

# STEPUP

Sales Tax Estate Planning Underwriting & Product Newsletter

## Transferring US Retirement Plans to Canadian RRSPs



Canadian residents who have worked abroad may have participated in foreign retirement plans while out of the country. In many cases, they lived and worked in the U.S. for a period of time. A common question is whether they can move those retirement savings or consolidate retirement plans in Canada. Canadian residents may continue to defer tax on their Individual Retirement Account (IRA), their employer sponsored retirement plans like a 401(k) (name taken from the Internal Revenue Code (IRC) section that describes this plan) and/or Roth IRA (US equivalent of a tax-free savings account (TFSA) accounts after returning to Canada, thanks to the Canada-US Tax Treaty. Specifically, Treaty Article XVIII, para. 81(1)(r) of the Income Tax Act (Canada) deals with the tax deferral of IRAs owned by Canadian residents. American citizens and Canadian green card holders must follow different rules than those discussed in this article. If someone was a Canadian resident while participating in a 401(k) plan for instance, as a cross border commuter, working in the US and living in Canada, then that person would not be eligible to transfer a 401(k) to an RRSP directly. Consider that the payments being transferred must relate to services rendered by the individual or their spouse/common law spouse or former spouse during the period that the individual was working and resident outside of Canada. Canadian citizens returning to Canada have 4 choices on what to do:

- 1) Withdraw the money in one lump sum.
- 2) Transfer the monies to an IRA and leave it in place. The Canada Revenue Agency (CRA) considers a transfer from a 401(k) to an IRA to be tax



**Peter A. Wouters,**  
Director, Tax  
Retirement &  
Estate Planning  
Services

Peter works with independent advisors and other professionals raising awareness on issues and concerns faced by affluent individuals, professionals and business owners. He supports efforts in researching and developing optimal solutions for clients aimed at improving their financial well-being and supporting their personal wishes and lifestyles. He has provided 1000s of workshops, seminars and technical support throughout the country on tax, retirement income and estate planning issues, concepts and strategies to both advisors and consumers. As an accredited Registered Financial Gerontologist, a good deal of his time is spent on building awareness and educating people of all professions who work with or specialize in the needs, expectations and issues of elders. Comprehensive lifestyle planning is an important element of these processes.

The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides internal and broker support, including seminars, education, advanced concept illustrations & Client case technical consultations.

**Peter can be reached at**  
[peter.wouters@empire.ca](mailto:peter.wouters@empire.ca)



# Transferring US Retirement Plans to Canadian RRSPs

neutral for plan owners who return to Canada. The individual can benefit from naming beneficiaries, flexible withdrawal options and spreading income across generations. Remember that only a duly licensed advisor may service the account and provide advice or run afoul of both US and Canadian regulations.

The Canada-US Treaty permits continued deferral of the growth in the plan until withdrawals are made or income commences (covered for IRAs under para. 81(1)(r)ITA). Money coming out of the plan is subject to income tax.

- 3) Leave the balance with the former employer's 401(k) plan or in the Roth IRA. Canadian resident plan holders must file an annual election on their Canadian income tax returns to defer income tax on their 401(k) and IRA plans.

Please note that even if the now Canadian residents want to leave the money in the US retirement plan, they may be forced to move their money because some plans have the option to kick plan members out either because of the size of the account or because the plan member is no longer a US resident or deemed resident.

To make matters worse, a US plan administrator may give the plan member a certain amount of time to transfer the account (30-60 days) after which, they will liquidate the account, withhold income tax and any administrative costs or penalties and send the balance to the now former plan member in Canada.

- a) Both IRA and 401(k) plans offer the same tax deferral as Canadian RRSPs and RRIFs provided that the individual owner continues to follow CRA election and reporting rules and regulations. Furthermore, taxable payments from these plans qualify as pension income once the individual reaches age 65 so become eligible for the pension credit.
- b) Roth IRAs are considered to be specified foreign property by the CRA so must be declared under foreign asset reporting rules. A feature of a Roth IRA is that there is no mandatory age for the plan to be collapsed and after age 59 ½, contributions plus growth can be withdrawn tax-free, provided the seasoning period of 5 years has been satisfied. (at least 5 years from the beginning of

the year for which the individual first set up and contributed to the plan) Prior to that age, growth, (not contributions) are taxable. A best practice is to examine the tax implications of collapsing the plan in the U.S., especially if minimum distributions upon retirement will be tax-free. In some cases, the individual may be better off leaving the plan in the U.S if permitted by the plan's terms and administrator.

