Transferring Your IRA / 401k to Canada

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When moving between Canada and the USA, there are common challenges that individuals often face. Aside from the practical aspects of the move, there are also tax and financial considerations to assess. In particular, you may have accumulated savings in a recognized retirement arrangement like a 401k plan or an individual IRA. What should one do with these retirement plans if your move across the border and what are some of the consequences? There is no simple answer for the procedure to follow but below are some tips and general information.

Issues and Concerns

Often expatriate employees accrue retirement and or pension benefits while working for an employer. If you decide to move back home (Canada in this case), what should you do with the 401k or IRA account? Your choices are to (a) leave it in the US and have someone manage the investments for you; (b) cash out the plan and pay a lot of unnecessary tax; (c) start to a retirement distribution (if you are of retirement age); (d) transfer the plan to an RRSP in Canada.

An added complexity in the above four choices is that they are affected by tax implications and securities regulations.

401k/IRA Options

A 401k is an employer sponsored defined contribution (DC) retirement arrangement. If contributions were made by your employer while you were a resident of US, you will be allowed to make a transfer of a lump-sum payment from your 401k. Specifically, you will be able to transfer a 401k to a rollover IRA (employer permitting) and then transfer the IRA to a Canadian RRSP.

Leave 401k/IRA

If you choose this option, you would essentially leave the plan intact until you require the income during retirement. Unless the manager of the 401k permits, you may be required to transfer the 401k to an IRA. If you are over the age of 59.5, you would see a 20% withholding tax on your distributions. If you are under this age threshold, there would be an additional 10% penalty tax unless you meet certain conditions. There would be no real tax implications on the earnings within the plan until you begin to make withdrawals. CRA would typically tax you on an IRA if the IRS would view a similar position, which is normally once you start withdrawals.

Choosing to leave the plan as is in the US can also lead to other complications. Many investment firms and brokerages will not allow an investment account (retirement account or otherwise) to be held by a non-resident. You will need to open an investment account with either a discount/online broker or a full service investment firm before terminating your US residency. If you wait until you have moved to Canada to secure investment accounts and initiate transfers of IRAs, it may be cumbersome although not impossible. Unlike some Canadian investment firms, US investment firms are very reluctant to have an investment/retirement account held by a non-resident of the US.

Cash Out 401k/IRA

This is option is perhaps the least favored. There is no compelling reason why you should redeem your IRA and cash out the plan, unless you really need the cash. It doesn't make sense from either an investment or tax perspective.

Transfer 401k/IRA

The transfer of a 401k ultimately to an RRSP usually occurs as follows:

1. Open a Rollover IRA account with an investment firm capable of crossborder investment management.
2. Rollover the 401k to an IRA while still a resident of the US. You cannot roll a 401k directly to an RRSP.
3. Withdraw all of the IRA as a Canadian resident (you will be assessed 20% withholding tax, possibly reduced to 15%). If you are under 59.5 years, there will be an additional 10% penalty which is not recoverable.
4. The net resulting lump sum payment is then transferred to an RRSP. The subsequent deposit into an RRSP must occur in the year of withdrawal or within 60 days of year-end. Determine the value of the transfer in Canadian dollars.
5. The full gross withdrawal including the withholding tax is included as Canadian income with a deduction referencing a section 60(j)(ii) transfer. This results in no additional tax liability to Canada.
6. The 20% withholding tax paid to the IRS in #3 above may be claimed as a foreign tax credit (FTC) for Canadian tax purposes. FTCs require a more detailed explanation.

Now the complications. The 401k must be a transferrable plan with a lump sum transfer in recognition of pension or superannuation tenure and employment services rendered while a non-resident of Canada. There are different rules for individuals living in Canada and working in the US or in the case of temporary employees working in the US for less than 5 years.

The withholding tax paid to the IRS that is claimed as a foreign tax credit in Canada requires the advice of a tax practitioner. Generally, the taxes paid in the US can be used to reduce the tax liability in Canada. However, since the concept of FTCs are multi-faceted, it can take several years of claiming credits to attempt to reduce the initial 20% withholding tax that was paid, and depending on the amount, may never be recovered.

Bear in mind that you haven't really paid tax to Canada yet on the IRA withdrawal, only to the IRS. Therefore, you need to have sufficient Canadian income tax owing for certain sources in order to utilize the FTCs. Canada views the IRA withdrawal as a transfer while the US views it as an early lump sum withdrawal and thus applies the 20% withholding tax.

Furthermore, you should also discuss the transfer with your tax practitioner as well as the Canada Revenue Agency to ensure that you manage not only the tax liability but also any benefits that may be affected once withdrawals begin, particularly if you are a beneficiary of a 401K or IRA (inherited plan).

A final distinction also needs to made if the IRA account has been subject to proceeds from a ROTH conversion Such conversions would taint the account and this technique would become muddied because Canada does not recognize ROTH plans in the same context as "foreign retirement arrangements." Furthermore, TFSAs and ROTHs are separate categories with another set of rules and guidelines for anyone wishing to move across jurisdictions.

Transfer from RRSP/LIRA to IRA

Thus far we have only explored the mechanics of a person moving from the US to Canada but what solutions exist for a person moving from Canada to the US? Unfortunately, RRSPs or LIRAs (locked-in plans) cannot be transferred to an IRA. Please also be aware that the place and timing of these transactions should be aligned with pre- and post-move planning that captures the realities of residency and ceasing of non-residency. Many aspects of the information contained herein can also be applicable to retirement arrangements from other countries like the United Kingdom.

For further, detailed information, please feel free to contact the author Naveen Gopal at naveen@pacificapartners.com or at **1-877-576-8908**.

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