Sun Life Global Investments

# Transfer of a foreign retirement plan into a Canadian RRSP

In a world where cross-border mobility is important, many Canadians have benefited from work opportunities outside Canada in recent years. Some of these Canadians may have accumulated rights in a foreign retirement plan while working abroad and, coming back to Canada, many may have left such pension plans in a foreign jurisdiction.

The *Income Tax Act (ITA)*, allows Canadian residents, under certain conditions, to transfer foreign retirement plans to a Canada Registered Retirement Savings Plan (RRSP).

In this document, we will discuss the rules applicable when transferring a foreign retirement plan – including a U.S. retirement plan – into an RRSP on a tax-deferred basis. We will also discuss the benefits and possible drawbacks of doing such a transfer.

**Note that it is essential that an investor seek advice from a qualified tax advisor, financial planner, and/or legal advisor before acting on any of the information included in this document.**

## Foreign pension plans and the *Income Tax Act*

There is no specific provision within the *ITA* that allows a Canadian resident to do a direct transfer of a foreign retirement plan into Canadian RRSPs.

However, paragraph 60(j) of the Income Tax Act allows, under certain conditions, to do an indirect transfer into an RRSP of amounts that qualify as a superannuation or pension benefit from a foreign pension plan.

**When determining whether benefits withdrawn from a foreign retirement plan will qualify under the par 60(j), a taxpayer should consider the following:**

- The withdrawal from the foreign retirement plan, must be received as a lump sum payment, and not be part of a series of periodic payments.
- The pension benefit must be included in the individual's Canadian income tax, under subparagraph 56(1)(a)(i), and not exempt from tax in Canada because of a tax treaty.
- When withdrawing a benefit from a foreign pension plan, the gross amount of the benefit withdrawn may be contributed to a Canadian RRSP, provided that the contributions to the plan relate to services rendered by the taxpayer while a non-resident of Canada.
- The person must be a resident of Canada at the time of the contribution to their RRSP.
- The contribution to the RRSP must take place by December 31st of the calendar year in which the person turns 71.

If all of these criteria are met, paragraph 60(j) of the *ITA* will allow the taxpayer to claim an offsetting deduction, if an RRSP contribution is made in the year the pension benefit is received or within 60 days after the end of that year. The amount of the deduction is limited to the lesser of the amount contributed and the amount of the benefit included in income. No RRSP contribution room is required; the deduction is over and above an individual's regular RRSP deduction limit.

If the requirements above are satisfied, the RRSP contribution can be designated as a "transfer" on Line 14 of Schedule 7, in the Canadian taxpayer's return for the year.

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Note that when funds are withdrawn from a foreign pension plan, taxes are generally withheld in the foreign jurisdiction. The applicable foreign withholding tax rate varies, depending on the country's income tax legislation and whether a tax treaty might have been entered into between that country and Canada. Often, the first step for an investor would be to contact the foreign retirement plan administrator to confirm the withholding rate applicable in their situation.

A foreign tax credit will often be available to a Canadian resident to help minimize the risk of double taxation. (See section, Foreign Tax Credit.)

Even if it is possible to transfer the foreign retirement plan into a Canadian RRSP under the *ITA*, you must also consider any restrictions imposed by foreign countries. Some countries impose restrictions on the ability to withdraw pension benefits. The investor should therefore confirm with the foreign retirement plan administrator and with their tax advisor whether any restrictions could prevent them from withdrawing their pension benefits and contributing them to a Canadian RRSP.

## Common procedures to transfer a foreign retirement plan to a Canadian RRSP

**Hypothetical case scenario**
**(For this example, all values are in Canadian dollars)**

An investor holds $100,000 in a foreign retirement plan and wishes to transfer the plan to a Canadian RRSP:

1. Contact the plan administrator to withdraw the foreign retirement plan of $100,000 in 2021;
2. A withholding tax of $15,000 (assuming a 15% withholding tax rate) would be withheld in the foreign jurisdiction, at the time of withdrawal;
3. A cheque for $85,000, in a foreign currency, would be received by the Canadian resident investor;
4. The investor would contribute the proceeds of $85,000 to their RRSP; alternatively, should they have $15,000 in their bank account, a $100,000 contribution could be made to their RRSP. No RRSP contribution room would be required.
5. In April 2022, the investor would declare $100,000 as income in Canada under S.56(1)(a)(ii) of the *ITA* (in addition to any other income earned in 2021).
6. The investor may claim a deduction of $85,000 (or $100,000, depending on the amount contributed into the RRSP) under S.60(j) of the *ITA* representing the portion of the foreign plan that was contributed to their RRSP.

