HOW TO REPORT CANADIAN REGISTERED PLANS TO THE IRS

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ABOUT MAX REED

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Max solves US tax problems for Canadians including:

- Adding corporations on the UX tax implications of cross-border transactions and initial public offerings;
- Helping citizens in Canada deal with US tax issues including renouncing their US citizenship; and
- Advising Canadian investment funds on investments into the United States and receiving investments from US taxpayers.

Max is the co-author (with Dick Pound of Stikeman Elliot) of A Tax Guide for American Citizens in Canada, as well as over 20 technical and plain language articles on a wide range of cross-border tax topics. Recognized for his expertise, Max is often invited to speak at conferences and seminars for tax professionals and the general public. He was invited to testify before the Canadian House of Commons Finance Committee on the impact of US tax law on Canadians.

Prior to joining SKL, Max worked at White & Case LLP, an international law firm in new York City where he provided US tax advice to individuals, corporations, and foreign states.

He holds a BA and two law degrees from McGill University, where he won several academic and leadership awards and is admitted to the bars of BC and New York.

Outline

- Overview of the different Canadian registered plans
- US income tax consequences of those plans
- TFSA/RESP/RDSP may not be entities separate from their owners
- TFSA/RESP/RDSP may not be trusts for US tax purposes
- If not a trust, then a partnership or disregarded entity
- Plain paper disclosure preferable

Types of Registered Plans

- Registered Pension Plan (RPP)
- Registered Retirement Savings Plans (RRSP)
- Tax Free Savings Account (TFSA)
- Registered Education Savings Plan (RESP)
- Registered Disability Savings Plan (RDSP)

Registered Pension Plan

- Employer sponsored pension plan
- Contributions to Canadian pension plan tax deductible for US federal tax purposes if certain criteria met
- No special form required to take treaty deferral
- Not reportable on FBAR (Form FinCen 114)
- Reportable on Form 8938

RRSP

- Income is tax deferred under Article 18(7) of Canada-US Treaty
- No special form required to take treaty deferral
  - Form 8891 was eliminated by Rev. Ruling 2014-55
- Reportable on FBAR (Form FinCen 114)
- Reportable on Form 8938

RRSPs For US citizens

- Contributions to RRSPs not tax deductible on Form 1040
- Income inside plan can be treaty deferred
- US treaty deferral is automatic, but can be revoked with consent of commissioner
- Watch out for states that don't allow deferral (i.e. California)
- Distributions from the plan
  - Basis (i.e contributions) tax free
  - Income is taxable upon distribution

RRSPs Canadians moving to the US

- There is a strategy by which Canadians (not US taxpayers) moving to the US can take money out of their RRSP and only pay 15% tax
- Prior to moving, clients should sell and re-purchase all stocks
- Basis for US purposes should be FMV at time of departure assuming stocks sold and repurchased
- Some controversy whether this works or not so will go into technical detail as to why it should

RRSP basis bump for Canadians moving to US

- IRS position (Rev. Proc. 2014-55) is that section 72 applies to withdraws
- If so, code section 72(w) may block contributions/income earned while NRA from being basis
- Section 72 applies to distributions from 402(b) plans
- RRSP is not subject to 402(b) since not an employees trust
- Alternatively, s. 72(w) should not apply since no employee/employer contribution

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RRSP basis bump for Canadians moving to US

- S. 72 applies to annuities, insurance contracts, and endowment contracts
- RRSP is not the latter two – unlikely the former as does not fit definition of annuity in § 1.72-4(b)(2)
- Even if s. 72 does apply, s. 72(w) should not block basis
- Section 72(w) blocks contributions/income earned by plan from being basis if no foreign tax paid
- Contributions subject to CPP/EI
- CPP is an income tax per Rev. Rul. 68-411

RRSP basis bump for Canadians moving to US

- Per Rev. Proc. 89-45 → Investment in the contract, i.e. basis, is earnings in the plan prior to becoming US taxpayer
- This Revenue Procedure was superseded by later rulings (but not revoked and not contradicted)
- Arguably still authoritative
- Conclusion – client moves to US, have them sell and re-purchase RRSP assets
- Assets would only be subject to 15% tax in Canada if paid on a periodic basis

Tax Free Savings Account

- Investment income inside the plan is tax free in Canada
- Investment income is taxable in the US to the holder
- Reportable on FBAR (Form FinCen 114)
- Reportable on Form 8938
- How to disclose to IRS?

