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HELP YOUR CHILD PURCHASE A HOME WITH AN FHSA

Today's housing market remains challenging, leaving many first-time home buyers hard-pressed to come up with a down payment. So, quite often, parents or grandparents want to help out. As of April 1, 2023, a new avenue has opened to help fund a down payment: the First Home Savings Account (FHSA).

Although you can't contribute directly to an adult child's FHSA, you can gift funds to that child so they can make a deposit into their FHSA. There is no attribution of investment income back to you.

HOW THE FHSA WORKS

You must be at least 18 years old to open an FHSA, or the age of majority in your province. Account holders can contribute up to $8,000 a year to their FHSA, to a $40,000 maximum—which means a couple can contribute a maximum of $80,000. As with a Registered Retirement Savings Plan (RRSP), contributions can be claimed as a deduction against taxable income to reduce the amount of tax payable. The account can remain open for up to 15 years. Investments grow tax-free in the account, and withdrawals for a down payment are tax-free—the same treatment as for investment growth and withdrawals in a Tax-Free Savings Account (TFSA). So, an FHSA provides some of the best features of an RRSP and a TFSA.

GIVING YOUR CHILD A HEAD START

Parents who help children buy a home typically gift funds for the down payment at the time of purchase. An advantage of starting earlier by gifting funds for the child's FHSA is that your money goes further, thanks to the FHSA's tax deduction, tax-free growth and tax-free withdrawal. You can make a greater impact.

Also, note that an account holder can defer their tax deduction to a future year—saving more tax by claiming the deduction when they're in a higher tax bracket. ■

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Is it time to review your will?

An article in this issue talks about taking a fresh look at all of the beneficiaries or legatees you have named. While doing so, it's a good idea to review your will in its entirety. You may need to update it if your marital status has changed, your assets or net worth has increased, or you want to adjust any inheritance amount. An update could also be required upon the birth or adoption of a child or grandchild. In addition, be sure your executor or liquidator remains the right choice.

INVESTING DURING A MARKET RECOVERY

When markets have been below their peak for some time, it's helpful—psychologically and financially—to keep in mind that down markets have always been followed by recoveries. Psychologically, you'll feel reassured that better days are ahead. Financially, you'll be able to continue investing while prices are lower.

No one, experts included, knows when a bear market will end. What we do know is that, historically, the market eventually rebounds and our attention turns to investing during the recovery period.

TWO SCHOOLS OF THOUGHT

When the market shows signs of a recovery, some investors and money managers believe in taking an active approach. The practice is to invest more heavily in companies within sectors that outperform during market recoveries—typically, consumer discretionary, materials and real estate. Industrials and energy have also been known to be in the mix.

The other approach is to maintain a well-diversified portfolio, without reacting to prevailing or anticipated market conditions. This passive approach avoids the risk of overweighting sectors that end up underperforming and gives you the security of knowing you'll likely participate in whichever sectors happen to benefit from the upswing.

Which approach is better? The active versus passive approach is one of the longest-standing debates in the investment community. The answer often depends on personal preference and risk tolerance.

RECOVERIES COME IN ALL VARIETIES

Economists describe each recovery by the letter or shape it resembles when charted on a graph. A V-shaped recovery is the best-case scenario, where the downstroke of the V shows the falling market and the upstroke traces a quick, direct recovery. Shapes also include U, W, L and swoosh, among others. This means investors must be prepared for just about any type of rebound—from short to long, from smooth to bumpy.

WHEN A RECOVERY IS VOLATILE

The path to recovery can begin with considerable volatility, tempting some investors to hold off on making their regular contributions. They no longer want to risk seeing their portfolio value fall. With an eventual market rebound in sight, these investors would rather wait on the sidelines during the volatile period until they're more confident the market is in full recovery mode.

However, holding off is a gamble in itself. If you resume investing when prices are higher, which is quite likely, you'll end up purchasing

fewer shares or fund units for your money. Investing during a recovery should be the same as in any other stage: contribute on a regular basis to a well-diversified portfolio designed to meet your investment objective, time horizon and risk tolerance.

