The Home Buyer's Plan – Is It Right For Me?

What Is It?

If you are considering purchasing (or building) your first home, the Federal Government's Home Buyers' Plan is an option you may want to consider. This plan was first introduced in the 1992 Federal Budget to assist first time home buyers. The plan allows you to withdraw up to $25,000 from your RRSP. There is no tax withheld on this withdrawal, however, the funds must be repaid in annual minimum amounts over a period of 15 years.

You Should Know

As with any plan there are several "rules" you should be aware of:

- The home you are buying must become your principal residence.
- Two people can withdraw from their RRSPs for the same home (they need not be spouses) however, the home must be intended to be the principal residence of both.
- You cannot have owned a home, or have lived in a home owned by your spouse, in any of the five calendar years beginning before the time of withdrawal.
- The home must be located in Canada.
- Before withdrawing from your RRSP you need to have a written agreement to buy or build a home. You must acquire your home by October 1st of the year following the year that you withdraw the money.
- You must repay this money to your RRSP over the next 15 years starting in the second calendar year after withdrawal.
- Your payment is due within 60 days of the end of each year. If you don't make this payment then this amount is added to your income for the year and as a result will be taxed at your highest marginal tax rate.
- If you make a contribution to your RRSP within 90 days prior to your withdrawal, that contribution will not be deductible if the contributed funds were needed for the withdrawal.
- There are special rules for withdrawals to buy a home for the benefit of a disabled person who qualifies for the disability tax credit. These rules allow for previous ownership and multiple withdrawals.

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Each year Canada Revenue Agency will provide an annual statement informing you of your minimum repayment requirement.

One More Important Point

There is one other important point to consider. By withdrawing funds from your RRSP under this plan, you are forgoing the investment income and the related tax-deferred compounding of that income during the time that this money would have been in your RRSP. This results in the reduction of your RRSP balance and subsequently the income available to you during your retirement.

As an example, assume a 30 year old investor takes $20,000 out of his RRSP under the plan and begins to repay the amount right away ($1,333/year over 15 years). Had he left the amount untouched till age 71, the $20,000 would have grown on a tax-deferred basis to approximately $400,000 (assuming an 8% rate of return). However, the home buyers' withdrawal together with the subsequent repayment (1/15th per year) would result in an RRSP balance (at age 71) of approximately $230,000, a difference of $170,000 from the RRSP that was left untouched.

While this is a significant amount, it does not necessarily mean that a home buyers' withdrawal is a poor strategy to follow. A home buyers' withdrawal strategy however, should be well thought out. This may mean for instance, that a comparison be done of the amount of interest that is saved due to the smaller mortgage balance that results from the home buyer's withdrawal. Also, where other non-registered funds are available it would be wise to use this money (before you use RRSP funds), since the investment returns earned on it are not deferred but are instead taxable to you each year.

In The End

So, although the decision to use RRSP funds is never an easy one, as long as you weigh both the advantages and disadvantages of the Home Buyers' plan, you will be in a much better position to make an appropriate decision.

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