Canada Revenue Agency Agence du revenu du Canada

Canada

2002 RRSP/RRIF Consultation Session

October 28, 2002

Minutes

Summary of discussion

Our 2002 consultation session in English was held on October 28th and the French session was held on October 30th. This report summarizes the discussions of both the English and French sessions. The word **we** in this report refers to the Assessment and Collections Branch of the Canada Customs and Revenue Agency (CCRA), unless otherwise stated, and **you** refers to the financial industry.

Following are the topics that were discussed at the conference:

Presentation by Assessments and Collections Branch

[Only that portion applicable to US plans transferred to RRSPs has been included]

APPENDIX C

Additional Questions

15) What are the rules regarding the transfer of funds from an American Individual Retirement Account (IRA) to an RRSP?

Answer: Paragraph 60(j) of the Act allows a taxpayer to deduct for a year amounts contributed (transferred) to an RRSP in the year or within 60 days after the end of the year for certain amounts received in the year from a non-registered pension plan that are included in the taxpayer's income for the year. The deduction applies if the amount is directly transferred on the taxpayer's behalf, or if the taxpayer receives the amount and then makes a contribution in respect of the amount received. Concerning amounts from IRAs, it is extremely unlikely that American Financial Institutions will directly transfer the amounts because of American tax withholding rules that apply to amounts paid from IRAs to individuals who are not residents in the U.S.

The following discussion deals with the application of paragraph 60(j) to certain amounts received from different types of IRAs.

1. Superannuation or pension benefits received from a non-registered pension plan

Subparagraph 60(j)(i) of the Act provides that certain payments received from non-registered pension plans are eligible for contribution and deduction under paragraph 60(j). **To qualify, the payment must meet all of the following requirements.**

a) It must be a **superannuation or pension benefit.** The part of the benefit, if any, for which an amount is deducted under subparagraph 110(1)(f)(i) of the Act because of a relieving measure in the Canada-U.S. Tax Convention is not eligible for contribution and deduction under paragraph 60(j).

This public document provided by Gary P Gauvin LLC - Canada U.S. Tax Experts - www.garygauvin.com

b) It must be a **lump-sum payment,** and cannot be part of a series of periodic payments.

c) It must be attributable to services rendered by:

- the taxpayer; or
- the taxpayer's spouse or common-law partner; or
- the taxpayer's former spouse or common-law partner

In a period throughout which that person **was not resident in Canada**.

d) It must be included in income under subparagraph 56(1)(a)(i) of the Act for the year in which it is received.

If an employer has contributed to a **Simplified Employee Pension IRA (SEP-IRA)** for its employees, we consider the arrangement to be a pension plan and amounts paid from such arrangements to be superannuation or pension benefits. Generally, such an arrangement also qualifies as an employee benefit plan.

A SEP-IRA is a written arrangement under which an employer sets up individual retirement accounts for its employees. They permit an employer to make contributions towards employees' retirements, although such contributions are not mandatory. An employee who participates in a SEP-IRA can make contributions to his or her SEP-IRA, to his or her regular or spousal IRA, or to both, although, such contributions may or may not be deductible under U.S. tax laws.

To summarize, a lump-sum payment from a SEP-IRA that is included in income under subparagraph 56(1)(a)(i) qualifies for contribution and deduction under subparagraph 60(j)(i) to the extent that:

- an amount is not deducted in respect of the included amount under subparagraph 110(1)(f)(i); and
- the benefit is attributable to services rendered by the taxpayer, or the taxpayer's spouse or common-law partner, or the taxpayer's former spouse or common-law partner in a period throughout which that person was not resident in Canada.

The following payments received by a taxpayer from a SEP-IRA **do not qualify** for contribution and deduction under paragraph 60(j):

a) The part of a payment that represents a return of the non-deductible SEP-IRA contributions made by:

- the taxpayer; or
- the taxpayer's spouse or common-law partner; or
- the taxpayer's former spouse or common-law partner.

