Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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Taxation of Canadian registered savings plans for U.S. persons

Understanding the U.S. tax implications

There are a number of registered savings plans available to Canadian residents that provide tax and other benefits (e.g. tax deferral, exemption of income from tax and certain government incentives). These plans are intended to promote savings for various purposes. Some of the common plans include a registered retirement savings plan (RRSP), registered retirement income fund (RRIF), tax-free savings account (TFSA), registered education savings plan (RESP) and a registered disability savings plan (RDSP). U.S. persons who have an interest or involvement in these plans may be subject to punitive U.S. tax, additional U.S. filing requirements and/or even double taxation, making some of these plans undesirable from a U.S. tax perspective. This article summarizes the U.S. tax implications (including U.S. income tax and U.S. transfer tax) that may apply when a U.S. person has an interest in or involvement with these plans (e.g. as a plan owner, contributor of property or beneficiary).

This article is intended for U.S. citizens and other persons considered to be U.S. residents for U.S. income tax and U.S. transfer tax purposes who reside in Canada. The information provided is based on U.S. federal tax and the Canada-U.S. income tax treaty (Treaty). For U.S. tax purposes, a spouse refers to a person to whom you are legally married (it does not include a common-law partner).Therefore, any reference to a spouse in this article refers to a legally married individual only. This article also assumes you have a basic understanding of the Canadian tax and estate planning benefits of these registered savings plans. If you would like further information on one or more of these plans, please ask your RBC advisor for separate articles on these topics.

Overview of the U.S. tax system

Foreign trust rules

The U.S. income tax system includes complex U.S. foreign trust rules. A detailed discussion of the U.S. foreign trust rules and filing requirements is beyond the scope of this article. However, as a general overview, these rules may affect U.S. persons who are involved with a non-U.S. trust (foreign trust). The tax implications to a U.S. person who has an interest or involvement with a foreign trust depends on whether the foreign trust is classified as a foreign grantor or foreign non-grantor trust, as well as the person's role in the trust (i.e. owner, contributor or beneficiary). A Canadian registered plan that is set up in Canada as a trust may potentially qualify as a foreign trust for U.S. income tax purposes. In this article, it's assumed this is the case.

The foreign trust rules can result in the trust income being subject to double taxation or punitive U.S. taxation. A U.S. person involved in a foreign trust may also be subject to annual filing requirements (additional forms and statements) that are in addition to the filing of their annual U.S. income tax return. Note that the U.S. government has provided some relief to U.S. persons from the annual filing requirements associated with foreign trusts for certain registered plans including an RRSP, RRIF, RESP and RDSP (a TFSA is not subject to this relief).

U.S. transfer tax

The U.S. transfer tax system consists of a U.S. gift tax, U.S. estate tax and U.S. generation skipping transfer tax (GSTT). The U.S. transfer tax system is discussed in greater detail in a separate article that you may obtain from your RBC advisor. However, as a general overview, U.S. gift tax may apply to gifts made during your lifetime and U.S. estate tax may apply to the fair market value (FMV) of property you own upon your death. GSTT imposes another layer of gift or estate tax if you make a taxable gift or bequest to a "skip person" such as a grandchild or great-grandchild.

In certain circumstances, U.S. gift tax may apply when contributions are made to a Canadian registered savings plan by a U.S. person or when a distribution is made from the registered savings plan to a beneficiary. Also, a U.S person may be exposed to U.S. estate tax on the FMV of property held in a registered savings plan upon their death.

U.S. tax treatment

The following sections provide an overview of the U.S. tax treatment that applies to a U.S. person who has an interest or involvement in a Canadian registered savings plan (i.e. is the owner, contributor of property or a beneficiary of the plan) based on the U.S. foreign trust rules and the U.S. transfer tax system.

The foreign trust rules can result in the trust income being subject to double taxation or punitive U.S. taxation.

It's important to seek advice from a qualified cross-border tax advisor about whether you should invest in a specific Canadian registered savings plan. In particular, you'll want to consider the after-tax return of investing in this plan, which should take into account both the Canadian and U.S. tax implications of doing so and any additional U.S. tax preparation fees you may incur as a result of investing in the specific registered savings plan.

RRSP and RRIF

If you are the annuitant of an RRSP or RRIF, or named as a beneficiary or successor holder of one of these plans, you are generally not subject to adverse tax treatment. Therefore, an RRSP or RRIF may be appropriate for you.

Contributions to your own RRSP

In general, RRSP contributions are not tax-deductible in the U.S. like they are in Canada. However, contributions to certain company-sponsored group RRSPs are deductible in the U.S. under the Treaty.

