Tax-Free First Home Savings Account (FHSA)

Announcer: Welcome to the Empowered Investor Podcast. Have you ever felt overwhelmed by the sheer volume of choices and voices telling you how to plan or invest for your future? With a straightforward approach, host Keith Matthews of Tulett, Matthews & Associates cuts through the noise to help you create a winning action plan for you and your family. The decision-making framework discussed in this show can transform you and your investment experiences and will increase your odds of becoming financially secure. Learn more and subscribe today at TMA-invest.com.

Keith: Welcome to the Empowered Investor. My name is Keith Matthews and I'm joined by my co-host Marcelo Taboada. Marcelo, how are you today?

Marcelo: I'm doing great, Keith. What a great episode you had last week. I listened to it and we did the intro together, so it got me thinking. The fact that we have so much land in this country and we have a home affordability problem is mind-boggling to me. But I guess that's what we're talking about today, right? So the subject we're covering today is the new account that the government created. What's the name? Can you even say it? It's a mouthful, right?

Keith: The account name that we're going to be discussing today is the First Home Savings Account or Tax-Free. Is it actually the Tax-Free First Home Savings Account?

Marcelo: The official name is FHSA, so First Home Savings Account. It doesn't even have "tax-free" in the name, but it is tax-free, which is quite confusing.

Keith: Perfect. So we're going to review why the government put this account in place, discuss exactly how it works, the mechanics behind it, who benefits from this account, and in the end, maybe discuss some ideas as to what kind of effect this is going to have. Then we'll share with our audience some of the surveys around how people feel about it. This is now going to add to a long list of various investment and saving accounts that Canadians have access to. Let's go over the list and this is the last one being added. We've always had the RRSP, we have the RESP for education, the RDSP for disability savings plan, the Tax-Free Saving Account, the Home Buyer's Plan which was linked to RRSPs, and now finally, in this most recent budget and ready to be launched for 2023, we have the First Home Savings Account.

Marcelo: Yes.

Keith: Okay, so what was the government trying to address in bringing this plan to Canadians?

Marcelo: As I was saying in the intro, we have a huge problem in Canada. It's becoming unaffordable for a lot of people to own a first home or to own a home. It's a big political subject now; it's not only a financial subject. It was at the center of the last campaign and the last budget as well. The government came up with this new account that allows people to save, they think effectively, for when they're buying a new home. They want to address home affordability pretty much. They think that with this account, it will give people a better chance of affording a home. That's the intention behind it.

Keith: The attempt is to make sure, or to allow individuals to save more effectively for a down payment on a home. That's the big issue, trying to break in. Last week with Steve LaFleur, we spoke about the supply side. He, along with a lot of other policy analysts, are proposing that the real issue is increasing supply in Canada. By increasing supply, we'll have better selection, better choice for Canadians, and better prices. What this plan attempts to do is supercharge a young person's ability to save for the down payment. Okay, so let's go over some of the mechanics of the plan.

Marcelo: The mechanics are you must be between the ages of 18 and 40. You can only open an account as of 2023 to use this account. You must not have owned a home for the last four years. So that's important because if you own a home and you're thinking you can use this for a rental unit or a second home, you're wrong. You cannot use this account for that.

Keith: So Marcelo, if you owned a home 10 years ago and you don't own it anymore, can you still use this plan to buy a home as a down payment?

Marcelo: The contribution room—you have 15 years to use this account. So the moment you open it, Keith, you have 15 years to use the money. The total contribution room is $40,000. Now this is where it gets interesting. The maximum you can contribute is $8,000 a year. If you do not use the $8,000 that year—let's say you open it in 2023 and you do not use the $8,000—the contribution room that you leave on the table does not carry over to the next year. So the next year you will only have $8,000 again.

Keith: So each annual contribution is use it or lose it, but you still get to keep your $40,000 total limit.