This amount is not required to be included in income under subparagraph 56(1)(a)(i) because of the relieving measures provided in clause 56(1)(a)(i)(D) of the Act. As such, it does not satisfy the condition in 1d) above.

b) The part of a payment that is attributable to services rendered by:

- the taxpayer, or
- the taxpayer's spouse or common-law partner; or
- the taxpayer's former spouse or common-law partner in a period throughout which that person **was resident** in Canada. This amount is not included in income as a superannuation or

pension benefit under subparagraph 56(1)(a)(i). Rather, it is included in income as an amount from an employee benefit plan under paragraph 6(1)(g) of the Act. As such, it does not satisfy the conditions in 1c) and 1d) above.

2. Amounts received from a "foreign retirement arrangement" (FRA)

Subparagraph 60(j)(ii) of the Act provides that certain "eligible amounts" received by a taxpayer in a year qualify for contribution and deduction under paragraph 60(j) for the year in which they are received. One such amount is the amount determined under section 60.01 of the Act for the year.

Section 60.01 provides that an amount received in a year by a taxpayer from an FRA is an "eligible amount" for purposes of paragraph 60(j), **if all of the following conditions are met**.

a) It must be included in the taxpayer's income under clause 56(1)(a)(i)(C.1) of the Act for the year in which it is received.

b) It must be a **lump-sum payment**, and cannot be part of a series of periodic payments.

c) It must have been derived from contributions made to the FRA by:

- the taxpayer; or
- the taxpayer's spouse or common-law partner; or
- the taxpayer's former spouse or common-law partner.

As indicated above, clause 56(1)(a)(i)(C.1) and section 60.01 use the term "foreign retirement arrangement" (FRA) to describe the amount that has to be included in income and that is an "eligible amount." An FRA is defined in subsection 248(1) of the Act as a "prescribed plan or arrangement". Section 6803 of the *Income Tax Regulations* provides that the following IRAs are FRAs.

- An Individual Retirement Trust Account referred to in subsection 408(a) of the Internal Revenue Code (IRC).
- An Individual Retirement Annuity Account referred to in subsection 408(b) of the IRC.
- An Individual Retirement Custodial Account referred to in subsection 408(h) of the IRC.
- An Individual Retirement Trust Account set up under an Employer and Employee Association Trust Account referred to in subsection 408(c) of the IRC if such an account meets the requirements of subsection 408(a) of the IRC.

We refer to these IRAs as trusteed, annuity, and custodial IRAs.

Accordingly, clause 56(1)(a)(i)(C.1) requires a taxpayer to include in income certain amounts received from trusteed, annuity and custodial IRAs for the year in which they are received. The amount that has to be so included is the part of the amount received from such an IRA that would have to be included in the taxpayer's income in the U.S. if the taxpayer had been resident in the U.S.

Generally, U.S. tax law requires a taxpayer to include in income all amounts received from an IRA for the year in which the amounts are received. However, where the funds in an IRA are comprised of deductible and non-deductible contributions, and earnings thereon, the part of an amount received (based on a IRC legislative calculation) that represents a return of non-deductible contributions is not taxable in the U.S.

Accordingly, if an amount is received by a Canadian resident from an IRA that had non-deductible contributions made to the IRA, the eligible amount for purposes of paragraph 60(j) is limited to the part received that would have been taxable in the U.S. if the recipient been resident in the U.S. In such cases, the recipient has to first determine this amount to determine the maximum amount that can be

contributed and deducted under paragraph 60(j). Such recipients should be directed to the IRS for information about what part of the payment would have been taxable in the U.S. if the recipient had been a U.S. resident.

Concerning 2c) above, please note that an IRA lump-sum payment derived from an amount transferred to the IRA from a U.S. pension plan at the direction of the taxpayer, or at the direction of the taxpayer's spouse or common-law partner, or former spouse or common-law partner satisfies the requirement that the lump sum must have been derived from contributions made to the IRA by such a person. In other words, the term "contribution" takes on its ordinary meaning. As such, an IRA lump-sum payment is an "eligible amount" if it is in respect of an amount from a U.S. pension plan previously contributed directly or indirectly to the IRA and all the other conditions required to be considered an "eligible amount" are met.

