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In this article, the authors consider the use of Canadian registered plans (the Canadian tax-free savings account and the retirement compensation arrangement) by U.S. persons working in Canada and whether those plans should be treated as foreign trusts in the United States, arguing that the United States should provide clear administrative guidance on the U.S. tax treatment of such plans.

This article is one in a series of proposals sponsored by the California Lawyers Association Taxation Section and presented to various policymakers and government officials. However, the comments in it reflect the individual views of the authors who prepared them and do not represent the position of the California Lawyers Association.

Although the authors and presenters of this report might have clients affected by the rules applicable to the subject matter of this report and have advised clients on the applicable law, no participant has been specifically engaged by a client to participate in this project.

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The ongoing pandemic has made mobility a necessity for many families and professionals around the world. Cross-border migrations between the United States and other countries are usually wrought with tax complexities. These migrations are particularly complex when foreign retirement and savings plans are maintained by an individual relocating to the United States or by a U.S. expatriate returning home after many years. The competitive advantage of the United States regarding trade and commerce is being silently eroded by adverse U.S. tax classification and treatment of these foreign retirement, pension, and savings plans that benefit U.S. persons (USPs). Many have opted to renounce U.S. citizenship to preserve the financial wealth they have accrued abroad, and those who have achieved professional success in the United States resort to terminating their lawful U.S. permanent resident status and return to their home countries to discontinue the extraterritorial reach of U.S. tax laws after they depart the United States.

The U.S. taxation of contributions, accruals, and distributions from foreign pensions and retirement plans (collectively, foreign plans) owned by USPs remains a controversial area of U.S. tax law that requires definitive guidance as the number of USPs residing outside the United States is large and steadily increasing. Complexity arises in part because foreign plans often do not fit squarely with the types of plans available to USPs living in the United States. Until the U.S. tax classification and treatment of such foreign plans are addressed by Congress or the Department of the Treasury, annual U.S. tax reporting of foreign pensions remains fraught with proverbial "traps for the unwary." In the absence of conclusive guidance from federal tax authorities, many tax practitioners have resorted to reporting foreign plans owned by USPs (directly and beneficially) as either IRC section 402(b) nonexempt employees' trusts, which are not subject to disclosure on Form 3520 and Form 3520-A under IRC section 6048, or as foreign grantor trusts under IRC sections 671-679. These entities are also subject to reporting on the foreign bank account report as required by the Foreign Account Tax Compliance Act. This repetitive reporting increases the administrative burden on USPs living abroad and U.S. taxpayers living in the United States who have a beneficial interest in these accounts. The annual reporting, enforcement, and collection of information, taxes, and penalties on these accounts places additional strain on IRS resources with no corresponding increase in the revenue generated.

It is no secret that many U.S. executives and athletes have pursued more lucrative careers just across the border in Canada during the pandemic. Being employed in Canada means active participation in the robust Canadian retirement and savings environment that offers more opportunities for an individual to maximize retirement savings during the most profitable years of their career. However, the favorable tax treatment of Canadian retirement and savings plans do not extend beyond Canada's borders. U.S. tax laws do not provide any definitive guidance on the treatment of Canadian tax-free savings accounts (TFSAs) and retirement compensation arrangements (RCAs). As foreign trusts, TFSAs and RCAs would be subject to annual information reporting under IRC section 6048, which is made by filing Form 3520, "Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts," and Form 3520-A, "Annual Information Return of Foreign Trust With a U.S. Owner." However, there is no consensus among cross-border tax practitioners on whether these two plans should be subject to any foreign trust reporting. On one hand, a TFSA is functionally more similar to a Roth IRA, which is taxed under IRC section 408A, than it is to a traditional trust taxed under subchapter J of the IRC. A Roth IRA is not subject to any Canadian taxation as long as no contributions are made to the Roth IRA while the USP is a resident of Canada. On the other hand, the RCA has no direct U.S. equivalent. This type of arrangement is structured to encourage athletes and executives to work in Canada by (1) reducing the amount of Canadian-source compensation income that would be subject to Canadian ordinary tax rates; and (2) allocating a portion of such individual's Canadian-source earnings to a Canadian trust that generates no taxable income. In the rare case an RCA does generate taxable income, it will be highly taxed in Canada and consequently not subject to U.S. tax after the application of foreign tax credits for Canadian taxes paid on such amounts. Similarly, in retirement, the distributions from RCAs will be taxed in Canada at ordinary income rates, which are likely to result in no U.S. tax payable under relief that is provided under the Canada-U.S. income tax convention and protocols (the tax treaty).[1]

For Canadian tax purposes, the TFSA is a tax-deferred Canadian registered plan initially intended to provide additional retirement savings to individuals already benefiting from Canadian registered retirement plans. It is primarily a contract between a subscriber and a financial institution that will hold the TFSA on behalf of the subscriber. Under the agreement, the subscriber contributes a maximum of C $6,000 per year in after-tax dollars to the TFSA. The subscriber's

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[1] Convention between the United States and Canada with respect to Taxes on Income and Capital, signed on Sept. 26, 1980, as amended by protocols signed June 14, 1983, Mar. 28, 1984, Mar. 17, 1995, July 29, 1997, and Sept. 21, 2007.

contribution may earn income inside the plan without any current taxation on such accruals. Canadian income tax is also not triggered when distributions are made by the financial institution to the subscriber. The TFSA is very similar to a U.S. Roth IRA when the USP takes a qualified distribution.[2] There are some subtle differences between the two plans (there is no income threshold as a condition for eligibility to contribute to a TFSA, unused contributions may be carried forward to future years, and TFSA funds may be withdrawn without penalty); however, these differences could be mitigated by providing an exemption from trust reporting until a distribution is made under the plan.

Canadian RCAs also are intended to provide additional retirement savings for cross-border athletes and executives. It is a contract between an individual (the holder) and a participating financial institution (the custodian) under which the holder or their employer makes contributions to an RCA trust. These contributions are deductible from the income of the respective contributor, but all contributions are subject to a 50 percent refundable tax at the time of contribution. Moreover, any income earned in the RCA is also subject to a 50 percent refundable tax in the year such income is earned in the RCA. No tax is paid by the holder until benefits are received at retirement, but all such distributions are subject to tax in Canada. The refundable 50 percent tax imposed on contributions and earnings are then refunded to the RCA trust at a rate of C $1 for every C $2 distributed until the refundable tax has been entirely repaid.

Contributions to an RCA may not exceed the amount required to fund retirement benefits based on the generally accepted guidelines for pensions, equal to about 70 percent of pre-retirement income for an employee with 35 years of service for a defined benefit plan.[3] Failure to follow the generally accepted guidelines increases the risk that the Canada Revenue Agency could deem the RCA not to be an RCA but rather a salary deferral arrangement with additional substantial tax and penalties payable.[4] To ensure the RCA continues to qualify under the CRA's generally accepted guidelines, the involvement of a qualified actuary may be required. There are substantial Canadian tax compliance obligations imposed on RCAs; the custodian must apply for and obtain both a contribution account number before any contributions are made and a distribution account number before any distributions are made. The distributions are also subject to withholding by the custodian and subsequent reporting to the CRA.

Because of the absence of specific administrative guidance on the U.S. tax treatment and reporting of TFSAs and RCAs, these foreign plans have been subject to inconsistent tax treatment by tax practitioners and USPs. Many USPs and their tax advisers do not view these plans as subject to disclosure. Some view the plans as foreign employees' trusts under IRC section 402(b) that are exempt from disclosure on Form 3520 and Form 3520-A. Others report the plans as foreign grantor trusts and file forms 3520 and 3520-A each year. Because enforcement against foreign entities can be difficult, U.S. tax laws make the USP accountable for filing and liable for any taxes and/or penalties on such filings or for a failure to file. However, these penalties apply inconsistently because of divergent reporting approaches. The civil penalties imposed on inaccurate and untimely filed foreign trust reporting under IRC section 6677 are substantial. Therefore, the USP donor/contributor or USP beneficiary faces a very high risk of incurring penalties for failing to correctly report an interest in a TFSA or RCA in any given year. This issue is particularly problematic, not because of the low annual contribution limits on the TFSA, but because of the potentially substantial carryforward of unused contributions to future years.

The accurate and timely filing of forms 3520 and 3520-A was one of six additional international compliance campaigns rolled out by the Large

[2] IRC section 408A(d).

[3] *See* Jack Bernstein, "RCA Planning," 6(9) *Canadian Tax Highlights* 70-71 (1998); David Harding and Kevin Dunphy, "Individual Pension Plan," 2018 *St. John's Tax Seminar* 5:1-10 (2018).

[4] We note that if this reclassification for Canada Revenue Agency purposes were to occur, there would be Canadian income tax consequences, which will have a corresponding effect on the U.S. taxable income reported by the USP taxpayer. However, this will likely be resolved through the application of FTCs.

Business and International Division[5] on May 18, 2018. Although this campaign has ended, the impact of the Form 3520/Form 3520-A campaign on USPs abroad and in the United States continues to be perpetuated with a flurry of IRS notices issued to taxpayers assessing IRC section 6677 civil penalties for failure to comply with IRC section 6048 reporting requirements regarding foreign trusts. Because the statute of limitations for assessing IRC section 6677(a) and (b) penalties ends three years after a complete and accurate Form 3520/Form 3520-A is filed, the statute of limitations may remain open indefinitely. Foreign retirement, pension, and savings accounts (including Canadian TFSAs and RCAs) are within the category of foreign trusts that are subject to Form 3520/Form 3520-A filing and therefore are subject to penalties for failure to timely file.

Treasury regulations promulgated under IRC section 6048 require grantors of foreign trusts and beneficiaries of foreign grantor trusts to file Form 3520 (in the case of an ordinary transfer to the trust) and Form 3520-A (foreign grantors) to report their activities and interest. We propose that TFSAs be exempt from annual foreign trust reporting under IRC section 6048 until withdrawals or distributions are received by a USP, similar to reporting requirements for Canadian registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs),[6] registered education savings plans (RESPs), and registered disability savings plans (RDSPs).[7]

Exempting TFSAs from annual foreign trust requirements also alleviates administrative burdens and costs for the foreign trust reporting program. TFSAs usually have small balances, but they are subject to substantial civil penalties for inaccurate or untimely filed forms 3520 and 3250-A, in addition to FBAR disclosure. However, the potential for TFSAs to carry substantial balances is far from remote because the TFSA regime provides for unused contributions to be carried forward to future years. This fact, combined with the ability of a USP taxpayer to exercise discretion and control over TFSA investments, as well as withdraw amounts from the TFSA for any reason without penalty, would support continued foreign trust reporting obligations for USP account holders of TFSAs in the year withdrawals or distributions are made.

Although more significant amounts are involved for RCAs than for TFSAs, such amounts are subject to a substantial 50 percent tax on contributions and 50 percent tax on earnings in Canada. Withdrawals and distributions can be made only after the employee reaches retirement, and such amounts would be taxed at ordinary rates. Therefore, it would be unlikely that a USP would avoid payment of U.S. taxes on RCA amounts on distribution. We believe that USPs' compliance burden and the IRS's administrative burden can be relieved if the foreign trust reporting exemption available for IRC section 402(b) plans is extended to RCAs. Foreign trusts that constitute IRC section 402(b) nonqualified deferred compensation trusts are exempted from this tax filing requirement under IRC section 6048(a)(3)(B)(ii). These provisions state that contributions made to a nonqualified foreign trust under a plan that provides for pensions, profit-sharing, stock bonus, sickness, accident, unemployment welfare, and similar benefits, or a combination of such contributions, are not required to be reported under IRC section 6048. Consequently, a USP beneficiary of a Canadian RCA should have no affirmative obligation to file Form 3520 until withdrawals or distributions are made by the RCA trust to the USP beneficiary.

We recommend that regulations under IRC section 6048 be amended, or further administrative guidance be issued, to clarify the annual foreign trust reporting requirements for Canadian TFSAs and RCAs on Form 3520 and Form 3520-A.

I. Foreign Trust Classification

Generally, U.S. citizens and U.S. lawful permanent residents (green card holders) are treated as U.S. residents for U.S. tax purposes,[8]

[5] IRS, "IRS Announces the Identification and Selection of Six Large Business and International Compliance Campaigns" (May 21, 2018).

[6] *See* Rev. Proc. 89-45, 1989-2 C.B. 596, *superseded by* Rev. Proc. 2002-23, 2002-1 C.B. 744.; Rev. Proc. 2014-55, 2014-44 IRB 753, at section 2, subparagraph.01.

