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## **[¶3529] Registered retirement savings plans and registered retirement income funds**

As noted earlier in the discussion on the departure tax, an emigrating individual will not be subject to the deemed disposition in respect of rights in most types of pension and deferred income plans, including the individual's RRSP or RRIF. Accordingly, the individual can normally retain the RRSP or RRIF upon emigrating, and the income in the plan will continue to grow on a tax-free basis in Canada. As a result, it is generally advisable to top up an individual's RRSP, to the maximum extent possible, before the move from Canada.

However, the income tax laws in the new country of residence should be reviewed, in order to determine whether the income earned inside of the RRSP or RRIF will be taxed while the individual is resident in that country. In some cases (but not always) there will be a specific exemption in the country's tax laws in respect of this type of income. In other cases, specific tax treaty relief is provided. For example, under the Canada-U.S. treaty, the individual can make an election to ensure that the taxation of income earned inside of the RRSP or RRIF is deferred until it is actually distributed to the individual.

If an emigrant previously withdrew funds from an RRSP under the "Home Buyers' Plan", the balance of the funds should be repaid by the earlier of the date the individual files a tax return for the year of emigration and 60 days after the individual becomes a non-resident. If the balance is not repaid within that time, the unpaid amount is included in income in that year.

Distributions from the RRSP or RRIF while the individual is non-resident will be subject to 25% withholding tax in Canada under Part XIII. In some cases, the withholding rate may be reduced by treaty. For example, in the case of an annuity purchased under an RRSP, the withholding tax on the annuity payments will often be reduced to 15%. The distributions will generally also be taxable in the new country of residence. If the new country is a treaty country, a credit will generally be available in respect of the Canadian withholding tax.

### **Section 217 election in respect of certain types of income, including RRSP and RRIF benefits**

A special election is allowed under section 217 of the *Income Tax Act*, which allows the non-resident to elect to pay regular tax under Part I rather than the Part XIII 25% withholding tax on income paid out of an RRSP or RRIF (as well as with respect to certain alimony, pension and other similar payments from Canadian sources). By way of this election, such payments are not taxed under Part XIII but are added in computing the individual's taxable income earned in Canada and taxed under Part 1. For the purposes of determining the non-resident's tax rate under Part 1 on the benefits, the non-resident's worldwide income is taken into account.

The section 217 election will often be beneficial where the non-resident's Part I tax liability for Canadian benefits, after taking into account the allowable deductions and tax credits, would be less than the 25% withholding that would otherwise apply to the gross amount of such benefits under Part XIII. In effect, the section 217 election helps to ensure that a non-resident who receives such benefits is not put in a less favourable position than if

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the individual were resident in Canada and could take certain deductions or tax credits that would reduce the tax payable under Part I . The election is made in a return filed for the applicable year, within six months after the end of the year.

If the non-resident wants to make a section 217 election on benefits not yet received, an application can be made to reduce the tax that the payer would otherwise have to withhold at source. The individual can make the application by filing a completed Form NR5, "Application by a Non-Resident of Canada for a Reduction in the Amount of Non-Resident Tax Required to Be Withheld."

## **Recent Case**

**Assessment of non-resident under section 217 gave taxpayer full benefit of treaty** (1)

## **Compliance with U.S. Tax Laws Re RRSPs and RRIFs** (2)

A Notice issued by the US Internal Revenue Service (IRS) in April 2003 subjected US citizens and residents to complex US filing requirements if they owned, contributed to, or made withdrawals from, Registered Retirement Savings Plans (RRSPs) or Registered Retirement Income Funds (RRIFs). Failure to file the forms could have resulted in severe penalties.

On August 1, the IRS issued a new notice (the August Notice) that provides some relief to those who at least attempt to comply. However, those who ignore the filing requirements may still be assessed severe penalties.

