

THE NAVIGATOR



CHARLES W CULLEN III
CFP(Canada and U.S.), CIM
Associate Portfolio Manager
& Wealth Advisor
902-424-1092
charles.cullen@rbc.com

DAYNA PARK
Associate
902-421-0244
dayna.park@rbc.com

PAMELA HUNTER
Marketing Associate
902-494-5694
pamela.hunter@rbc.com

1959 Upper Water Street
Suite 1400
Halifax NS B3J 3N2

www.cwcullen.com

MOVING TO CANADA WITH A U.S. ROTH IRA

Time is limited for making a Treaty election to defer Canadian tax

Did you move to Canada this year, and are you wondering what to do with your U.S. Roth Individual Retirement Account (Roth IRA)? Perhaps you are a U.S. citizen with a Roth IRA who moved to Canada or a Canadian who accumulated assets in a Roth IRA while working and living in the U.S. who has now returned to Canada.

For U.S. income tax purposes, when contributions are made to your Roth IRA, they cannot be claimed for an income tax deduction to reduce your U.S. taxable income. However, income accruing in the plan is not taxable, and distributions made at maturity are received free of U.S. tax.

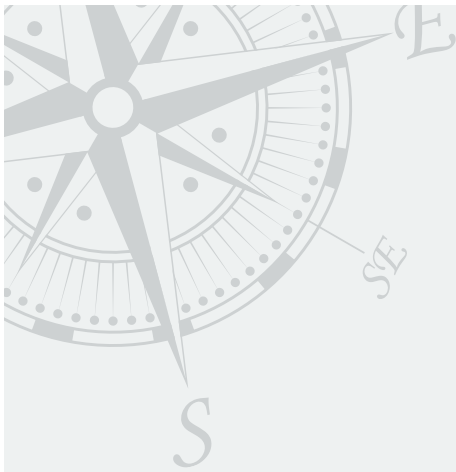
Canadian residents cannot transfer a Roth IRA to a Registered Retirement Savings Plan (RRSP) the same way they can a traditional IRA or 401(k) plan (i.e. using special provisions permitted by Canadian tax laws that allow you to make a contribution to your RRSP without using RRSP contribution room). Furthermore, income accruing in your Roth IRA is generally subject to Canadian tax unless you make a one-time election under the Canada-U.S. Income Tax Treaty (Treaty) to defer taxation. When distributions are eventually made, they too may be

exempt from Canadian tax by the Treaty (under certain conditions).

Since it is possible for your Roth IRA to be exempt from Canadian and U.S. tax, you may consider holding onto it. But, you should ensure you meet the criteria and make the one-time Treaty election by the filing deadline. Due to changes in the Treaty that clarified the status of Roth IRAs as “pensions,” new procedures were developed by the Canada Revenue Agency (CRA) in 2010 regarding the filing of the one-time Treaty election. Prior to the new procedures, Canadian residents may have qualified for tax deferral by making a declaration annually on their Canadian income tax return referred to as a “protective claim.” However, the procedures for making a protective claim are no longer recognized by the CRA. Currently, when you move to Canada with a Roth IRA, you have



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When you move to Canada with a Roth IRA, you have to meet a specific filing deadline if you wish to make a one-time Treaty election to defer Canadian taxation.

to meet a specific filing deadline if you wish to make a one-time Treaty election to defer Canadian taxation (which is the same filing due date as your personal income tax return due date for your first year of residence, which normally falls on April 30 of the following year). In 2010, when the new procedures were introduced, if you were a Canadian resident before January 1, 2010 with a Roth IRA, you were required to make the one-time Treaty election by April 30, 2011.

