Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

Transferring a U.S. retirement plan to your RRSP or RRIF

How to tax-efficiently consolidate with your RRSP or RRIF

Please contact us for more information about the topics discussed in this article.

This article discusses transferring your U.S. retirement plan to your registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) on a tax-efficient basis. This planning is available only to Canadian tax residents in the year of transfer; they must also be the original U.S. plan owner, or a spouse or common-law partner who inherited the U.S. plan or acquired the plan because of a relationship breakdown. Canadian residents include individuals who are U.S. persons (i.e. U.S. citizens and green card holders) living in Canada.

Prior to August 4, 2023, this planning was available only to Canadian tax residents who are turning age 71 or under in the year of transfer, as the rules only allowed for a transfer to an RRSP. On August 4, 2023, the federal government released draft legislation proposing to allow transfers to a RRIF as well. Although the draft legislation is not yet law, it is deemed in force as of August 4, 2023. Note that financial institutions may not be in a position to administer these changes until the proposed legislation becomes law.

Not everyone can or will benefit from transferring a U.S. retirement plan to their RRSP/RRIF, so it's very important to consult with a qualified cross-border tax advisor. Your tax advisor will help you determine not only if your U.S. plan is eligible and if your plan can be transferred on a tax-efficient basis, but also whether it makes sense for you to transfer your U.S. plan rather than leaving it in the U.S.

Canadian taxation of U.S. retirement plans

Income and gains earned within a U.S. retirement plan are generally tax-deferred for U.S. income tax purposes and are generally subject to U.S. income tax when distributions are made from the plan. Under the Canada-U.S. Income Tax Convention (Treaty), a Canadian resident with a U.S. retirement plan that's a pension will benefit from the same tax deferral and tax treatment on distributions in Canada. For this reason, it's generally acceptable to keep your U.S. retirement plan while you're a Canadian tax resident. Your overall income tax rate on distributions received will be the higher of the two countries' tax rates, which is generally Canada's.

If a U.S. retirement plan isn't a pension under the Treaty, the income and gains earned in the plan are subject to Canadian tax annually and don't benefit from the tax deferral under the Treaty. These types of plans aren't discussed in this article.

If you choose to collapse your U.S. retirement plan while you're a resident of Canada without any further planning, you'll accelerate the timing of taxation in both countries. Although foreign tax credits (FTCs) may be claimed to minimize or eliminate double tax, collapsing the plan will end the benefit of tax deferral in both countries.

The options to discuss with your qualified cross-border tax advisor include leaving the plan in the U.S., collapsing the plan and bringing the assets to Canada, or transferring it to your RRSP/RRIF if you can do so tax-efficiently. This last option is the focus of this article.

Canadian rules that allow for a tax-efficient transfer to an RRSP/RRIF

The tax-efficient transfer of a U.S. retirement plan to your RRSP/RRIF is based on special rules contained in the Canadian Income Tax Act (ITA), but it isn't a direct tax-free rollover. To do this transfer, you must withdraw from your U.S. retirement plan and deposit the amount withdrawn to your RRSP/RRIF under the special rules. The ITA allows you to pay into your RRSP/RRIF, without contribution room, and claim a special RRSP/RRIF deduction in respect of "certain amounts" received in the year. The deposit to your RRSP/RRIF must be made in the year you withdraw from your U.S. retirement plan or in the first 60 days of the year following the year of withdrawal.

The "certain amounts" include a lump-sum payment that's income received in the year as a superannuation or pension benefit included in your income for the year for Canadian tax purposes. The lump-sum payment must be payable out of or under an unregistered pension plan (based on Canadian tax rules), including a "foreign pension plan," and attributable to services rendered by

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you or your spouse or common-law partner, or former spouse or common-law partner, in a period throughout which the person rendering the services wasn't resident in Canada when they provided the services.

The "certain amounts" also include a payment that is an "eligible amount" for the year. An eligible amount is a lump-sum payment you receive out of or under a "foreign retirement arrangement," which is included in your income for Canadian tax purposes but doesn't include the portion that can reasonably be considered to derive from contributions to the foreign retirement arrangement made by anyone other than you or your spouse or common-law partner, or your former spouse or common-law partner.

Note, for a transfer from a foreign retirement arrangement, there isn't a requirement to have made the contributions to the plan while you were a non-resident of Canada; for a transfer from a superannuation or pension, however, there is a requirement to have provided the services while you were a non-resident of Canada.