Marcelo: Correct. In an ideal world, if you have $8,000 a year, you'll max out this account in five years, but you have 15 years to reach the $40,000 limit. I hope we're not confusing here.

Keith: What about deductions? Does this generate a deduction like an RRSP, or is it like a Tax-Free Saving Account?

Marcelo: Correct. If the RRSP met with the TFSA in a bar and they had a baby, this would be the account. This would be the byproduct of that. It's like a mix of both. You have the tax deduction in the year, and when you use it to buy your first home, it is not taxed. It's very important that people know that because let's say your kids put their money in that account and they say, "Look, I'm not going to buy a house, but I may use the money to buy a car." The money will be taxed. You get the deduction, but when you take it out, to avoid being taxed, you need to use it to buy a home. That's the qualifying statement there.

Keith: I like your analogy, Marcelo, about the RRSP and the Tax-Free Saving Account meeting in a bar.

Marcelo: I do not condone one-night stands, by the way, but that's good.

Keith: So what you're saying is, of course, you get your full deduction like an RRSP, and then when you buy your home, you get to use all of the capital. Really what you're doing is getting the marginal tax benefit on all of your contributions throughout those accumulation years. That's what you're saving. That's what's adding to your down payment. That's what's making it bigger.

Marcelo: Correct. Now to sum up, you have, like I said at the beginning, 15 years. This is important, Keith. Let's say one person puts $8,000 every year for five years. You have $40,000 there accumulating, not paying taxes. It's a tax-deferred account, so any interest, capital gains, dividends that are generated in the account do not pay taxes. Now let's say year 15 hits and you haven't bought a home, you're still renting, and you do not have the intention of buying a home. You must transfer this amount to your RRSP. This will be an in-kind transfer. It does not generate a new deduction, it does not generate new RRSP room, but it must be transferred.

Keith: It doesn't generate new RRSP room, but it is added to your RRSP. In theory, and this to me I think is one of the things that the government's going to have to relook at, because for somebody who is going to be a renter and not have the intention to buy a home, they can be funding two accounts here, and that's not what the intention was. So they have to figure some of that stuff out still.

Marcelo: Yeah, so the big caveat here, and it's a big disclaimer too, is that this is an account the government is still looking at. As of April 27th, I read a good article in the Globe and Mail pretty much going over all the details, and there was a big disclaimer at the end that the government is still looking at a lot of the intricacies and nuances of this account. One of the ones we were talking about off mic is if you—maybe we want to get into that, but let's say you have a contribution one year, but maybe your income is not that high. Can you defer that deduction for another year when you're making a higher salary? I think that's not clear yet. And that's one of the things that's huge because let's go through your example. I think that's a good one for people to listen to because it has huge implications if they do figure it out right.

Keith: Yeah, what we're talking about is you can see at some point parents gifting money to their kids to make those contributions. You want that compounding to occur early. So the idea would be parents gifting in their kids' early 20s. They may be university students at that point, maybe not working full-time, maybe have very low incomes, and may not be able to benefit from the deduction. Can this individual defer the deduction until they're 25, 26, 27 when their incomes are significantly higher? That would be a way of—I don't want to use the word gaming the system—taking advantage of a program. It still seems that's not clear, and that's something that's got to be sorted out.

Marcelo: Yeah, so that's another point they're going to have to clarify.

Keith: So can two people save for a down payment on a home?

Marcelo: Yeah, I was just going to get into it. The last two points I wanted to make are if I have a spouse and we both have no homes, we both can take advantage of this account. So you can potentially combine $80,000 between these two accounts. And the last thing is that if you want to use the Home Buyer's Plan combined with this account, you cannot do that. So you must choose between one or the other. That's important because if somebody were to be in a situation where they have this account and they have a First Home Savings Account and they have accumulated also in their RRSPs, and they say, "I have $40,000 here and $30,000 in my RRSP, I'm going to combine both and put $70,000 down," you cannot do that. You can only use one.