***Note:** This article will provide you with information regarding the criteria that must be met under the Treaty to qualify for the deferral of Canadian tax on the income earned in a Roth IRA and the new procedures that must be followed to make the one-time Treaty election. It will also provide you with information regarding the criteria that must be met in order for you to be exempt from Canadian tax under the Treaty on the distributions received from the plan. This document is for information purposes only and should not be construed as offering tax or legal advice. If you have a Roth IRA, you should consult with your tax advisor to discuss how these rules impact you.*

TREATY PROVIDES FOR A TAX DEFERRAL AND EXEMPTION

The new changes to the Treaty were the result of the Fifth Protocol to amend the Canada-U.S. Income Tax Treaty (Fifth Protocol), which made changes that impacted Roth IRAs for taxation years after December 31, 2008. The Fifth Protocol allows a Roth IRA to qualify as a “pension” under the Treaty and permits Canadian residents to elect to defer Canadian tax on income accrued in the plan. However, the Roth IRA will qualify as a pension only for as long as “Canadian contributions” have not been made to the Roth IRA after December 31, 2008 while you

were resident of Canada, and only if the one-time Treaty election to request the deferral is made by the filing deadline.

A Canadian contribution does not include a rollover from another Roth IRA or a Roth 401(k) arrangement that qualifies as a pension under the Treaty. However, a conversion or a rollover from a traditional IRA, traditional 401(k) plan or profit-sharing plan to a Roth IRA after December 31, 2008 will be considered a Canadian contribution and will make the tax-deferral election invalid from the date of the contribution.

The changes to the Treaty do not explicitly provide guidance if you are a Canadian resident who made Canadian contributions inadvertently to your Roth IRA before the new changes came into force. You should speak to your tax advisor if you made Canadian contributions to your Roth IRA before December 31, 2008 and before a valid election was made.

When you receive distributions from the Roth IRA, they may be exempt from Canadian taxation if no Canadian contributions were made and the distribution would otherwise be exempt from U.S. taxation if you had been a resident of the U.S. when it was received.

WHAT IF A “CANADIAN CONTRIBUTION” IS MADE?

If you filed the one-time Treaty election but you subsequently made a Canadian contribution to your Roth IRA, a portion of your Roth IRA will cease to be considered a pension under the Treaty. As a result, the one-time Treaty election will no longer be valid and all subsequent income earned or accrued in the Roth IRA after that time will have to be reported on your Canadian tax return.

The one-time Treaty election must be filed by the filing due-date of your personal income tax return in the first year you become a resident of Canada.

However, even if you made a Canadian contribution, any income accrued up to the time of the Canadian contribution will continue to be eligible for deferral. Also, the balance in the Roth IRA at the time immediately before the first Canadian contribution may still be distributed as a tax-free amount.

Here is an example of a Roth IRA that is a custodial account:

July 1, 2008 – Mr. Smith moves to Canada with a Roth IRA of \$1,100.

April 30, 2011 – Mr. Smith elects under paragraph 7 of Article XVIII of the Treaty to defer any taxation in Canada with respect to income accrued in his Roth IRA while he is a resident of Canada.

June 30, 2011 – The balance in his Roth IRA is \$1,120 (growth of \$20). The growth is not taxed in Canada by reason of the election.

July 1, 2011 – Mr. Smith makes an after-tax contribution of \$100.

June 30, 2015 – The balance in his Roth IRA is now \$1,270 (previous balance of \$1,120, plus \$100 contribution and \$50 growth). The growth of \$50 is subject to tax in Canada in the year it is earned.

July 1, 2015 – Mr. Smith makes a withdrawal of \$1,270. Of that amount, \$1,120, which was in the Roth IRA on June 30, 2011 (the balance of his

Roth IRA before his first Canadian contribution), is treated as a distribution from a pension plan that, pursuant to paragraph 1 of Article XVIII of the Treaty, is exempt from tax in Canada, provided it would be exempt from tax in the United States under the Internal Revenue Code if it were paid to a resident of the U.S. The remaining \$150 consists of the after-tax contribution of \$100 and the growth of \$50 that was subject to Canadian tax in the year of accrual, and thus, will not attract additional taxes at the time of withdrawal.