Contributions made to your RRSP are not subject to U.S. gift tax. However, you may have exposure to U.S. estate tax on the FMV of your RRSP or RRIF when you pass away.

Relief provided by the Treaty

The U.S may classify an RRSP or a RRIF as a foreign grantor trust. Ordinarily, a U.S. person who makes contributions to a foreign grantor trust is subject to U.S. income tax on the income earned in the trust annually and is subject to additional annual filing requirements. The Treaty, however, provides the following relief:

- An RRSP and a RRIF are treated as pension plans under the Treaty, and as such, you may elect to defer U.S. federal income tax on the income and capital gains earned on property in these plans until there's an actual withdrawal or distribution from these plans. The election to defer is automatic and is made by not including the income or capital gains earned in these plans on your U.S. income tax return. You may also elect to not follow the Treaty deferral provisions and include the income and capital gains earned in the plan annually on your U.S. tax return.
- You are exempt from the additional filing requirements under the U.S. foreign trust rules with respect to an RRSP or a RRIF. This exemption applies regardless of whether you elect to defer the tax on income and capital gains earned in your RRSP or RRIF.

- If you use these plans to invest in a passive foreign investment company (PFIC), which are generally investments classified by the U.S. as non-U.S. investment corporations such as Canadian mutual funds, you may have relief from potentially punitive U.S. tax and reporting rules (known as the PFIC rules) that may otherwise apply. If you would like more information on the PFIC rules, please ask your RBC advisor for a separate article on this topic.
- When you withdraw funds from your RRSP or RRIF, the entire withdrawal is taxable as income in Canada at your marginal tax rate. For U.S. tax purposes, where you have elected under the Treaty to defer U.S. tax until there's a withdrawal, a withdrawal will be considered annuity income and consist of both a taxable and non-taxable portion. The non-taxable portion (called the "investment in the contract") generally represents your original contributions (converted to U.S. dollars using the exchange rate on the date of contribution). The taxable portion is the value of the plan less the investment in the contract. The calculation of the taxable portion of your withdrawal is complex and should be discussed with a qualified cross-border tax advisor.

  With the Treaty election, both Canadian and U.S. income tax is incurred in the same year (i.e. the year when a withdrawal is made). Double taxation is minimized or eliminated due to the ability to claim a foreign tax credit on your U.S. federal income tax return for the Canadian income tax you incurred.

  Where you do not elect to defer U.S. taxation of your RRSP or RRIF under the Treaty, you will report the income and capital gains earned in your RRSP or RRIF annually in the same manner as if the plan was a non-registered account. The income earned in the plan maintains its character for U.S. income tax purposes. Future withdrawals from the plan, which may include previously taxed income and capital gains, as well as your original contributions to the plan, are subject to U.S. tax only to the extent they include an untaxed amount.

  It generally makes sense to elect under the Treaty to defer U.S. tax where you will otherwise incur a U.S. tax liability annually that you are unable to offset with foreign tax credits.

Retiring in the U.S.

If you plan to retire in the U.S., it may be to your advantage not to make the tax deferral election discussed above. This may be appropriate where you expect to have a sufficient amount of excess foreign tax credits relating to other sources of income that can be used to eliminate your annual U.S. tax liability with respect to income and capital gains earned in the RRSP or RRIF. These foreign tax credits may be accumulated during your Canadian residency, as Canadian tax rates are generally higher than U.S. tax rates. These credits can only be carried forward for 10 years for U.S. tax purposes.

> If you're a U.S. person living in Canada, ordinarily you're not subject to U.S. state income tax on your worldwide income.

When you move to the U.S. and become a non-resident of Canada and withdraw funds from your RRSP or RRIF, the entire withdrawal will be subject to a Canadian non-resident withholding tax of 25% (or 15% in certain circumstances). For U.S. tax purposes, the taxable portion of the withdrawal is the value of the plan less the investment in the contract. For a U.S. person, the investment in the contract is generally your contribution to the plan, plus any income included in your U.S. taxable income. The calculation of the taxable portion of your withdrawal is complex and should be discussed with a qualified cross-border tax advisor.

As a result of this strategy, you may end up paying an overall lower rate of tax than you would if you had elected under the Treaty to defer the tax on income earned in your RRSP or RRIF.

U.S. state tax

If you're a U.S. person living in Canada, ordinarily you're not subject to U.S. state income tax on your worldwide income. If you have moved from the U.S. to Canada, you will generally cease U.S. state residency for tax purposes. However, in certain states (such as California), you may continue to be considered a resident of that state for tax purposes if you maintain sufficient residential ties to it or are considered domiciled in that state. Examples of residential ties may include owning a home in that state or the continued residence of certain family members in that state. This may be the case even though you are currently living in Canada, and are considered to be a Canadian resident.

