

Foreign Pension Transfers

Prepared by The Investors Group Advanced Financial Planning Team

Canadian residents who have previously worked in a foreign country and have “superannuation or pension benefits” from this employment often find the concept of transferring the pension to Canada an attractive alternative. Benefits of these transfers include a deferral of Canadian taxation, greater control over investments, and increased ease of administration from the owner’s perspective. However, there are some potential pitfalls including taxation in the country of origin and restricted transferability from the foreign country.

This article outlines the major issues involved with the transfer of a foreign pension to Canada, but because of the potentially significant tax consequences individuals should always seek independent accounting advice and contact the pension plan administrator.

Definition and Rules

Section 56(1)(a)(i) of the Income Tax Act states that foreign pension income will be taxable income in Canada if it is considered to be a “superannuation or pension benefit”, unless a tax treaty with a foreign country specifically states that the

income is non-taxable. A “superannuation or pension benefit” is generally considered to be a payment from a plan in which contributions have been made by an employer on behalf of an employee in consideration for services rendered by the employee or by a government and these contributions are used to provide a periodic payment on or after the employee’s retirement in consideration for employment service.

A traditional US Individual Retirement Account (IRA) is the lone exception to this in that even though it does not meet the definition of a “superannuation or pension benefit”, section 56(1)(a) of the Income Tax Act makes a specific provision in which the benefits from a traditional IRA are taxable income in Canada.

Payments from a Roth IRA are not considered to be taxable income in Canada according to Article XVIII of the Canada-US tax treaty.

Canadian taxpayers are allowed to transfer a foreign pension benefit to their RRSP without affecting their contribution room. Under section 60(j)(i) of the Income Tax Act individuals can claim a deduction to offset the income inclusion of the foreign

pension benefit. To utilize this rollover the benefit can either be transferred directly to their RRSP or a contribution can be made within 60 days of the end of the year in which the payment was made. The rollover is also available when payments are made as a death benefit to a surviving spouse or as part of a divorce or separation agreement. A pension transfer by an individual who has turned 71 in a prior year will not be eligible for the rollover.

Issues for consideration

Although the rollover provided for in the Canadian Income Tax Act appears to make the transfer of a foreign pension plan a relatively simple matter, there are many issues which make this decision quite complex.

To begin with it needs to be determined if the pension plan is transferable. Some countries prohibit the transfer of pension plans and transfers in other countries are often restricted at the pension plan level. It should also be determined if the entire plan can be transferred or only a portion of it. If a transfer is allowed, are there any restrictions in terms of the type of plan or benefits that must

continued from previous page

be provided from the plan it is transferred to. In most cases these questions can be answered by the pension plan administrator.

The next item of consideration should be the tax consequences in the country of origin of the pension plan. Individuals should work with a tax advisor with expertise in the tax laws of the originating country to determine the amount of foreign withholding taxes if the plan is transferred. Any penalties for the transfer of the plan should also be taken into account. If the plan is left in the foreign country, the tax implications of this decision should be considered.

Finally, the Canadian tax implications should be considered. Will there be any foreign tax credits available to the individual on their Canadian tax return? If there are, will they be able to completely offset the foreign taxation or only partially offset it? If the plan is left in the country of origin, what will the Canadian tax consequences be?

US pension transfers

Due to the close proximity of Canada and the US there are many Canadians who may be interested in transferring amounts from a US pension arrangement such as an IRA, 401(k), or 403(b) to Canada.

The most important consideration is that a transfer will be a taxable event in the US, as there is no rollover

recognized for US tax purposes. US citizens, US residents, and green card holder are required to file a US tax return based on their worldwide income and the entire pension transfer amount must be included in income in the year of transfer and will be subject to US tax at their marginal tax rate. Since the US tax system does not recognize an RRSP contribution as a deduction, double taxation would result from this transfer. Therefore, in most cases a pension transfer is usually not in the best interests from a financial perspective for these individuals due to the fact that if the plan is left in the US it will continue to grow in a tax sheltered environment in both Canada and the US.

There may be some cases in which an individual may wish to pursue a transfer even if they are a US citizen, US resident or green card holder. For example, if their account was small or they felt they were receiving poor service from the plan administrator. If this is the case the plan should not be transferred to an RRSP as double taxation would result, but rather to a non-registered investment.

If the individual is not a US citizen, US resident, or green card holder than there will be non-resident withholding taxes of up to 30% on the transfer to an RRSP. There may be foreign tax credits available on the Canadian tax return to offset the US withholding tax, but in order to fully

utilize the foreign tax credits the individual must have Canadian tax payable in the year of transfer equivalent to the amount of the US withholding tax. For this calculation the Canadian tax payable does not include any income from the pension applied to the RRSP.

An age penalty of 10% will be applied by the US to any individual who is under the age of 59½ on the date of the transfer. This age penalty is not recoverable by the individual due to the fact that a foreign tax credit cannot be claimed on it.

UK pension transfers

UK pensions can be transferred to financial institutions that are recognized by the UK pension authorities as “Qualified Recognized Overseas Pension Schemes” (QROPS). Investors Group has a locked-in RSP plan, an unlocked RSP plan, and a LIF plan approved as QROPS. Other conditions required for a transfer are that at least 70% of the transferred funds will be used to provide income for life and the UK taxation authorities are advised when the individual starts to receive benefits.

The taxation issues of a UK pension transfer are not always clear due to the fact that the Canada – UK tax treaty does not comment on the non-resident withholding tax rate on lump sum transfers, although withholding taxes on lump sum transfers to QROPS are not currently imposed.

continued on next page

continued from previous page

Pension payments from the UK that are considered periodic are not subject to non-resident withholding taxes. Therefore, the individual should seek advice from the UK pension administrator regarding the withholding tax that would be charged before a transfer is initiated.

As long as the pension funds are transferred to a QROPS there are usually no penalties associated with a UK pension transfer.

Summary

Foreign pension transfers are legitimate options in the right circumstances, but individuals should consider all factors involved in the transfer before taking any action. It is extremely important to attain independent accounting advice and to contact the pension plan administrator before initiating a transfer. Contact your Investors Group Consultant for further information.



This report is intended as a general source of information only, and is not intended as a solicitation to buy or sell specific investments, nor is it intended to provide tax, legal or investment advice. Clients should discuss their situation with their Investors Group Consultant for advice based on their specific circumstances.

TMTrademark owned by IGM Financial Inc. and licensed to its subsidiary corporations.

"Foreign Pension Transfers" ©2009 Investors Group Inc.

(03/2009) MP1568

The Plan
by  Investors
GroupTM