- 4) Transfer the plan monies to an RRSP, preferably in one lump sum. Withdrawals and transfers can be done over more than one year but care must be taken to avoid any appearance that the transactions are periodic payments. If the transfer generates a foreign tax credit that is more than the plan holder/ client can use, there is no carry forward of the excess. This is one reason that the transfer may be made over more than one tax year. You will need to work with a US advisor/tax specialist to make sure the proper steps are followed and that the monies are now sitting in a plan that is transferable.

The Income Tax Act (Canada) allows for a transfer of a pension plan to an RRSP under para. 60(j)(i) and permits a transfer of an IRA under 60(j)(ii) all monies in the plan, both original employee and employer contributions. The Canada Revenue Agency (CRA) considers a 401(k) to be a US pension plan. It is defined as an employee benefit plan under ss. 248(1) of the Income Tax Act (Canada) and CRA Document 9410515. The transfer can be executed without using existing RRSP contribution room, for all original contributions to the 401(k) provided that the individual was a US resident for income tax purposes when the contributions were made. The transferred value cannot include amounts contributed from anyone other than the Canadian taxpayer or taxpayer's spouse, like the employer under a matching scheme in order to avoid using up RRSP contribution room.

The transfer involves declaring the 401(k) monies as income for Canadian tax purposes and getting a deduction for the amount deposited in the RRSP. The US will generally apply a 30% withholding tax on lump sum payments. The amount being transferred must be designated as a transfer on Schedule 7 of the taxpayer's Canadian income tax return in the year of transfer in order to get the offsetting deduction from the income inclusion as a result of taking the money

# Transferring US Retirement Plans to Canadian RRSPs

out of the US retirement plan. Once withdrawals have begun from the US retirement plan however, they generally cannot be rolled over to an RRSP.

The client needs to submit IRS form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting with the trustee or plan administrator in order to benefit from the Canada-US Tax Treaty which lowers US withholding tax from 30% to 15%. The US Treasury Regulation ss1441 and Withholding Tax on Non-resident Aliens and Foreign Entities, IRS publication 515 dealing with periodic payments state that it is immaterial whether the payment is made in a series of payments or in a single lump sum. The more conservative and arguable assumption is to base calculations on a 30% withholding tax. If this ends up being too high, the taxpayer may file a US tax return for a refund which may otherwise not be necessary. The individual must also provide his/her Social Security Number or Individual Taxpayer Identification Number (ITIN). If the individual does not have either of these numbers, (s)he can apply for an Individual Taxpayer Identification Number using IRS Form W-7, Application for IRS Individual Taxpayer Identification Number. There is no need to file a US income tax return unless there are other US income tax obligations.

The monies may already be in an IRA as opposed to still being in the 401(k). If the monies are in a 401(k) and the plan holds only individual monies, the individual can make a transfer to an RRSP. If the employer had a matching program for contributions, the best practice is to transfer first to an IRA if possible. The funds need to be in the IRA (a US advisor can do this), then set up a Canadian RRSP and transfer the monies. In essence, it looks like the individual is withdrawing all monies from the IRA, gets hit with withholding tax, perhaps an age penalty as well, then moves the balance to an RRSP, tops up the RRSP with personal funds to match the Canadian dollar equivalent to the USD original amount. Tax returns will take care of the rest.

Upon collapse of the U.S. plan, the U.S. administrator will withhold either 15% or 30% (likely the latter) tax for non-resident aliens or non-U.S. citizens. Normally the withholding tax is 30% for U.S. residents, but Article XXII of the Canada-U.S. tax treaty reduces this withholding to 15% for periodic payments.