Some states, like California, do not follow the provisions of the Treaty, and will tax income and capital gains earned in an RRSP or RRIF annually. These states may also not allow foreign tax credits for Canadian tax incurred on RRSP or RRIF withdrawals to be claimed on its state tax return. Therefore, if you are subject to U.S. state tax, there is a potential for double taxation of the income and capital gains earned in your RRSP or RRIF.

Pension income splitting

Under Canadian pension income splitting rules, it may be possible to report up to half of your RRIF withdrawal

on your spouse's Canadian tax return. In Canada, each person files a separate individual tax return. Therefore, from a Canadian tax perspective, it may be beneficial to use pension income splitting when your spouse is in a lower tax bracket than you. The U.S. gives married couples a choice of filing their income taxes jointly or separately. If you and your spouse file jointly, the use of pension income splitting generally does not pose any tax problems. However, if you do not file jointly in the U.S., but file separately, there may be a mismatch in terms of the income inclusion for Canadian and U.S. tax purposes that could result in double taxation. As such, careful analysis is required to determine whether pension income splitting will benefit you.

Contributions to a spousal RRSP

If you, as a U.S. person, make contributions to a spousal RRSP, you are considered to have made a contribution to a foreign grantor trust. As the grantor, you are subject to U.S. income tax on income and capital gains earned on those contributions. However, U.S. tax may be deferred by making an election under the Treaty (as discussed earlier) and not including the income on your tax return.

When a withdrawal is made by your spouse from their spousal RRSP and is subject to the Canadian spousal RRSP attribution rules, the amount withdrawn will need to be reported on your Canadian tax return. You may also be subject to U.S. income tax on a portion of the withdrawal made by your spouse from the spousal RRSP. As such, you may claim a foreign tax credit for the Canadian tax you incur on the withdrawal to minimize or eliminate double taxation.

If a withdrawal from a spousal RRSP is not subject to the Canadian spousal RRSP attribution rules or attribution only applies to a portion of the withdrawal, there may be double taxation. This is because you may be subject to U.S. income tax on a portion of the withdrawal made by your spouse from the spousal RRSP, but your spouse is subject to Canadian income tax on this withdrawal. If you and your spouse file separate U.S. income tax returns or your spouse is not a U.S. person and does not file a U.S. return, you will not be able to claim a foreign tax credit for the taxes incurred by your spouse in Canada on your U.S. tax return. However, if you and your spouse file your income taxes jointly in the U.S., you may be able to claim foreign tax credits for your and your spouse's Canadian tax liability on the withdrawal from the spousal RRSP, which may minimize or eliminate double taxation.

Contributions to a spousal RRSP may be subject to U.S. gift tax if your spouse is not a U.S. citizen to the extent you have used up your annual exclusion. Generally, you are not exposed to U.S. estate tax on property in a spousal RRSP on your death; however, your spouse may have exposure

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to U.S. estate tax on the property held in the spousal RRSP upon their death if your spouse is a U.S. person or the plan holds U.S. situated assets.

U.S. beneficiary or successor annuitant

A U.S. beneficiary or successor annuitant (in the case of a RRIF) of your plan is not subject to U.S. income or U.S. transfer tax while you are alive with respect to your plan.

In general, when you pass away, your RRSP or RRIF will be wound up, and the FMV of the plan at the date of death will be included in your final Canadian income tax return. There are exceptions to this tax treatment. For example, if your surviving U.S. spouse is named as the successor annuitant of your RRIF, the plan may continue and your spouse will become the owner of plan. Any tax on the RRIF proceeds that would otherwise result from your death is deferred. If your spouse is named as a beneficiary of your RRSP or RRIF, it may be possible to transfer the property in the plan to your spouse's own RRSP or RRIF on a tax-deferred basis. In each of these cases under the Treaty, U.S. income tax may be deferred until a distribution from the plan is received by the beneficiary or successor annuitant.

If the successor annuitant or beneficiary of your RRSP or RRIF is a U.S citizen spouse, you will not be subject to U.S. estate tax upon your death on the FMV of these plans. Your U.S. citizen spouse may be subject to U.S. estate tax on any property received from your RRSP or RRIF that they continue to hold on their death.

