Canada – Domestic

- “Pension” - payment received from
  - IRA
  - RRIF
  - RRSP (including GRRSP)
  - 401(k)
  - Private pensions paid by employers (including IPP and DPSP)

  Canadian Domestic Law –ITA 212(1) - and applies 25% tax rate

- “Periodic pension payment” from Canadian perspective is a RRIF

- Pension taxed as ordinary income as resident of Canada.

Canada – Tax Treaty

- Example: Canadian ceases residency and becomes US resident during the year and receives CDN pension
- Article XVIII Pensions and Annuities
  - Paragraph 1 – pension can be taxed in arising state (ie. Canada) and in resident state (ie. US). Exclusion available in arising country must also apply in other resident (eg. Payment from roth IRA would not be taxable)
  - Paragraph 2(a) – if periodic pension (eg. RRIF), then arising state should not tax more than 15%. This means if it is from a RRIF, the Canadian NR withholding rate is reduced from 25% to 15%
  - Paragraph 2(b) – annuities limited to 15%
- Practically most pension payments are limited to 15% tax in arising country as it will be captured as periodic or annuity
- Lump sump – not eligible for reduced treaty rate

Canada – Tax Treaty
Diff between SS and regular pension

- Paragraph 5 – CPP received by US resident is only taxable in US (Canadian withholding tax reduced from 25% to 0%)
  - Paragraph 5(b) – CPP received should be taxed as though it were benefits under US Social Security Act (ie. only 85% taxable in US)

Pension Income – US – Domestic Law

- Generally includes:
  - Individual retirement accounts (IRA): Traditional IRA and Roth IRA
  - 401(k) which are rolled over into IRA before distributing

Pension Income – US – Domestic Law

- U.S. Code § 1441 - Withholding of tax on non-resident aliens
  - (a) General rule "…. withhold from such items a tax equal to 30 percent"

Pension Income – US – Tax Treaty Override

- Example: US resident departs US and establishes residency in Canada receives US sourced pension

- Article XVIII(2)(a)/(b) – if periodic or annuity pension, then arising state should not tax more than 15% (ie. if periodic the US NR withholding rate is reduced from 30% to 15%)
  - Publication 575 – “Periodic payments are amounts paid at regular intervals (such as weekly, monthly, or yearly) for a period of time greater than one year (such as for 15 years or for life).”

Pension Income – US – Tax Treaty Override

- Paragraph 5 – US Social Security received by Canadian resident is only taxable in Canada (withholding tax reduced from 30% to 0%)
    - Paragraph 5(a) – US Social Security received should be taxed as though it were benefits under CPP, but 15% is exempted in Canada (ie. only 85% taxable in Canada and 0% in US)

General Sourcing Rules
Example – US Citizen in Canada

- Example: US Citizen, resident of Canada and receives US sourced pension

    - On US side would be treated as US sourced, so no FTC is available

General Sourcing Rules
Example – US Citizen in Canada

- Result –
- Canadian Return
  - Pension income reported as US sourced income on Canada return
  - On Canadian return claim FTC

Deduction for Pension Contribution - Short-term cross border (US to Canada)

- Requirements: US employee inbound to Canada
  - Must be a member of US QRP prior to starting to work in Canada
  - Must be a non-resident of Canada prior to starting Canadian assignment
  - Employee must be taxable in Canada on assignment earnings
  - Assignment in Canada must be less than five years
  - Contributions made while in Canada must be attributable to services performed in Canada
  - Participation in pension plan limited to home country plan (cannot also participate in Canadian plan)

**Article XVIII paragraphs 8 – 9*

Deduction for Pension Contribution - Short-term cross border (US to Canada)

- Where these tests are met
  - Deduction for contributions to US plan permitted in Canada to the extent the contributions qualify for tax relief in the US if the assignee had been resident in the US and performed the services in the US
  - Canadian employer also allowed corporate deduction for employer contributions to US plan
  - Deduction allowed, limited by lesser of
    - the actual contribution, and
    - the amount allowed under domestic law of home country applicable to a resident of the home country
  - Form RC267 Employee Contributions to a United States Retirement Plan– Temporary Assignments – should be completed

Deduction for Pension Contribution - Commuters (Canada to US)

- Form RC268 – Employee Contributions to a United States Retirement Plan – Cross-Border Commuters
  - Canadian resident commuting to the US to work for a US employer, participating in a US QRP