[7] *See* Rev. Proc. 2020-17, 2020-12 IRB 539.

[8] *See* IRC section 7701(b)(1)(A).

regardless of where they live in the world. A U.S. resident is subject to U.S. federal income taxation on income from whatever source derived including, but not limited to, compensation for services, pensions, and income from an interest in a trust.[9] This general rule of worldwide taxation potentially applies to all distributions received by a U.S. resident from foreign retirement, pension, and similar deferred compensation plan arrangements unless there is a specific statutory or treaty provision that exempts such income from U.S. tax. In the absence of definitive guidance on how such foreign plans are taxed for U.S. purposes, tax practitioners have reported them as either foreign grantor trusts or foreign nonexempt employees' trusts under the IRC, which would confer an annual information reporting obligation for U.S. residents who have beneficial interests in such foreign trusts.

A. Foreign Grantor Trusts

As a preliminary matter, trusts are classified for U.S. tax purposes as either foreign or domestic trusts under IRC section 7701(a)(30)(E) and (31)(B). Under these provisions, a trust is presumed to be a foreign trust unless the following conditions are satisfied: (1) a court or courts within the United States would be able to exercise primary supervision over administration of the trust, and (2) one or more USPs have the authority to control all substantial decisions of the trust. A trust would be treated as a USP on any day that the trust meets the "court test" and the "control test."[10] Based on our understanding of Canadian RCAs and TFSAs, these likely would be classified as foreign trusts for U.S. tax purposes because (1) they are Canadian resident trusts that are controlled by Canadian resident custodians and trustees, and (2) a U.S. court would not have primary supervision over the administration of these trusts.

As foreign trusts for U.S. tax purposes, all contributions, income, and earnings of the trust potentially would be included in the gross income of their USP beneficiaries under IRC sections 671-679. This determination is made after considering the applicable U.S. tax laws and regulations below.

1. Subchapter J Taxation

Generally, subchapter J of the IRC[11] provides for taxation of trust income to the trust itself or its beneficiaries. Generally, under IRC section 641, a trust's taxable income is taxed to the trust or its beneficiaries. However, there are exceptions under IRC section 651 and section 661 that impose the tax on the beneficiaries of the trust if the income is distributed or required to be distributed to the beneficiaries. If either IRC section 651 or section 661 applies, the beneficiary is taxed on the qualifying income, and the trust receives a corresponding deduction. However, IRC section 643(a) generally provides that the deduction cannot exceed the trust's distributable net income, which is the taxable income of the trust with specified modifications.[12] If a trust's distributable net income for a tax year is not distributed to the beneficiaries,[13] it is considered undistributed net income under IRC section 665(a). Generally, no adverse consequences result from a trust declining to distribute all its distributable net income for a tax year, except that the trust (which becomes subject to the highest marginal federal income tax rate much more quickly than do individual beneficiaries) will be taxed on the undistributed net income, and the beneficiaries will not.

Because a foreign trust's income is generally not subject to taxation by the United States, if distributed net income is not distributed to its beneficiaries who are U.S. residents, taxation on this income generally will be deferred. To discourage foreign trusts from deferring distribution of distributed net income to its U.S. beneficiaries, IRC sections 665 through 668 provide that if a foreign trust makes distributions of undistributed net income (from preceding tax

[9] *See* IRC section 61(a)(1), (10), (14).

[10] Treas. reg. section 301.7701-7(a)(2). Safe harbor for the court test is met if the trust instrument does not direct that the trust be administered outside the United States, the trust is in fact administered exclusively in the United States, and the trust is not subject to an automatic migration provision under Treas. reg. section 301.7701-7(c)(1)(i-iii).

[11] Subpart J of the IRC (sections 641-692) provides for the taxation of trust income.

[12] Distributable net income for a U.S. trust is taxable income plus tax exempt income but excluding capital gains and losses. *See* IRC section 643(a)(6).

[13] *See generally* IRC section 662.

years) to the U.S. beneficiaries, each such distribution is classified as an accumulation distribution. The accumulation distribution is allocated to preceding years and subject to tax, including an interest charge thereon, intended generally to treat the income as if it had been taxed in the year the income was earned.[14] This interest charge, also known as the throwback tax, can result in a significant tax liability for a U.S. resident beneficiary.

IRC sections 671 through 679 (collectively, the grantor trust rules) provide an exception to the general taxation regime of subchapter J. IRC section 671 provides that where it is specified in subpart E of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall be included in computing the taxable income and credits for the grantor or the other person those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the grantor trust (to the extent that such items would be taken into account under this chapter in computing the taxable income or credits against the tax of an individual). Any remaining portion of the trust shall be subject to subparts A through D of subchapter J. Hence the income, deductions, and credits of the grantor trust are included in the computation of the grantor's taxable income and not in the taxable income computation of a trust or its beneficiaries as would otherwise be required under IRC section 641. Consequently, neither the distributable net income nor undistributed net income is generally taxable to beneficiaries who are receiving distributions from a grantor trust.

The grantor trust rules potentially apply to an RCA or TFSA when a beneficiary of such trust is or becomes a U.S. resident for U.S. tax purposes (a U.S. resident beneficiary). IRC section 679(a) and related provisions provide that a USP who directly or indirectly transfers property to a foreign trust (other than to specified foreign trusts that are deferred compensation or charitable trusts as provided generally under Treas. reg. section 1.679-4(a)(2) and (3)) shall be treated as the owner of the portion of such trust attributable to such property if there is a U.S. beneficiary of the trust for that year.[15] A person treated as "the owner of any portion of a trust" by the grantor trust rules must include income from that portion of the trust's property in his or her personal income.[16]

The grantor trust rules would potentially apply to transfers of property to trusts made by the U.S. resident beneficiary within five years before attaining U.S. residency (the five-year lookback period). Under IRC section 679(a), a direct or indirect transfer of property to a foreign trust made by a noncitizen or a nonresident of the United States within five years of becoming a USP is treated "as if such individual transferred to [the foreign] trust on the [U.S.] residency starting date an amount equal to the portion of such trust attributable to the property transferred by such individual to such trust in such transfer."[17] With few exceptions, the gain inherent in transferred assets is fully taxable at ordinary tax rates to a USP who transfers assets to a non-U.S. trust.[18]

If the above grantor trust rules apply to RCAs and TFSAs, a U.S. resident beneficiary would have U.S. income tax exposure from (1) contributions made to the trust upon transfer to the trust and (2) income generated by and accrued in the trust on a current basis. Our position, as discussed later in Section III, is that the grantor trust rules do not apply to an RCA because a U.S. resident beneficiary of an RCA cannot access funds contributed to such account by the Canadian employer until retirement age is reached, similar to a nonexempt employee's trust under IRC section 402(b). Moreover, amounts in an RCA are already subject to a 50 percent refundable Canadian tax on contributions and earnings, meaning that the RCA itself is not tax free. Finally, distributions received by a U.S. resident beneficiary of an RCA would be subject to tax in Canada at ordinary income tax rates and be includable in gross income for U.S. tax purposes. However, a TFSA would be subject to the grantor trust rules, so a U.S. resident

[14] *See generally* IRC section 665(b).

[15] IRC section 679(a)(1).

[16] IRC section 671.

[17] IRC section 679(a)(4)(A).

[18] IRC section 684.

beneficiary would have current U.S. income tax liability and reporting obligations as further discussed in Section IV.

B. Nonexempt Employee Trusts

Generally, IRC section 402(a) provides an exemption for amounts received by a beneficiary of an employee's trust[19] that meets the requirements of IRC section 401(a) as a qualified employee's trust and that is exempt from tax under IRC section 501(a) as an exempt employee's trust. Neither the RCA nor the TFSA would qualify as an exempt employee's trust because they are foreign trusts rather than domestic trusts as required under IRC section 401(a).[20] As a corollary, they will also fail to meet IRC section 501(a) requirements for an exempt employee's trust.

Because RCAs and TFSAs are not classified as exempt employees' trusts under IRC section 402(a), the taxability of distributions made to a U.S. resident beneficiary would fall under the parameters of IRC section 402(b), which applies to nonexempt trusts. Section 402(b) addresses the tax treatment of a beneficiary of a trust that is not exempt under IRC section 501(a).[21] Such trusts are considered funded plans for U.S. tax purposes because the assets are protected from the claims of creditors of the employer and related entities.[22] Tax practitioners have noted that IRC section 402(b) often applies to non-U.S. trust arrangements associated with foreign equity and deferred compensation plans.[23]

Foreign trusts that fall under IRC section 402(b) are typically created when an employer enters into a trust arrangement under which the trustee is the legal owner of the trust assets and the employer is the settlor, contributing cash or shares on behalf of an employee. The employee has a beneficial ownership interest in the trust. The right in this interest may be subject to service or performance conditions that must be satisfied for the employee's right to be nonforfeitable and for the employee to receive a future distribution of trust assets from the trustee. If the amounts contributed are vested[24] upon contribution, then such amounts are treated as taxable compensation income to the employee under IRC section 402(b)(1).[25] However, if the benefits vest after the contribution is made, then the employee's inclusion into income is equivalent to the fair market value of his interest in the trust as of the vesting date.[26] Eventual distributions from the trust to the employee would be taxable upon receipt under IRC section 72, which allows for the amount already taxed at the time of contribution (if applicable) to be taken into account as part of such employee's basis and therefore excluded from additional tax.

Both the RCA and TFSA must run the gauntlet of IRC section 402(b) provisions to determine the extent of potential U.S. income tax exposures arising from trust distributions to a U.S. resident beneficiary. Under IRC section 402(b)(1), employer contributions to a trust that qualifies as an IRC section 402(b) nonexempt funded plan would be includable in the current year in a U.S. resident beneficiary's gross income as compensation and subject to tax if such amounts are not subject to a substantial risk of forfeiture. As a corollary, subsequent distributions to a U.S. resident beneficiary from the trust would be taxable to such beneficiary upon receipt under IRC section 402(b)(2), except that amounts already

[19] We note that the IRC does not have a definition of what constitutes an employee's trust.

[20] IRC section 401(a) provisions only apply to "a trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries."

[21] In other words, it governs the taxation of an employee with an interest in a trust associated with a plan that is not a U.S. tax-qualified plan under IRC section 401(a).

[22] *See* Veena K. Murthy, "Selected Cross-Border Equity and Deferred Compensation Issues With Funded Foreign Plans," 42 *Compensation Plan. J.* 67 (2014). In footnote 3, Murthy commented that such trusts are often referred to as secular trusts as opposed to rabbi trusts. The term "rabbi trust" is based on a private letter ruling regarding the tax treatment of assets contributed to a trust created for a rabbi by his congregation under which payments to the rabbi could occur only when his service ended. The IRS ruled that the amounts were not taxable when placed in the trust because the assets were subject to the claims of creditors of the congregation. *See* LTR 8113107; *see also* Rev. Proc. 92-64, 1992-2 C.B. 422; and Rev. Proc. 92-65, 1992-2 C.B. 428, 1992-33 I.R.B.

[23] *See* Murthy, *supra* note 22; Cynthia Blum, "U.S. Income Taxation of Cross-Border Pensions," 3(6) *Fla. Tax Rev.* 259 (1996).

[24] The term "vested" means that there is no longer a substantial risk of forfeiture as determined under IRC section 83 principles.

[25] *See also* Blum, *supra* note 23, at 306.

[26] *See* Treas. reg. section 1.402(b)-1(b)(2).

taxed to the beneficiary at the time of contribution would be excluded from the income inclusion amount under IRC section 72(w). Moreover, if the U.S. resident beneficiary is a highly compensated employee (HCE)[27] and the RCA or TFSA fails to meet requirements of a qualified plan for broad coverage[28] and participation of employees,[29] then the U.S. resident beneficiary must include in gross income the value of the vested accrued benefit on an annual basis under IRC section 402(b)(4). The application of each of these provisions under IRC section 402(b)(2) and IRC section 402(b)(4) are discussed below.

II. IRS Guidance

The United States has not released any definitive guidance on the U.S. tax classification and treatment of Canadian TFSAs or RCAs. However, there have been opportunities over the last decade for the U.S. Treasury Department and the IRS to address the tax classification and treatment of TFSAs when the IRS issued a series of administrative notices clarifying the U.S. tax classification and treatment of RRSPs and other Canadian registered plans such as RRIFs, RESPs, and RDSPs. Since the TFSA was introduced by the Canadian government in 2008, the IRS has released two revenue procedures addressing Canadian registered plans, which could have included guidance for TFSAs to simplify the U.S. tax reporting obligations of USPs.

