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Be careful using RRSP to buy home

Many rules apply to tax-free withdrawals

Ownership status, closing dates can decide eligibility

My client was very excited about her new condominium when she came to see me, to review the builder's agreement of purchase and sale. She went over the points I had raised with the builder's sales rep and then went to her bank to withdraw money from her Registered Retirement Savings Plan, or RRSP, for the first of four $5,000 deposits.

It was only then she discovered, to her dismay, that the federal Home Buyers' Plan would not allow her to use her RRSP money to buy a condominium scheduled for an occupancy closing in June, 2007.

Here's how the Home Buyers' Plan, or HBP, works and why my client couldn't use her own RRSP money for a deposit on her dream residence.

Ordinarily, withdrawals from a taxpayer's RRSP are added to that year's taxable income and subject to income tax at regular personal rates. Under the HBP, withdrawals from a taxpayer's RRSP are not subject to tax, as long as the required repayments are made when they come due.

Up to $20,000 can be withdrawn from an RRSP to buy or build a qualifying home for a taxpayer who is a first-time buyer or for a related, disabled person. If the taxpayer is buying the qualifying home with his or her spouse or common-law partner, or even with other individuals in partnership, each buyer can withdraw up to $20,000.

Naturally, the money cannot be withdrawn if it is not already in the plan, or if it is not cashable as in the case of locked-in pension benefits, or guaranteed investment certificates which have not reached maturity.

In order to qualify to participate in the HBP, a number of pre-conditions have to be met before applying to withdraw RRSP funds:

- You have to enter into a written agreement to buy or build a qualifying home.
- You have to intend to occupy the qualifying home as your principal place of residence.
- You have to be considered a first-time homebuyer.
- Your HBP balance on Jan. 1 of the year of the withdrawal has to be zero.

Under the Income Tax Act, a first-time buyer is a person who has not owned a principal residence for five years preceding the withdrawal, and who has not lived in a principal residence owned by his or her spouse or common-law partner for the same period of time.

This definition is often confused with the first-time buyer definition under the Ontario Land Transfer Tax Act. Under that law, the first $2,000 in land transfer tax is forgiven on a purchase of a house from a builder if the buyer has never ever owned his or her own house in the past.

After qualifying, several additional conditions must be met at the time of the RRSP withdrawal:

- Neither the taxpayer or the spouse or common-law partner can own the qualifying house more than 30 days before a withdrawal is made.
- You have to be a resident of Canada.
- You have to fill out form T1036.
- You have to receive all the withdrawals in the same year.
- You cannot withdraw more than $20,000 per person.
- You have to buy or build the qualifying home before Oct. 1 of the year after the withdrawal is made.

It's this last point that effectively makes it impossible for virtually anyone buying a new home or condominium from a builder to use the RRSP money as a deposit at the time of signing the deal.

If the funds are withdrawn at the beginning of January in any year, the house must be purchased, the deal closed and the deed registered within 21 months before Oct. 1 of the next year. If the withdrawal is made late in the year, the Oct. 1 deadline can be as little as nine months later.

In today's market, many closings especially condominiums do not have an occupancy or closing date within that time. As a result, RRSP money cannot be used as an upfront deposit, and that's unfortunate.

It's not unusual today for agreements of purchase and sale to permit closings to occur as late as five years after the offer is signed. Some pending transactions now in my office have estimated closing dates as late as 2008, but with the built-in extensions, those closings could take place in 2010.

At the time the Income Tax Act provisions for the Home Buyers' Plan were written, closing dates of new homes did not contemplate delays as long as these.

If the Oct. 1 time limit in the Income Tax Act could be extended to reflect the realities of today's building industry, more people could take advantage of the HBP to make that all-important first deposit on a new home.

Once the home is purchased and the money is spent, the taxpayer has up to 15 years to repay the amount withdrawn under the HBP. Minimum annual payments are one-fifteenth of the total initial withdrawal, and the first repayment is due the second year after the year of the withdrawal.

Larger payments can be made, but failure to make a payment will result in that amount being added to the taxpayer's income in that year and the loss of the ability to play catch-up for the missing payment in future years.

I asked my client if she could withdraw the deposit money from her RRSP, pay tax on it and use the remainder as a deposit, but that would have required a withdrawal of more than $30,000 to net the necessary $20,000, and the RRSP wasn't that big.

As a result, my client is being forced by the HBP regulations to buy a resale residence instead of the new condo of her dreams.

Maybe it's time for the government to rethink some of the HBP rules.

Details of the HBP are available on the Canada Revenue Agency website: http://www.cra-arc.gc.ca/tax/individuals/topics/rrsp and http://www.cra-arc.gc.ca/tax/individuals/topics/rrsp/withdrawals/hbp/menu-e.html .