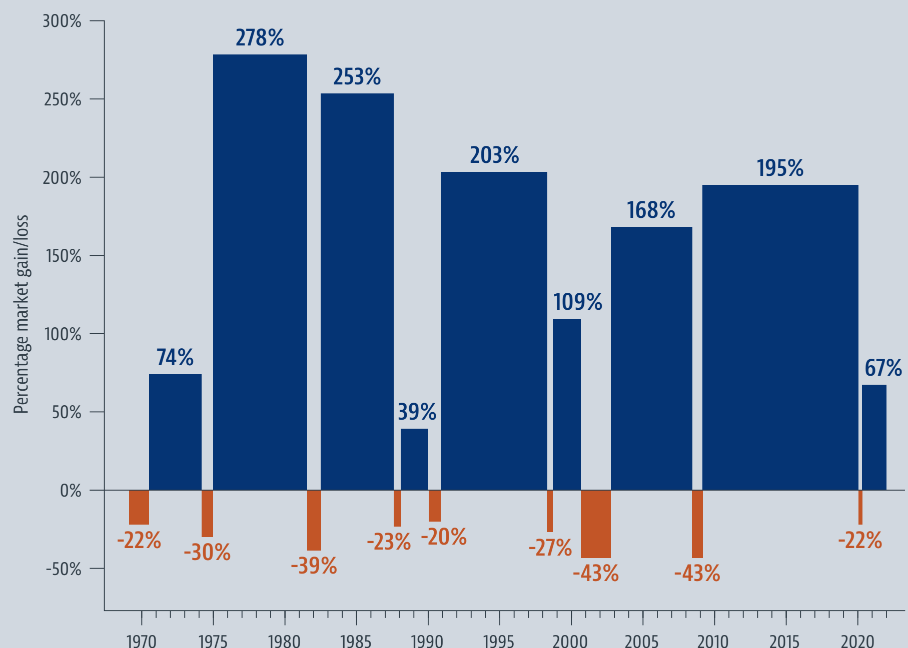
INVESTING MORE

When a market rebound is under way, some people may be inclined to invest more than their regular contribution amounts—for example, extra cash from regular savings or a recent lump sum such as a tax refund. Investors who were hesitant about investing extra cash during the downturn may suddenly feel more optimistic about buying into the market when they see a potential bull run on the horizon. While a rebound could be an opportune time to invest more, it's important to stick to your personal asset allocation. If you choose only equities to take advantage of the rising market, you'll end up investing beyond your risk tolerance. ■

A HISTORY OF BULL AND BEAR MARKETS IN CANADA

S&P/TSX COMPOSITE TOTAL RETURN INDEX FROM 1970 TO 2022

The chart defines bull markets as an increase of 20% or more and bear markets as a decrease of 20% or more.



Source: Bloomberg

SPLIT YOUR INCOME TO SAVE TAX

As an individual, you can save tax by using credits, deductions, exemptions and registered investment accounts. As part of a couple or family, you have opportunities to save tax by transferring money to your spouse or a child who's in a lower tax bracket.

Here are some of the more common methods of splitting income.

HAVING THE LOWER-INCOME SPOUSE INVEST

Due to attribution rules, if the higher-income spouse gives money to the lower-income spouse to invest in a non-registered account, the higher-income spouse is subject to tax on any income and capital gains. However, there's an easy and effective way to get around this: the primary income earner pays all of the bills and household expenses, enabling the other spouse to make non-registered investments. Now, investment income is taxed at a lower rate. It's helpful for each spouse to keep a separate bank account and investment account, in case the Canada Revenue Agency (CRA) wants evidence of how the lower-income spouse made the investments.

GIFTING FUNDS TO FAMILY MEMBERS

If your spouse or children lack the funds to contribute to their Tax-Free Savings Account (TFSA), you can give them the cash as a gift. This way, more family money is invested in a tax-free environment. Depending on a child's situation, you may also or alternatively wish to gift funds for their First Home Savings Account (FHSA) or Registered Retirement Savings Plan (RRSP). Quite often, a child who is just starting out builds RRSP contribution room, but rent or mortgage and car payments prevent them from making their full RRSP contribution. In all of these cases, the attribution rules do not apply.

OPENING A SPOUSAL RRSP

Today's pension income-splitting rules limit the ways a spousal RRSP can be useful, but benefits do remain. You contribute to a spousal RRSP in your income-earning years, receiving a tax deduction based on your current tax rate. Eventual withdrawals are favourably taxed at the spouse's lower tax rate in retirement. Find more information in the *Income-splitting in retirement* section.

HIRING YOUR SPOUSE OR CHILD

A business owner can hire their spouse or child, using company income to pay a family member's salary. The salary qualifies as a tax deduction whether the company is a sole proprietorship or a corporation. Also, the spouse or child benefits tax-wise by receiving an RRSP tax deduction, provided they contribute to their plan. The job must be legitimately required for the business to operate, the pay must be appropriate for the position, and you should issue a T4 slip (and an RL-1 slip in Quebec). ■

INCOME-SPLITTING IN RETIREMENT

One or more of these methods may be relevant to you during your retirement years.

PENSION INCOME-SPLITTING

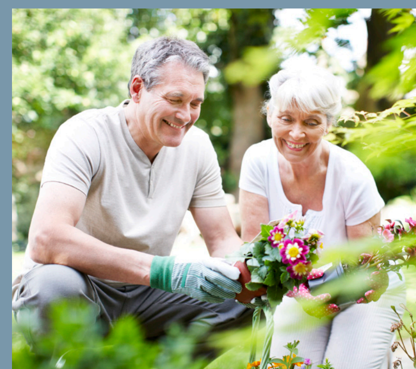
In retirement, you can save tax by having up to 50% of the higher-income spouse's eligible pension income taxed at the other spouse's lower tax rate. At age 65 or older, the most common types of pension income eligible for income-splitting are Registered Retirement Income Fund (RRIF) payments, company registered pension plan (RPP) payments and life annuities from a Registered Retirement Savings Plan (RRSP). Note that the spouse receiving any of these payments doesn't need to be 65 or older.