In Rev. Proc. 2014-55,[30] the IRS provided guidance for applying paragraph 7 of Article XVIII (pensions and annuities) of the tax treaty. The revenue procedure eliminated previously issued information reporting requirements on USP beneficiaries[31] and annuitants[32] of a Canadian retirement plan[33] to report contributions to, distributions from, and ownership of Canadian retirement plans under the simplified reporting regime of IRS Notice 2003-75 (obsoleting as a consequence IRS Form 8891, "U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans"[34]) or under reporting obligations imposed by IRC section 6048 (Form 3520).[35] It did not, however, affect any reporting obligations for IRS Form 8938, "Statement of Specified Foreign Financial Assets," under IRC section 6038D or Financial Crimes Enforcement Network Form 114, "Report of Foreign Bank and Financial Accounts," imposed by 31 U.S.C. section 5314.[36] Most importantly, it made clear that distributions received by any USP beneficiary or annuitant from a Canadian retirement plan must be included in the gross income of the beneficiary or annuitant for U.S. tax purposes (including the portion thereof that constitutes income accrued in the plan and not previously taxed in the United States) under IRC section 72.[37]

In Rev. Proc. 2020-17,[38] the IRS further exempted some USPs from information reporting requirements imposed by IRC section 6048 on Canadian RESPs and RDSPs,[39] to the extent such plans constituted a "tax-favored foreign retirement trust" under section 5.03 of Rev. Proc. 2020-17 or a "tax-favored foreign non-retirement savings trust" under section 5.04 of Rev. Proc. 2020-17 (collectively, applicable tax-favored foreign trusts). However, the exemption only applies to USPs who have been previously

[27] IRC section 402(b)(4)(A).

[28] IRC section 401(a)(26).

[29] IRC section 410(b).

[30] Rev. Proc. 2014-55, at section 4.

[31] According to section 3 of Rev. Proc. 2014-55, "the term 'beneficiary' means any individual who holds an interest in a Canadian retirement plan or plans and who would be subject to current U.S. income taxation under the domestic law of the United States on undistributed income accrued in such plan or plans."

[32] "'Annuitant' means an individual who is designated pursuant to a Canadian retirement plan as an annuitant and is not also a beneficiary as defined above." *Id.*

[33] "'Canadian retirement plan' means any trust, company, organization, or other arrangement that is within the scope of Article XVIII(7) of the [tax treaty]." *Id.*

[34] *See id.* at section 5 ("Information Reporting With Respect to Canadian Retirement Plans)." Form 8891 was made obsolete as of December 31, 2014. *Id.* at section 5.02.

[35] Indeed, Rev. Proc. 2014-55 eliminated reporting obligations of custodians of Canadian retirement plans to file a Form 3520-A. Section 5.01 of Rev. Proc. 2014-55 was made retroactive and effective for tax years beginning on or after January 1, 2003.

[36] Rev. Proc. 2014-55, at section 5.

[37] *See id.* at section 6 ("Distributions From Canadian Retirement Plans").

[38] *Supra* note 7.

[39] *See* Robert E. Ward, "IRS Provides Reporting and Penalty Relief for Canadian RESP and RDSP Arrangements, As Well as Other Foreign Retirement and Non-Retirement Plan Trusts," 49 *Tax Mgmt. Int'l J.* 5 (May 8, 2020).

compliant regarding their income tax obligations related to such trusts.

In rendering applicable tax-favored foreign trusts exempt from the annual foreign trust reporting requirements, the IRS pointed out that IRC section 6048(d)(4) "authorizes the Secretary to suspend or modify any requirement under section 6048 if the United States has no significant tax interest in obtaining the required information."[40] The IRS stated:

> The Treasury Department and the IRS have determined that, because applicable tax-favored foreign trusts generally are subject to written restrictions, such as contribution limitations, conditions for withdrawal, and information reporting, which are imposed under the laws of the country in which the trust is established, and because U.S. individuals with an interest in these trusts may be required under section 6038D to separately report information about their interests in accounts held by, or through, these trusts, it would be appropriate to exempt U.S. individuals from the requirement to provide information about these trusts under section 6048.[41]

Based on the narrow definition of tax-favored foreign non-retirement provided in section 5.04 of Rev. Proc. 2020-17, tax practitioners were not hard-pressed to ascertain that Canadian RESPs and RDSPs would fall within the exemption from IRC section 6048 reporting because these trusts are organized in Canada exclusively for providing income for medical, disability, or educational benefits and have limited contribution amounts of $10,000 or less annually or $200,000 or less on a lifetime basis. Moreover, Canadian RESPs and RDSPs are already subject to strict conditions for withdrawal and annual information reporting by the Canadian government to maintain their status for Canadian tax purposes. The administrative burdens posed by such foreign trusts on IRS resources far outweigh the benefits generated from IRS enforcement efforts directed at delinquent foreign trust filings for USP interests in such assets. Such assets are low-balance depositary accounts that would be an unlikely offshore vehicle for U.S. tax avoidance by USPs residing in Canada.[42] However, TFSAs and RCAs are not low-value accounts, as discussed below.

III. RCAs

Professional ice hockey players on both sides of the Canada-U.S. border pursue lucrative but short careers spanning an average of 5.5 years.[43] It is therefore in the players' self-interest to carefully invest these earnings for maximum growth and minimal taxation. Canada's tax regime and rate structure make tax planning a priority for U.S. athletes playing for Canadian hockey teams. An RCA provides a way for a player to shelter income from taxes during their lucrative years playing for a Canadian team in the National Hockey League while spreading tax liability over their post-career years when income is lower. The popularity of RCAs among hockey players is reflected by the fact that Canadian financial institutions and wealth management agencies market RCAs to players of Canadian NHL teams who are contemplating retiring outside of Canada.[44] Without an RCA in place, a professional athlete who is or becomes a USP ("USP athlete") would not be rewarded for playing for an NHL team based in Canada because income and earning potential is substantially front-loaded and subject to considerably higher taxes in Canada than the United States. Therefore, it is very likely that U.S. hockey players who are playing for, or have played for, one of these Canadian teams already have RCAs.[45]

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[40] *See* Rev. Proc. 2020-17, *supra* note 7, at section 2 ("Background").

[41] *See id.* at section 3 ("Information Reporting Under Section 6048 With Respect to Applicable Tax-Favored Foreign Trusts").

[42] *See* Marsha Laine Dungog and Liguo Cooper Xu, "Should Canadian RESPs and RDSPs Be Exempt From Foreign Trust Reporting?" *Tax Notes Federal*, July 22, 2019, p. 475.

[43] Fraser Lang, "Planning for the Future: The RCA and Professional Hockey Players — July 2021," GBL Insights.

[44] Matthey Bailey, "Retirement Compensation Arrangements (RCAs) for Players of Canadian NHL Teams Who Retire Outside of Canada," RBC Wealth Management (2016); *see also* Lang, *supra* note 43.

[45] For example, for the 2021-2022 National Hockey League season, about 26 percent of the active players in the league are U.S. citizens. There are seven Canadian hockey teams, all of which have U.S. citizen players. RCAs are also offered to Major League Baseball players on Canadian teams, and most of those players are USPs. For the 2022 season, about 69 percent of the players on the Toronto Blue Jays' active roster are USPs.

Unlike other Canadian registered plans, an RCA allows for a funding limit that is based on the average of the player's best three years of earnings, with no maximum, as would be required in other plans.[46] Before the start of each season, the player can elect how much of their salary is allocated for RCA contributions. A player's ability to control the contribution to an RCA is no different from the ability of a U.S. employee to designate contributions to an employer-sponsored plan or 401k.

RCA contributions are made to an investment account (the RCA trust) by the team on a payroll basis. The contribution, net income earned, and gains realized are subject to a 50 percent tax. This tax is remitted to a non-interest-bearing account held by the CRA, called a refundable tax account. These funds remain assets of the RCA trust but do not earn any interest. Upon retirement, as funds are withdrawn from the RCA, the RCA trust is reimbursed from the refundable tax account, so the two accounts remain balanced.[47] All funds paid to the player from the RCA are subject to ordinary income tax rates in the year received.[48]

The prevalence of RCAs among cross-border professional athletes, as well as executives and owners of Canadian corporations, warrants definitive guidance from the U.S. Treasury Department and the IRS on the tax classification and treatment of these types of compensation arrangements. Failure to do so would perpetuate confusion and delinquency for the tax classification and treatment of these RCAs as IRC section 402(b) employees' trusts, which should be exempt from foreign trust reporting by a player who is, or becomes, a USP athlete.

A. Canadian Classification

For Canadian tax purposes, the RCA is a Canadian resident trust. It is defined under subsection 248(1) of the Income Tax Act of Canada as:

> a plan or arrangement under which contributions . . . are made by an employer or former employer of a taxpayer, or by a person with whom the employer or former employer does not deal at arm's length, to another person or partnership (in this definition and in Part XI.3 referred to as the "custodian") in connection with benefits that are to be or may be received or enjoyed by any person on, after or in contemplation of any substantial change in the services rendered by the taxpayer, the retirement of the taxpayer or the loss of an office or employment of the taxpayer.

The term "RCA" under subsection 248(1) of the ITA does not include a registered retirement plan, a registered pension plan, an employee trust (for life and health), a salary deferral arrangement, or a plan or arrangement established for purposes of deferring the salary or wages of a professional athlete for his services with a team that participates in a league having regularly scheduled games.

The RCA trust is a nonregistered, employer-sponsored, and employer-funded plan that is exempt from Canadian taxation under Part I of the ITA. However, it is subject to a tax under Part XI.3 (subsection 207.5), which imposes a 50 percent tax on all contributions made and a 50 percent tax on any net income earned or gains realized by the trust. The tax is payable annually, within 90 days after the end of the trust tax year, and is refundable to the trust when retirement benefits are distributed to the player. The refundable tax is collected through withholding at source upon contribution to an RCA or distribution to a player under subsections 153(1)(p) and (r) of the ITA. The refundable tax is held in a non-interest-bearing refundable tax account that is repaid to the trust custodian once benefit distributions are paid by the trust to the player (employee).

B. U.S. Classification

1. IRC Section 402(b)(2)

Under IRC section 402(b)(1), employer contributions made to a foreign nonexempt trust that constitutes a foreign funded plan would generally be fully includable in the employee's gross income in the year of contribution to the extent such amounts are not subject to a

[46] Lang, *supra* note 43.

[47] *Id.*

[48] *Id.*

substantial risk of forfeiture. This would generally be the case if the RCA was created for a USP athlete. If the athlete was not a USP athlete at the time such amounts were contributed to the RCA trust, there is no income inclusion for the contributions made by a Canadian employer. Therefore, regarding the RCA, all the employer contributions made to the RCA trust for the benefit of the player would be fully includable in the gross income of such player if they were a USP athlete.

Under IRC section 402(b)(2), distributions received from the RCA trust would be taxable to the USP athlete in the year such distributions take place or are made available under IRC section 72 subject to some exclusions as discussed below.

2. IRC Section 72

IRC section 72(a) provides general rules for income inclusion of any amount received as an annuity. However, when an IRC section 402(b) trust is involved, principles under IRC section 72 are applied to the distribution amount received by the employee, such that only the portion of the distribution that exceeds previously taxed amounts is includable in the distributee's gross income. This applies on a pro rata basis for each distribution. IRC section 72(b)(1) provides for the exclusion from gross income of that portion of each payment that represents a return of the distributee's investment in the contract:

> Gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date).

As provided above, the portion of the RCA trust distribution that would be includable in the USP athlete's gross income (and subject to tax) would specifically exclude amounts that constitute the USP athlete's investment in the contract. The term "investment in the contract" is defined under IRC section 72(c)(1) as:

> (A) the aggregate amount of premiums or other consideration paid for the contract, minus
>
> (B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

To determine which portion of the RCA trust distributions would be taxable to the USP athlete as gross income, we would need to determine the portion of the distributions made to the USP athlete that would, if made, constitute such athlete's investment in the contract and therefore be excludable from his or her gross income.