The special rules in the ITA only apply where the withdrawal from the foreign pension plan or the foreign retirement arrangement isn't part of a series of periodic payments (i.e. it must be considered a lump-sum withdrawal). The Canada Revenue Agency (CRA) has indicated that whether a payment is considered a lump sum or a series of periodic payments is based on the particular facts and circumstances in each case. They have not provided an opinion specifically related to these rules but have stated for other purposes that, in general, a periodic payment is one of a series of at least three equivalent payments made under an arrangement that specifies the interval between payments. It may be reasonable to apply this view here as well and suggests that a withdrawal of the entire plan in two equal or unequal payments in different years may qualify as lump-sum payments. It's important for you to seek professional tax advice on how to structure your withdrawal to ensure it's considered a lump-sum payment.

Does your U.S. retirement plan meet the requirements?

To meet the requirements under the special ITA rules just discussed, the U.S. retirement plan must be classified under Canadian tax law as either a foreign pension plan or foreign retirement arrangement.

Foreign pension plan

For the U.S. retirement plan to be classified as a foreign pension plan, it must be set up by an employer as a superannuation or pension plan. This generally means an arrangement to which contributions were made by or on behalf of an employer or former employer in consideration for services you rendered as an employee and are used to provide you an annuity or other periodic payment on or after your retirement. Some examples of the types of U.S. retirement plans that may qualify include a 401(k), 403(b), or 457 plans.

Don't assume that your U.S. retirement plan automatically qualifies, even if it's one of the types of plans just mentioned. It's possible that the plan could contain terms that may exclude it from being a superannuation or pension plan under Canadian tax rules. It's important to have your U.S. retirement plan documents reviewed by a qualified tax advisor.

A U.S. Individual Retirement Account (IRA) is a foreign retirement arrangement for Canadian income tax purposes (as discussed in the next section). However, certain employer-sponsored IRA plans, such as SIMPLE IRA or Simplified Employee Pension (SEP) IRA plans, which are established for the benefit of employees, may satisfy the requirements of a foreign pension plan.

Foreign retirement arrangement

A foreign retirement arrangement includes a plan or arrangement to which specific subsections of the U.S. *Internal Revenue Code* applies. These U.S. rules deal with certain types of IRAs established as trusts, annuities (Individual Retirement Annuity) or custodial accounts. Some examples include traditional IRAs and rollover IRAs.

Rollover IRAs

For U.S. income tax purposes, it's generally possible to transfer a U.S. company pension plan, on a tax-deferred basis, to a rollover IRA. There are different reasons you may do this. For example, the U.S. company pension plan may require the transfer to a rollover IRA upon the employee's retirement or death, to allow the deferral of income tax to continue. You may also need to transfer the U.S. company pension plan to a rollover IRA to move it to another U.S. financial institution.

For Canadian tax purposes, the transfer to a rollover IRA generally isn't a taxable event.

A rollover IRA is a foreign retirement arrangement, but the portion that can reasonably be considered to derive from contributions made by anyone other than you or your spouse or common-law partner, or your former spouse or common-law partner, isn't an eligible amount which can be transferred to an RRSP/RRIF without contribution room. The amount transferred (employer and employee contributions) from the U.S. pension plan to the rollover IRA at the individual's request may be considered a contribution to the rollover IRA by the individual for the purposes of the special rules. However, where the rollover was from a U.S. pension plan that is attributable to services rendered by the employee in a period throughout which the employee wasn't a non-resident of Canada when they provided the services, the CRA has stated that they may apply the general anti-avoidance rules (GAAR) to disallow a transfer of the employer contributions to an RRSP/RRIF, under the special rules, if the sole purpose for the transfer to the rollover IRA was to circumvent the non-resident requirement.

For the U.S. retirement plan to be classified as a foreign pension plan, it must be set up by an employer as a superannuation or pension plan. This generally means an arrangement to which contributions were made by or on behalf of an employer or former employer in consideration for services you rendered as an employee and are used to provide you an annuity or other periodic payment on or after your retirement.

Where all or a portion of your rollover IRA cannot be transferred to an RRSP/RRIF under the special ITA rules, if it makes sense in your circumstances, you may choose to contribute the ineligible portion to your RRSP, if you have sufficient RRSP contribution room (refer to the separate section that discusses using RRSP contribution room if your plan doesn't qualify).