Some retirees, depending on their retirement income strategy, convert all or a portion of their RRSP to a RRIF before the mandatory age of 71 to take advantage of income-splitting tax savings.

SPOUSAL RRIF PAYMENTS

A spousal RRSP becomes a spousal RRIF in retirement. While pension income-splitting enables you to allocate up to 50% of eligible pension income to your spouse, taking payments from a spousal RRIF allows you to split more than 50% of pension income.

Also, if you retire before 65, pension income-splitting is mainly limited to company RPP payments (except in Quebec, where residents are unable to split pension income under age 65). However, the lower-income spouse could make spousal RRSP or spousal RRIF withdrawals before 65, providing a source of retirement income that's taxed at their lower rate.



CPP/QPP SHARING

The Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) allow a couple to save tax by splitting their pension amounts, reducing the higher-income earner's benefit and increasing that of the lower-income earner. The resulting benefit amounts may not be equal, as the government's calculation only takes into account the period during which the couple has been living together. ■

SPRING CLEAN YOUR BENEFICIARY CHOICES

Say that the holder of a Registered Retirement Savings Plan (RRSP) names their spouse as the beneficiary. Later, the couple divorces. The RRSP holder removes their ex-spouse from their will. However, with all the activity surrounding the divorce, they neglect to change the RRSP beneficiary designation from their ex-spouse to their child.

If the RRSP holder passes away before converting the plan to a Registered Retirement Income Fund (RRIF), the RRSP assets could go to the ex-spouse. It gets worse. The tax liability on the RRSP assets, equal to about half their value, must be paid by the estate, leaving even less for the child.

This scenario shows the need to ensure your beneficiary designations are all up to date.

KEEP A BENEFICIARY RECORD

To begin, it's helpful to keep an online or paper record of beneficiaries that you specified in your will and designated for all relevant financial vehicles. These may include an RRSP, RRIF, Tax-Free Savings Account (TFSA), Registered Education Savings Plan (RESP), life insurance policy or segregated fund.

Note that for registered plans, the beneficiary can be designated on the registered plan documentation in provinces other than Quebec. Residents of Quebec name their legatee (beneficiary) for each registered account in their will, not on the account form—with one exception. A legatee can be named on the form when the investment is an eligible insurance product, such as a segregated fund.

WHEN TO MAKE A CHANGE

The most common reason to add or change a beneficiary is when you or someone in your family has a significant change in their life. Events or situations could be marriage, divorce, birth or adoption of a child, or the passing of a loved one. For example, someone remarries and names their new spouse as the beneficiary of their RRSP. Or an individual has a new grandchild and updates their will to add the grandchild as a beneficiary, also establishing a trust. Ideally, you update your beneficiary designations when the event arises. However, reviewing your choices from time to time allows you to catch any changes you may have overlooked.

Also, changes in your or a beneficiary's financial situation or updates to your estate plan can call for a beneficiary review. Maybe a parent designated both children as beneficiaries of a vacation property, but recently one child moved out of the province—so there's a decision to make. Or perhaps a retiree has a permanent life insurance policy no longer needed to protect the family, so they change the beneficiary from their spouse to a charity.

Changes to beneficiaries may be needed for a variety of reasons, including ones that are unique to your situation. Be sure to keep a record of your beneficiaries, and don't wait too long before conducting a review. ■

SHOULD YOU CO-SIGN A LOAN?

Your son asks if you'll be a co-signer so he and his wife can qualify for a mortgage. Or a friend who's struggling financially wants to know if you'll co-sign a car loan.

If anyone asks you to co-sign a loan, it's not a decision to take lightly. You would be obligated to make any payments your family member or friend misses. In fact, you would be legally responsible for the entire loan amount.

MAKING YOUR DECISION

The trust factor is key. Say the primary borrower is responsible, has a reliable income, and only needs a co-signer because their credit history is insufficient. You might feel confident to co-sign. However, if the borrower is known to be reckless with money, you may wish you hadn't been asked.

You may also find it helpful to imagine your reaction if your family member or friend can't make one or more payments. Would you be understanding of their situation or feel resentful?

Another concern is if word of your favour gets out. What if other relatives or friends now want you to co-sign, or ask for an outright loan?

SAYING YES OR NO

When you feel confident in your family member's or friend's ability to honour the loan, co-signing can make a positive difference in their life and be gratifying to you.

If you decide against co-signing, you may wish to explain that it's nothing personal. You're aware that financial issues sometimes lead to damaged relationships, and that's not a risk you want to take with them or anyone. ■

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