Distribution from IRA or 401(k)
Reasons for rolling to an RRSP

- Client may wish to consolidate retirement plans
- Easier for Canadian resident to administer funds if they are in Canada
- US IRA account administrator may want to close accounts of US non-resident aliens
- Continued tax deferral, if possible
- Investment diversity motivation

Distribution from IRA or 401(k)
US and Canadian tax treatment of distributions

- Withdrawal from IRA / 401(k) – Canadian Taxation
  - Taxable income inclusion in year received [56(1)(a)(i)(C.1)]
  - Roth IRA distributions not taxable in Canada if
    - A valid election is made
    - Relate to contributions and earnings prior to a contribution as a resident of Canada and
    - Distribution is excluded from taxable income in the US if resident in the US
  - Pension income is foreign source; claim foreign tax credit for US tax in the year
    - 10% Penalty, if any, is now creditable in Canada (income tax ruling 2011-0398741I7(E))
  - May be able to rollover to an RRSP under paragraph 60(j)

Distribution from IRA or 401(k)
US and Canadian tax treatment of distributions

- Withdrawal from IRA / 401(k) – US Taxation
  - Traditional IRA distributions are generally taxable (non-deductible contributions and rolled over after tax amounts are not taxable)
  - Roth IRA distributions are not included in gross income if it is a qualified distribution or a return of your regular contributions
  - Early withdrawal penalty of 10% if not 59 1/2 years
  - If US non-resident alien at time of withdrawal, 30% non-resident US tax withheld
    - May be reduced to 15% under Treaty if paid as periodic pension [Article XVIII]

Rollover of IRA/401(k) Distributions Into an RRSP

- RRSP contribution room is <u>not required</u> and does not affect the eligible contribution
- Contribution to RRSP under s.60(j)(i) must occur within 60 days of the end of the taxation year in which the IRA / 401(k) distribution occurred
- Need to designate amount as eligible for the subparagraph 60(j)(i) deduction
- No prescribed forms are specified – report on return on Schedule 7, part 3
- Only **lump sum** payments from IRA / 401(k) are eligible
- **IRA**: Original contributions need to have been made by the individual (or spouse or former spouse) – employer contributions are generally *not eligible*
- **401(k)**: benefit must be attributable to services rendered while that person was <u>not</u> a resident in Canada

Rollover of IRA/401(k) Distributions Into an RRSP

- Only the amounts attributable to services rendered by the taxpayer or a spouse during a Canadian non-resident period
- It is only the residency of the person providing the employment services to the employer that is relevant in determining eligibility – residency when no services are rendered will not taint the eligibility – i.e., investment earnings while a resident of Canada may be eligible for the transfer
- Distribution is not exempt from Canadian income tax by virtue of Article XVIII(1) since the distribution is taxable in the US

Rollover of IRA/401(k) to an RRSP

- Foreign Tax Credit [126(1)]

  Calculation is based on the following ratio:

  $$\frac{\text{Foreign income (gross of RRSP deduction)}}{\text{Total net income (net of RRSP deduction)}}$$

- Full tax credit can be taken (i.e., the 30% US withholding tax plus the early withdrawal penalty of 10%) provided that the Canadian tax otherwise payable is equal to or exceeds the US tax withholdings plus the early withdrawal penalty

- Subsection 20(12) deduction may be available if US tax is not fully creditable

Rollover from 401(k) to IRA Article XVIII Paragraph 1

- In Canada - taxable pension income but can claim deduction on line 256 under 110(1)(f)(i) pursuant to Article XVIII(1)

- Article XVIII Paragraph 1

  Pensions and annuities arising in the US paid to a resident of Canada may be taxed in Canada

  If the pension income is not taxable to a resident of the US it is also exempt from taxation in Canada

Some useful tips

- Read form 1099 – R carefully. Always request this from the taxpayer.
- Box 1 – gross distribution.
- Box 2a – taxable amount – if taxable amount not determined is checked on 2b, then you will need to analyze whether the amount reported in box 2a is taxable.
- Box 2a – taxable amount – if taxable amount not determined is not checked on 2b, then the entire amount in box 2a is taxable.
- More important enter the 1099-R accurately with correct distribution code in Box 7.
- If you see unusual code, read instructions and seek help.