Keith: Yeah, and I suspect the way that's going to evolve is that, for example, next year if a young person wants to buy a home, they will still have more money potentially in their RRSP and they could tap into the Home Buyer's Plan. But as the years progress, the First Home Savings Account, as the account sizes start to grow, will clearly be the beneficial direction that individuals will take. Marcelo, just to reiterate a really important point: if money goes into this First Home Savings Account, it cannot be used to purchase anything other than a home. Your first home actually. Is it your first home or your second home?

Marcelo: It could be your second home if you haven't owned a home in the last five years.

Keith: Correct. So you can't put money in here to purchase a car, to help with your university tuition, to invest in a business.

Marcelo: Sorry, correction. It's four years, not five. Very important. So we said at the beginning that if you owned a home in the last four years, you cannot open this account. I just said five, it's four. So I want to make that correction for the listeners.

Keith: Okay, so do we want to spend a few minutes going over the difference between the First Home Savings Account and the Home Buyer's Plan?

Marcelo: Yes, we absolutely do. Because it's important. I think the main difference is the fact that you can't use both. Now the biggest difference is that the money you take from the First Home Savings Account does not have to be paid back, versus the Home Buyer's Plan where you do have to pay it back. So if you take the maximum of $35,000, the CRA rules are that you have to pay that money back into the RRSP over the next 15 years. Now, if, for example, you have a bad situation in your life and in year two you do not have the money to put into the RRSP to pay back the Home Buyer's Plan, that amount gets added to your taxable income that year. So that's, in my opinion, a huge advantage of this new First Home Savings Account versus the Home Buyer's Plan. It has more flexibility and you do not have to pay it back.

Keith: Very cool. And the limits are $35,000 for the Home Buyer's Plan and $40,000 for the First Home Savings Account.

Marcelo: Correct.

Keith: Okay. So let's switch gears here a little bit and spend a bit of time on how we see you're a young person, Marcelo. You're in your mid-thirties. I know lots of individuals in their early to mid-twenties. How do we see this being used? Who's going to benefit from this account, and practically speaking, how do we think it's going to evolve?

Marcelo: If you're a young person with a very good salary, to me it's clear that if your objective in the next five years is to own a home, your vehicle of savings should be the FHSA. So if you have, let's say, dollar for dollar the money and you want to own a home, that's where the money should go. Now obviously, if you have extra savings and you can start planning for retirement and it makes sense for you to put it in an RRSP, I think that would be my secondary option. But I do see this by and large benefiting young Canadians who are high-income earners because if you want to max out the $8,000 a year, that's about $600 and some change that you have to save every month. So not everybody can benefit from that.

Keith: Yeah, it is deductible too though. So you do get a tax break.

Marcelo: Correct.

Keith: Yeah, so I 100% agree with you. I think this account, like many accounts, really favors the higher-income young person. I think we as advisors are always going to be asked by individuals which one should I contribute to: my RRSP, my Tax-Free Saving Account, or now this First Home Savings Account. I think that's going to be a common discussion in the next few years as to what to do. My preference would be to tell all young people I like the idea of starting RRSPs even though sometimes you might make the argument that maybe the Tax-Free Saving Account might be a bit more beneficial. But I like the fact that you've got to get people starting thinking about their retirement. Just getting over that hurdle is a huge one. I think the next one is at the same or maybe equal level as this new First Home Savings Account. I think both these accounts, the RRSP and the First Home Savings Account, for those that have reasonable incomes, are the way to go and the Tax-Free Saving Account will sit out on the side for a little bit.

Marcelo: Yeah. I think in an ideal world, if you can be saving 10% of your net income for your retirement into RRSPs and you have the extra money to maximize the First Home Savings Account, that's the winning scenario for me.

Keith: You're not going to like my answer, Marcelo, because I'll tell you I think the numbers should be higher. I know we talk about this offline and you tell me all the young people nowadays they want to spend a bit more money, and I'd say yeah, but you got to pay yourself first. So my old school thought would be if possible, at the highest levels that you can imagine because this is where all the benefit comes. The more you can put away in your twenties, the bigger your accounts are in your forties.