If your spouse is not a U.S. citizen, you may be subject to U.S. estate tax on the FMV of your RRSP or RRIF upon your death to the extent any credits or deductions you may be entitled to claim do not otherwise eliminate or defer your tax liability. This may result in double taxation (i.e. U.S. estate tax to you now and Canadian income tax to your spouse later). You should discuss possible strategies to minimize or eliminate the possibility of double taxation with a qualified cross-border tax advisor.

If your U.S. spouse becomes the owner of your RRSP or RRIF, or transfers the property to their own RRSP or RRIF,

the contributions they make to these plans are not subject to U.S. gift tax. However, your surviving spouse may be exposed to U.S. estate tax on the property held in the RRSP or RRIF upon their death.

Where someone other than your spouse is a beneficiary of your RRSP or RRIF, there will generally only be an opportunity to defer Canadian income tax on the FMV of the property held in your plan on death where the beneficiary of your plan is a financially dependent minor or disabled child or grandchild and certain other conditions are met. There may also be U.S. income tax implications to your U.S. beneficiary with respect to income and capital gains earned on your RRSP or RRIF proceeds after your date of death. Your U.S. beneficiary should seek advice from a qualified cross-border tax advisor on this matter.

For U.S. estate tax purposes, the property in your plan will be included in your taxable estate. If you are subject to Canadian income tax and U.S. estate tax on the property in these plans, foreign tax credits may be utilized to minimize or eliminate double tax. In addition, property owned by a U.S. beneficiary directly or through a registered plan may be exposed to U.S. estate tax upon the beneficiary's death.

TFSA

A TFSA that qualifies as a foreign trust may not be appropriate for a U.S. person due to the U.S tax treatment of income and capital gains earned in the plan and the additional filing requirements under the foreign trust rules. Also, a U.S. beneficiary of a TFSA may be exposed to the U.S. foreign trust rules after the death of the holder until the plan is wound up.

Contributions by TFSA holder

A TFSA may be classified a foreign grantor trust for a U.S. person who makes contributions to the plan. A TFSA is not a tax-free account from a U.S. tax perspective. U.S. income tax applies annually on investment income, including realized capital gains, earned in the plan. If you have adequate foreign tax credits related to Canadian taxes incurred on passive income earned outside this plan, you may be able to use those credits to reduce your U.S. income tax liability with respect to income and capital gains earned in the TFSA. If the TFSA is considered to be a foreign grantor trust, you will also have additional filing requirements. Significant penalties may apply for failing to comply with them.

Unfortunately, the Treaty election that allows you to defer U.S. income tax on income earned in an RRSP or a RRIF is not available for a TFSA. In addition, if you hold PFICs in your TFSA, you may be subject to the PFIC rules.

A TFSA that qualifies as a foreign trust may not be appropriate for a U.S. person due to the U.S tax treatment of income and capital gains earned in the plan and the additional filing requirements under the foreign trust rules.

Contributions you make to your own TFSA are not subject to U.S. gift tax. However, the property in your TFSA may be exposed to U.S. estate tax on your death. As well, while you cannot contribute to your spouse's TFSA directly (as only a holder can contribute to their own TFSA), if you gift funds to your spouse to enable them to make contributions, you may be exposed to U.S. gift tax if your spouse is not a U.S. citizen to the extent you exceed the available annual exclusion.

U.S. beneficiary or successor holder

A U.S. beneficiary or successor holder of your TFSA is not exposed to U.S. income or U.S. transfer tax during your lifetime. If you designate someone as the beneficiary of your TFSA, upon your death, the plan will be wound up and the property in the plan will be transferred to them. If you designate your spouse as a successor holder, the plan will continue with your spouse as the new plan holder.

For U.S. tax purposes, your TFSA may continue to be classified as a foreign grantor trust until your plan is wound up. This means a U.S. beneficiary would pick up the income and capital gains earned in the TFSA on their annual U.S. tax return, even if it was not paid out.

Where a surviving spouse is the successor holder of your TFSA, the TFSA will be classified as a foreign grantor trust and your U.S. spouse will be subject to the U.S. foreign trust tax and reporting requirements.

If the successor holder or beneficiary of your plan is a U.S citizen spouse, you will not be subject to U.S. estate tax on the TFSA assets upon your death. However, your U.S. citizen spouse will include the TFSA property in their estate upon their death. If your beneficiary or successor holder is your spouse, but is not a U.S. citizen, or is someone other than your spouse, you may be subject to U.S. estate tax on property held in your TFSA, to the extent any credits or deductions you may be entitled to do not otherwise eliminate or defer your tax liability.

