Home Buyers' Plan (HBP)

Introduction

Under normal circumstances, funds withdrawn from a registered retirement saving plan (RSP) are subject to tax in the year of withdrawal. However, there are certain provisions that permit the withdrawal of funds from an RSP without immediate tax consequences. One such provision is the **Home Buyers' Plan (HBP)** which allows a Canadian resident to **withdrawal** up to $25,000 (effective January 28, 2009) from their RSP on a tax-free basis in order to buy or build a qualifying home. Withdrawals from an RSP that meet all applicable HBP conditions do not have to be included in current income, nor will they be subject to with withholding taxes in the year of withdrawal.

The Basics

Starting on January 28, 2009, under the HBP program you and your spouse or common-law (hereinafter collectively will be referred to partner as the "Partner") can each withdraw up to $25,000, tax-free, from your respective RSPs under the HBP. The funds withdrawn may serve as an alternative source of cash for financing the down payment on your new home, thereby reducing the mortgage interest expense you would otherwise have to pay. You can make more than one withdrawal as long as the total of all withdrawals is not more than $25,000. The monies that are withdrawn from the RSPs under the HBP must be paid back each year over a period of 15 years (beginning in the second year following the year of withdrawal). If a payment is not made in a particular year it will be included in your income for that year.

If you are the **annuitant** of a spousal RSP, you may make an eligible HBP withdrawal from that plan. In this situation, the attribution rules would not apply. The repayment can be made to any RSP, including the spousal RSP, of which you are the annuitant of the plan.

Conditions for participating in the HBP

In order to participate in the HBP you must be a "**first-time**" home buyer. You would **not** be considered a first- time home buyer if you or your Partner have owned and lived in a home as a principal place of residence at any time beginning the four previous calendar years and ending 31 days before your HBP withdrawal.

Example: *In 2005, John lost his job, sold his principal residence which he was occupying and moved into a rented apartment. In 2007, he got a lucrative job as a senior engineer with the city. In September 2009 John would like to participate in the HBP and withdraw funds from his RSP for the purchase of a new principal residence. Since John owned and occupied his home during the period beginning January 1 of 2005 (the fourth year before the year he wants to make the withdrawal (2009), he would not be considered a first time-home buyer. He should therefore wait until 2010 in order to qualify.*

Other conditions that must be met to participate in the HBP include:

- You must enter into a written agreement to buy or build a qualifying home before withdrawing funds (i.e. a signed agreement of purchase and sale). Obtaining a pre-approved mortgage does not satisfy this condition.
- You must intend to occupy the qualifying home as your principal place of residence no later than one year after buying or building it.
- You must make all withdrawals in the same calendar year up to and including end of January of the following year. Any amount withdrawn after January of the following year will not be an eligible withdrawal under the HBP and you will have to include it in your income.
- A regular RSP contribution made during the 89-day period just before the HBP withdrawal from that RSP may not be deductible in whole or in part if the fair market value of your withdrawal includes part or all of the contributions made during the 89-day period before the HBP withdrawal. In this situation you should wait 90 days after the last contribution to your RSP before making your HBP withdrawal.

Example: ***Jennifer, a 35 year old business executive, is a Canadian resident who has never owned a home as a principal residence. Her RSP at the beginning of 2012 was worth $15,000. She intended to withdraw $25,000 under the HBP in April 2012. She topped up her RSP by contributing her maximum 2011 allowable RSP room of $12,000 on February 29, 2012. She then withdrew $25,000 in April 2012 under the HBP. Since the fair market value of her withdrawal included part of the contribution made during the 89-day period just before the HBP withdrawal, Canada Revenue Agency (CRA) would deny the deduction for $10,000 of the $12,000 RSP contribution.***

In addition to not being able to claim the deduction on that portion of the contribution, she also forfeits the RSP room. In order to reap the maximum benefit by using the program, Jennifer should either:

- ***Wait until May 29, 2012 (90 days after the contribution) or later, before making the HBP withdrawal; or***
- ***Withdraw $15,000 as planned and defer the withdrawal of the balance until 90 days following her contribution.***

Note: *If the FMV of the HBP withdrawal has been in the plan before the additional contribution, the new contribution will be eligible for a deduction (i.e. the 89- day rule will not apply on the HBP withdrawal).*

You must complete Form T1036, *Home Buyers' Plan (HBP) – Request to Withdraw Funds from an RSP.*

If any of the above conditions are not met either before or after the HBP withdrawal, you risk the inclusion of the withdrawn funds in your income for that year.