FILING THE ONE-TIME TREATY ELECTION

The one-time Treaty election is irrevocable and must be filed for each Roth IRA account you hold. The one-time Treaty election must be filed by the filing due date of your personal income tax return for the first year you become a resident of Canada. For example, if you became a resident of Canada in Year 1, the filing deadline of your return (and the one-time Treaty election) for the first year of residence would generally be April 30 of Year 2. If you miss the filing deadline, speak to your tax advisor for advice on the next steps.

There is no prescribed form to complete to make the one-time Treaty election. The Canadian tax authorities suggest that the election be made in the form of a letter containing the following information:

1. Your name and address
2. Your Social Insurance Number and Social Security Number
3. The name and address of your Roth IRA trustee or plan administrator
4. The Roth IRA account number
5. The date that the plan was established
6. The date you became a resident of Canada
7. The balance of the Roth IRA as of the date you became a resident of Canada
8. The amount and date of the first Canadian contribution you made to the Roth IRA, if any
9. A statement signed by you indicating that you elect to defer Canadian taxation under paragraph 7 of Article XVIII of the Treaty with respect to any income accrued in the Roth IRA for all taxation years ending before or after the date of the election, until a Canadian contribution is made

You should mail the one-time Treaty election to:

Income Tax Ruling Directorate
16th Floor, Tower A, Place de Ville
320 Queen Street
Ottawa, ON K1A 0L5

FOREIGN REPORTING INFORMATION RETURNS

If you have filed a valid election and you have not made a Canadian contribution to the Roth IRA, you are

Please contact us for more information about the topics discussed in this article.

not required to include your Roth IRA if you need to complete any foreign reporting information returns such as the T1135 – Foreign Income Verification Statement.

WHAT IF I HAVE NOT FILED THE ELECTION ON TIME?

If you have been a resident of Canada for some time with a Roth IRA and you were not aware of the filing requirements, you may have missed the deadline for making the one-time Treaty election. Speak to your tax advisor to determine whether it makes sense to request taxpayer relief from the CRA. This may mean contacting the CRA and asking if they will accept a late-filed election. If you have previously reported the accrued income earned in your Roth IRA on your Canadian tax return, you may even consider asking the CRA to amend those returns to remove the income reported.

Where an election is not filed, is not valid or is not accepted, the income accrued in the Roth IRA will be taxable

annually. The rules regarding the Canadian taxation of Roth IRAs can be complex. This is because a Roth IRA may be set up as an individual retirement account (i.e. a custodial account or a trust) or an individual retirement annuity (i.e. a contract from a life insurance company). If the Roth IRA is set up as a custodial account, then you must pay tax on the interest earned or accrued in the account on an annual basis. If the Roth IRA is set up as a trust, then there are a number of complex rules, such as the foreign accrual property income (FAPI) rule, that may apply, and you may have to pay tax on the income accrued in the Roth IRA. In addition, you may need to include your Roth IRA on foreign reporting information returns such as the T1135. The taxation of a Roth IRA that is structured as an individual retirement annuity with an annuity contract depends on the terms of the contract. You should consult with a qualified tax advisor to determine how the plan will be taxed.

Where a tax deferral or exemption of

Canadian tax cannot be achieved, you may consider whether it makes sense to collapse your Roth IRA. While it may be advantageous for a Canadian resident who is not a U.S. citizen to collapse the plan, this may not necessarily be the case for a Canadian resident who is also a U.S. citizen and, for U.S. tax purposes, still enjoys a tax deferral and exemption. Therefore, it is important to consider both Canadian and U.S. tax implications.

Speak to your tax advisor regarding the taxation of and reporting requirements for your Roth IRA if you are unable to file an election.

DON'T DELAY

If you moved to Canada this year, own a Roth IRA and wish to take advantage of these rules to allow for the tax-deferred growth of your Roth IRA and avoid taxation on eventual distributions, make sure you consult with your tax advisor without delay to find out how these rules could impact you, and to ensure that a valid election is filed on a timely basis.

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