Roth plans

For U.S. income tax purposes, Roth plans, such as a Roth IRA or a Roth 401(k), allow for income and growth in the plan to be earned on a tax-deferred basis and distributions from the plans may be received free from U.S. income tax (provided certain conditions are met). The same tax treatment may apply in Canada under the Treaty. Therefore, you're generally better off keeping these plans intact in the U.S. rather than collapsing them, provided you can meet the criteria for tax-free treatment for both U.S. and Canadian income tax purposes.

For a Canadian resident (non-U.S. citizen or U.S. domiciliary) who is subject to U.S. estate tax only on U.S. situs property, it could make sense to collapse the plan. Since these plans are considered U.S. situs property, if you have significant U.S. estate tax exposure, you may consider collapsing your Roth plan to reduce the amount of U.S. situs property you own. If the conditions for tax-free treatment are not met and collapsing the plan results in taxation, you may be wondering whether you can implement the strategy of transferring your U.S. Roth plan to your RRSP/RRIF under the special ITA rules. Roth IRAs don't fall under the definition of foreign retirement arrangements or a foreign pension under Canadian rules, so wouldn't be eligible for transfer to an RRSP/RRIF under the special ITA rules. However, it is possible that a Roth 401(k) may be a foreign pension plan and eligible for transfer to an RRSP/RRIF under these rules.

For more information about Roth plans, ask your RBC advisor for a separate article on Roth IRA plans, which includes a separate section discussing Roth 401(k) plans. You should speak to your qualified tax advisor about whether it makes sense to collapse these plans.

Inherited plans and relationship breakdown

If you inherit a U.S. retirement plan from a deceased spouse or common-law partner, or because of a relationship breakdown, you may also be able to transfer the plan to your RRSP/RRIF without contribution room on a tax-efficient basis where it makes sense for you. If you inherit the plan from anyone other than a spouse or common-law partner, or former spouse or common-law partner, you wouldn't be able to transfer it under the special ITA rules. However, if you have RRSP contribution room and it makes sense in your circumstances, you may choose to use your room to transfer the U.S. plan to your RRSP (refer to the separate section that discusses using RRSP contribution room if your plan doesn't qualify).

If you inherit a U.S. retirement plan from a deceased spouse or common-law partner, or because of a relationship breakdown, you may also be able to transfer the plan to your RRSP/RRIF without contribution room on a tax-efficient basis where it makes sense for you.

Using RRSP contribution room if your plan doesn't meet the requirements

It's possible your U.S. plan is a foreign pension plan or foreign retirement arrangement, but it doesn't meet the additional criteria under the special ITA rules to allow a lump-sum withdrawal to be transferred to your RRSP/RRIF. Perhaps you inherited the U.S. plan from a parent. You can still achieve a tax-efficient transfer to your RRSP provided you have sufficient RRSP contribution room and can claim a full FTC. When using RRSP contribution room, you can choose to make an RRSP contribution to your RRSP or to a spousal RRSP plan.

You should confirm with your qualified tax advisor whether it makes sense for you to use your RRSP contribution room to transfer your U.S. plan to your RRSP or a spousal RRSP when it's already tax deferred as a U.S. plan. An example where this strategy may be useful is if you're not a U.S. citizen or U.S. domiciliary and you have exposure to U.S. estate tax. Since your U.S. plan is U.S. situs property, it could make sense to collapse the plan to reduce the amount of U.S. situs property you own. If you have sufficient RRSP contribution room, you can contribute the funds to your RRSP, or a spousal RRSP, to offset your Canadian taxable income and claim FTCs to recoup the U.S. income tax and early withdrawal penalty, if applicable. Remember though, to reduce your U.S. estate tax exposure, the funds inside the RRSP shouldn't be invested in U.S. situs property, otherwise the value of that property would still be included in determining your U.S. estate tax.

If you're a U.S. citizen or U.S. domiciliary, you're subject to U.S. estate tax on the value of your worldwide property. Therefore, for U.S. estate tax purposes, it wouldn't matter whether you have a U.S. retirement plan or an RRSP/RRIF.

The section on evaluating whether to transfer the U.S. plan to your RRSP/RRIF discusses other important considerations.

Overview of steps to transfer a U.S. retirement plan to your RRSP/RRIF

Get information from plan administrator

If you're a resident of Canada and interested in moving your U.S. retirement plan to Canada, your first step may be to confirm with the U.S. plan administrator, whether lump-sum withdrawals are permitted from the plan, if there are any penalties or fees, the withholding tax rate they will apply to your withdrawal as a resident of Canada, and any U.S. documentation that may need to be completed.