Registered Education Savings Plan

- Investment income is tax deferred in Canada
- Investment income is taxable to child when withdrawn
- Withdrawals from plan to child may be gifts from U.S. holder (consider educational exclusion of gifts)
- Investment income is taxable in the US to the holder
- Reportable on Form 8938
- Reportable on FBAR (Form FinCen 114)

Registered Disability Savings Plan

- Relatives contribute money, government matches it
- Disabled dependent withdraws money
- Investment income is tax deferred in Canada
- Investment income is taxable in the US to the holder if holder is US citizen
- Withdrawals from plan to beneficiary may be gifts
- Reportable on Form 8938
- Reportable on FBAR (Form FinCen 114)

Disclosing RESP/TFSA/RDSP

- No IRS guidance on how to report Canadian registered plans except for RRSP
- Plans may not be an entity separate from their owner
- Plans are unlikely to be classified as trusts
- Plain paper disclosure is recommended as an insurance policy against penalties

RESP Not a Trust Under Canadian Law

- Under Canadian law, trusts require 3 certainties: certainty of intention, certainty of object, and certainty of subject-matter
- Canadian courts have held that an RESP is not a trust because no certainty of intention (because revocable)
- See → Re Payne 2001 ABQB 894 or MacKinnon v Deloitte & Touche, 2007 SKQB 39
- Same logic would apply to TFSA

Not separate entities

- Entity classification regime only applies to those that are separate from owners
- Rev. Rul. 2004-86 (re: Delaware Statutory Trust) sets out criteria for when an entity is separate from its owners:
  - Recognized under local law as a separate entity
  - Creditors may not assert claims against property held by the entity
  - The entity can be sued
  - Entity's beneficial owners have limited liability
  - Entity can be merged with other entities
- Entity must have a "business purpose" under case law

Not separate entities (2)

- These plans more closely resemble bank accounts than legal entities
- Not trusts under Canadian law
- Unlikely (but unclear) that they have legal personality under Canadian law
- They don’t have a business purpose
- If not entities then no disclosure necessary

Plans are unlikely to be trusts

- Definition of trust under § 301.7701-4(a):
- In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby **trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts**. Usually the beneficiaries of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Plans are unlikely to be trusts

- "Trustees take title to the property"
  - In most TFSA and RESP arrangements the purported trustee is a financial institution
  - Does not take title to property
- Purpose is to conserve property
  - Purpose is to shelter income from tax; not conserve property
- Under ordinary rules in chancery or probate courts
  - TFSA/RESP are created under Income Tax Act rather than trust statutes

Plans are unlikely to be trusts (2)

- Mexican Land Trust Revenue Ruling Supports this view (Rev Rul 2013-14)
- Even if trustee takes title, not a trust if beneficiary has sole tax responsibility
- Applies best to TFSA but also to other plans
- If not a trust, then no Forms 3520/3520-A required and compliance cost of plans reduced significantly

If not trusts, then what?

- If TFSA/RESP subject to entity classification regime, but not trusts then:
- One owner – disregarded entity – requires Form 8858
- Two owners – partnership – requires Form 8865

How to disclose

- No tax avoidance purpose – all income reported
- Attach form letter (or Form 8275) to Form 1040 that describes plan and asks for IRS guidance
- IRS has replied to such a letter stating they don't know if 3520/3250-A required
- Even if IRS takes position that Form 3520 required, reasonable cause may excuse penalties
- Contact – max@polaristax.com if you want a sample of the letter we use

Reasonable Cause

- Under Code section 6677 penalty for failing to file Form 3520
- *James v. United States* [2012 U.S. Dist. LEXIS 114356 (MD FL 2012)] on what is reasonable cause for failing to file 3520:
  - citing Internal Revenue Manual reasonable cause = “good faith effort was made to comply with the law”
- Plain paper disclosure is textbook good faith

Conclusion

- No IRS position on how to report TFSA/RESP
- Not a trust under Canadian law
- Good argument no reporting at all required since essentially a bank account with some restrictions
- Not a trust under US tax rules
- Disclose by way of form letter or Form 8275
- Ask for IRS guidance
- Reasonable cause excuses any penalties
- Best position – transfer RESP to non-US person to avoid issues