease to be an FHSA, and the individual would not be permitted to open an FHSA, after Dec. 31 of the year in which the earlier of these events occurs:

- the fifteenth anniversary of the individual first opening an FHSA; or
- the individual turns 71.

Any savings not used to purchase a qualifying home could be transferred, tax-free, into an RRSP or RRIF. Otherwise, the savings would have to be withdrawn on a taxable basis.

Qualified investments:

An FHSA would be permitted to hold the same investments that are allowed to be held in a TFSA, which include mutual funds, publicly traded securities, government and corporate bonds, and GICs.

The prohibited investment rules and non-qualified investment rules applicable to other registered plans would also apply to FHSAs.

Contributions:

Annual contributions must be the lesser of an accountholder's annual limit ($8,000) and their remaining lifetime limit ($40,000). Individuals could claim an income tax deduction for contributions made in a taxation year. Contributions made within the first 60 days of a calendar year could not be attributed to the previous tax year, as they can be with RRSPs.

Carry forward:

An individual would be allowed to carry forward unused portions of their annual contribution limit, up to $8,000 and subject to their lifetime contribution limit.

Therefore, an individual contributing $5,000 to an FHSA in 2023 would be allowed to contribute $11,000 in 2024. Carry-forward amounts would only begin accumulating after the FHSA is open.

As with TFSAs, an individual may hold more than one FHSA, but the total amount an individual contributes to all of their FHSAs cannot exceed their annual and lifetime contribution limits. Taxpayers would generally be responsible for ensuring they do not exceed their limits.

Contributions made to an FHSA following a qualifying withdrawal to buy a first home would not be deductible from net income.

Un-deducted contributions:

Like with the rules governing RRSPs, an individual could claim a deduction for the tax year in which a contribution is made or carry it forward indefinitely.

Qualifying withdrawals:

Certain conditions must be met for an FHSA withdrawal to be non-taxable (a.k.a. a qualifying withdrawal).

The taxpayer must meet the definition of a first-time home buyer. Individuals may make qualifying withdrawals within 30 days of moving into the home.

The taxpayer must also have a written agreement to buy or build a qualifying home before Oct. 1 of the year following the year of withdrawal and intend to occupy the qualifying home as their principal place of residence within one year after buying or building it.

The qualifying home must be located in Canada.

Individuals that make a qualifying withdrawal could transfer any un-withdrawn savings on a tax-free basis to an RRSP or RRIF until Dec. 31 of the year following the year of their first qualifying withdrawal.

Non-qualifying withdrawals:

Withdrawals that do not qualify would be included in the individual's income. Financial institutions would be required to collect withholding tax, just like with taxable RRSP withdrawals. Non-qualifying withdrawals would not reinstate either the annual contribution limit or the lifetime contribution limit.

Transfers:

An individual could transfer funds from an FHSA to an RRSP, RRIF or another FHSA on a tax-free basis.

Funds transferred to an RRSP or RRIF are then subject to those accounts' rules. These transfers would not reduce, or be limited by, an individual's available RRSP contribution room, and would not reinstate an individual's FHSA lifetime contribution limit.

Individuals would also be allowed to transfer funds from an RRSP to an FHSA on a tax-free basis, subject to the FHSA annual and lifetime contribution limits and the qualified investment rules. Although such transfers would be subject to FHSA contribution limits, they would not be deductible and would also not reinstate an individual's RRSP contribution room.

Tax benefits and credits:

Income, losses and gains in respect of investments held within an FHSA, as well as qualifying withdrawals, would not be included (or deducted) from income for tax purposes or taken into account in determining eligibility for income-tested benefits or credits.

An individual would not be permitted to make both an FHSA withdrawal and Home Buyers' Plan withdrawal for the same qualifying home purchase.

Spousal issues:

The FHSA holder would be the only taxpayer permitted to claim deductions for contributions made to their FHSA. Individuals would not be able to contribute to their spouse's FHSA and claim a deduction.

However, an individual could contribute funds provided to them by their spouse without triggering the attribution rules.

On the breakdown of a marriage or a common-law partnership, an amount may be transferred directly from the FHSA of one spouse to the other's FHSA, RRSP or RRIF. Such transfers would not reinstate any contribution room of the transferor, and would not be counted against any contribution room of the transferee.

Overcontributions:

Like TFSAs, overcontributions are subject to a monthly 1% tax. When a taxpayer's annual contribution limit resets at the beginning of each calendar year, overcontributions from a previous year may cease to be an overcontribution.

A taxpayer would be allowed to deduct an overcontributed amount in the tax year in which it ceases to be an overcontribution, but not earlier. However, if a qualifying withdrawal is made before an overcontribution ceases to be an overcontribution, no deduction would be provided for the overcontributed amount.

FHSAs at death:

Like with TFSAs, individuals would be permitted to designate their spouse or common-law partner as the successor accountholder, in which case the account maintains its tax-exempt status.

The surviving spouse must meet the eligibility criteria to open an FHSA. Inheriting an FHSA in this way would not impact the surviving spouse's contribution limits. Inherited FHSAs would assume the surviving spouse's closure deadlines.

If the surviving spouse is ineligible, amounts in the FHSA could instead be transferred to their RRSP or RRIF, or withdrawn on a taxable basis.

If the beneficiary of an FHSA is not the deceased accountholder's spouse or common-law partner, the funds would need to be withdrawn and paid to the beneficiary. Amounts paid to the beneficiary would be included in the income of the beneficiary for tax purposes. When such payments are made, the payment to the beneficiary would be subject to withholding tax.

Non-residents:

Taxpayers would be allowed to contribute to their existing FHSA after emigrating from Canada, but they would not be able to make a qualifying withdrawal as a non-resident. Specifically, a taxpayer withdrawing funds from an FHSA must be a resident of Canada at the time of withdrawal and up to the time a qualifying home is bought or built.

Withdrawals by non-residents would be subject to withholding tax.

Borrowing to invest:

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

Amanda and I are both qualified CERTIFIED FINANCIAL PLANNER® professionals at your service to assist in all areas of comprehensive financial planning including financial goal discovery, cash flow/budget analysis, retirement income planning, tax savings, estate planning, insurance needs analysis, investment planning, education saving planning, special purpose or major purchase planning.

I wish to thank you for your continued confidence and for the opportunity to serve you in all aspects of Financial Planning. As always, I will continue to keep in touch with you but if you have any questions or concerns, that you would like to discuss or review, please do not hesitate to contact either Amanda or I by email or by calling us at 519-894-2661 or toll-free at 1-800-716-5538.

Have a great day!

Respectfully Yours,

Gary

investia.ca

Gary H. Attack, BBA, CFP®, RFP, RRC®

CERTIFIED FINANCIAL PLANNER®

Investia Financial Services Inc.

203-1601 River Rd. E, Kitchener, ON N2A 3Y4

T: 519-894-2661

TF: 1-800-716-5538

Fax: 519-894-6656

gary@ghafinancial.com

www.ghafinancial.com

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