Engage a qualified cross-border tax advisor

It's very important to engage a qualified cross-border tax advisor who can review your U.S. retirement plan to evaluate whether a transfer to an RRSP/RRIF is possible and makes sense for you. They can determine if the plan meets the requirements under the special ITA rules and estimate whether you will be able to fully recoup the U.S. tax and penalties, if any.

Collapse the U.S. retirement plan by making a lump-sum withdrawal

Once you and your qualified tax advisor have decided that this strategy makes sense for you, you may execute the transfer by making a lump-sum withdrawal from your U.S. retirement plan. This lump-sum withdrawal is subject to

U.S. tax and possibly an early withdrawal penalty if you are under the age of 59½. The plan administrator is not required to withhold the penalty for early withdrawal. Instead, if it applies, it is assessed on your U.S. income tax return.

If you're a U.S. citizen or green card holder, a U.S. withholding tax rate of 10–20% may apply. The gross amount of the withdrawal is reported on your U.S. income tax return and is subject to U.S. tax at graduated tax rates. If you're a Canadian resident and not a U.S. citizen or green card holder, you're generally subject to a 30% U.S. withholding tax rate on a lump-sum withdrawal, although some plan administrators may withhold at a lower tax rate of 15%, assuming you're properly documented as a Canadian resident. You may need to file a U.S. non-resident income tax return but should confirm this with your qualified cross-border tax advisor.

If a U.S. income tax return is required, your ultimate U.S. tax liability and penalties, if any, are calculated on the return. It may not be the same as the U.S. tax withheld. You'll receive a tax refund if the withholding tax is larger than your ultimate U.S. tax liability or you may need to pay additional U.S. tax if it's lower.

Deposit gross amount to your RRSP/RRIF

The gross amount (before U.S. withholding tax is applied) of the lump-sum withdrawal from your U.S. retirement plan is included as income on your Canadian tax return in Canadian dollars. By depositing this amount to your RRSP/RRIF under the special ITA rules, you can claim an offsetting RRSP/RRIF deduction equal to the amount that's included as income on your Canadian tax return. The effect is a complete offset of the income included on your Canadian tax return, resulting in no taxable income in Canada related to the transfer.

You must make the deposit by the end of the regular RRSP contribution deadline, which is no later than 60 days after the end of the year in which the lump-sum withdrawal is made.

Claim FTCs

You can claim FTCs on your Canadian tax return for any U.S. tax and penalties paid. To fully recoup the U.S. tax and penalties, you must have sufficient Canadian income tax. FTCs reduce your Canadian tax liability that you would otherwise incur, so if you don't have sufficient Canadian tax, you won't be able to recoup all of the U.S. tax and penalties paid. You can't carry forward this type of FTC.

There are a few options your qualified tax advisor may suggest if they estimate you don't have sufficient Canadian tax to claim an FTC that will recoup all of the U.S. tax and penalty. These include:

If you're a U.S. citizen or green card holder, a U.S. withholding tax rate of 10–20% may apply. The gross amount of the withdrawal is reported on your U.S. income tax return and is subject to U.S. tax at graduated tax rates.

- Breaking up the lump-sum withdrawal into two equal or unequal amounts over two years. The CRA may not consider this a series of periodic payments.
- Waiting until age 59½ to make a withdrawal to avoid the 10% early withdrawal penalty. This would reduce the amount you need to recoup on your Canadian tax return as an FTC.
- Create additional Canadian taxable income (e.g. selling stock with accrued gains) to increase your Canadian tax liability to allow you to fully recoup the U.S. tax and penalties.
- Delay claiming optional tax deductions that will reduce your Canadian tax liability.

Before you make a withdrawal from your U.S. retirement plan using this strategy, it's important to confirm whether you'll be able to fully recoup the U.S. tax and penalty, if any. If you can't, you could be subject to double tax. This is because you'll have paid U.S. tax (and possibly penalties) on the amount withdrawn from the U.S. plan and will then pay Canadian taxes when you withdraw the same amount in the future from your RRSP or RRIF.

Canadian and U.S. taxation after the transfer

When withdrawals or payments from an RRSP, a RRIF or an annuity are eventually received, they're taxable for Canadian tax purposes.

