

Tax Options for Retirement Accounts at Death in a Cross-Border Context

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In cross border situations when the owner¹ of a tax deferred retirement account (such as a Canadian RRSP/RRIF or U.S. IRA or 401(k)) dies, there are often complexities regarding the tax consequences for the deceased and the account beneficiaries or heirs. For example, consider the following scenarios:

- A) Where a Canadian owner dies leaving a Canadian tax deferred account to a U.S. resident beneficiary;
- B) Where a US tax resident dies owning a Canadian tax deferred retirement account;
- C) Or the reverse situation, where a U.S. owner of a U.S. tax deferred retirement account dies leaving the account to beneficiaries located in Canada; and
- D) Canadian resident leaving a US tax deferred retirement account. This article briefly outlines the basic principles that apply to most retirement plans, although specific exceptions may apply in certain situations.

Death of a Canadian Owner

The Canadian rules generally maintain the status of tax deferred retirement accounts when transferred from a deceased spouse to a surviving spouse.² A tax-deferred rollover of the account can generally be realised by a designation of beneficiary in all common law provinces or by specific bequest in a Will in the province of Quebec. If the surviving spouse is not a Canadian resident, the tax recognition will still be deferred until the death of a surviving spouse. Similarly, a tax-deferred rollover of the account is also possible for a minor or a mentally/physically infirm child or grandchild that was financially dependent of the deceased owner at time of death. The roll-over generally requires a transfer of the deceased's retirement account to the retirement account of the qualified beneficiary, or a purchase of a qualifying annuity.

For a Canadian resident with no surviving spouse (or other qualifying beneficiary), the gross value of the tax deferred account is added to the final tax return of the deceased owner and taxed accordingly at the regular tax rates. It can alternatively be distributed to a beneficiary child/grandchild that was financially dependent on the deceased and taxed in the beneficiary's hands, which can provide an income-splitting opportunity in some situations.

Upon the death of a Canadian resident annuitant, where the beneficiary is a U.S. resident, the fair market value (FMV) of the retirement account would be included and taxed in the deceased's final Canadian tax return. Thereafter, the distributions in excess of the date of death FMV (i.e., any growth in FMV or income earned after death in the RRSP/RRIF) are taxable to the non-resident beneficiary. Specifically, the growth would be subject to Canadian non-resident withholding tax, generally at 25% but this rate may be reduced by a Tax Treaty that Canada maintains with the non-resident's home country.

If the owner was a U.S. citizen or a U.S. resident (i.e. not a resident of Canada) at time of death, the Canadian retirement account can be transferred tax deferred to the surviving spouse. If there is no surviving spouse, Canada will withhold 25% of the gross value of the account. In the U.S., this post-mortem distribution will form part of the worldwide taxable estate of the deceased, but will not be taxable income in the year of death.

Death of a US owner

The U.S. tax rules are substantially different than the Canadian rules. When the owner of a U.S. tax-deferred retirement plan dies, the U.S. tax rules will apply to the beneficiaries regardless of whether they are located in Canada or in the U.S.

Canada still has jurisdiction over the beneficiaries that are Canadian residents, however, under the Canada U.S. tax convention, Canada and the U.S. have agreed to limit their taxation rights. Such that where an amount is not taxable in one country³, it will not be taxable in the other country.

When a deceased owner was a resident of the U.S., the U.S. tax deferred retirement account can benefit from the U.S. deferral options available to U.S. beneficiaries. For a non-spouse beneficiary, the available options have changed on January 1st 2020. The Secure Act⁴ provides changes to US retirement plans, including relief for the 401k administrator to acquire an annuity, changing the reporting age at which the plan must start to distribute the accumulated savings⁵ and eliminating the stretch" distribution for non-spouse beneficiaries.

When the deceased owner of a U.S. tax-deferred retirement account was a resident of Canada (regardless of citizenship or green card status), it is possible to benefit from the U.S. deferral options if the estate executor (estate liquidator in Quebec) elects to distribute the plan to the beneficiary (but only on the portion of the U.S. tax-deferred retirement account that had not yet been received at death, but not on the portion that must be received in the year of death). The portion of the U.S. tax-deferred retirement plan that was not received at time of death qualifies as “rights or things” under Canadian tax rules.⁶ Such “rights or things” distributed to the beneficiary will be taxable in the beneficiary’s hands. Because the Canada-U.S. Tax Treaty provides for non-tax recognition in Canada if it’s not immediately taxable in the U.S., it may also benefit from the deferral allowed under the US tax law. The deferral options are summarized in the following chart. The pre and post Secure Act modifications are reflected for deaths before 2020. Note that non-spouse beneficiaries may still benefit from the “stretch distribution”, and the RMDs begin at age 70½.