3. Exclusion From Gross Income

IRC section 72(w) applies to nonexempt foreign trust distributions received by a U.S. resident beneficiary with previously vested contributions in such trust earned entirely while such individual was a nonresident alien performing services outside the United States. IRC section 72(w) would exclude from the USP's investment in the contract amount any portion of the trust distribution that corresponds to nontaxable contributions and nontaxable earnings. Such amounts would not be treated as part juof the USP's investment in the contract that would constitute basis, such that it would be generally taxable to the U.S. resident beneficiary. IRC section 72(w) defines nontaxable contributions and nontaxable earnings as follows:

> (2) "applicable nontaxable contribution" means any employer or employee contribution —
>
> > (A) which was made with respect to compensation —
> >
> > > (i) for labor or personal services performed by an employee who, at the time the labor or services were performed, was a nonresident alien for purposes of the laws of the United States in effect at such time, and
> > >
> > > (ii) which is treated as from sources without the United States, and
> >
> > (B) which was not subject to income tax (and would have been subject to income tax if paid as cash compensation when the services were rendered) under the

laws of the United States or any foreign country.

(3) "applicable nontaxable earnings" means earnings —

(A) which are paid or accrued with respect to any employer or employee contribution which was made with respect to compensation for labor or personal services performed by an employee,

(B) with respect to which the employee was at the time the earnings were paid or accrued a nonresident alien for purposes of the laws of the United States, and

(C) which were not subject to income tax under the laws of the United States or any foreign country.

Applying IRC section 72(w)(2)(A) to the RCA of a Canadian player before he or she became a USP athlete (that is, a U.S. resident for tax purposes) is not an issue. After all, the RCA is an arrangement between the Canadian player and his or her Canadian employer regarding services performed in Canada. The primary issue that arises in this scenario is from IRC section 72(w)(2)(B)'s definition of nontaxable contributions under the IRC. As we discussed, 50 percent of the contributions made to an RCA are subject to a refundable tax amount that is remitted to the CRA. However, such amounts are ultimately refunded back to the custodian of the RCA when distributions from the RCA trust are made. Therefore, it is unclear whether the refundable tax constitutes a foreign income tax for purposes of IRC section 72(w)(2)(B) and (w)(3)(C), such that contributions and earnings accrued in the RCA trust would be classified as previously taxed contributions and earnings and constitute part of the USP athlete's investment in the contract that is not subject to tax upon distribution.[49]

Treasury has yet to promulgate regulations for guidance on what would constitute a foreign income tax under these provisions. Treasury regulations have, however, in addressing FTCs, offered guidance under Part III of subchapter N, on what would constitute a creditable income tax and when such tax is considered to have been paid for purposes of IRC section 901. Specifically, IRC section 901(b) allows a credit for any foreign "income, war profits, and excess profits taxes." According to these Treasury regulations, the predominant character of the foreign tax must be that it is consistent with an income tax in the U.S. sense of the term.[50] This requires that the foreign tax must be likely to reach net gain in the normal circumstances in which it applies.[51] Although it can be argued that the refundable tax is not an income tax in the U.S. sense of the term, it is difficult to do so with a high degree of confidence. If we assume, for sake of discussion, that it is an income tax, the next question is whether the contribution and the earnings are subject to that tax. To analyze that issue, it is important to understand how the refundable tax operates.

Part XI.3 of the ITA (subsection 207.5) requires that the employer withhold and remit 50 percent of the contribution to the RCA to the CRA.[52] This creates refundable tax.[53] The balance of the refundable tax account at the end of the year is compared to the balance at the beginning of the year. If there is an increase, additional refundable tax must be paid into the RCA.[54] If, however, there is a decrease in the balance, then the RCA may receive a refund payment from the CRA for the decrease.[55] Income received by the RCA increases

[49] We note that for a Canadian player who was not a U.S. resident (a USP athlete) at the time contributions and earnings were accruing in the RCA trust, such amounts would not have been subject to U.S. income tax.

[50] New York State Bar Association, "Report No. 1332 Relating to the Definition of a Creditable Tax for Purposes of Sections 901 and 903," at 6 (Nov. 24, 2015).

[51] *See generally* Treas. reg. section 1.901-2(b). In Rev. Rul. 67-187, 1967-1 C.B. 185, the IRS ruled that the special refundable tax in effect in Canada at the time was not an income tax but rather a "compulsory loan" because it was repayable with interest within a specified time. The RCA refundable tax may be distinguished from the special refundable tax in that it does not bear interest, an important indicium of a loan, whether compulsory or otherwise, and the timing of the refund of the tax can vary according to the pattern of contributions, income, and distributions of the particular RCA. As provided by Treas. reg. section 1.901-2(b), the term "net gain," does not appear to be applicable to either contributions or distributions, which are not "net" of any expenses other than the refundable tax itself.

[52] ITA regulation 103(7).

[53] ITA subsection 207.5(1) ("refundable tax").

[54] ITA subsection 207.7(1).

[55] ITA subsection 207.7(2).

the ending balance of refundable tax.[56] The calculation of refundable tax on hand at the end of the year includes a reduction for 50 percent of current distributions.[57] If, for instance, there were no contributions or income during the year and the entire RCA balance were distributed, the ending refundable tax balance would go to zero, and all refundable tax previously remitted would become refundable. The employer may claim a deduction in the year of the contribution.[58] The employee must include distributions from the RCA in his or her income.[59] When the custodian makes a distribution to the employee, it must withhold income tax at source.[60]

The phrase "subject to income tax" in IRC section 72(w) can have the broad meaning of being generally subject to the taxing power or jurisdiction of a tax regime. However, the usage in IRC section 72(w)(2) and (3) appears to have a narrower meaning, in that this IRC section also uses the phrase in saying, "would have been subject to income tax if paid as cash compensation." That phrase can be construed to mean, in the reciprocal, that if the employee received a cash payment, it would be taxable. Applying that usage to the RCA, a contribution to the RCA would be subject to tax if the RCA were taxed on the receipt of the contribution. Similarly, the income would be subject to tax if the RCA were taxed on the receipt of the income. Both the contribution and the income give rise to a payment of refundable tax.[61] However, to the extent that the tax is refundable, it will be refunded to the RCA trust one day. Once again, the Treasury regulations promulgated to address the FTC regime have contemplated the issue of a tax that is reasonably certain to be refunded and concluded that such a tax is not considered to have been paid:

> To the extent that it is reasonably certain that the amount will be refunded, rebated, abated, or forgiven. It is reasonably certain that an amount will be refunded, rebated, abated, or forgiven to the extent the amount exceeds a reasonable approximation of final foreign income tax liability to the foreign country.[62]

Based on our understanding of the RCA regime, it would appear reasonably certain that the refundable tax will be refunded no later than when all the funds of the RCA trust have been distributed to the employee and the refundable tax balance reaches zero. Moreover, the final tax liability of the RCA trust would be zero because all refundable tax will be refunded to the RCA trust eventually. It is also clear that the Canadian resident player who is the employee beneficiary of the RCA trust will ultimately bear the final tax liability because RCA trust distributions are taxable to the employee and subject to payroll withholding taxes. If a Canadian player (either a U.S. citizen who plays in Canada and returns to the U.S. or a Canadian citizen who plays in Canada and subsequently relocates to the U.S.) migrates to the United States and becomes a USP athlete, distributions from the RCA also would be subject to Canadian withholding taxes because such amounts would be paid to a nonresident of Canada at the time of distribution. Based on our review of the RCA regime and the manner in which the refundable tax is calculated, paid, and refunded, we conclude that RCA contributions earnings accrued in the trust from such contributions are both not subject to income tax in the sense in which that phrase is used in IRC section 72(w)(2) and (3) and, consequently, the RCA contributions are applicable nontaxable contributions, and the RCA earnings are applicable nontaxable earnings, under IRC section 72(w).

We further note that a USP athlete who migrates to Canada to work for a Canadian employer and establishes an RCA in the course of that employment would not be able to meet the conditions of IRC section 72(w)(2)(B) and (w)(3)(C) to include contributions and earnings in

[56] ITA subsection 207.5.

[57] *Id.*

[58] ITA subsection 20(1)(r). The employer must file T 737-RCA to report the contribution. The RCA also reports the contribution on its T3-RCA. Distributions from the RCA are reported by the custodian on the T4A-RCA.

[59] ITA subsection 56(1)(x).

[60] ITA subsection 153(1)(q).

[61] More precisely, as described in the preceding paragraph, RCA income goes into the overall calculation of the refundable tax balance at year-end, which may or may not require a payment of refundable tax depending on the calculation.

[62] Treas. reg. section 1.901-2(e)(2).

the RCA while he was a resident of Canada in his investment in the contract. This is because notwithstanding the status of the refundable tax as a foreign income tax for U.S. FTC purposes, such a USP would be subject to U.S. tax on his worldwide income (which would include the contributions and earnings in an RCA established for his benefit by the Canadian employer).

Our review of the legislative history of IRC section 72(w) supports our conclusion that both contributions and earnings accrued in the RCA trust would be subject to U.S. tax upon distribution to the formerly Canadian player if he were to become a U.S. resident for tax purposes (that is, a USP athlete) or to the USP athlete who migrates to Canada to work for a Canadian employer. The House conference report to the American Jobs Creation Act of 2004 (P.L. 108-357),[63] which codified IRC section 72(w), specifically stated that it was Congress's intent to remain consistent with U.S. model treaty provisions that provide for exclusive residence-based taxation of pension distributions to the extent such distributions were not previously included in taxable income in the other country.[64] The codified version of IRC section 72(w) would exclude from a taxpayer's basis some contributions and earnings that were not previously taxed while the taxpayer was a nonresident alien employee. The conference report states:

> The following example illustrates how the conference agreement could affect the amount of a distribution that may be taxed by the United States pursuant to a tax treaty.
>
> Assume the following facts. A, a nonresident alien individual, performs services outside the United States, in A's country of residence, country Z. A's employer makes contributions on behalf of A to a pension plan established in country Z. For U.S. tax purposes, no portion of the contributions or earnings are included in A's income (and would not be included in income if the amounts were paid as cash compensation when the services were performed) because such amounts relate to services performed without the United States. Later in time, A retires and becomes a permanent resident of the United States.
>
> Under the conference agreement, the employer contributions to the pension plan would not be taken into account in determining A's basis *if A was not subject to income tax on the contributions by the foreign country and the contributions would have been subject to tax by a foreign country if the contributions had been paid to A as cash compensation when the services were performed.* Thus, in those circumstances, A would be subject to U.S. tax on the distribution of all of the contributions, as such distributions are made. However, if the contributions would not have been subject to tax in the foreign country if they had been paid to A as cash compensation when the services were performed, under the conference agreement, the contributions would be included in A's basis. Earnings that accrued while A was a nonresident alien would not result in basis if not taxed under U.S. or foreign law. Earnings that accrued while A was a permanent resident of the United States would be subject to present-law rules. . . .
>
> The conference agreement authorizes the Secretary of the Treasury to issue regulations to carry out the purposes of the conference agreement, including regulations treating contributions as not subject to income tax under the laws of any foreign country under appropriate circumstances. *For example, Treasury could provide that foreign income tax that was merely nominal would not satisfy the "subject to income tax" requirement.*
>
> The conference agreement also changes the rules for determining basis in property received in connection for the performance of services in the case of an individual who was a nonresident alien at the time of the performance of services, if

[63] *See* H.R. Rep. No. 108-755, at 790-791 (2004).

[64] *Id.* at 790.

> the property is treated as income from sources outside the United States. In that case, the individual's basis in the property does not include any amount that was not subject to income tax (and would have been subject to income tax if paid as cash compensation when the services were performed) under the laws of the United States or any foreign country. [Emphasis added.][65]

Based on the above passage, the concept of foreign income tax under IRC section 72(w) would exclude merely nominal tax (for example, a low- or zero-tax jurisdiction). Assuming the refundable tax was an income tax, there is an argument that the RCA trust was subject to nominal tax, if at all, because the refundable tax would be ultimately refunded back to the RCA trust when it commences trust distributions to the USP athlete.