If you're a U.S. person, you may also be subject to U.S. income tax on a portion of the withdrawals or payments. Generally, this would be the portion representing income and growth on amounts transferred to the RRSP/RRIF. The taxable portion may also be subject to an additional 3.8% net investment income tax in the U.S. (ask your qualified tax advisor for more information on whether this applies to you).

Evaluating whether transferring a U.S. retirement plan to an RRSP/RRIF makes sense for you

In addition to the considerations already discussed, the following are some other factors to assess in deciding whether it makes sense to transfer a U.S. retirement plan to your RRSP/RRIF.

You should compare the attributes of your U.S. retirement plan to an RRSP/RRIF, including the age you're required to begin receiving distributions, the amount of the required annual distributions, investment restrictions, account currency options, and the tax treatment of the distributions. The first required distribution for a U.S. plan is the year you turn age 73, but for an RRSP/RRIF, it's in the year you turn age 72. U.S. persons may be subject to an additional 3.8% net investment income tax in the U.S. on distributions from an RRSP/RRIF. This tax doesn't apply to distributions from a U.S. retirement plan.

Consider the importance of the Canadian pension income splitting rules to you. These rules allow for up to 50% of eligible pension income to be allocated to your spouse or common-law partner and reported on their Canadian tax return. This could lower your family's overall tax burden if your spouse or common-law partner is in a lower tax bracket. Depending on the type of U.S. retirement plan you hold, a distribution may be eligible for pension income splitting at any age, or only if received in the year you turn age 65 or later. In some cases, the plan may not be eligible at all for pension income splitting. For example, if you receive a payment from a U.S. company pension plan, it will generally be eligible for pension income splitting at any age, whereas those transferred to an RRSP/RRIF will only be eligible for pension income splitting once you're age 65 or over, and provided the RRSP is converted to a RRIF or other income stream. A U.S. IRA isn't eligible for pension income splitting.

It's important to understand the tax treatment of your plan upon your death and on the transfer to different types of beneficiaries. For example, the tax deferral for a U.S. retirement plan may be longer than for an RRSP/RRIF. For both U.S. and Canadian income tax purposes, if a spouse inherits a U.S. retirement plan or an RRSP/RRIF, the plans generally can remain tax-deferred during the surviving spouse's lifetime (a spouse for U.S. tax purposes doesn't include a common-law partner). In Canada, the tax deferral generally comes to an end on the death of the surviving spouse (with exceptions if the beneficiary is a financially dependent minor child or grandchild or a financially dependent child or grandchild with a disability). However, for a U.S. retirement plan, it's possible to extend the tax deferral for both U.S. and Canadian income tax purposes even where the plan is left to other beneficiaries, such as an adult child. Certain inherited U.S. retirement plans may allow up to an additional 10 years of tax deferral for U.S. and Canadian income tax purposes (this is subject to certain minimum required annual distributions under U.S. tax rules). Additionally, if the beneficiary of your U.S. retirement plan is a non-resident of Canada, not only does your estate get to defer the tax in the U.S. and Canada, but there would also be no future Canadian income tax to the non-resident beneficiary on distributions from the U.S. plan. Of course, the beneficiary would need to determine the taxation on distributions from the U.S. retirement plan in their country of residence.

As discussed earlier, if you aren't a U.S. citizen or U.S. domiciliary and have significant U.S. estate tax exposure, transferring your U.S. retirement plan to an RRSP/RRIF and avoiding investments that are U.S. situs property inside your RRSP/RRIF could reduce your exposure.

It may be important to you to have all of your financial and retirement accounts located in the same country and managed by the same advisor. The tax-efficient transfer to an RRSP/RRIF can help you consolidate your plans within Canada on a tax-deferred basis. However, once you transfer the U.S. retirement plan to an RRSP/RRIF, there is no equivalent strategy to transfer the property in your RRSP/RRIF back to a U.S. retirement plan.

If you're a temporary resident of Canada and will eventually move from Canada and become a non-resident, this may factor into your decision to either keep your U.S. plan intact or transfer it to an RRSP/RRIF. Please speak to a qualified tax advisor to help you evaluate this further.

Conclusion

Before you decide to collapse your U.S. retirement plan to implement the strategies discussed in this article, it's very important that you obtain advice from a qualified cross-border tax advisor to determine if your plan qualifies under the special ITA rules, if the transfer can be implemented on a tax-efficient basis and that it makes sense for you to implement the transfer as opposed to keeping the U.S. plan intact.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.