If your beneficiary is a U.S. person and they contribute the property received from your TFSA to their own TFSA, the foreign grantor trust rules will apply in respect of the property contributed to their own plan. The beneficiary will not be subject to U.S. gift tax on this contribution or any further contributions made by them to their TFSA.

Your beneficiary or successor holder may be subject to U.S. estate tax on property in their TFSA or property held directly by them upon their death.

RESP

Ideally, a U.S. person should not be the subscriber of an RESP nor a contributor to an RESP where the RESP will qualify as a foreign grantor trust, due to the risk of double taxation of the income earned in the RESP and the government grant and bond paid into the plan. If the RESP is considered to be a foreign grantor trust, a U.S. beneficiary of an RESP will not be subject to U.S. income tax when they receive a distribution from the plan, provided the necessary filing requirements are met. However, if the plan is classified as a foreign non-grantor trust, punitive U.S. tax rules may apply to a distribution received by a U.S. beneficiary from this plan, making an RESP less desirable for them. These concepts are discussed further in the following sections.

U.S. subscriber

Generally a U.S. person who's a subscriber of an RESP is treated as an owner of a foreign grantor trust for U.S. tax purposes because they may reclaim contributions made to the RESP under certain conditions. This is also the case where the subscriber is not a U.S. person. However, a subscriber who is U.S. person, is subject to U.S. income tax annually on: 1) income earned on your contributions to the RESP (excluding unrealized capital gains); 2) government grant paid into the plan as a result of those contributions; 3) government bond paid into the plan; and 4) income earned in the plan on the grants and bonds. When these amounts are eventually distributed to the RESP beneficiary or to you, you are not subject to further U.S. income tax.

You may also be subject to tax on income and capital gains earned on contributions made to the RESP by a third party, as well as grant paid into the plan as a result of these contributions and income and capital gains earned on the grant. (See discussion related to third-party contributor in the next section for more information).

There is no relief under the Treaty to defer U.S. income tax on income and capital gains earned in the plan, which is available for retirement plans, such as RRSPs and RRIFs. There's also no relief from the PFIC rules if you hold these investments in an RESP.

Contributions you make to an RESP are not subject to U.S. gift tax. However, there may be U.S. gift tax when distributions from the RESP are received by a beneficiary of the plan (unless you are the beneficiary). You may also be subject to U.S. estate tax on the value of the property in the RESP upon your death.

Ideally, a U.S. person should not be the subscriber of an RESP nor a contributor to an RESP where the RESP will qualify as a foreign grantor trust, due to the risk of double taxation of the income earned in the RESP and the government grant and bond paid into the plan.

U.S. third-party contributor

A U.S. third-party contributor to an RESP may be treated as an owner of a foreign grantor trust with respect to their contributions to the RESP if they are the beneficiary of the RESP, their spouse is a beneficiary of the RESP, or another U.S. person is a beneficiary of the RESP. Where the trust is a foreign grantor trust, the U.S. contributor is generally subject to the same tax treatment that applies to a U.S. subscriber of an RESP.

If a third-party contributor is not a U.S. person and they do not have the authority to take back the funds contributed, the contributor will not be considered the owner of a foreign grantor trust with respect to their contributions, regardless of whether their spouse is a beneficiary of the RESP or another U.S. person is a beneficiary of the RESP. In this case, if the subscriber of the plan is a U.S. person and they have the authority to take out the contributions made by the third-party contributor to the RESP for their own benefit, the U.S. subscriber will generally be subject to the same foreign grantor trust tax treatment as discussed earlier, where the contributions were made directly by a U.S. subscriber. If the subscriber is not a U.S. person, the RESP will qualify as a foreign non-grantor trust with respect to the third-party contributor's contributions.

When a U.S. beneficiary receives a distribution from an RESP that qualifies as a foreign non-grantor trust, the beneficiary may be subject to punitive U.S. tax rules (known as the throwback rules) with respect to the portion of the distribution that represents income that has accumulated in the plan and was not paid out in the year it was earned. The portion of the distribution that represents accumulated income would include income earned on the contributions made by the third-party contributor, government grants paid into the plan as a result of those contributions, government bonds paid into the plan, and income earned on those grants and bonds. When paid out, the portion considered to be accumulated income loses its character and is taxed as ordinary income. An interest charge is also applied based on the tax on the accumulated income. While a U.S. beneficiary may be able to claim a foreign tax credit on their U.S. income tax return for Canadian income tax paid on the

RESP distribution, if any, it may not completely eliminate the beneficiary's U.S. tax liability.

