

Rev. Rul. 89-95, 1989-2 CB 131, IRC Sec(s). 894

ISSUE

If a beneficiary of a Canadian registered retirement savings plan (“RRSP”) rolls over the proceeds of the plan into a Canadian registered retirement income fund (“RRIF”), can the amount rolled over qualify for continued deferral from United States income tax under Article XXIX, Paragraph 5 of the United States – Canada Income Tax Convention?

FACTS

Example 1:

A, a United States citizen, is a beneficiary of a Canadian RRSP established during a period when A worked and resided in Canada. A intends to retire. Under Canadian law, it is not possible for A to receive periodic distributions of the proceeds of the RRSP; accordingly, A rolled over the proceeds into an RRIF, which is similar to an RRSP but which is permitted by Canadian law to make periodic distributions to a beneficiary. The rollover is not treated as a taxable event by Canada.

Example 2:

The facts are the same as in Example 1 except A is a Canadian citizen resident in the United States. While a resident of the United States, A rolls over proceeds of the RRSP into an RRIF.

LAW AND ANALYSIS

Article XXIX, Paragraph 5 of the United States – Canada Income Tax Convention, 1986-2 C.B. 258, (Convention) provides that a beneficiary of a Canadian RRSP may elect, under rules established by the competent authority of the United States, to defer U.S. income taxation with respect to income accrued in the plan but not distributed, until such time as a distribution is made from such plan, or any plan substituted therefor. Deferral shall not be available for income which is reasonably attributable to contributions made to the plan by the beneficiary while the beneficiary is not a resident of Canada.

The technical explanation to the Convention states that the purpose of this provision is to avoid a mismatch of U.S. taxable income and foreign tax credits attributable to the Canadian tax on such distributions. *See* Technical Explanation of The Convention Between The United States Of America And Canada With Respect To Taxes On Income And On Capital Signed At Washington, D.C. on September 26, 1980. 1986-2 C.B. at 295. Canada generally does not tax contributions to or accumulations in an RRSP: under the Convention, Canada generally will impose a withholding tax of 15 percent on distributions. Because an RRSP is not a “qualified” plan for U.S. tax purposes, there is no

deduction allowed for contributions to such a plan and earnings of the plan are taxable annually to the beneficiary. By deferring U.S. tax on earnings in the plan attributable to Canadian contributions until there is a distribution, U.S. tax generally will be imposed in the same years that Canadian tax is imposed, so that U.S. citizens and residents may credit the Canadian tax against their U.S. tax liability.

Article XXIX, Paragraph 5 of the Convention provides that deferral is available until there is a distribution from the RRSP “or any plan substituted therefor.” Canadian law permits tax-free rollovers from an RRSP to either another RRSP or to an RRIF. For purposes of the Convention, a rollover of an amount from an RRSP into an RRIF that is treated as tax-free under Canadian law will be interpreted to be a rollover into a plan “substituted” for the RRSP. Amounts rolled over from the RRSP into the RRIF will qualify for continued deferral of U.S. tax until income is distributed from the RRIF. Accordingly, the amounts rolled over by A (and earnings on those amounts) will be eligible for deferral from U.S. tax until distributed, to the extent such amounts would have been eligible for deferral if they remained in the RRSP.

HOLDING

In the event of a rollover of proceeds from a Canadian RRSP to a Canadian RRIF that qualifies for tax-free treatment in Canada, the RRIF will be treated as a plan “substituted” for the RRSP so that (i) the roll-over will not be treated as a distribution that subjects the proceeds to immediate U.S. tax, and (ii) the proceeds of the RRIF may qualify for continued deferral of U.S. taxation under Article XXIX, Paragraph 5 of the United States – Canada Income Tax Convention.