Exception to the “first-time” home buyer’s condition

You are not required to meet the "first-time" home buyer's condition if you are a disabled person or a relative of a disabled person (related by blood, marriage, common-law partnership or adoption) and you utilize the HBP withdrawal for one of the following:

- to acquire a home that is more accessible or better suited to your needs;
- to acquire a home for a disabled person and the home is more accessible or better suited to the needs of that person; or
- to give the funds to a disabled person to acquire a home that is more accessible or better suited to the needs of that person.

Repayment of your HBP withdrawals

Generally, you have to repay at least 1/15th of the original HBP balance each year (beginning in the second year following the withdrawal). For instance, there is an annual minimum repayment of $1,666 for a $25,000 HBP withdrawal ($25,000/15 = $1,666). However, you may repay more than the required minimum which will reduce future minimum repayments. CRA will send you a statement every year indicating the minimum amount that must be repaid.

You will not receive an RSP deduction for your HBP repayments. If you repay less than the minimum amount required in a particular year, you will have to include the difference as RSP income in that year.

As mentioned previously, you can contribute the repayments to any of your RSPs, including a spousal plan of which you are the annuitant. To make a repayment under the HBP, you have to make contributions to your RSP in the year the repayment is due or in the first 60 days of the following year. Once your contribution is made, you can designate all or part of the contribution as a repayment under the HBP.

Example: Michael Hunt signed an agreement of purchase and sale in January 2012 to buy a new home. In February 2012 he withdrew $25,000 from his RSP valued at $55,000 and completed Form T1036. The purchase closed in January 2013. Since the RSP withdrawal was made under the HBP program no tax was withheld. He was able to use the full amount withdrawn towards the home purchase.

Since Michael made the withdrawal in 2012 he has a year grace period before payment starts. Hence, he must repay $1,666 (1/15th of $25,000) to his RSP during 2014 or the first 60 days of 2015. If he repays only $1,000, he will have to include $666 in income for 2014 and pay tax on that amount. He would still be required to pay $1,666 (1/14th of $23,333) for the year 2015.

On the other hand, if Michael repays $10,000 in 2014 instead of the minimum required, this will reduce, but not eliminate his obligation to continue paying the balance in later years until the withdrawal is nil. In this case his minimum repayment during 2015 or by March 1, 2016 will be $1,071 (1/14th of the balance of $15,000).

Triggering an immediate repayment of your HBP withdrawals

Any of the following situations may trigger an immediate repayment or inclusion in your income of the outstanding balance of your HBP withdrawal:

- **When you die:** Your legal representative has to include as income the outstanding HBP balance on your tax return for the year of death. However, if at the time of death you have a Partner who is a resident of Canada, he/she and your legal representative can jointly elect to have the HBP balance (less any RSP contributions designated as an HBP repayment for the year of death) transferred to your surviving Partner. Subsequent HBP annual payments have to be made to your surviving Partner RSPs.
- **When you reach the age limit to mature your RSP:** You will not be able to make an HBP repayment after the year in which you reach age 71. If the balance is not repaid in full, you will have to include as income, each year, the required annual repayment until the outstanding HBP balance has been reduced to nil.
- **When you become a non-resident:** You have to repay your outstanding HBP balance in full before the date you file your return for the year, or no later than 60 days after you cease to be a Canadian resident, whichever is earlier.

Is the HBP appropriate for you?

The HBP program is surely an alternative source of cash for funding the down payment on your home. However, there are a number of factors you may wish to consider in assessing this option.

Firstly, if you do not have sufficient funds for a 25% down payment to qualify for a conventional mortgage, you will need to take out a high-ratio mortgage and incur extra costs for Canada Mortgage and Housing Corporation (CMHC) mortgage insurance. In this situation, it may be more advantageous to use your RSP funds to increase your down payment so as to qualify for a conventional mortgage.

Secondly, if you intend to make only the minimum annual payment, it will take 16 years (including the one- year grace period from your HBP withdrawal) before the HBP withdrawal is fully repaid. If you are depending on your RSP for retirement income, you may want to assess the decline in value that will result from the loss of the tax-deferred compound growth that will occur when you withdraw a large amount of RSP funds.

However, it can be argued that you are creating equity in a principal residence which also allows tax-free compounding, since your principal residence is eligible for a full tax exemption.

Lastly, you need to assess your current and future cash flow positions. Remember, you have probably reduced the mortgage interest expense but not eliminated it. Your cash flow should be able to accommodate your mortgage payments (principal and interest), property taxes and the annual minimum HBP repayments. Ensuring that there is sufficient cash flow for all these repayments is very important.

The appropriateness of this plan should be reviewed with a qualified tax advisor.

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