Planning to Buy Your 1st Home? Get Ready for a New Tax-Free Savings Account!

Description

Some people feel more secure by owning their homes. If you have been planning to buy your first home, listen up! You can save tonnes of money from income taxes by using a tax-free First-Home Savings Account (FHSA).

By now, you're probably very familiar with the Tax-Free Savings Account (TFSA), which was introduced in 2009 and can save thousands of dollars of taxes for Canadians in the long run. The Canadian government hopes to introduce a new tax-free savings account by early 2023. Get ready for the FHSA!

The purpose of the new tax-free savings account

The FHSA is there to help Canadians saving for their first home. You must be at least 18 years old to open an account. You can contribute up to $8,000 per year and up to $40,000 in your lifetime to the account. Investments including GICs, bonds, exchange-traded funds (ETFs), mutual funds, and stocks are all eligible for the FHSA.

Similar to RRSP contributions, FHSA contributions are tax deductible, which means you'll reduce your taxable income for the year when you make FHSA contributions. Unlike RRSP withdrawals for the Home Buyers' Plan (HBP), FHSA withdrawals do not need to be repaid. Similar to earnings in TFSAs, your FHSA earnings will be tax free.

The money saved in your FHSA must be used towards buying your first home within 15 years of opening the account. Otherwise, your other option would be to transfer the funds to your RRSP or RRIF. In this scenario, you won't need to worry about not having sufficient RRSP/RRIF room.

First-time home buyers in their 30s

Let's say you're 35. You probably don't want to wait for the full 15 years to buy your first home. If you do, you would be essentially buying your home when you're 50 … and then, you'll still have to make many years of mortgage payments. Ideally, you would want to pay back your entire mortgage before you retire.

You should still consider taking advantage of the tax-free First-Home Savings Account to help you really get down on saving a sizeable down payment. That is, you might want to max out the $8,000 per year of contributions for five consecutive years to arrive at the $40,000 life-time maximum by the end of the period and potentially buy a home around then.

First-time home buyers in their early 20s

Let's say you're 24, just finished university or college, and have been working for a year or so. If you plan to own a home, you can also open a FHSA when it becomes available. However, you don't necessarily have to be as aggressive as home buyers in their 30s with your FHSA contributions. You might contribute $4,000 a year instead, which would require a commitment of 10 years of doing this to reach the lifetime contribution amount.

Rising interest rates

As interest rates rise, it'll become costlier to borrow. Mortgage payments will also rise. Canadian housing prices could cool off somewhat as a result. So, it's a good idea to observe the changes in mortgage interest rates over time. Right now, on Ratehub, the best five-year variable mortgage rate is 1.90%, whereas the best fixed rate is 3.39%.

Other tools to help you save to buy your first home

Remember that there are also other tools to help you save for your first home — the TFSA and RRSP. The TFSA is more flexible, because you can withdraw from it for anything without any penalty — just in case you change your mind about buying a home. There's also the HBP for the RRSP from which you're essentially borrowing money from yourself. However, you'll have to pay back the withdrawn amount of up to $35,000 within 15 years.

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