TD Wealth

Your U.S. retirement plan

Bringing it home

If you are a Canadian resident who has lived and worked in the U.S., it's likely you may have contributed to a U.S.-based retirement plan. The most common are the traditional Individual Retirement Account (IRA) or 401(k). The latter is named for the provision of the U.S. Internal Revenue Code that authorizes it. The funds may have accumulated in the plan while you were resident in the U.S.

A traditional IRA is similar to an RRSP. They are both registered accounts. The IRA allows individuals to contribute earned income up to the annual limit to the plan, where investments are allowed to grow tax-free until they the funds are withdrawn. You generally cannot make regular contributions to a traditional IRA starting in the year you reach 70 ½ years of age. A 401(k) is an "elective deferral plan" that allows employees and/or employers to contribute a portion of their employment income to the plan on a pre-tax basis.

Canadians that have a U.S. pension plan can leave it in the U.S. to continue to grow on a tax-deferred basis, until it is withdrawn. Depending on your plan, there may be annual filing requirements at tax time.

If you move back to Canada, you may have questions about your IRA or 401(k) plan. Can those savings be moved back to Canada? Can you contribute these savings to an RRSP? What are the tax implications? What if you simply leave the savings in the U.S.?

Under certain conditions, you can withdraw the funds in your U.S. retirement plan. The funds will be subject to U.S. withholding tax, and then moved into an RRSP, without using up any of your RRSP contribution room.

Bringing the funds to Canada: tax implications on both sides of the border

If you decide to transfer your traditional IRA or 401(k) plan to an RRSP, you would collapse the U.S. retirement plan and make a lump sum withdrawal. The lump sum withdrawal could then be contributed and designated as a transfer to your RRSP. Only lump sum amounts — rather than periodic payments — may be designated as a transfer to an RRSP.

Meanwhile, U.S. withholding tax will be applied to the lump sum withdrawal from your U.S. retirement plan. The U.S. Internal Revenue Service (IRS) requires U.S. financial institutions to withhold 30% on withdrawals from U.S. pension plans, unless a tax treaty with the withdrawer's country of residence specifies a different rate.

Canada and the U.S. have a tax treaty — the *Canada-United States Income Tax Convention*. Under the treaty the withholding tax is typically lowered to a 15% withholding rate for periodic pension payments. It is unclear if the lower 15% rate would apply to lump sum withdrawals. Before you make a withdrawal, you should check with your tax advisor and U.S. plan administrator to determine which withholding rate would be applied.

Moving the funds from your U.S. plan to a Canadian RRSP must be done:

- in the year the funds are withdrawn from your traditional IRA or 401(k), or within the first 60 days of the following year; and
- before the end of the year that you turn age 70 ½

It is important to note that if you make a lump sum withdrawal before age 59 ½, a 10% penalty for an early withdrawal would apply under the U.S. tax rules in addition to the U.S. withholding tax imposed.

For Canadian tax purposes, the lump sum withdrawal from a traditional IRA or 401(k) plan would result in an income inclusion in the year of withdrawal. However, if the lump sum amount is fully contributed to an RRSP and designated as a transfer in the same year (or within 60 days after the end of the year), a deduction would offset the aforementioned income inclusion.

Before you make a withdrawal, you should check with your tax advisor and U.S. plan administrator to determine which withholding rate would be applied.

In addition, U.S withholding taxes paid on the lump sum withdrawal may be claimed as a foreign tax credit on your Canadian income tax return. In general, a foreign tax credit may be claimed up to Canadian taxes payable on foreign sourced income. As a result, an individual may not be able to claim or fully utilize a foreign tax credit, however U.S. withholding taxes paid that may not be claimed as a foreign tax credit may be deducted against income.

For example, if you withdraw $100,000 from your U.S. retirement plan you will receive an amount of $70,000 and pay $30,000 in U.S. withholding tax (30%). However, you may contribute up to $100,000 and designate it as a transfer to your RRSP. The $30,000 U.S. withholding tax may be claimed as a foreign tax credit or deduction for foreign taxes paid on your Canadian income tax return.

Are you planning to move back to Canada and hold savings in a U.S. retirement plan? Consult with a tax specialist to ensure you are aware of all the tax implications.

Keeping the funds in the U.S.: required minimum withdrawals

In general, Canadian residents may keep their savings in a traditional IRA or 401(k) plan in the U.S. and savings may continue to grow on a tax-deferred basis for Canadian and U.S. tax purposes. Depending on the type of U.S. retirement plan, there may be annual filing requirements at tax time to ensure deferral continues.

An owner of a traditional IRA must generally start receiving *required minimum distributions* (RMDs) by April 1 of the year following the year in which the owner reaches age 70 ½. RMDs must be made annually by December 31st in subsequent years. RMDs are calculated by dividing the account balance on December 31st of the preceding year by the applicable distribution period or life expectancy from either the Uniform Lifetime table or the Joint Life and Last Survivor Expectancy table published by the IRS. The Joint Life and Last Survivor Expectancy table is used by planholders whose only beneficiary is a spouse who is more than 10 years younger.

Once the right table for you is determined, RMD calculations for a given year are based on the age of the planholder on December 31st of the applicable year, the plan account balance on December 31st of the year preceding the applicable year, and on the applicable distribution period from the relevant table.

If a distribution is not made when RMDs are required to begin, or distributions are not sufficient to meet the RMD, you may be required to pay a 50% excise tax on the amount not distributed as required.

Distributions from a U.S. retirement plan would be subject to U.S. withholding and are included in income for Canadian tax purposes. The Treaty provides a 15% withholding tax rate for periodic pension payments, which would generally apply to RMDs from your U.S. retirement plan if you are a resident of Canada for treaty purposes. U.S. withholding taxes paid may be claimed as a foreign tax credit to reduce Canadian taxes payable.

If you worked in the U.S. and left your U.S. retirement plan there, you will eventually be required to make withdrawals. Speak with your tax specialist about the timing of withdrawals and tax implications.

Returning to the U.S.?

If you are leaving the door open to returning to the U.S., you might consider waiting before moving U.S. retirement plan funds to an RRSP. Transferring funds from your RRSP to an IRA or 401(k) could trigger tax in both Canada and the U.S.

Have you moved back to Canada, yet remain unsure whether you will stay? Talk to your TD advisor and a tax specialist about options for your U.S. retirement account and the tax implications.

Now you can:

- Review the possibility of repatriating your U.S. retirement plan funds into a Canadian RRSP
- Talk to your tax specialist about the tax implications of leaving the funds in the U.S.
- Decide what to do with your U.S. plan based on where you plan to take up residence during retirement

This article provides a general overview of some of the U.S. and Canadian tax considerations around certain types of retirement accounts and Canadian residents. It does not address additional considerations applicable to persons who are U.S. citizens or otherwise treated as residents of the United States for U.S. tax purposes. The U.S. and Canadian tax rules are complex, and tax consequences can vary depending on your individual circumstances. You should speak with your tax advisors before taking any action with respect to any retirement accounts.