

# United States: IRS makes it easier to claim favourable treatment on certain Canadian retirement plans

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## In brief

The Internal Revenue Service (IRS) recently issued [IR 2014-97](#) and [Rev. Proc. 2014-55](#) that make it easier for taxpayers who are beneficiaries of either of two popular Canadian retirement plans to obtain favourable US tax treatment. The IRS simplified procedures by eliminating the filing of certain forms and allowing automatic qualification for this treatment if an individual meets the criteria.

## In detail

### Background

Article XVIII (*Pensions and Annuities*), paragraph 7, of the US-Canada income tax treaty permits US citizens and resident aliens to defer tax on income accruing in certain Canadian pension and employee benefits plans until it is distributed. Otherwise, this income may be considered taxable, even if it is not distributed. Without such relief, double taxation may arise due to the mismatch in timing under US and Canadian laws.

In the past, taxpayers elected this treaty benefit in relation to two of the more popular plans, registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs) on Form 8891 (*U.S. Information Return for*

*Beneficiaries of Certain Canadian Registered Retirement Plans*) and attached it to their timely filed US income tax return. If a taxpayer failed to do this, the primary way to correct the omission and retroactively obtain the treaty benefit was to request a private letter ruling from the IRS, a costly and often time-consuming process. More recently, taxpayers were permitted to correct failures via 'streamlined procedures', but these too carried qualification requirements and penalty exposure.

Taxpayers who participated in RRSPs and RRIFs were also previously required to file Form 8891 each year and report details about each RRSP and RRIF, including contributions made, income earned and distributions

made, regardless of whether they chose the special tax treatment.

### Automatic qualification for certain tax deferral

[Rev. Proc. 2014-55](#) announced that the IRS is eliminating Form 8891 as of December 31, 2014. Taxpayers are no longer required to file the form for any year, past or present. Also, the IRS is eliminating the annual reporting requirements on Form 8891 which had replaced reporting obligations imposed by Form 3520 (*Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*) that was previously applicable to RRSP and RRIF plans.

The change will allow eligible individuals (such as Canadians that are tax

resident in the US) with RRSPs and RRIFs to automatically qualify for tax deferral similar to that available to participants in US individual retirement accounts (IRAs) and 401(k) plans.

### **Eligible individuals**

In general, US citizens and resident aliens who are beneficiaries of a Canadian retirement plan qualify for this special treatment as long as they filed and continue to file US income tax returns for any year they were required to do so and have properly reported any and all distributions as income on their US returns. Also, the individual must not have reported any RRSP and RRIF plan earnings as US taxable income during any taxable year in order to be eligible.

### **Relief for individuals who failed to elect**

An eligible individual who did not previously make an election pursuant to the US-Canada income tax treaty to defer US tax on the earnings associated with the RRSP or RRIF plans will be treated as having made the election. Moreover, they will be deemed to have made such election in

the first year in which the individual would have been entitled to the benefit. In effect, the IRS is granting retroactive relief, assuming the individual meets the criteria for eligibility. Such relief does not require use of the streamlined program, offshore voluntary disclosure programs, ruling requests or amended returns.

### **The takeaway**

The changes are welcome relief for mobile individuals that are beneficiaries of an RRSP or RRIF. Most notably, the new procedures reduce the amount of information needed to accompany an individual's US income tax return.

Notwithstanding, interests in these plans may still be reportable under other US reporting regimes including Form 8938 (*Statement of Specified Foreign Financial Assets*) and FinCEN 114 (*Report of Foreign Bank and Financial Accounts (FBAR)*). Previously, a person who timely filed Form 8891 with respect to an RRSP or RRIF was exempt from reporting those interests on Form 8938 as long as they noted that Form 8891 was also

being filed. Presumably Form 8938 will be amended to reflect this new change.

Form 8891 will not be eliminated until December 31, 2014. For those individuals who have not yet filed their 2013 individual income tax return but will do so this year, the Form may still be filed in order to utilize the exception noted on Form 8938.

Another important benefit under the new IRS guidance is the retroactive relief provided to eligible taxpayers who failed to properly elect this favourable US tax treatment in the past. The relief will allow them to enjoy US tax deferral without the burden and cost of obtaining a private letter ruling, participating in certain programs, and filing amended returns.

As a final note, the new IRS guidance applies only to *income accrued* in a Canadian retirement plan and addressed in Article XVIII, paragraph 7 of the US/Canada income tax treaty, and not to any *contributions* to the plan. The latter requires a separate analysis of US and treaty rules.

## **Let's talk**

For a deeper discussion of how this issue might affect your business, please contact your IAS engagement team or one of the following team members:

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