The conference report also illustrates that the foreign country income tax on contributions and earnings in the foreign trust must have been imposed on the nonresident alien himself and not on the foreign trust entity. Based on our review of the RCA structure, the refundable tax is imposed on the RCA trust and not on the USP athlete as the beneficiary of the RCA trust. Even if the above passage from the conference report were expanded to include a foreign income tax on contributions and earnings paid by the foreign trust (instead of the nonresident individual as illustrated in the conference report), in the absence of Treasury regulations under IRC section 72(w) directly addressing this issue, we doubt that the refundable tax would constitute an income tax in the U.S. sense for reasons already discussed. Indeed, the nature of the refundable tax is closer to a deposit[66] than a tax because the 50 percent tax on contributions and accrued earnings is ultimately refunded back to the foreign trust when trust monies are distributed to the employee beneficiary (such that the beneficiary, in fact, receives the gross amount initially contributed by the employer and earnings accrued on such amounts). Further, if the contributions were made directly to the nonresident alien employee as cash compensation (rather than the foreign trust), such amounts would have been immediately subject to Canadian income tax as compensation income.

Applying the above provisions of IRC section 72(w)(2) and (w)(3) to the RCA trust, we conclude that the entire amount of the employer contributions made by a Canadian employer to an RCA trust account for the benefit of its USP athlete would constitute nontaxable contributions under IRC section 72(w)(2). We reach this conclusion because all the employer contributions into the RCA trust were subject to a 50 percent refundable tax according to Part XI.3 of the ITA (subsection 207.5). The application of the refundable tax to such contributions would not rise to the level of an income tax in the U.S. sense. As a result, the portion of the RCA trust distributions made to a USP athlete that constitutes nontaxable contributions would be subject to U.S. income tax if the USP athlete were to receive such amounts as a resident of the United States under IRC section 72(a), (c), and (w).[67]

We also conclude that a portion of the RCA trust distributions that represent earnings accrued in the RCA trust from formation date to present would also constitute applicable nontaxable earnings. Such amounts would be excluded from the USP athlete's investment in the contract amounts under IRC section 72(w)(3).[68] This is because all the accrued earnings in the RCA trust were subject to the same 50 percent refundable tax, which we do not believe would constitute an income tax in the U.S. sense. Further,

[65] *Id.* at 790-791 (citations omitted).

[66] The refundable tax with respect to the RCA is different from the special refundable tax, which the IRS had previously determined to be a compulsory loan, not an income tax in Rev. Rul. 67-187. *Supra* note 51.

[67] If the RCA was not subject to the refundable tax, then there would be the possibility that a portion of the employer contributions to the RCA trust may constitute nontaxable contributions to the extent that the USP athlete: (1) filed a U.S. Form 1040NR to apportion their Canadian hockey team compensation to "income from personal services performed in the United States" in the same year as such contributions, and (2) the USP athlete took a treaty-based position under Article XV(2) of the tax treaty to file such returns as a nonresident alien. IRS, "U.S. Tax Guide for Aliens," Publication 519 (2022).

[68] If the RCA was not subject to the refundable tax, then there would be the possibility that a portion of the earnings accrued in the RCA trust may constitute nontaxable earnings to the extent that the Canadian athlete: (1) filed a U.S. Form 1040NR to apportion his Canadian hockey team compensation to income from personal services performed in the United States in the same year that earnings accrued to the RCA trust, and (2) such athlete took a treaty-based position under Article XV(2) of the tax treaty to file such returns as an nonresident alien.

a portion of these earnings would not have been subject to U.S. income tax to the extent the amounts were accruing in a foreign trust while the athlete was a nonresident alien.

In light of this analysis, distributions from the RCA trust to a USP athlete (regardless of whether or not he or she became a U.S. resident after establishment of the RCA or was already a USP player at the time of its creation) would be taxable to the individual as gross income subject to U.S. federal income taxes.[69] We also note that because the RCA trust distributions would be computed and paid to the athlete based on the Canadian dollar, the amount payable to such athlete as gross income each year will fluctuate in terms of U.S. dollars, which would be the applicable functional currency as a U.S. resident. Treas. reg. section 1.72-2(b)(3) would need to be applied to properly take into account the foreign exchange component that would be includable and excludable from such athlete's gross income for U.S. taxes.[70]

4. IRC Section 402(b)(4)

If an HCE is a member of an employee pension plan, then IRC section 402(b)(4) imposes additional hurdles to show that the plan meets the requirements of a qualified plan under IRC section 401(a)(26) (broad-based retirement plan) and section 410(b) (minimum employee participation). Otherwise, if the plan does not meet the requirements of IRC sections 401(a)(26) or 410(b), then the HCE is required to include in his gross income his vested accrued benefit (that is, the amounts in excess of his investment in the contract) in the trust as of the end of each trust year that falls within, or which ends with, the employee's tax year. If IRC section 402(b)(4) applies to the USP athlete because the RCA trust fails one of the tests outlined in IRC section 402(b)(4), then all earnings accrued in the trust will be included in the HCE's current gross income subject to U.S. tax, regardless of actual distributions.

For IRC section 402(b)(4) purposes, an HCE is defined under IRC section 414(q)[71] as an individual who was a 5 percent owner[72] of the employer at any time during the year or preceding year, or for the preceding year had compensation[73] in excess of US $80,000 as adjusted annually under IRC section 415(d) (cost of living adjustments). Employees who are nonresident aliens[74] and receive no earned income[75] that constitutes income attributable to services performed in the United States are not treated as employees for purposes of determining whether a pension plan has any HCEs.[76]

If the USP athlete was a nonresident alien when the RCA trust was funded for his or her benefit for services performed outside the United States, it would appear that the RCA trust, as a foreign nonexempt trust that is a funded plan, would have no employee that would qualify as an HCE for purposes of determining if the RCA trust constitutes a foreign funded qualified plan under IRC sections 401(a)(26) and 410(b) until sometime when such individual became a U.S. resident.

The issue that arises is that, even if the USP athlete became eligible for HCE status, he or she would no longer be an employee of the Canadian employer that established the RCA trust, nor would the USP be receiving any compensation for services provided within the United States to the Canadian employer in excess of US $80,000 (as adjusted for inflation) when he or she became a U.S. tax resident. Therefore, such a USP athlete would be ineligible to claim HCE status for his or her U.S. tax residency year under IRC section 414(q). Ultimately, the RCA trust would not have

[69] The distribution amounts subject to tax would be equivalent to the fair market value of the RCA at the time of distribution reduced by the amount of employer contributions made.

[70] Under Treas. reg. section 1.72-2(b)(3), a specified fixed dollar amount is considered to be the amount received as an annuity and is excludable from your gross income each year. All amounts in excess of that fixed dollar amount are considered to be amounts received not as an annuity and therefore includable in your gross income. The excludable fixed dollar amount is determined by dividing the investment in the contract by the number of periodic payments anticipated using the actuarial tables of Treas. reg. section 1.72-9.

[71] IRC section 402(b)(4)(C).

[72] As defined under IRC section 416(i)(1).

[73] Compensation within the meaning of IRC section 415(c)(3).

[74] IRC section 414(q)(8), referencing "nonresident aliens" as defined in IRC section 7701(b)(1)(B).

[75] Under IRC section 911(d)(2), earned income generally includes wages, salaries, and professional fees.

[76] There is no guidance from the applicable sections of the IRC, Treasury regulations, or the IRS that a Canadian athlete would be classified as an HCE if he or she filed a U.S. Form 1040NR and took a treaty-based position for nonresident status under Article XV(2) of the tax treaty for years when such athlete earned Canadian employer compensation for services performed within the United States.

any HCE individual that would trigger the gauntlet rules of IRC section 402(b)(4) because the USP athlete would no longer be an HCE individual on which IRC section 401(a)(26) and 401(b) tests can be performed.

5. IRC Section 409A

Although it would appear that distributions received from the RCA trust would be taxable to the USP athlete under IRC section 402(b), there remains the risk that accrued earnings in the trust that remain undistributed may be taxable to the USP athlete as current income each year. This risk arises if the RCA trust constitutes a nonqualified deferred compensation plan under IRC section 409A. This statutory provision[77] provides for specified requirements that, if violated, would cause such athlete to recognize all earnings accrued in the trust, which would be currently includable in the athlete's gross income to the extent such amounts are not subject to a substantial risk of forfeiture.[78] Consequently, the USP athlete's exclusive right to receive the trust assets as the sole beneficiary of the RCA trust (which likely constitute compensation income) may constitute deferred compensation, which will cause the athlete to recognize such accrued earnings as current gross income subject to tax.

Treasury regulations promulgated under IRC section 409(A) (the 409A regulations) define a nonqualified deferred compensation plan as including a plan under which an employee obtains a legally binding right to receive property in a future tax year when such property will be substantially vested (as defined under Treas. reg. section 1.83-3(b)).[79] There are, however, exemptions to what would be considered deferred compensation under the 409A regulations. There are two exemptions in Treas. reg. section 1.409A-1(b)(6)(i) that may apply to prevent the inclusion of accrued earnings in the RCA trust as current gross income for U.S. tax purposes:

> If a service provider receives property from, or pursuant to, a plan maintained by a service recipient, there is no deferral of compensation merely because the value of the property is not includible in income by reason of the property being substantially nonvested (as defined in section 1.83-3(b)), or is includible in income solely due to a valid election under section 83(b). For purposes of this paragraph (b)(6)(i), a transfer of property includes the transfer of a beneficial interest in a trust or annuity plan, or a transfer to or from a trust or under an annuity plan, to the extent such a transfer is subject to section 83, section 402(b) or section 403(c). In addition, for purposes of this paragraph (b), a right to compensation income that will be required to be included in income under section 402(b)(4)(A) is not a deferral of compensation.

As stated in the above Treasury regulation, a transfer of property to a trust, if such property includes a right to compensation income, is not considered a deferral of compensation for purposes of IRC section 409A if it is already subject to the income inclusion rules of IRC section 402(b)(4).[80] However, the USP athlete would be unable to claim this exemption because we think that the USP athlete would not be subject to IRC section 402(b)(4).

6. Substantially Non-Vested

The other exemption to IRC section 409A under Treas. reg. section 1.409A-1(b)(6)(i) involves the transfer of property (such as a right to compensation) to a foreign trust that is an IRC section 402(b) plan. Under Treas. reg. section 1.409A-1(b)(6)(i), amounts contributed by a Canadian employer to an RCA trust with the USP athlete as the sole beneficiary would not be treated as deferred compensation under IRC section 409A if the athlete's right to such property is substantially non-vested under Treas. reg. section 1.83-3(b).

Treas. reg. section 1.83-3(b) provides that property is substantially non-vested when it is subject to a substantial risk of forfeiture and is nontransferable. Both conditions must be satisfied

[77] American Jobs Creation Act of 2004, P.L. 108-357, section 885.

[78] *See* IRS Rev. Rul. 2007-48, 2007-30 IRB 129.

[79] Treas. reg. section 1.409A-1(b)(6)(ii).

[80] Treas. reg. section 1.402A-1(b)(6)(i).

to establish that the property placed in trust is substantially non-vested. A USP athlete's beneficial interest in an RCA trust would not be substantially non-vested for the following reasons.

First, the assets in the RCA trust are not subject to a substantial risk of forfeiture. Under Treas. reg. section 1.83-3(c)(1), property is subject to a substantial risk of forfeiture if the transfer has conditions directly or indirectly on the: (1) future performance (or refraining from performance) of substantial services by any person or (2) the occurrence of a condition related to the transfer, which, if not satisfied, would result in forfeiture.

In a typical arrangement, the Canadian employer would set aside monies in the RCA trust for the USP athlete's benefit upon his or her retirement or in the event of loss of employment. There are no conditions that would divest the USP athlete of his or her right to receive the property before or upon such athlete's retirement. The only implicit condition to the transfer of such property is the passage of time until the athlete's retirement or departure from the Canadian employer, and the mere passage of time does not constitute a risk of substantial forfeiture.

Second, a USP athlete's right to receive the RCA trust assets are not nontransferable because such rights can be sold, assigned, or pledged to another person (except the Canadian employer). Treas. reg. section 1.83-3(d) provides that "the rights of a person in property are transferable if such a person can transfer any interest in the property to any person other than the transferor of the property, but only if the rights in such property of such transferee are not subject to a substantial risk of forfeiture." Therefore, property is transferrable if the person receiving the property can sell, assign, or pledge (as collateral for a loan or security or any other purpose) his interest in the property to any person other than the transferor of such property. Based on this definition, a USP athlete's right to receive the RCA trust assets is transferable.

Because a USP athlete's right to receive the RCA trust assets is not substantially non-vested under IRC section 83 and its regulations, there is a risk that the RCA trust would constitute deferred compensation for IRC section 409A purposes. Consequently, the earnings accruing in the RCA trust would be currently includable in the USP athlete's gross income under IRC section 409A and subject to U.S. tax. We would, however, take the position that the accrued earnings potentially subject to U.S. tax would cover only earnings accrued in the RCA trust, starting on the date such USP athlete first departed Canada and became a U.S. resident under U.S. domestic tax laws.