Summary

In the cross-border context, tax-deferred retirement plans can benefit from the Canada/U.S. Tax Treaty. Specifically, upon death, a surviving spouse that is not a resident of Canada can benefit from a rollover on Canadian tax-deferred retirement accounts and similarly, Canadian beneficiaries of a U.S. tax-deferred retirement account can benefit from the U.S. deferral rules. As this is a very complex area of taxation, please consult with an external cross-border tax specialist for confirmation of the tax implications in both Canada and the U.S., in the specific situation.

For more information, please speak with your BMO financial professional.

Required Minimum Distributions for IRA Beneficiaries (after 2019)		
Secure Act Changes	Same as under but RMDs begin at 72 years old instead of 70½.	5. Under the new legislation, the distribution period for non-spouse designated beneficiaries is limited to 10 years, rather than the beneficiary’s lifetime. 6. The limit does not apply to designated beneficiaries who are disabled or chronically ill. 7. For any child of the owner who has yet to reach the age of majority at date of the owner’s death, the 10 year limitation only starts once the child reaches age of majority.

Required Minimum Distributions for IRA Beneficiaries ⁷ (after 2019)			
	Spouse only	Non-spouse Designated Beneficiary	No designated beneficiary (including an estate, charity, or some trusts)
IRA owner dies on or after required beginning date	Designated Beneficiary Spouse may treat as his/her own; or Distribute over spouse’s life using Table I <ul style="list-style-type: none"> Use spouse’s current age each year, or Distribute based on owner’s age using Table I⁸ Use owner’s age as of birthday in year of death Reduce beginning life expectancy by 1 for each subsequent year 	Distribute using Table I <ul style="list-style-type: none"> Use younger of: <ul style="list-style-type: none"> beneficiary’s age or owner’s age at birthday in year of death Determine beneficiary’s age at year-end following year of owner’s death Use oldest age of multiple beneficiaries Reduce beginning life expectancy by 1 for each subsequent year Can take owner’s RMD for year of death 	Table I <ul style="list-style-type: none"> Use owner’s age as of birthday in year of death Reduce beginning life expectancy by 1 for each subsequent year Can take owner’s RMD for year of death
IRA owner dies before required beginning date	Can take owner’s RMD for year of death Spouse may treat as her/his own; or Take entire balance by end of 5 th year following year of death; or Distribute based on Table I <ul style="list-style-type: none"> Use spouse’s current age each year Distributions do not have to begin until owner would have turned 70½ 	Take entire balance by end of 5 th year following year of death; or Distribute based on Table I <ul style="list-style-type: none"> Use beneficiary’s age at year-end following year of owner’s death Reduce beginning life expectancy by 1 for each subsequent year 	Take entire balance by end of 5 th year following year of death



¹ The term “annuitant” is used in Canada. The term “owner” is used in the U.S. The term “owner” includes both throughout this article.

² In Canadian tax law the term “spouse” is liberally defined. It includes a spouse by marriage or a common law spouse, including same sex spouses.

³ See Article XVIII, paragraph 1, *in fine*.

⁴ The **Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019**, Pub.L. 116-94, was signed into law by President Donald Trump on December 20, 2019 as part of the Further Consolidated Appropriations Act, 2020 (2020 United States federal budget).

⁵ Known as the “Required Minimum Distribution” (RMD). This is the calculated amount that must be taken out of the retirement plan by the owner with severe penalties for omitting. It is conceptually similar to the minimum withdrawal of a Canadian RRIF.

⁶ Sub-section 70(3) ITA.

⁷ Partial Source: <https://www.irs.gov/retirement-plans/required-minimum-distributions-for-ira-beneficiaries> as updated by the IRS on January 15, 2020.

⁸ RMD Calculation table I available at: <https://www.irs.gov/retirement-plans/plan-participant-employee/required-minimum-distribution-worksheets>

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