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PENSIONS

Dealing with cross-border obstacles

Employees with individual retirement accounts may need a little help

By Darren Coleman

Today, more than one million Americans live and work in Canada, and an even larger number of Canadians live and work in the United States. Those with an individual retirement account (IRA) who are permanently or temporarily residents in Canada may find their American financial institution will no longer hold their IRA, and ask them to move it.

Similarly, few investment firms will open new IRA accounts for Canadian residents, leaving them with significant taxes and penalties. (This situation does not affect Canadians with retirement savings plans when moving to the U.S.)

Take, for example, the CFO of a U.S. pharmaceutical company who took a posting in Canada to manage the company's interests north of the border. His U.S. investment advisor said he had 90 days to move his IRA to Canada, or cash it out and pay the tax. This was a surprise to him.

According to Securities Exchange Commission (SEC) legislation, an advisor must be registered in the jurisdiction where the person resides. This means the CFO's U.S. financial institution would no longer represent him because he was now non-resident there.

Another American who was also moving to Canada — with US$3 million invested in an IRA-registered account — had the same problem. She had 90 days to move the account, or she would face taxes of US$230,000.

In both cases, the executives worked with and obtained tax advice through their respective HR departments. As they participated in workplace 401K pension plans and IRA plans, the transition across the border was made with the co-operation and advice of their employers.

Rules for salespeople

The Securities Exchange Act of 1934 says Canadian salespersons cannot deal with clients in the U.S. unless registered with a dealer who, in turn, is registered in both countries. Otherwise, they may face charges. The initial intent of this act was to protect investors by having their advisors and financial institutions registered where they lived.

In 2000, the SEC granted an exemption from broker-dealer registration for firms and salespersons dealing with U.S. residents who have Canadian self-directed, tax-advantaged retirement plans such as registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs). The exemption is subject to certain conditions but the net result is that in most states, a Canadian can retain RSP accounts in Canada and continue to benefit from the tax deferral offered.

Americans in Canada, or Canadians returning home with 401K pension plans and IRAs in tow, don't have the same benefit. The issue is not that the 401K pension plan or IRA becomes immediately taxable — the Canada-U.S. Income Tax Convention says residents may enjoy continued tax deferral of their IRA, 401K plan and Roth IRA balances once they return to Canada, just as they would if they were still U.S. residents.

However, continuing tax deferral is not automatic; many Canadian plan owners must file an election each year with their Canadian tax returns to defer tax on their IRA and 401K plan balances. Curiously, the Canada Revenue Agency (CRA) provides no guidance for plan owners wanting to make this election except for Roth IRAs.

This doesn't seem like a tax issue, which is why most tax and HR professionals don't catch it when advising clients about moving across the border. One client was informed by her accountant there would be no tax consequences in returning to Canada, only to have her U.S. brokerage firm tell her the IRA had to be transferred or moved within 90 days, or it would be cashed out, resulting in more than US$250,000 in tax.

This is not initially a tax problem but a regulatory and compliance issue that becomes a tax problem.

The challenge? Most U.S. brokers and financial institutions won't maintain IRA accounts for people who return to Canada because of recent changes from Canadian securities administrators regarding registration requirements for all broker, dealer and advisor firms doing business here. After reviewing exemption requirements for individual investors and registration requirements for dealers, many of them feel that the cost and complexity to comply outweigh retaining the client. So they terminate those relationships and ask for the accounts to be transferred to another firm and advisor.

The taxpayer must then find an institution to take on a new account for a Canadian resident, which can be time-consuming and frustrating. There have also been situations where a U.S. institution took on the account and then changed its mind during the transfer process.

Canadian investment firms cannot open IRAs since these are U.S. tax-sheltered plans. While it may be possible for the proceeds of an IRA to be moved to an RSP, it's rare. Only lump sum amounts (not periodic payments), contributed by the plan owner or spouse to an IRA, may be transferred to the plan owner's RRSP.

Employer contributions to the plan owner's IRA may not be transferred to an RRSP unless the plan owner has enough existing RRSP contribution room to accept the employer contributions.

What should an investor with an IRA do when returning to Canada? Find a way to leave the IRA in the U.S. by working with an advisor who is fully licensed in both countries and can offer an IRA to Canadian residents.

This is the best option since the IRA is not liquidated, so it can still be managed by the client and a qualified financial advisor while the client is in Canada. Also, it can remain intact should the plan holder return to the U.S.

The challenge is finding an institution that offers such a service. This solves the problem of having an IRA while residing in Canada. Indeed, U.S. financial firms happily transfer the accounts of American residents to such institutions. It removes them from any regulatory challenges in dealing with a non-resident, and lets them avoid liquidating an IRA.

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