C. Canada-U.S. Tax Treaty

1. Article XVIII

The tax treaty generally provides that pensions arising in Canada and paid to a resident of the United States may be taxed in the United States, but the amount of any such pension that would be excluded from taxable income in Canada if the recipient were a Canadian resident would be exempt from U.S. taxation.[81] For this purpose, the treaty defines pension as including "any payment under a superannuation, pension or other retirement arrangement."[82]

The U.S. Treasury explained that article 9 of the 1995 protocol amended Article XVIII (pensions and annuities) of the tax treaty, substituting the phrase "other retirement arrangement" for the phrase "retirement plan":

> The purpose for this change is to . . . provide that "pensions" includes, for example, Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs) in Canada. The term "pension" also would include amounts paid by other retirement plans or arrangements, whether or not they are qualified plans under U.S. domestic law; this would include, for example, plans and arrangements described in section 457 or 414(d) of the Internal Revenue Code.[83]

The U.S. Joint Committee on Taxation further commented:

> The existing treaty has a provision limiting source-country taxation of pensions. Article 9(1) of the proposed

[81] *See* tax treaty Article XVIII(1).

[82] *See* tax treaty Article XVIII(3)(a).

[83] U.S. Treasury technical explanation to the 1995 protocol.

> protocol makes a slight change in the definition of the term "pensions." The protocol clarifies that the definition of pensions includes, for example, payments from a U.S. individual retirement account (an "IRA"), and provides that the definition of pension includes, for example, payments from a Canadian registered retirement savings plan (a "RRSP") or registered retirement income fund (a "RRIF").[84]

Because the RCA trust is a retirement arrangement that is not an RRSP, RRIF, or a qualified plan under IRC section 401(a) or IRC sections 457 or 414(d),[85] the question that arises is whether it would nonetheless constitute an "other retirement arrangement" under Article XVIII(3)(a) and therefore, a pension. We do not believe that it would qualify as an other retirement arrangement because an RCA is not considered among that class of retirement or other employee benefit arrangements favored under Canadian tax laws. Indeed, the JCT noted:

> Under present law, certain Canadian retirement plans that are qualified plans for Canadian tax purposes do not meet U.S. internal law requirements of qualification. The existing treaty, however, permits a U.S. taxpayer who is a beneficiary of an RRSP to obtain U.S. tax deferral corresponding to the deferral that the RRSP provides under Canadian tax law, to the extent that income is reasonably attributable to contributions made to the plan by the beneficiary while he was a Canadian resident (see Rev. Proc. 89-45, 1989-2 C.B. 872). *The proposed protocol expands the class of retirement or other employee benefit arrangements favored by Canadian law with respect to which the United States will grant corresponding deferral of U.S. tax, and provides that Canada will provide reciprocal treatment to a Canadian taxpayer who is a beneficiary under a pension plan or other arrangement that qualifies for deferral of U.S. tax under U.S. law.* [Emphasis added.][86]

This passage confirms that the term "pension" under Article XVIII(3)(a) was expanded to include other retirement plans or arrangements that received favorable treatment under Canadian law that would not satisfy qualified plan treatment under U.S. laws. An RCA arguably does not receive favorable tax treatment in Canada. Indeed, an RCA is omitted from the class or category of retirement plans that would be afforded qualifying plan treatment in Canada for purposes of Article XVIII.[87]

The term "qualifying plan" under paragraph 15 of Article XVIII is limited to:

> a trust, company, organization, or other arrangement that (a) is a resident of that State, generally exempt from income taxation in that State and operated primarily to provide pension or retirement benefits; (b) is not an individual arrangement in respect of which the individual's employer has no involvement; and (c) the competent authority of the other Contracting State agrees generally corresponds to a pension or retirement plan established in and recognized for tax purposes in that State. Thus, U.S. individual retirement accounts (IRAs) and Canadian registered retirement savings plans (RRSPs) are not treated as qualifying retirement plans. . . . *In addition, a Canadian retirement compensation arrangement (RCA) is not a qualifying retirement plan because it is not considered to be generally exempt from income taxation in Canada.* [Emphasis added.][88]

Based on the foregoing authorities, we conclude that the RCA trust, classified as an RCA under Canadian domestic law, would not qualify as a pension under Article XVIII(3)(a). This

[84] Joint Committee on Taxation, "Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Canada," JCS-15-95 (May 23, 1995).

[85] *See also* U.S. Treasury technical explanation to the 2007 protocol, stating: "In addition, a Canadian retirement compensation arrangement (RCA) is not a qualifying retirement plan because it is not considered to be generally exempt from income taxation in Canada."

[86] JCT, *supra* note 84.

[87] Tax treaty Article XVIII(8)-(14) and (15).

[88] Technical explanation to the 2007 protocol, *supra* note 85.

conclusion stands even if the Canadian Income Tax Conventions Interpretation Act (ITCIA) section 5 definition of pension includes an RCA.[89] It is evident from the above commentary on Article XVIII(1) and (3) that only tax-favored Canadian plans would be offered tax treaty benefits. It is also evident that the ITCIA section 5 definition of pension only applies in the absence of a treaty definition for pension. Finally, because Article XVIII(3) defines "pensions," application of ITCIA section 5 would be premature. Therefore, a USP athlete would not be able to apply the provisions of Article XVIII(1) to exclude from U.S. income taxes the accrued earnings in, and distributions received from, the RCA trust.

Articles XVIII(7), (8), (9), and (10) — all of which deal with the tax relief accorded to pension plans in Canada or the United States for the benefit of citizens and residents of the other country — would seem to apply to an RCA. The RCA may be a trust for U.S. tax purposes, but clearly it is an other arrangement that provides for pension benefits. However, these provisions all require that Canada provide tax relief to such a structure for the United States to grant similar relief, up to the limits of similar relief provided in the United States for similar U.S. pensions. Unfortunately, the RCA receives no such tax relief in Canada and indeed is taxed and withheld on in Canada to such a degree that, if credit were granted in the United States, it would be hard to think of a situation in which U.S. federal tax would be payable. It could be argued perhaps that an RCA does provide tax relief in that the income of the arrangement is not taxed in the hands of the beneficiary when earned, but it is taxed heavily in the structure. However, that relief is technical rather than effective.

2. Article XXII: Income From a Trust

Although the RCA does not technically meet the treaty definition of pension or other retirement arrangement under Article XVIII of the tax treaty, it would alternatively qualify as a Canadian resident trust under Article XXII, which states:

> 1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State, except that if such income arises in the other Contracting State it may also be taxed in that Other State.
>
> 2. To the extent that income distributed by an estate or trust is subject to the provisions of paragraph 1, then, notwithstanding such provisions, income distributed by an estate or trust which is a resident of a Contracting State to a resident of the other Contracting State who is a beneficiary of the estate or trust may be taxed in the first-mentioned State and according to the laws of that State, but the tax so charged shall not exceed 15 percent of the gross amount of the income; provided, however, that such income shall be exempt from tax in the first-mentioned State to the extent of any amount distributed out of income arising outside that State.

If the RCA trust distributions were treated as a payment out of a trust rather than a pension, and further, as income from the trust rather than capital,[90] then such amounts would be subject to 15 percent withholding tax as income distributed from a Canadian resident trust to a USP athlete (if such athlete were to become a resident of the United States), regardless of periodic or lump sum payments under Article XXII, which addresses "Other Income."[91] However, because Canadian domestic tax law does not tax distributions from an RCA (in fact, the refundable tax is paid back to the RCA trust as distributions

[89] As defined in ITCIA section 5, "pension" means "in respect of payments that arise in Canada, (a) if the convention does not include a definition [of] *pension*, a payment under any plan, arrangement or contract that is (i) a registered pension plan, (ii) a registered retirement savings plan, (iii) a registered retirement fund, (iv) a retirement compensation arrangement." (emphasis in original).

[90] The reduced rate of 15 percent applies to income and not to the distribution of capital — that is, the employer contribution. *See* ITA subsection 212(1)(c), which also only applies to income of the trust that is income with reference to ITA subsection 104(13).

[91] Canadian practitioners acknowledge that the inclusion of RCAs in "pension" under the treaty when there is no definition of pension, results in anomalous results because only periodic payments from an RCA can qualify as a pension under tax treaty Article XVIII(2), while lump sum payments do not. *See* David W. Ross, "Withholding Taxes on Retirement Compensation Arrangements," XIII(2) *Tax'n of Executive Compensation & Retirement J.* 801 (2009) (commenting on CRA Technical Interpretation 9530510).

are made), we do not think Article XXII would apply.

IV. TFSAs

The TFSA has proven to be enormously popular with Canadians. According to the latest statistics, there are over 15 million unique TFSA holders with a cumulative FMV of C $350 billion.[92] This means that about 39 percent of all Canadian residents have a TFSA.[93] Although it is a popular belief that there are over 1 million Americans living in Canada,[94] according to the U.S. government's Federal Voting Assistance Program (which conducts the Overseas Citizen Population Analysis every two years following the general election), there are only about 660,935 eligible U.S. voters living in Canada.[95] Based on the average percentage of Canadian residents owning TFSAs and the statistics available, there are perhaps as many as 390,000, but more likely closer to 260,000, USPs who have TFSAs. These TFSAs could have a market value of as much as C $7.9 billion but perhaps closer to C $5.2 billion (or about US $6 billion to US $4 billion depending on the assumptions made and the exchange rate).

Addressing the issue of exactly what are TFSAs for U.S. tax purposes and how they ought to be reported by USPs who are Canadian residents is an issue of some significance. This is particularly the case if the reporting for TFSAs is both repetitive (that is, the same account is being reported on multiple forms filed by the USP with the IRS) and the advice being given to USPs in Canada by tax professionals is inconsistent.

A. Background and Structure

The Canadian government introduced TFSAs in 2009.[96] The TFSA has been described as "a flexible, registered, general-purpose savings vehicle that allows Canadians to earn tax-free investment income to more easily meet lifetime savings needs."[97] Although the TFSA was intended to complement RRSPs and increase retirement savings,[98] a recent study shows that Canadians appear to have diverted their savings away from RRSPs and into TFSAs.[99]

Canadian TFSAs are intentionally easy to create. All that is required are two parties (a Canadian resident, as holder, and an entity, as issuer) to enter a "qualifying arrangement" that is treated as a trust.[100] The issuer must be a federally or provincially licensed trust company, a life insurance company qualified to issue annuities, or a bank or credit union that is a member of the Canadian Payments Association.[101] The agreement must be a trust agreement with a trust company, an annuity contract with a life insurance company, or a deposit agreement with a financial institution.[102] The agreement also must provide that all contributions must be made to the issuer "in consideration of, or to be used, invested or otherwise applied for the purpose of, the issuer making distributions under the arrangement to the holder."[103] Moreover, the agreement must

92 *See* CRA, "Tax-Free Savings Account Statistics (2019 Tax Year)" (last accessed Sept. 28, 2022).

93 Canada's population for 2019 — the same year as the latest TFSA stats — is about 37.5 million. *See* Statistics Canada, "Population Estimates, Quarterly" (last accessed Sept. 1, 2022).

94 *See* Wikipedia, "Immigration to Canada" (last visited Sept. 1, 2022). There is no statistical proof of these 1 million Americans in Canada, but this number shows up all over the internet. Based on the number of potential registered voters, 1 million seems like a low number. For example, there are many children of USPs born in Canada, who are American citizens by virtue of their birth abroad to a U.S. citizen parent, who do not hold U.S. passports or disclose this status in the ordinary course of their day-to-day lives. Additionally, many other Canadian residents do not even know they are U.S. citizens by birth and therefore USPs for U.S. tax purposes. The authors routinely need to explain this to clients, including those who are highly sophisticated individuals. If there are half a million known U.S. citizens/voters in Canada, according to the U.S. government, we would ballpark the actual number of U.S. citizens in Canada at well above 1 million and perhaps closer to 2 million.

95 Kenneth Chan, "Toronto Has the World's 3rd Largest Population of Americans Living Outside of the USA," *DH News*, Oct. 10, 2016; *see also* Federal Voting Assistance Program, "State of the Overseas Voter" (last visited Sept. 1, 2022). There are more potential U.S. voters in Canada than live in the states of Alaska, Vermont, North Dakota, South Dakota, or Wyoming.