A U.S. contributor to an RESP who does not have the authority to determine who receives the funds contributed and cannot take back their contributions may be subject to U.S. gift tax on contributions made to the RESP. However, they are not subject to U.S. estate tax on property in the RESP when they pass away.

Note that each financial institution may have their own internal policies relating to third-party contributions. Check with your financial institution to determine if there are any restrictions with respect to contributions made by a third party and withdrawals of these contributions.

U.S. beneficiary

If a U.S. beneficiary is also the subscriber of the RESP or has made contributions to the RESP, the RESP may qualify as a foreign grantor trust in respect of the U.S. beneficiary. In this case, the U.S. beneficiary is subject to U.S. income tax on the income and capital gains earned on the contributions, the grant paid into the plan as a result of those contributions, bond paid into the plan and income earned on the grant and bond paid into the plan annually. No further U.S. income tax will apply to these amounts when they're distributed from the RESP to the beneficiary

Where someone else is a subscriber and/or contributor to the RESP, and the RESP is a foreign grantor trust in respect of such persons (as discussed earlier), a U.S. beneficiary is not subject to U.S. income tax when they receive a distribution from the RESP, provided the necessary U.S. tax filings have been made. Your U.S. beneficiary should speak to a qualified cross-border tax advisor to determine what filings must be made to ensure this tax treatment. If the required U.S. tax filings are not made in this circumstance, the distribution may be treated as a distribution of accumulated income from a foreign non-grantor trust and may be subject to punitive U.S. taxation (i.e. the throwback rules discussed earlier).

When the RESP qualifies as a foreign non-grantor trust (which could be the case when a subscriber or contributor passes away, discussed in more detail later in this article), a distribution received by a U.S. beneficiary from the RESP may be subject to punitive U.S. taxation, i.e. throwback rules. A U.S. beneficiary may be able to claim a foreign tax credit on their U.S. income tax return for Canadian income tax paid on the RESP distribution to minimize double taxation; however, there may be a higher overall tax paid as a result of the potentially higher U.S. tax liability.

Contributions made to an RESP by a U.S. beneficiary who is not a subscriber to the plan, who doesn't have authority to determine who receives their contributions and who cannot take back the funds contributed may be subject to U.S. gift tax. However, in this case, the U.S. beneficiary will generally not be subject to U.S. estate tax on the property held in the RESP when they pass away.

To minimize or eliminate the potential for double taxation, it may be best to ensure the subscriber or contributor to an RESP is not a U.S. person, as they are generally not subject to U.S. tax (even though from a U.S. tax perspective, the RESP is a foreign grantor trust with respect to these non-U.S. persons).

Double taxation – RESP

There is the potential for double taxation due to differences in the Canadian and U.S. tax treatment of an RESP. For example, generally for Canadian tax purposes, income and capital gains earned in the RESP will not be taxable until the year in which it is distributed to a beneficiary (as an educational assistance payment), or under certain circumstances, to the subscriber (as an accumulated income payment). At that time, the income and capital gains will be taxable in the beneficiary's or subscriber's hands. For U.S. tax purposes, however, a U.S. subscriber or contributor may be subject to tax annually as a result of the foreign grantor trust rules. Foreign tax credits can't be claimed where different taxpayers are subject to Canadian and U.S. taxation and generally, when taxes in each country are incurred in different tax years. As a result, there may be double taxation.

To minimize or eliminate the potential for double taxation, it may be best to ensure the subscriber or contributor to an RESP is not a U.S. person, as they are generally not subject to U.S. tax (even though from a U.S. tax perspective, the RESP is a foreign grantor trust with respect to these non-U.S. persons).

If you're currently a subscriber to an RESP, you may wish to determine whether you can change the subscriber and replace yourself with a non-U.S. person and whether it would make sense to do so to minimize any U.S. tax issues. You should speak to a qualified tax advisor to determine the steps you may need to take to change the subscriber of the plan. From a U.S. tax perspective, if the beneficiaries of the RESP are U.S. persons or your spouse, the RESP will continue to be a foreign grantor trust to you and you will continue to be subject to tax on the income and capital gains earned on your original contributions to the plan, grant paid into the plan as a result of those contributions and bond paid into the plan.

If the beneficiaries of the RESP are not U.S. persons or your spouse, then provided you name someone who is not a U.S. person and someone other than your spouse as a replacement subscriber, you will no longer be subject to U.S. income tax on the income and capital gains earned in the RESP. This will, however, change the trust's classification from a foreign grantor trust to a foreign non-grantor trust, and will result in a deemed disposition for U.S. tax purposes of the assets held in the trust related to the contributions you made and the grants and bonds in the plan while you were the grantor. The net capital gains will be taxable to you as the U.S. grantor on your U.S. tax return.

