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CROSS-BORDER WEALTH MANAGEMENT

California Residents: Does Your **Financial Advisor** Tax-Manage Your **RRSPs**?

Navigating Tax Implications: Canadian Retirement Accounts for California Residents

California residents who hold RRSPs, LIRAs, RRIFs or other Canadian tax-deferred accounts are subject to a unique set of tax planning and reporting requirements. Unlike most states, California does not allow Canadian retirement accounts to grow on a tax-deferred basis. And that can present a serious income-tax problem for residents of California, given the fact that the state taxes the annual income distributions (interest and dividends) and realized capital gains inside Canadian registered plans.

What are California's Tax Rules?

California rules require its tax residents to include annual investment earnings on their Form 540. Unlike the taxpayer's U.S. federal return, the State of California (Franchise Tax Board) requires that you pay tax annually on your RRSP earnings.

You would be responsible for including your interest (line 2), dividends (line 3), and capital gains (line 7) of Schedule CA. They will ultimately appear in Column C for additions to income. If you have a capital loss, the loss would be reported in Column B of line 7. The State of California's tax position on this matter is reported in the Franchise Tax Board Legal Branch.

Tax Reporting Challenges: California's Treatment of Canadian Retirement Accounts

For California residents, the tax treatment of RRSP/RRIF income can have significant financial implications. The state's tax regulations require that the taxpayer's complete tax return, including IRS Form 8938: Statement of Specified Foreign Financial Assets, be included. This allows the Franchise Tax Board to determine if a taxpayer has an RRSP and has included the accrued income within their Form 540 return. Adding to the complexity, if a California resident were receiving distributions from their RRSP/RRIF with Canadian withholding tax being remitted to the Canada Revenue Agency (under the Treaty), this tax would not be eligible as a foreign tax credit for California State tax purposes. The state does not recognize, nor is it a party to, the Canada—U.S. Income Tax Treaty.

What can be done to minimize tax?

Unfortunately, and all too often, Canadian advisors overseeing Canadian retirement accounts are unfamiliar with California's treatment of these accounts. What's more, they do not offer investment strategies to ensure that the management style and philosophy employed are uniquely mapped to California's tax rules. And why would they? Their core clientele are Canadian residents with RRSPs and not U.S. residents living in California. That is one of the reasons we suggest clients living in the United States, and especially California, work with a properly licensed and registered Canada-U.S. cross-border financial advisor.

Tax-Efficient Investing Strategies for Canadian Retirement Accounts in California

At Cardinal Point, we strive to reduce taxable transactions inside clients' Canadian retirement accounts through a tax-managed style of investing. First, we treat the account as if it were taxable (non-registered) rather than a traditional, tax-deferred retirement account. In doing so, we always consider the future tax consequences of each security selected. For example, an RRSP account being managed on behalf of a Canadian resident might typically include higher-yielding, income-producing securities. This makes sense under Canadian tax rules for residents of Canada because investment income inside an RRSP plan is tax-sheltered. In California, however, the exact opposite is true. Therefore, we select investment securities that attempt to limit large taxable transactions or distributions inside the account.

Another key aspect of tax managing a Canadian retirement account is employing tax-loss selling when possible. When a security with a capital gain is sold, we proactively sell a security in the account with an unrealized capital loss to offset the gain where possible. If a security in the account has a large unrealized capital gain, we may attempt to reduce the holding over a number of years to minimize taxes versus selling out the entire position at once and incurring a hefty tax bill. The ultimate goal is to tax manage the account to the greatest degree possible without compromising the integrity of the client's overall investment strategy or performance.

Other Considerations for RRSPs

Aside from tax-managing Canadian retirement accounts on behalf of California residents, we also provide the following strategies:

- U.S. dollar-Denominated RRSPs: We have the ability to manage your RRSPs in U.S. dollars, eliminating the need to monitor the Canada-U.S. exchange rate.
- Cross-Border Account Integration: We offer integration with your U.S. investment accounts so that the investment strategies of your Canadian and U.S. accounts complement each other.
- Proper Tax Reporting: Our firm provides Canada-U.S. tax reporting and preparation services to ensure all IRS and state foreign account reporting and disclosures are done correctly.
- Discharging Your RRSP: We advise on the best process, timing, and tax strategy to distribute your RRSP.

California residents who hold Canadian tax-deferred accounts face a number of tax-planning and reporting challenges. In order to comply with the state's reporting requirements and preserve as much of your capital as possible, we strongly advise that you work with a qualified cross-border financial advisor. Please don't hesitate to contact the team at Cardinal Point if you are interested in learning more.

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