Provided that the investor has sufficient income and owes sufficient income tax in Canada, in 2021, they may be able to claim a foreign tax credit, in their Canadian income tax return, to offset some or all of the taxes withheld in the foreign jurisdiction.

As for the foreign tax credit, it cannot be carried forward into future years. (See comments in section on Foreign Tax Credit.)

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## Foreign Tax Credit

The combination of a foreign withholding tax and Canadian income tax associated with the inclusion of the foreign pension plan in income has the potential for double taxation. But Canadian taxpayers can generally claim a foreign tax credit, in their Canadian income tax return, to reduce or eliminate this potential for double taxation.[1]

**However, a foreign tax credit may not necessarily equal the foreign withholding tax. The following formula determines the size of the federal foreign tax credit that can be claimed:**

| **Lesser of:** | |
|---|---|
| Withholding tax paid in the foreign jurisdiction<br>**or** | Foreign non-business income<br>X Canadian income taxes otherwise<br>payable Worldwide income |

## Hypothetical case scenario

So imagine a situation in which an individual wants to transfer $100,000 (in Canadian dollars) from a foreign retirement plan. The foreign plan administrator will generally withhold some taxes. Let's assume a withholding rate of 20% for this example. Imagine also that this Canadian taxpayer will earn a $150,000 salary during the year (increasing their total gross Canadian income from worldwide sources to $250,000) and contributing $100,000 to their RRSP (thus obtaining a deduction of $100,000). This taxpayer's total federal tax bill for the year would be $28,000.

**Using these parameters, the foreign tax credit that the Canadian taxpayer could claim would be the lesser of:**

| **Lesser of:** | |
|---|---|
| Tax withheld in the foreign jurisdiction: $20,000<br>**or** | $\dfrac{\$100{,}000}{\$150{,}000\ (\$250{,}000 - \$150{,}000)} \times \$28{,}000 = \$18{,}667$ |

In this situation, the Canadian taxpayer would only be able to claim $18,667 in Foreign Tax Credit in their Canadian tax declaration, and not $20,000.

Note that foreign tax credit available in Canada, must be used in the year in which the Canadian resident receives the income from the foreign retirement plan. Unused foreign tax credit applicable to non-business foreign income cannot be accumulated, and may not be carried forward in future years. To ensure that there is a strategy in place to allow the investor to claim a full foreign tax credit , it's important to consult with a qualified tax advisor.

[1]Paragraph 126, *Income Tax Act* (Canada). See also Canada Revenue Agency's Income Tax Folio S5-F2-C1, Foreign Tax Credit.

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## Transferring a U.S. retirement plan to an RRSP

If an investor worked in the United States, they may have participated in a 401(k) or 403(b) plan, or contributed to a traditional Individual Retirement Account (IRA), or another U.S.-based retirement plan (see Annex 1 for a description of various U.S. retirement plans).

It may be possible to transfer these plans into a Canadian RRSP on a tax deferred basis, using the procedure mentioned above. 401(k) and 403(b) are transferable under par 60(j)(i) *ITA*, and IRAs are transferrable under par 60(j)(ii) of the *ITA*.

**There a few things to note however with the transfer of U.S. retirement plans:**

- A lump sum withdrawal by a Canadian (non-U.S. citizen/Green Card holder) should be subject to a 30% U.S. non-resident withholding tax rate.[2] However, some plan administrators have a different interpretation of the *Internal Revenue Code* and of the Tax Treaty signed between Canada and the U.S., and, in some instances, might use a 15% withholding rate. The first step for the investor would be contact the U.S. plan administrator to confirm the tax withholding rate applicable to their situation.
- If a taxpayer is under the age 59 ½ when transferring amounts from a Traditional IRA, 401(k) or 403(b), a 10% early withdrawal penalty will apply.[3] This 10% penalty is considered foreign tax credit for Canadian income tax purposes and may be claimed on a Canadian income tax return.
- Note that Roth IRAs are not considered to be foreign pension plans nor foreign retirement arrangements so withdrawals from these plans do not qualify under the provisions discussed above. (See section on Roth IRA.)
- If the taxpayer or their employer made contributions to a 401(k) for services rendered in a period when they were a resident of Canada (for example, they lived near the border and commuted to the U.S. to work), the plan will not qualify for a transfer under par 60(j) *ITA*.
- Note that if the investor is a U.S. citizen or green card holder, it is possible that they also have the obligation to file an income tax return in the US (on their worldwide income). In this case, the tax payable on the collapse of the 401(k)/IRA could be higher than the amount of the withholding tax.

