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CROSS-BORDER WEALTH MANAGEMENT

U.S. IRAs Can Be a Taxing Issue for **Canadian Beneficiaries**

An individual retirement account (IRA) is a personal savings plan offered in the United States. Similar to the Canadian registered retirement savings plan (RRSP), the IRA offers income tax benefits to individuals who are saving money for retirement. But what are the tax implications when a Canadian citizen inherits a U.S. IRA?

Let's look at an example to see how this works. Let's say you have an Aunt Betty in Ohio. She dies and then names you as the beneficiary of her traditional IRA, and you inherit the lump sum distribution of $100,000. Because you're a Canadian resident who only spends a week or two every year in the U.S., you assume you'll be getting that money free of taxes since it's an inheritance. Think again. Before you go spending that $100K, it's important to consider the tax consequences on each side of the border.

On the U.S. Side

As is the case with the Canadian RRSP, IRA contributions are tax deductible and can grow tax deferred inside the plan. Taxes are payable upon the money's withdrawal from the plan. If Aunt Betty's IRA beneficiary had been a relative living in the U.S., the amount paid from that IRA to that beneficiary would typically be subject to U.S. taxes.

As a nonresident beneficiary of the IRA, you'd generally need to pay a flat income tax rate of 30% on the distribution. In addition, a beneficiary who is a nonresident alien would be subject to 30% federal U.S. income withholding upon distribution of the IRA. Fortunately, under the Canada/U.S. Tax Treaty, the tax and withholding rates drop to 15%. In order to qualify for this lower rate, it is necessary to complete and submit IRS Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding) to the custodian or trustee for the IRA.

On the Canadian Side

When an IRA is inherited by a beneficiary living in Canada, the amount paid from the IRA to the individual is typically taxable in Canada—in addition to being subject to U.S. tax. When filing a tax return in Canada, you must include the distribution from the IRA with your income. This will allow you to claim a foreign tax credit for the taxes paid to the U.S, including any U.S estate taxes paid on the IRA.

Unique Opportunity

Despite the tax implications described above, a unique opportunity could also be utilized to allow for the continued tax-deferred growth of the IRA in both Canada and the U.S. Under certain rules, beneficiaries of IRAs could establish what is referred to as an "Inherited IRA" account. U.S. resident beneficiaries typically utilize these accounts to minimize current tax. The cross-border specialists at Cardinal Point Wealth Management often assist beneficiaries that live in Canada in the establishment of an Inherited IRA account that can be managed on their behalf. The Canadian beneficiary would be required to obtain a U.S. Individual Taxpayer Identification Number (ITIN) through the Internal Revenue Service (we can assist with this), and an Inherited IRA account would be established with one of our U.S. custodians. Due to the tax implications on both sides of the border, it typically makes more sense to look at setting up an Inherited IRA as opposed to paying current income tax on the distribution.

However, every situation is different and Cardinal Point's cross-border experts can help ensure that Canadian beneficiaries of IRA accounts fully understand the implications, options and reporting requirements in the U.S. and Canada.

Contact Cardinal Point for more information

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