Clients who are relocating to Canada or have already moved back from the U.S. and are over the age of 59 1/2 and under the age of 70 1/2 are the best prospects. If the individual

is under the age of 59 1/2, there will be an additional 10% penalty applied by the US Internal Revenue Service (IRS) which is not recoverable. Exceptions may be made if the early withdrawal is due to death or disability. Although the IRS does not provide clear direction on early withdrawal penalty tax for non-residents and the Internal Revenue Code has conflicting sections describing the application of penalty tax, a best practice approach is to pay the penalty tax and avoid potential additional penalties and interest charges. The penalty as well as any withholding tax may be claimed as foreign tax credits on the Canadian taxpayer's federal income tax return.

Assuming the now Canadian resident client is over age 59 1/2 and under the age of 70 1/2 and was a US resident for US income tax purposes when the 401(k) contributions were made, the client will get a credit for the Canadian dollar equivalent of the amount of the transfer and needs to deposit the entire amount into an RRSP (not a RRIF) to take full advantage of para. 60(j). Hopefully the client has sufficient extra money to make up the difference withheld in the US to bring the total contribution up to the equivalent of the original 401(k) amount. The client can then deduct the entire amount from his/her Canadian income. By topping up the RRSP, the client will optimize the foreign tax credit since the entire IRA account will now be in the RRSP like a 60(j) rollover. The contribution to the RRSP must be made within 60 days following the end of the year the withdrawal was made from the 401(k) plan (assuming the client did not turn age 71 during the year the withdrawal was made). If not done by this time, then there will not be an offsetting RRSP deduction for Canadian income tax purposes against the inclusion amount for the withdrawal from the US retirement plan. The foreign tax credit may not match the US withholding tax. The credit is not a dollar for dollar offset of Canadian taxes against US taxes. It is really the lesser of the foreign taxes paid and a proportion of the Canadian taxes paid. That proportion is calculated by dividing the individual's foreign income by his/her total adjusted income. The foreign income is not reduced by the deduction under para. 60(j) of the Income Tax Act (Canada). (CRA Document 9634955)

The individual can only contribute to his/her own RRSP but not to a locked-in plan. A contribution cannot be made to a spousal RRSP or a RRIF. This means that if an individual is over the age of 71, the rollover strategy discussed in this article cannot be used. Both 401(k) and IRA plans must

# Transferring US Retirement Plans to Canadian RRSPs

commence required minimum distributions (RMDs) by the end of the year that the plan member turns age 70 1/2. These distributions may come directly from the plan. There is no equivalent RRSP to RRIF conversion mechanism.

The IRS applies a 50% penalty tax of the RMD for individuals who fail to take their withdrawals on time. Canadian taxpayers may be able to claim this penalty as a foreign tax credit as well.

A client should deal with a cross border tax advisor to determine that the foreign tax credit is large enough to completely offset the US withholding tax. You need to keep in mind that foreign tax credits that aren't used in a given year cannot be carried forward to future tax years since the income is not foreign business income. (s. 126 of the Income Tax Act (Canada))

The selection of one of the four choices for Canadian residents owning IRAs or 401(k) plans depends on the facts of each situation and is dependent upon individual circumstances. An individual contemplating a transfer strategy needs to have sufficient liquid dollars available or ready access to cash to optimize the tax savings. An independent cross border tax specialist should be involved in deliberations and execution of a transfer strategy to optimize tax benefits and achieve what the client wants.

**Updated April 2021 from an article first published in 2013.**

Empire Life Investments Inc. is the Manager of the Empire Life Mutual Funds (the "Funds"). The units of the Funds are available only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such units.

The information in this document is for general information purposes only and is not intended to provide legal, tax, financial or professional advice. The Empire Life Insurance Company assumes no responsibility for any reliance made on or misuse or omissions of the information contained in this document. Please seek professional advice before making any decision

Empire Life Investments Inc. is the Portfolio Manager of the Empire Life segregated funds and is a wholly owned subsidiary of The Empire Life Insurance Company. Segregated fund contracts are issued by The Empire Life Insurance Company.

® Registered trademark of **The Empire Life Insurance Company** - used under license.

FOR ADVISOR USE ONLY

**Empire Life Investments Inc.**

165 University Ave., 9th Floor, Toronto, ON M5H 3B8

**Insurance & Investments – Simple. Fast. Easy.®**  
empire.ca info@empire.ca 1 877 548-1881

INV-3048-EN-06/21