## Roth IRA

Note that Roth IRAs are not considered foreign pension plans nor foreign retirement arrangements, so a deduction under paragraph 60(j) of the *ITA* cannot be claimed in connection to withdrawals from these plans.[4] Therefore, you cannot contribute lump sum withdrawals from a Roth IRA plan to your RRSP without using available RRSP contribution room.

That being said, would it be worthwhile for a Canadian resident to transfer sums held in a Roth IRA into a Canadian RRSP, or even to transfer them into a Canadian TFSA?

More precisely, what is the tax treatment, in Canada, for a Roth IRA held by a Canadian resident?

Under the Canadian Income Tax Act, a Roth IRA is not considered a registered plan, and income and distributions should therefore be taxable for Canadians.

However, Article XVIII of the Canada-United States Tax Convention (1980), commonly referred to as the Canada-U.S. Tax Treaty, may apply to either defer or relieve taxation in Canada.[5] The Fifth Protocol to the Canada-U.S. Tax Treaty specifies that under the new subparagraph 3(b) of Article XVIII, a Roth IRA is considered a "pension" for purposes of the Convention as long as no contribution is made to the Roth IRA by or on behalf of the individual, while the individual is resident in Canada.

[2]https://www.irs.gov/retirement-plans/plan-distributions-to-foreign-persons-require-withholding
[3]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-tax-on-early-distributions
[4]Income Tax Folio S5-F3-C1, Taxation of a Roth IRA. [5]Income Tax Folio S5-F3-C1, Taxation of a Roth IRA.

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Thus, if no contribution is made to the Roth IRA, while the holder is a Canadian resident, the Roth IRA will continue to be subject to Article XVIII of the Convention. And, under paragraph 7, the individual can elect to defer Canadian taxation with respect to the income accrued in the Roth IRA.

Thus, Canadian residents are exempt from taxation on accrued income and distributions from a Roth IRA, provided that a valid Election is filed, a contribution is not made while the holder is a resident of Canada, and provided distributions would not be taxable in the U.S. if the individual were resident there.

Any individual resident in Canada who wishes to defer taxation in Canada of income accrued in a Roth IRA should file a one-time irrevocable Election for each Roth IRA that they own.

Once an Election is made, there is no requirement to make another Election for subsequent years.

If an Election has been filed and no contribution has been made to the Roth IRA while the holder is resident in Canada, there is no requirement on the part of the holder of the Roth IRA to include information relating to the Roth IRA in the Form T1135, Foreign Income Verification Statement.

In conclusion, while it might be tempting for Canadian to repatriate sums held in a Roth IRA, doing so, a Canadian resident taxpayer could lose a tax sheltered instrument equivalent to a Tax Free Savings Account (TFSA) provided a proper election is made.

## Inheriting a foreign retirement plan for Canadian Residents

For a spouse or a common-law partner who is the beneficiary of a foreign pension plan, an IRA, and a 401(k), the amount received may be taxable as income under paragraph 56(1)(a)(i) of the Income Tax Act. It is however possible to contribute the proceeds of such a plan into a Canadian RRSP following the procedure outlined in a previous section.[6]

A person that is the beneficiary of a foreign pension plan, an IRA, and a 401(k), other than from a late spouse or common-law partner, must also include the value in their income under paragraph 56(1)(a)(i) *ITA*. If they have sufficient RRSP contribution room, this inheritance, or a portion of it, can be contributed in an RRSP to lessen the impact of this income inclusion.