You may be subject to U.S. gift tax as a result of transferring your interest in the plan to a new subscriber. However, once you replace yourself as subscriber of the RESP, you will not be subject to U.S. estate tax on the property in the RESP on your death, unless you pass away within three years of the date of replacement.

Before removing and replacing yourself as subscriber, it's important to consider that you may no longer have access to the contributions made to the plan. Depending on the terms of the RESP, if your contributions are not used by the beneficiary of the RESP, the new subscriber may be able to take back these contributions and they will become their property.

Death of a subscriber/third-party contributor

Subscriber's death

As previously mentioned, if you are a subscriber to an RESP, on your death, you may be subject to U.S. estate tax on the property in the RESP.

Where a subscriber passes away and a successor subscriber is named, subject to the terms and conditions of the RESP, the successor subscriber may have the same rights as the previous subscriber. This may include the ability to take out the contributions made to the plan by the deceased subscriber and any third-party contributors. If this is the case, and the successor subscriber is a U.S. person, the RESP may continue to qualify as a foreign grantor trust for the successor subscriber, not only with respect to new contributions made to the plan but also with respect to the contributions made by the deceased subscriber. The tax implications discussed earlier for a U.S. subscriber will apply to the successor subscriber going forward.

If the successor subscriber is not a U.S. person, even if they are a spouse, the plan may be reclassified as a foreign non-grantor trust with respect to the deceased subscriber's contributions. A U.S. beneficiary may be subject to the U.S. throwback rules on any future income and capital gains earned on the property existing in the plan at the time of the subscriber's death.

> Ideally, a U.S. person should not be the holder of or contributor to an RDSP due to the foreign trust rules and the risk of double taxation.

If a successor subscriber does not immediately take over the plan, the RESP may also qualify as a foreign non-grantor trust for its U.S. beneficiaries in respect of the contributions made by the deceased subscriber. A U.S. beneficiary may be subject to punitive taxation when they receive a distribution from the plan that consists of income and capital gains earned on the property in the plan since the date of the subscriber's death.

Third-party contributor's death

If you're a third-party contributor, on your death, you're generally not subject to U.S. estate tax on property in the RESP unless you have the authority to determine who receives the funds contributed to the RESP or the authority to take back your contributions. When a third-party contributor of the RESP that is a foreign grantor trust passes away, the RESP may be reclassified as a foreign non-grantor trust with respect to their contributions. This would occur where the subscriber is not a U.S. person or if the subscriber is a U.S. person, where they don't have the ability to take out the contributions made to the plan by a third-party contributor. A U.S. beneficiary may be subject to punitive U.S. taxation when they receive a distribution of income or capital gains earned on the third party's contributions after the third-party contributor's death.

RDSP

Ideally, a U.S. person should not be the holder of or contributor to an RDSP due to the foreign trust rules and the risk of double taxation. Where a U.S. person is the beneficiary of an RDSP that is classified as a foreign grantor trust, and the holder or contributor is not a U.S. person, an RDSP may be appropriate, provided the necessary U.S. filings (where required) are made by the U.S. beneficiary under the foreign trust rules. Where the RDSP qualifies as a foreign non-grantor trust, it may not be appropriate for a U.S. beneficiary due to the punitive U.S. tax treatment that may apply.

U.S. holder or contributor

The U.S. tax treatment for a U.S. person who's the holder of or contributor to an RDSP will depend on whether the RDSP qualifies as a foreign grantor or foreign non-grantor trust.

If you, as a U.S. person, are the holder of or contributor to an RDSP and you're the beneficiary of the plan, or the plan beneficiary is your spouse or another U.S. person,

the RDSP will qualify as a foreign grantor trust in respect of the contributions you make to the plan. Otherwise, the RDSP will qualify as a foreign non-grantor trust.

A U.S. holder of or contributor to an RDSP that qualifies as a foreign grantor trust is subject to U.S. income tax on the income and capital gains earned on the contributions made to the plan, government grant paid into the plan as a result of those contributions, government bond paid into the plan and on the income earned on the government grant and bond. An election under the Treaty to defer U.S. income tax on the income and capital gains earned in the plan is not permitted like it is for a retirement plan such as an RRSP and a RRIF. If PFICs are held in the plan, the PFIC reporting rules will apply.

A U.S. holder or contributor to an RDSP that qualifies as a foreign non-grantor trust is not subject to U.S. income tax.