96 Introduced as Bill C-50, The Budget Implementation Act, 2008, received Royal Assent on June 18, 2008. It became effective January 1, 2009.

97 *See* Letter from Jim Yager, The American Chamber of Commerce in Canada, to Mark Mazur, assistant secretary (tax policy), Department of the Treasury, and Robert Stack, deputy assistant secretary (international affairs), Department of the Treasury (Mar. 4, 2016).

98 Department of Finance Canada, "The Budget Plan 2008: Responsible Leadership," at 277 (Feb. 26, 2008).

99 Leslie Berger, Jonathan Farrar, and Lu Zhang, "An Empirical Analysis of the Displacement Effect of TFSAs on RRSPs," 67(2) *Canadian Tax J.* 309 (2019).

100 Para. (a) of the definition of qualifying arrangement in ITA subsection 146.2(1).

101 Para. (b) of the definition of qualifying arrangement in ITA subsection 146.2(1).

102 *Id.*

103 Para. (c) of the definition of qualifying arrangement in ITA subsection 146.2(1).

require that the issuer will file an election to register the arrangement as a TFSA with the CRA before the end of the tax year in which the agreement is made.[104]

The terms of the agreement must also state, and the issuer must also always comply with, the following terms[105]:

1) the TFSA must be maintained for the exclusive benefit of the holder;[106]

2) while the holder is alive, only the holder or the issuer can determine the amount and timing of distributions[107] or the investing of funds;

3) no one other than the holder can make a contribution;[108]

4) distributions will reduce any tax imposed for over-contributions,[109] contributions by nonresidents,[110] or as a result of improper investments being held in the TFSA;[111]

5) the holder has the right to require the issuer to transfer the assets or the value thereof to another TFSA held by the same holder;

6) if the TFSA is a trust, the trust is prohibited from borrowing money or other property for the purposes of the arrangement; and

7) the arrangements must comply with prescribed conditions, of which there have been no such regulations issued to date.[112]

Although the majority of TFSAs are deposit agreements with financial institutions, the terms of the agreement between the holder and the issuer are more trustlike than an ordinary account with a financial institution. The TFSA is limited, however, on the kind of investments that can be made. TFSAs are limited to specified investments similar to RRSPs, such as cash, mutual funds, securities listed on a designated stock exchange, guaranteed investment certificates, bonds, and some shares of small business corporations.[113] Because the holder retains significant control over the TFSA and has sole power to direct payments, the TFSA bears the indicia of a grantor trust for U.S. tax purposes (as discussed below) and is likely not a separate entity from the holders as others have suggested.

For 2022, a Canadian resident age 18 years and older can contribute up to C $6,000 of his or her post-tax monies to a TFSA. The cumulative total lifetime contribution cannot exceed C $81,500. Both the annual amount and the lifetime maximum amount are adjusted annually for inflation. Under current legislation, the TFSA annual contribution, if unused, can be rolled over to the succeeding year but will always be subject to the lifetime contribution limit. There is no personal deduction for contributions made to a TFSA. However, neither income earned within a TFSA nor withdrawals from it affect eligibility for Canadian federal income tested benefits, such as Old Age Security, the Guaranteed Income Supplement, and the Canada Child Tax Benefit. Moreover, an individual may provide funds to their spouse or common law partner for investment in a TFSA, with TFSA assets generally

[104] Para. (d) of the definition of qualifying arrangement in ITA subsection 146.2(1).

[105] Para. (e) of the definition of qualifying arrangement in ITA subsection 146.2(1) (stating that the arrangement must comply with ITA subsection 146.2(2)).

[106] *See* para. (a) of "qualifying arrangement conditions" in ITA subsection 146.2(2).

[107] Please see the definition of distribution in ITA subsection 146.2(2)(b).

[108] ITA subsection 146.2(2)(c). However, the CRA has indicated that it will allow spouses to provide gifts to each other to fund TFSAs. *See* CRA, "Tax-Free Savings Account (TFSA), Guide for Individuals," RC4466(E) Rev. 22.

[109] ITA subsection 207.02 sets the tax payable for excess contributions to a TFSA at 1 percent per month, for any month in which there is an excess amount *at any time* in the month.

[110] ITA subsection 207.03.

[111] Under ITA subsections 207.04 and 207.06, there is a tax on the FMV of prohibited or nonqualified investments acquired by trusts, equal to 50 percent of the FMV of the prohibited or nonqualified investment. This tax will be payable by the holder of a TFSA if the TFSA acquires a prohibited or nonqualified investment or an investment held by the TFSA becomes a prohibited or nonqualified investment. This tax can be recovered if the property is disposed of by the TFSA before the end of the calendar year following the calendar year in which the tax arose and only if it is not reasonable to consider that the TFSA holder knew, or ought to have known, at the time the property was acquired, that it was, or would become, a prohibited or nonqualified investment.

[112] The explanatory notes to ITA subsection 146.2(2) state that no specific conditions were anticipated and to date none have been issued. *See* Department of Finance Canada, "Tax Provisions From the 2008 Federal Budget Contained in Bill C-50 With Explanatory Notes" (2008).

[113] Government of Canada, "Types of Permitted Investments" (last updated Dec. 13, 2021).

transferrable to a spouse or common law partner upon death.

B. Canadian Classification

The TFSA and the RRSP are the predominant tax-preferred savings accounts available for Canadians' personal savings, but the two are not subject to the same Canadian tax treatment. On the one hand, the RRSP is an example of a tax-deferred savings plan: Contributions are made with pretax cash, and withdrawals are generally fully taxable.[114] On the other hand, the TFSA is an example of a trust that is not taxable in Canada because it is essentially a tax-prepaid savings plan.[115] Contributions to a TFSA are made with after-tax cash,[116] and generally, there are no Canadian tax consequences when an amount is contributed to such a trust unless it carries on one or more businesses or holds one or more properties that are nonqualified investments.[117] Withdrawals from a TFSA are also tax free, and the entire amount withdrawn can be recontributed to the TFSA in future years.

With both RRSP and TFSA plans, income earned in the plan is not taxed (although, in the case of an RRSP, such income is taxed in the year of withdrawal).[118]

Because of the tax-advantaged nature of the TFSA, all contributions, accruals, and distributions are closely tracked by the CRA. First, a Canadian social insurance number must be provided by any Canadian resident opening a TFSA. Second, the issuers[119] of a TFSA are required to report all TFSAs to the CRA during the tax year in which contributions are made. Third, invalid contributions made to the TFSA during a year are subject to a monthly penalty tax that is a percentage of the highest excess contribution amount. Invalid contributions are contributions that exceed the annual contribution limit or contributions made by a non-Canadian resident. The penalty taxes can be applied concurrently if both types of invalid contributions take place. The tax is paid and reported to the CRA.[120]

In recent years, the rampant popularity of TFSAs has made it the focus of CRA attempts to curb its use by penalizing gains made through stocks held in a TFSA.[121] Such attempts, representing the CRA's effort to crack down on similar accounts throughout Canada, have uncovered C $110 million (US $83.75 million) in unpaid taxes.[122]

C. U.S. Classification

TFSAs have been excluded from all U.S. tax guidance, which has otherwise exempted USP taxpayers with interests in Canadian registered plans such as RRSPs, RRIFs, RESPs, and RDSPs from foreign trust reporting requirements. Absent clear guidance for TFSAs, there is no uniformity in the tax classification and reporting of TFSAs among tax practitioners. This breeds inadvertent noncompliance among U.S. individuals with TFSAs who rely on their U.S. and Canadian tax practitioners and return preparers to accurately report their interests in a TFSA. Cross-border tax practitioners either report the TFSA as a foreign grantor trust or not at all because of the onerous U.S. statutory filing requirements for such trusts, a situation that has been pointed out in several submissions to Treasury by different interest groups and associations over the years.[123] Regardless of whether a TFSA is considered a "foreign financial account" subject to Form 8938 or FBAR[124] disclosure or a foreign grantor trust subject to Form 3520-A, a USP who is a Canadian resident and who contributes to a TFSA is subject

[114] Berger, Farrar, and Zhang, *supra* note 99.

[115] *Id.*

[116] The amounts contributed to a TFSA are post-tax monies and have been subject to Canadian tax at applicable marginal federal tax rates under Canada's graduated tax rate system.

[117] *See* ITA subsection 146.2(6).

[118] Berger, Farrar, and Zhang, *supra* note 99.

[119] Issuers would include trust companies, licensed annuities providers, a person who is or would be eligible to become a member of the Canadian Payments Association, or a credit union in which an individual has a qualifying arrangement under the ITA. *See* "Tax-Free Savings Account (TFSA), Guide for Individuals," *supra* note 108.

[120] CRA, "RC243 Tax-Free Savings Account (TFSA) Return" (last updated Oct. 8, 2021).

[121] *See Canadian Western Trust Company as Trustee of the Fareed Ahamed TFSA v. The Queen*, 2019 TCC 121 (2019).

[122] *See* James Munson, "Agency Memo Focus of Canadian Tax-Free Accounts Case," BNA Daily Tax Report (last updated Oct. 27, 2020).

[123] *See, e.g.*, Yager letter, *supra* note 97.

[124] *See* Financial Crimes Enforcement Network, "BSA Electronic Filing Requirements For Report of Foreign Bank and Financial Accounts (FinCEN Form 114)" (Jan. 2017).

to income taxation on the income of such TFSA each year. Also, if the TFSA is invested in Canadian mutual funds, the USP is also subject to additional adverse passive foreign investment company taxes and information reporting requirements, including Form 8621.[125]

The TFSA is very similar to the Roth IRA in the same way that an RRSP is similar to a traditional IRA. Although Canadian scholars have noted similarities[126] between the TFSA and Roth IRA, not just in their purpose but on several key characteristics, the two are not identical:

- The TFSA and the Roth IRA are funded with post-tax monies. There is no personal tax deduction afforded to taxpayers who open accounts.
- Funds in a TFSA and Roth IRA generally grow tax free (assuming Roth IRA guidelines are followed) and are generally not subject to tax on distribution after retirement.
- Annual contribution limits to a TFSA and a Roth IRA are fixed at C $6,000 (TFSA) and US $6,000[127] (Roth IRA) for 2022;[128] however, unlike a TFSA (which has an annual contribution limit comprised of the annual contribution limit and any unused prior-year contributions), unused contribution limits in a Roth IRA cannot be carried forward to future years.
- The account holder can direct how investments in a Roth IRA or TFSA are made.
- Amounts in a Roth IRA or TFSA can be contributed by a spouse or common law partner without any earnings accrued in such contribution being attributed back to the contributor.
- There is no limit on the amount that is eligible for rollover to a Roth IRA or TFSA.
- Higher-income taxpayers have their annual contributions to a Roth IRA reduced or eliminated if their modified adjusted gross income exceeds specified thresholds[129] each year; a TFSA does not have any income threshold.
- Unlike a TFSA, from which withdrawals can be made at any time, early pre-retirement distributions from a Roth IRA that are not "qualified distributions" are subject to a tax plus a 10 percent penalty on any portion attributable to the account earnings.[130]

D. Canada-U.S. Tax Treaty

1. Article XVIII

As discussed in Section IV.C regarding the tax treaty's application to an RCA, Article XVIII(1) also governs our analysis of the TFSA. As a refresher, Article XVIII(1) of the tax treaty generally provides that pensions arising in Canada and paid to a resident of the United States may be taxed in the United States, but the amount of any such pension that would be excluded from taxable income in Canada if the recipient were a Canadian resident would be exempt from U.S. taxation.[131] For this purpose, Article XVIII(3)(a) defines "pension" as including "any payment under a superannuation, pension or other retirement arrangement."[132]

The U.S. Treasury explained that article 9 of the 1995 protocol amended Article XVIII (Pensions and Annuities) of the tax treaty. Specifically, the current definition of pension under Article XVIII(3) was amended by substituting the phrase "other retirement arrangement" for the phrase "retirement plan." Treasury elaborated that:

> The purpose for this change is to . . . provide that "pensions" includes, for

[125] *See* Ward, "2012 Offshore Voluntary Disclosure Program: Issues and Opportunities," 41(10) *Tax Mgmt. Int'l J.* 548 (Oct. 12, 2012).