Marcelo: No, I agree with you, but it's the elephant in the room right now, right? I think we're hitting a bad period where incomes have gone up compared to 20-25 years ago, but expectations are way higher than before. People live in bigger homes, they want nicer cars, we have social media. And on top of that right now, we have huge inflation. So people want to party, people want to go out. It's hard to put that into pause to think about the future for a lot of young people.

Keith: You can still party, but you can do it without spending everything. You got to save. You got to be able to put money away for yourself first, I think anyway. One of the things that I'll say is that I'm not sure that the government really hit the mark here because again, it's one of these scenarios where yes, a few people will benefit. And we did the calculation. If you have a 40% marginal tax bracket, you will save 40% of $40,000. So that in essence is the government giving you $16,000. There's a small group of the population that will benefit from that. But at the end of the day, they're giving you $16,000. I'm not sure that's really going to help solve any type of home affordability issue because all it's doing is adding more money to the buyers, which in essence pushes prices up, making it a little less affordable for everybody else. But it's also, if you think about it, Marcelo, if the average home price in Canada is six, seven, eight—it's actually $800,000 across the board—but if you're looking at buying between six and eight, it represents about 2% of the home value. I'm not suggesting it doesn't make any sense. You have to do it, but it's not going to solve the issue.

Marcelo: Some could even say that it would make the situation worse because you're adding more power to the demand side, and the demand is not the problem. The problem is clearly the supply.

Keith: So you're just adding more fuel on the demand side for a certain group. Now does that group need the extra benefit? Absolutely. A hundred percent. But I'm not sure this is what they need. I think what they need is more supply. They need more choices.

Marcelo: This is in line with what people believe, right? We saw a survey that said that 72% of people who can benefit from this account believe that this account will not help them buy a house. So I think people know.

Keith: If you think about it, I think what most young individuals who are looking to buy homes are saying is that the appreciation levels of the homes are going up so rapidly that it's outpacing their ability to save for a down payment. So yes, this helps to save for a down payment. However, it doesn't keep up with the appreciation levels that we've seen in the last decade. Now we might finally see some softening of prices with interest rates going up a little bit, discussion of some supply, a little bit of curbing here and there. So multiple policies coming into place, we might see a softening and then individuals able to accumulate. So at the end of the day, our recommendation would still be if you can use it, do so.

Marcelo: Of course.

Keith: Marcelo, this is our intro show. We know that there's going to be more information coming out of the government. We're still also seven or eight months away from 2023. I do suspect we'll be doing another show on this very same topic in a year from now. Any final comments for our listeners?

Marcelo: If you can take advantage of it, for sure it's a tool that could help. But yeah, without getting too political, I think the government tried to just appease some of the first home buyers without having a really proper intention of fixing the housing problem. I think more needs to be done in terms of policy, just the stuff you discussed with Steve last week. But yeah, I'm expecting to see what they can do.

Keith: Thank you so much, Marcelo, for adding your comments in today's show. As always, you bring some great color and some great insights. For sure we'll be opening up these accounts starting next year. I do recall when the Tax-Free Saving Accounts were first opened, all of a sudden our firm just had hundreds of accounts to open up. I don't think we'll be having hundreds, but we're definitely going to have accounts to open up and we'll be there for our clients and listeners on any other questions. Thank you all. Have a wonderful week. Until next time.

Announcer: You've been listening to the Empowered Investor Podcast, hosted by Keith Matthews. Please visit TMA-invest.com to subscribe to this podcast, learn more about how his firm helps Canadian investors, or to request a complimentary copy of *The Empowered Investor*. Investments and investing strategies should be evaluated based on your own objectives. Listeners of this podcast should use their best judgment and consult a financial expert prior to making any investment decisions based on the information found in this podcast.