For U.S. gift tax purposes, a U.S. holder or contributor may be subject to U.S. gift tax on contributions made to the RDSP regardless of whether the RDSP qualifies as a foreign grantor or foreign non-grantor trust because you cannot take back the contributions made. However, as a holder or contributor, you are not subject to U.S. estate tax on the property held in the RDSP upon your death, provided you are not also the beneficiary of the plan.

U.S. beneficiary

When a U.S. person is a beneficiary of an RDSP as well as the holder or contributor, the RDSP will qualify as a foreign grantor trust. The beneficiary is subject to U.S. income tax annually in the same manner that applies to a U.S. holder of or contributor to an RDSP that qualifies as a foreign grantor trust.

If a U.S. beneficiary is not the holder of or contributor to an RDSP, but the RDSP is classified as a foreign grantor trust in respect of someone else who is the holder of or contributor to it, the U.S. beneficiary is not subject to U.S. income tax when they receive a distribution from the plan, provided certain informational filing requirements under the foreign trust rules are met.

If the RDSP qualifies as a foreign non-grantor trust, the U.S. beneficiary may be subject to punitive U.S. tax under the throwback rules (discussed earlier) on accumulated income earned in the plan when they receive distributions from the plan.

U.S. gift tax does not apply to contributions made to an RDSP by a U.S. beneficiary of the plan. However, a U.S. beneficiary may have exposure to U.S. estate tax on the assets in the RDSP when they pass away.

When a U.S. person is a beneficiary of an RDSP as well as the holder or contributor, the RDSP will qualify as a foreign grantor trust.

Double taxation

For Canadian and U.S. tax purposes, there could be a mismatch in the timing of taxation in respect of an RDSP in each country and different individuals may be subject to tax. This results in double taxation because foreign tax credits cannot generally be claimed for taxes incurred in prior years and taxes incurred by different individuals. This may occur, for example, when a U.S. holder or U.S. contributor is subject to U.S. tax annually under the U.S. foreign trust rules and the RDSP beneficiary is subject to Canadian tax when a distribution from the plan is received.

Replacement of RDSP holder during lifetime and upon death

Replacing a U.S. holder during their lifetime

If a U.S. person is the holder of an RDSP that has a U.S. beneficiary and qualifies as a foreign grantor trust, and it's necessary to replace the holder with another individual (i.e. because the current holder is no longer qualified to be a holder), the U.S. holder will generally still be subject to U.S. tax under the foreign grantor trust rules during their lifetime based on the contributions made to the plan and the government grant and bond received by the plan while they were the holder of the plan.

If the replacement holder is the U.S. beneficiary of the plan, or another U.S. person, the RDSP will be a foreign grantor trust for the replacement holder in respect of any contributions the new holder makes to the plan and on government grant and bond paid into the plan. If the replacement holder is not a U.S. person, the RDSP will be a foreign non-grantor trust with respect to the new contributions and the government grants and bond paid into the plan.

When a foreign grantor trust becomes a foreign non-grantor trust, there's a deemed disposition of the assets in the grantor trust that relate to the contributions they made to the plan and any grant and bond paid into the plan while they were the grantor. The U.S. grantor who is being replaced would include in income any net capital gain realized as a result of this disposition.

Death of U.S. holder or third-party contributor

When a U.S. holder of or contributor to an RDSP passes away, they will not be subject to U.S. estate tax on the value of the RDSP assets, provided they're not also the beneficiary of the plan.

If the RDSP is a foreign grantor trust and the U.S. holder or contributor passes away, the plan may be reclassified as a foreign non-grantor trust in respect of the contributions made by the deceased U.S. holder or contributor. If the beneficiary becomes the holder of the plan, it may continue as a foreign grantor trust and the beneficiary will be subject to U.S. tax annually on the income and capital gains earned in the plan, and any government grant or bond paid into the plan and income and gains earned on them.

Where the RDSP becomes a foreign non-grantor trust, a U.S. beneficiary may be subject to the punitive U.S. throwback rules when they receive a distribution from the plan. However, these rules will only apply to income and capital gains that accumulate in the RDSP on the property contributed by the deceased holder or contributor after their date of death, as well as any income earned on the grant paid into the plan as a result of the deceased holder's or contributor's contributions.

Summary

Various types of Canadian registered savings plans provide tax benefits and advantages for Canadian residents. However, where a U.S. person living in Canada is involved in these plans, U.S. tax laws must be considered. Sometimes, the U.S. tax implications are punitive, may outweigh the Canadian tax benefits and may render the plan inappropriate. If you're a U.S. person living in Canada, speak to a qualified cross-border tax professional for advice before participating in one of these plans.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.

Wealth Management