The August Notice acknowledges that, although Treasury and the IRS are working toward implementation of an alternative, simplified reporting regime for RRSPs and RRIFs for future taxable years, additional relief with respect to 2002 Form 3520 and Form 3520-A reporting requirements should be provided to RRSPs and RRIFs and their beneficiaries. Specifically, no Form 3520 or 3520-A is required to be filed for the 2002 tax year if the beneficiary of a RRSP:

- makes or has made an appropriate election pursuant to the Canada/US Income Tax Treaty to defer the income in the plan, and
- received no distribution from the plan during the 2002 tax year.

The August Notice also provides that if an individual, RRSP, or RRIF has filed a Form 3520 or 3520-A, but has failed to provide all appropriate information, the IRS may request the individual or plan to provide the information. However, unless the IRS requests such information and the individual or plan fails to provide the IRS with the information requested, no individual or plan that files or has filed a Form 3520 or 3520-A will be subject to failure-to-file penalties. When filing Form 3520 or 3520-A, the individual or plan should write "CANADIAN RRSP" or "CANADIAN RRIF" (as appropriate) at the top of the first page of the form.

The August Notice also provides that where an individual has filed his or her 2002 return on a timely basis without making the election to defer tax pursuant to the Canada/US Income Tax Treaty with respect to a RRSP or RRIF, and that individual would like to make

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the election for the 2002 tax year, he or she may make the election by filing an amended 2002 return in the appropriate format up to October 15, 2003.

It appears that the IRS recognizes that US citizens and residents with RRSPs and RRIFs may not have all the required information to file complete and accurate information returns. Consequently, the August Notice appears to provide relief by protecting the filer from severe penalties if they make a reasonable effort to complete the returns. If they are unable to obtain certain information, such as statements from the custodian/trustee of their plans, no penalties will be assessed unless such information is not provided upon specific request from the IRS. However, the August Notice also seems to imply that the filer continues to be faced with significant penalties if he or she does not attempt to comply with the filing obligations.

### **With Respect to Beneficiaries of RRSPs (3)**

Under Canadian tax law, income accrued in a Canadian registered retirement savings plan (a "RRSP") generally is not taxed until such amounts are distributed to the beneficiary. However, because a RRSP does not meet certain requirements of U.S. tax law, accrued income of a RRSP is taxed currently in the U.S. if the RRSP owner is either a U.S. citizen or a U.S. tax resident (a "U.S. Beneficiary"). This disparate treatment can result in mismatches in the timing of income and payment of tax, and, potentially, double taxation.

As a relief measure, the Canada-United States Income Tax Convention (the "Convention") allows a U.S. Beneficiary to elect to defer tax in the U.S. with respect to income accrued in a RRSP. If this election is made, the U.S. will not tax income accrued in the RRSP until such amounts are distributed to the U.S. Beneficiary.

For tax years ending on or after December 31, 2001, in order to make the election, the U.S. Beneficiary must attach a statement to his or her timely filed (including extensions) U.S. federal income tax return. That statement must include the following: (1) a statement that the U.S. Beneficiary is claiming the benefit of Article XVIII(7) of the Convention under Revenue Procedure 2002-23; (2) the name of the trustee of the RRSP and the RRSP plan number, if any; and (3) the balance in the RRSP at the beginning of that tax year. In addition, the U.S. Beneficiary must attach a copy of this statement to his or her timely filed (including extensions) U.S. federal income tax return for each subsequent year, until final distribution is made from the RRSP. A separate election must be made for each RRSP if a U.S. Beneficiary is the beneficiary of multiple RRSPs. A U.S. Beneficiary may also be required to file Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) with his or her U.S. federal income tax return. U.S. Beneficiaries of RRSPs are urged to contract their own tax advisors regarding the procedure for making this election under the Convention and the requirement that Form 8833 be filed.