## Considerations of transferring a foreign pension plan to an RRSP

**Here are some considerations of consolidating a foreign retirement plan with an RRSP:**

- It could simplify the management of a retirement portfolio, helping to ensure proper asset allocation is in place at all times, and allowing portfolio rebalancing in a timely manner.
- It could simplify managing income in retirement and could help us to ensure that tax-planning opportunities are optimized.
- It could reduce exposure to foreign currency. For a person wanting to retire in Canada, transferring a foreign retirement plan into an RRSP will allow for better matching of the currency of the future income stream with that of the future cost of living expenses. This will avoid foreign exchange risk that could potentially undermine the level of retirement income received.

[6] 2011-0409121E5. See also IT-528, par. 26.

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- It could potentially reduce or eliminate the exposure to foreign estate tax. Canadians who own U.S. assets may be subject to U.S. estate tax at death, even if they are not a U.S. resident, citizen or Green Card holder. For the purposes of U.S. estate tax, assets held in a U.S. retirement plan are considered to be situated within the U.S., irrespective of how the funds are invested. Assets held in an RRSP, will generally not be considered situated in the U.S. for the purpose of the U.S. estate tax.
- Securities regulations may impose restrictions on the trading activities of non-U.S. residents and limit the ability of their investment advisors to manage pension assets in a jurisdiction other than Canada, including retirement plans based in the U.S. and other foreign countries. Transferring a foreign-based retirement plan to an RRSP in Canada may provide more investment choice and greater flexibility to adjust investment holdings, as needs and market conditions change.
- It might not be right for everyone. It might be best to leave the foreign investment in place. (See, Conclusion.)

## Conclusion

While there are good reasons to transfer a foreign retirement plan into an RRSP, there are many issues to consider and tax implications to be aware of before proceeding. This strategy might not be right for everyone. In some cases, it may be best to leave the foreign retirement plan in place, and receive an income stream from it in retirement.

**It is thus important to seek advice from a qualified professional tax advisor, financial advisor, and/or legal advisor with cross-border experience before making any decision.**

## Annex 1

### Definitions

**Individual Retirement Account (IRA).** Often called a Traditional IRA, this is a tax-advantaged account that individuals can use to save and invest for retirement.[7] It is comparable to an RRSP.

**401(k).** A tax-advantaged, defined-contribution retirement account offered by many employers to their employees. It is named after a section of the *U.S. Internal Revenue Code*. Workers can make contributions to their 401(k) accounts through automatic payroll withholding, and their employers can match some or all of those contributions.[8] They are similar to a Defined Contribution Pension Plan.

**403(b).** Similar to a 401(k), the 403(b) is a retirement account for certain employees of public schools and tax-exempt organizations. Participants include teachers, school administrators, professors, government employees, nurses, doctors, and librarians.[9]

**Roth IRA.** An individual retirement account that allows qualified withdrawals on a tax-free basis provided certain conditions are satisfied. They are funded with after-tax dollars and the contributions are not tax-deductible. Money can be withdrawn tax-free.[10] They are similar to a TFSA.

[7] https://www.irs.gov/taxtopics/tc451 [8] https://www.irs.gov/retirement-plans/401k-plans
[9] https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-403b-tax-sheltered-annuity-plans
[10] https://www.irs.gov/retirement-plans/roth-iras

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**Here are some other characteristics of some of the most common U.S. retirement plans:**

