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FINANCIAL ADVISORY SUPPORT

IRS Reporting for U.S. Persons with RRSPs and RRIFs

U.S. Form 8891 — U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans

This article applies to you if you are a U.S. person holding a Canadian Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF). A "U.S. person" is defined as a U.S. citizen, U.S. green-card holder or any individual who is considered a U.S. resident alien and is required to file a U.S. resident tax return. This article is intended to provide general information only; you should seek professional tax assistance from your cross border tax advisor who can assist you with any questions on the topics discussed.

The Internal Revenue Service (IRS) requires a U.S. person who is an annuitant of an RRSP/RRIF to complete and file Form 8891 annually. Form 8891 is used to report information to the IRS regarding contributions made to your RRSP/RRIF as well as RRSP/RRIF distributions.

You can also use Form 8891 to make an annual tax deferral election. Although for Canadian tax purposes you enjoy tax-deferred growth on income and gains accruing inside your RRSP/RRIF, this deferral is not automatic for U.S. tax purposes. Instead, under U.S. federal tax laws, you are required to report income and gains accrued inside your RRSP/RRIF as taxable income, unless you make an election requesting that the tax deferral apply. If the annual election is not made, you must report the income and gains accrued in your RRSP/RRIF on Form 8891 and as taxable income on your U.S. tax return. This will result in a timing mismatch of income reporting and gains accruing in your RRSP/RRIF, and double taxation may occur.

Election to defer U.S. tax on accrued income in RRSPs/RRIFs

Form 8891 allows you to make an annual election with the IRS pursuant to Article XVIII(7) of the Canada-U.S. Tax Treaty (the "treaty") to defer recognition of the accrued income and gains in your RRSP/RRIF for U.S. tax purposes. When you make this election annually, the taxation of distributions from the RRSP/RRIF will occur in the same tax year for Canadian and U.S. tax purposes.

This election is only valid if a complete Form 8891 is attached to your U.S. income tax return (Form 1040) and your tax return is filed on time.

If you are subject to taxation in a specific U.S. state, you should also be aware that certain U.S. states do not follow the treaty and thus will not allow the tax deferral. As a result, income and gains accrued in your RRSP/RRIF may be taxable on an annual basis for U.S. state tax purposes, even if they are deferred for U.S. federal tax purposes.

The scope of this article does not discuss the specific U.S. state tax obligations for your RRSP/RRIF; therefore, it is important you contact your cross-border tax accountant to discuss possible tax obligations for your RRSP/RRIF under the applicable U.S. state tax laws.

Filing requirements of Form 8891

Form 8891 and its general instructions can be downloaded from the IRS website: www.irs.gov.

A separate Form 8891 must be filed for each RRSP/RRIF for which there is a filing requirement. If you and your spouse file a joint U.S. tax return, each of you must file your own Form 8891 for the RRSP/RRIF that you are the annuitant of.

The IRS has indicated that taxpayers must retain supporting documentation for the information required to be reported, including RRSP contribution receipts, Canadian tax slips T4RSP, T4RIF or NR4, and periodic or annual statements issued by the custodian of the RRSP/RRIF.

Annuitant and beneficiary is one and the same person

Form 8891 and the general instructions for completing the form make a distinction between the “annuitant” and the “beneficiary” of the RRSP/RRIF. For example, the general instructions define “beneficiary” as a person who has to pay U.S. income tax on RRSP/RRIF investment earnings if a treaty election is not made. And they define “annuitant” as an individual who is designated under the RRSP/RRIF as the annuitant.

Although the definitions in the general instructions appear to indicate the annuitant and beneficiary are two separate individuals, they are actually one and the same. Therefore, you should follow the instructions for the beneficiary, which require you to provide treaty-election information in section 6 of Form 8891, instead of following the instructions for the annuitant, which skip the treaty-election procedure.

If you decide not to make a treaty election to defer tax, you must report the undistributed earnings in section 10 of Form 8891 and on your U.S. tax return (Form 1040).

Tax on distributions from your RRSP/RRIF

As you may recall, you were able to deduct your RRSP contributions on your Canadian tax return. However, if distributions were made from your RRSP/RRIF in the year, the whole amount distributed is subject to taxation in Canada. If you were a resident of Canada when the distributions were made, you must report the distributions on your Canadian income tax return, and you will be subject to tax at marginal tax rates.

If you were a non-resident of Canada when the distributions were made, you will be subject to a flat Canadian non-resident withholding tax of 25% or possibly a reduced rate of 15% under the treaty if you lived in the U.S. and the distributions are considered periodic pension payments. Periodic pension payments include payments from a RRIF during the calendar year that were less than the greater of i) twice the minimum withdrawal required for the year or ii) 10% of the fair market value of the RRIF at the beginning of the year.

If you are a resident of a country other than Canada or the U.S., the treaty between Canada and that country (if a treaty exists) may have similar rules and will ultimately determine if the 25% Canadian non-resident withholding tax rate can be reduced.

As a non-resident of Canada, it is also possible to elect to file a Canadian s.217 tax return to report the RRSP/RRIF income and be subject to graduated tax rates instead of a flat non-resident withholding tax rate. However, this may only make sense if the tax at graduated tax rates is lower than the tax at the flat non-resident withholding tax rate. This election is completely voluntary, and you should discuss with your tax advisor whether it makes sense for you to make this election.

For U.S. tax purposes, in most cases, the contributions you made to your RRSP were not tax-deductible. For this reason, the portion of the distributions relating to contributions made to the plans is not taxable. You will need to figure out the taxable distributions from your RRSP/RRIF, report them on Form 8891 and on your U.S. tax return (Form 1040) and pay tax at graduated tax rates on the taxable portion. The calculation of the taxable portion of the distributions may be quite complex and beyond the scope of this article; therefore, you should seek professional tax assistance from your cross-border tax advisor, who can assist you.

You will be able to claim a foreign tax credit on your U.S. tax return for the Canadian taxes paid in order to reduce or eliminate double taxation.

Other reporting requirements

Prior to 2003, some U.S. persons with RRSPs/RRIFs were required to file Form 3520 — Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts or Form 3520A — Annual Information Return of Foreign Trusts with a U.S. Owner, which are very complicated; and substantial penalties could have been incurred if they were not filed on time. However, after 2003, if you are required to file Form 8891, you are no longer required to file Form 3520 or 3520A with respect to your RRSPs or RRIFs. Note that these forms may still be required in other situations, for example, if you are the subscriber of a Registered Education Savings Plan (RESP).

U.S. persons may be required to file Form TD F 90-22.1 — Report of Foreign Bank and Financial Accounts annually. The U.S. imposes foreign reporting requirements if the aggregate balance of your non-U.S. financial accounts exceeds US$10,000 at any time during the year. This includes amounts you hold at Canadian banks, brokerage firms and in registered retirement plans, locked-in retirement plans and Tax-Free Savings Accounts.