To summarize, a lump-sum payment from a trusteed, annuity, or custodial IRA that has to be included in income under clause 56(1)(a)(i)(C.1) is an eligible amount for purposes of contribution and deduction under paragraph 60(j) if it was derived from contributions made to the IRA by the taxpayer, or the taxpayer's spouse or common-law partner, or the taxpayer's former spouse or common-law partner.

Lastly, we would mention that we understand that IRA lump-sum payments made to individuals who are Canadian residents will have U.S. taxes withheld. The Act provides relief from double taxation where foreign income on which foreign tax has been paid has to be included as income in Canada. Relief is accomplished by the provision of a foreign tax credit calculated under subsection 126(1) of the Act.

In general terms, the calculation limits the credit to the lesser of the foreign taxes paid on the foreign income and the approximate federal income tax otherwise payable on that foreign income. As can therefore be concluded, if the part of the IRA lump-sum payment that is taxable in Canada is contributed to an RRSP, no federal tax would be payable on that foreign income. This therefore suggests that a taxpayer would not get credit for the foreign tax paid and would in effect pay tax twice on the same income; once in the U.S. when the lump sum payment is paid, and then in Canada as the amount is withdrawn from the RRSP or from a RRIF to which it was transferred.

However, the Act addresses this matter through subsection 4(3) of the Act. This provision provides, among other things, that a deduction allowed under paragraph 60(j) is not considered to be allocable to any particular source of income. The effect of this is that the foreign tax paid on the foreign income can be used as a credit against Canadian tax payable on Canadian source income. Nevertheless, to derive full benefit from this relieving provision, a taxpayer would have to have sufficient Canadian source income on which the foreign tax paid could be used to offset the Canadian tax liability on that Canadian income. Each province and territory also allows a provincial or territorial foreign tax credit in respect of the foreign tax paid that is not used to reduce federal tax, and have similar rules to calculate the credit.

Each case will be different and has to be considered on its own merits. This will ensure that a taxpayer who contributes some or all of an IRA lump sum payment to an RRSP gets full credit on his or her Canadian return for the foreign tax withheld on the IRA lump-sum payment.

16) Can you clarify paragraph 14 of interpretation bulletin IT-320R3, which mentions that money denominated in any currency, qualifies as an eligible investment in an RRSP. In addition, I would like to know if cash in American dollars can be held in an RRSP.

Answer: Paragraph (a) of the definition qualified investment in subsection 146(1) of the *Income Tax Act* (the Act) stipulates that in the case of a trust governed by an RRSP, an investment described in paragraph (a) of the definition qualified investment in section 204 of the Act if the reference to "trust" in that definition were read as "trust governed by an RRSP", is a qualified investment.

This public document provided by Gary P Gauvin LLC - Canada U.S. Tax Experts - www.garygauvin.com

Paragraph (a) of the definition qualified investment in section 204 of the Act provides that money is a qualified investment for an RRSP trust except where the money is held for its collectible value, or the fair market value of the money exceeds its stated value as legal tender in its country of issue. In addition, a deposit (within the meaning assigned by the *Canada Deposit Insurance Corporation Act* or with a branch in Canada of a bank) of money standing to the credit of the trust is also a qualified investment. As mentioned in paragraph 14 of interpretation bulletin IT-320R3, prior to 2003, a deposit also includes an amount on deposit with a bank outside of Canada that is listed in Schedule I or II to the *Bank Act*.

In our opinion, "money" includes bank notes and coins having legal tender in the country of issuance. We are also of the opinion that deposits mentioned in paragraph (a) of the definition qualified investment in section 204 of the Act can be denominated in Canadian dollars or any other currency.

This public document provided by Gary P Gauvin LLC - Canada U.S. Tax Experts - www.garygauvin.com