| Type of plan | Traditional IRA[11] | 401(k)[12] | 403(b)[13] | Roth IRA[14] |
|---|---|---|---|---|
| **Who can contribute?** | Individuals with earned income, without an age limit.[15] | Individuals can contribute part of their compensation to a 401(k) on a pre-tax basis. May be matched by the employer. There is no age limit for contributing to this type of plan.[16] | Similar to a 401(k). Available to certain employees of public schools, employees of certain tax-exempt organizations and certain religious organizations.[17] | Individuals of any age with earned income, without an age limit. You can contribute to a Roth IRA only if your income is less than a certain amount.[18] |
| **Contribution limits** | 2021 maximum of $6,000 (US), or 100% of earned income; plus if age 50 or over, additional contribution of $1,000 (US).[19] | 2021 maximum employee contribution for people aged 49 and under is $19,500 (US) with an additional contribution of $6,500 (US) those 50 and over. Employers can contribute additional amounts.[20] | 2021 maximum employee contribution for people aged 49 and under is $19,500 (US) with an additional contribution of US$6,500 those 50 and over. Employers can contribute additional amounts.[21] | 2021 maximum of $6,000 (US) or 100% of earned income; plus if age 50 or over, additional contribution of $1,000 (US).[22] |
| **Tax deductibility of contributions** | Yes, in most cases. Based on adjusted gross income of family and participation in other types of plans.[23] | Not deductible by individual however contribution is not included in taxable income in the U.S. until withdrawn from plan.[24] | Not deductible by individual however contribution is not included in taxable income in the U.S. until withdrawn from plan.[25] | Not deductible.[26] |
| **Taxation of growth** | Growth not taxed in the U.S. until withdrawn. If contribution was deductible, will be taxable when withdrawn.[27] | Growth and contribution amount not taxed in the U.S. until withdrawn.[28] | Growth and contribution amount not taxed in the U.S. until withdrawn.[29] | Growth not taxed in the U.S. provided funds not withdrawn until age 59 ½, or if you have had the account for a period of 5 years, or such time as you become disabled.[30] |
| **Rollover to Canadian RRSP available under Canadian *Income Tax Act*** | 60(j)(ii) rollover of a foreign retirement arrangement. | 60(j)(i) rollover of a foreign pension plan. | 60(j)(i) rollover of a foreign pension plan. | Tax-deferred rollover to a RRSP not permitted. |
| **Transfer of funds to an RRSP** | Within taxation year or within 60 days after the end of the year. | Within taxation year or within 60 days after the end of the year. | Within taxation year or within 60 days after the end of the year. | Not applicable. |
| **Age at which income must be taken from the plan** | Distribution may begin at age 59 ½. Distributions made prior to age 59½ may be subject to an additional 10% tax. Required Minimum Distributions (RMD) have to begin by April 1st of the year in which you turn 72.[31] | Distributions may begin at age 59 ½ or upon termination of employment. Distributions made prior to age 59½ may be subject to an additional 10% tax. Required Minimum Distributions (RMD) have to begin by April 1st of the year in which you turn 72.[32] | Distributions may begin at age 59 ½ or upon termination of employment. Distributions made prior to age 59½ may be subject to an additional 10% tax. Required Minimum Distributions (RMD) have to begin by April 1st of the year in which you turn 72.[33] | No mandatory age in which plan must be collapsed. No Required Minimum Distributions (RMD).[34] |

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[11]https://www.irs.gov/taxtopics/tc451

[12]https://www.irs.gov/retirement-plans/401k-plans

[13]https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-403b-tax-sheltered-annuity-plans

[14]https://www.irs.gov/retirement-plans/roth-iras

[15]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits

[18]https://www.irs.gov/retirement-plans/amount-of-roth-ira-contributions-that-you-can-make-for-2021

[16]https://www.irs.gov/retirement-plans/401k-plans#:~:text=401(k)%20Plans&text=A%20401(k)%20is%20a,can%20contribute%20to%20employees'%20accounts.

[17]https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-403b-tax-sheltered-annuity-plans#:~:text=A%20403(b)%20plan%20must,all%20employees%20of%20the%20organization.

[19]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits

[20]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits

[21]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits

[22]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits
https://www.irs.gov/retirement-plans/amount-of-roth-ira-contributions-that-you-can-make-for-2021

[23]https://www.irs.gov/retirement-plans/ira-deduction-limits

[24]https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview#:~:text=Two%20of%20the%20tax%20advantages,of%20the%20Internal%20Revenue%20Code.

[25]https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview#:~:text=Two%20of%20the%20tax%20advantages,of%20the%20Internal%20Revenue%20Code.

[26]https://www.irs.gov/retirement-plans/ira-deduction-limits

[28]https://www.irs.gov/retirement-plans/401k-plans

[29]https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-403b-tax-sheltered-annuity-plans#:~:text=A%20403(b)%20plan%2C,their%20salary%20to%20the%20plan

[27]https://www.irs.gov/retirement-plans/traditional-iras#:~:text=A%20traditional%20IRA%20is%20a,that%20gives%20you%20tax%20advantages.&text=Generally%2C%20amounts%20in%20your%20traditional,(withdrawal)%20from%20your%20IRA.

[30]https://www.irs.gov/taxtopics/tc451#:~:text=Contributions%20to%20a%20Roth%20IRA,IRA%20when%20it's%20set%20up.

[31]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds

[32]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds

[33]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds

[34]https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds

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