Historically, it was unclear to what extent a U.S. Beneficiary was required to file additional information with the Internal Revenue Service (the "IRS"). Specifically, it was unclear whether Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Foreign Gifts) or Form 3520-A (Annual Information Return of Foreign Trust with a U.S. Owner) were required to be filed with the IRS. The instructions for Form 3520 in previous tax years indicated that a U.S. Beneficiary of a RRSP generally was not required to file the Form 3520. In April of 2003, the IRS clarified (and, at least to some extent, changed) its position regarding the requirement that U.S. Beneficiaries of RRSPs file Form 3520 and Form 3520-A. In Notice 2003-25, the IRS indicated that it had become aware that

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many U.S. Beneficiaries and custodians of RRSPs were "unfamiliar" with the requirement that these forms be filed. In that Notice, the IRS described the reporting requirements applicable to RRSPs as follows:

- Form 3520 and Form 3520-A generally must be filed. Form 3520 generally must be filed for any tax year in which contributions are made to, or distributions are received from, a RRSP, and must be filed on or before the due date for the U.S. Beneficiary's U.S. federal income tax return. Form 3520-A generally must be filed by the fifteenth day of the third month after the end of the RRSP's tax year;
- The IRS will not enforce the requirement that Form 3520 or Form 3520-A be filed (and will not enforce penalties for failure to file) for tax years before 2002;
- The filing date for Form 3520 and Form 3520-A for the 2002 tax year is extended to August 15, 2003;
- If a U.S. Beneficiary has elected to claim the benefit of Article XVIII(7) of the Convention under Revenue Procedure 2002-23 and complies with the information reporting required by Revenue Procedure 2002-23, then Form 3520-A need not be filed (but the U.S. Beneficiary must continue to file Form 3520); and
- The significant penalties set forth in Section 6677 of the Internal Revenue Code will apply if Form 3520 or Form 3520-A is not filed by the relevant due date.

The IRS indicated that it is interested in establishing a simpler information reporting regime for U.S. Beneficiaries of RRSPs in future years, but gave no indication as to what such regime would be or when it would be instituted. U.S. Beneficiaries of RRSPs are urged to contact their own tax advisors regarding the requirement that Form 3520 and Form 3520-A be filed, and the procedure for filing such.

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## Endnotes

### 1 (Popup - Popup)

In *Merrins* (2003 DTC 5548), the taxpayer reported (on a Canadian T1 form) Old Age Security for 1998 ("OAS") pension of \$4,902, Canada Pension Plan benefits of \$6,008, and Superannuation Benefits of \$9,023, for a total income of \$19,933. He also claimed \$15,032 as a deduction from total income under the terms of the *Canada-Ireland Income Tax Agreement Act, 1967* (the "Treaty"). In addition, the taxpayer claimed a series of non-refundable tax credits under section 118 of the Act and reported nil taxable income for 1998. The Minister assessed the taxpayer for 1998 on the basis that the taxpayer had filed an election under section 217 of the Act, even though no such election had been filed. In dismissing the taxpayer's appeal (2002 DTC 1848), the Tax Court of Canada concluded that: (a) if the taxpayer's income was assessed under Part XIII of the Act, the section 118 group of non-refundable tax credits would not have been available; (b) the OAS is not related to past services and is not an exempt pension for the purposes of Article XI of the Treaty; (c) the section 217 election resulted in the non-taxation of Treaty-exempt income, which was in keeping with the intent of the Treaty; (d) the Minister assessed the taxpayer under section 217 of the Act, since he saw this to be advantageous for the taxpayer; and (e) the Minister's actions were appropriate in these circumstances. The taxpayer applied to the Federal Court of Appeal for a judicial review of the Tax Court's findings.

The taxpayer's application was dismissed. The Tax Court judge made no reviewable error. The taxpayer had the full benefit of the Treaty. Although his Treaty-exempt pension income was included in the calculation of his tax payable, section 217 gave him the benefit of Part I non-refundable tax credits, as well as a special tax credit equal to the tax payable in respect of the Treaty-exempt income. Ultimately, the taxpayer was taxed at a lower rate on his non-Treaty-exempt income. The Minister's assessment was affirmed accordingly.

### 2 (Popup - Popup)

Bulletin 3184, published by the Investment Dealers Association of Canada on August 7, 2003.

### 3 (Popup - Popup)

As published in the Investment Dealers Association (IDA) Bulletin 3158 on May 26, 2003.