[126] *See* Berger, Farrar, and Zhang, *supra* note 99; *see also* Yager letter, *supra* note 97; and Letter from Troy K. Lewis, AICPA, to Mark Mazur, assistant secretary (tax policy) Department of the Treasury, Robert Stack, deputy assistant secretary (international affairs) Department of the Treasury, and J. Mark Iwry, senior advisor to the secretary and deputy assistant secretary, Retirement and Health Policy Department of the Treasury (Mar. 4, 2016).

[127] Individuals age 50 years or older may make catch-up contributions.

[128] Also, Roth IRA contribution limits are increased for taxpayers who are at least 50 years old. For 2022, these taxpayers can contribute US $7,000.

[129] For 2022, income must be below $129,000 for single filers or $204,000 for joint filers. Roth IRA contributions are entirely phased out if income reaches $144,000 for single filers and $214,000 for joint filers.

[130] *See* IRS, "Distributions From Individual Retirement Accounts (IRAs)," Publication 590-B (2021).

[131] *See* tax treaty Article XVIII(1).

[132] *See* tax treaty Article XVIII(3)(a).

> example, Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs) in Canada. The term "pension" also would include amounts paid by other retirement plans or arrangements, whether or not they are qualified plans under U.S. domestic law; this would include, for example, plans and arrangements described in section 457 or 414(d) of the Internal Revenue Code.[133]

The JCT further commented:

> The existing treaty has a provision limiting source-country taxation of pensions. Article 9(1) of the proposed protocol makes a slight change in the definition of the term "pensions." The protocol clarifies that the definition of pensions includes, for example, payments from a U.S. individual retirement account (an "IRA"), and provides that the definition of pension includes, for example, payments from a Canadian registered retirement savings plan (a "RRSP") or registered retirement income fund (a "RRIF").[134]

Although a Roth IRA, which is explicitly considered a pension for purposes of the treaty under Article XVIII(3)(b), would not be subject to Canadian taxation under the treaty, this protection no longer applies when the owner of a Roth IRA migrates to Canada and becomes a Canadian tax resident. Under such circumstances, the treaty makes clear that any subsequent contributions to the Roth IRA (including conversions or rollovers from a qualified employer plan account) will cause the Roth IRA to lose its treaty protection. Thereafter, all growth accrued in the Roth IRA account would be subject to full Canadian taxation for as long as the person is a resident of Canada. Future distributions in excess of the account balance on the date of the disqualifying contribution are also subject to Canadian tax while resident in Canada. Assets in the Roth IRA are subject to Canadian deemed disposition rules when the person terminates his or her Canadian residence to the extent the appreciation in the Roth IRA related to the contribution on behalf of a resident.

Unlike a Roth IRA, a Canadian TFSA is not afforded treatment as a pension under Article XVIII(3) of the treaty. Nonetheless, to qualify as a pension under the treaty, a Canadian TFSA must constitute an other retirement arrangement under Article XVIII(3)(a) of the treaty. To do so, the TFSA must be a retirement arrangement that is not an RRSP, RRIF, or a qualified plan under IRC section 401(a) or sections 457 or 414(d) of U.S. domestic tax law.[135] We believe that a TFSA would qualify as an other retirement arrangement because, like the Roth IRA in the United States, it is considered among that class of retirement or other employee benefit arrangements favored under Canadian tax laws. Indeed, the JCT noted as follows:

> In addition, under present law, certain Canadian retirement plans that are qualified plans for Canadian tax purposes do not meet U.S. internal law requirements of qualification. The existing treaty, however, permits a U.S. taxpayer who is a beneficiary of an RRSP to obtain U.S. tax deferral corresponding to the deferral that the RRSP provides under Canadian tax law, to the extent that income is reasonably attributable to contributions made to the plan by the beneficiary while he was a Canadian resident (see Rev. Proc. 89-45, 1989-2 C.B. 872). *The proposed protocol expands the class of retirement or other employee benefit arrangements favored by Canadian law with respect to which the United States will grant corresponding deferral of U.S. tax and provides that Canada will provide reciprocal treatment to a Canadian taxpayer who is a beneficiary under a pension plan or other arrangement that qualifies for deferral of U.S. tax under U.S. law.* [Emphasis added.][136]

This quote confirms that the term "pension" under Article XVIII(3)(a) was expanded to include other retirement plans or arrangements that

[133] Technical explanation to the 1995 protocol, *supra* note 83.

[134] JCT, *supra* note 84.

[135] *See also* technical explanation to the 2007 protocol, *supra* note 85.

[136] JCT, *supra* note 84.

received favorable treatment under Canadian law that would not satisfy qualified plan treatment under U.S. laws. A TFSA is afforded favorable treatment under Canadian law. However, although it is essentially a trust account for retirement savings, it would not be included as part of the class or category of retirement plans that would be afforded qualifying plan treatment in Canada for purposes of Article XVIII because it can be created without any employer involvement.[137] The term "qualifying plan" under paragraph 15 of Article XVIII is limited to:

> a trust, company, organization, or other arrangement that (a) is a resident of that State, generally exempt from income taxation in that State and operated primarily to provide pension or retirement benefits; (b) is not an individual arrangement in respect of which the individual's employer has no involvement; and (c) the competent authority of the other Contracting State agrees generally corresponds to a pension or retirement plan established in and recognized for tax purposes in that State. Thus, U.S. individual retirement accounts (IRAs) and Canadian registered retirement plans (RRSPs) are not treated as qualifying retirement plans unless addressed in paragraph 10 of the General Note. . . .
>
> Paragraph 10 of the General Note provides that the types of Canadian plans that constitute qualifying retirement plans for purposes of paragraph 15 include the following and any identical or substantially similar plan . . .: registered pension plans [and] registered retirement savings plans.[138]

In light of this analysis, we would likely conclude that the TFSA would not qualify as a pension under Article XVIII(3)(a) of the tax treaty. However, we would nonetheless challenge this conclusion in light of the fact that the tax treaty treats a Roth IRA as a pension, notwithstanding that it is also an individual arrangement made without employer involvement. According to Article XVIII(3)(b):

> The term "pensions" also includes a Roth IRA, within the meaning of section 408A of the Internal Revenue Code, or a plan or arrangement created pursuant to legislation enacted by [the United States or Canada] after September 21, 2007 that the competent authorities have agreed is similar thereto. Notwithstanding the provisions of the preceding sentence, from such time that contributions have been made to the Roth IRA or similar plan or arrangement, by or for the benefit of a resident of [Canada] (other than rollover contributions from a Roth IRA or similar plan or arrangement described in the previous sentence that is a pension within the meaning of this subparagraph), to the extent of accretions from such time, such Roth IRA or similar plan or arrangement shall cease to be considered a pension for purposes of the provisions of this Article.

Roth IRAs are treated as pensions under the tax treaty, notwithstanding that they otherwise would not qualify under Article XVIII(3)(a), and payments from the United States to Canadian residents from Roth IRAs are tax free in Canada because such distributions are tax free in the United States. There is the caveat that if contributions are made to a Roth IRA for the benefit of a Canadian resident while the beneficiary is a Canadian resident, then any related amounts (distributions and income therefrom) will not be deemed to be pensions for the purposes of Article XVIII(3) and therefore may be taxed in Canada.

Because TFSAs were not introduced by Canadian legislation until after the fifth protocol was signed in 2007, it is not mentioned in Article XVIII of the tax treaty. However, it seems fairly obvious that the protocol was negotiated in light of the potential for Canada to establish a structure like a Roth IRA and for the two authorities to come to an agreement on this issue. Although there are many notable similarities between a Roth IRA and a TFSA that cannot be ignored, the two are not identical. Nonetheless, the question

[137] *See* tax treaty, Article XVIII(8)-(14) and (15).

[138] Technical explanation to the 2007 protocol, *supra* note 85.

must be raised as to why a TFSA is not protected under the tax treaty in the same way that a Roth IRA is.

We suggest that the difference in treatment of the Roth IRA and TFSA under the tax treaty is attributable to the fact that the TFSA allows for considerably more freedom regarding withdrawals and because contributions to a TFSA are not restricted by income level. Moreover, subsection 146.2 of the ITA says a TFSA is not a retirement savings plan for Canadian tax purposes. It would therefore be somewhat inconsistent for the CRA to request the United States to recognize something as a pension for the purposes of the tax treaty when Canadian domestic law clearly states it is not.

Article XVIII(7) of the tax treaty provides an alternative basis for extending treaty protection to a TFSA:

> A natural person who is a citizen or resident of a Contracting State and a beneficiary of a trust, company, organization or other arrangement that is a resident of the other Contracting State, generally exempt from income taxation in that other State and operated exclusively to provide pension or employee benefits may elect to defer taxation in the first-mentioned State, subject to rules established by the competent authority of that State, with respect to any income accrued in the plan but not distributed by the plan, until such time as and to the extent that a distribution is made from the plan or any plan substituted therefor.

This text was originally added to the tax treaty by the third protocol in 1995 (although its language was tweaked in the fifth protocol in 2007). Before that time, the opportunity to elect to defer taxation was limited to RRSP accounts. Paragraph 7 was added to extend the scope of elective deferral to pensions and employee plans. The technical explanation to the third protocol explains the scope of the extension of treaty benefits:

> As amended, paragraph 7 applies to an individual who is a citizen or resident of a Contracting State and a beneficiary of a trust, company, organization, or other arrangement that is a resident of the other Contracting State and that is both generally exempt from income taxation in its State of residence and is operated exclusively to provide pension, retirement, or employee benefits.[139]

Based on that, a USP who is a Canadian resident with a TFSA should be able to elect for a tax deferral on the income realized from TFSA asset investments if the following conditions are met:

- such individual is a beneficiary of the plan;
- the plan is exempt from income tax under Canadian law; and
- the plan is operated exclusively to provide pension, retirement, or employee benefits.

The TFSA would meet all three conditions. First, the USP (the holder of the TFSA) would be a beneficiary of the plan. Second, the TFSA investment earnings and distributions are not subject to Canadian taxation. Third, although the TFSA does not exclusively provide pension or employee benefits, it is intended to provide retirement savings because distributions would be tax free only if received by a Canadian resident individual on or after retirement age. The fact that Canadian tax law does not deem a TFSA to be a retirement plan under the ITA (but rather as a trust under subsection 146.2 of the ITA) should not deter the IRS from extending similar deferral opportunities for the TFSA for U.S. tax purposes as has been afforded to Roth IRAs for Canadian tax purposes.

2. Article XXII: Income From a Trust

Although the TFSA does not meet the tax treaty definition of pension under Article XVIII, it would alternatively qualify as a Canadian resident trust under Article XXII of the tax treaty. Article XXII(2) of the tax treaty provides:

> (1) Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State, except that if such income arises in

[139]Technical explanation to the 1995 protocol, *supra* note 83.

> the other Contracting State, it may also be taxed in that Other State.
>
> (2) To the extent that income distributed by an estate or trust is subject to the provisions of paragraph (1), then, notwithstanding such provisions, income distributed by an estate or trust which is a resident of a Contracting State to a resident of the Other Contracting State who is a beneficiary of the estate or trust may be taxed in the first-mentioned State and according to the laws of that State, but the tax so charged shall not exceed 15 percent of the gross amount of the income; provided however, that such income shall be exempt from tax in the first-mentioned State to the extent of any amount distributed out of income arising outside that State.

If the TFSA distributions were treated as a payment out of a trust rather than a pension, and further, as income from the trust rather than capital,[140] then such amounts would be subject to 15 percent withholding tax as income distributed from a Canadian resident trust to a USP, regardless of periodic or lump sum payments under Article XXII of the tax treaty, which addresses other income.[141] However, because Canadian domestic tax law does not generally tax distributions from a TFSA, we do not think Article XXII would apply.

V. Recommendations

Based on our analysis of TFSAs and RCAs, we recommend that Treasury and the IRS provide administrative guidance instructing tax practitioners to report:

- TFSAs as foreign grantor trusts that are not subject to annual foreign trust reporting requirements because the administrative burdens posed by such foreign trusts on IRS resources far outweigh the benefits generated from IRS enforcement efforts directed at delinquent foreign trust filings regarding U.S. beneficial interests. Such assets are low-balance depositary accounts that would be an unlikely offshore vehicle for U.S. tax avoidance by USP residents in Canada, and they are already subject to government oversight and reporting requirements in Canada. However, distributions to USP resident beneficiaries of TFSAs should be subject to foreign trust reporting by filing Form 3520.
- RCAs as foreign non-grantor trusts similar to IRC section 402(b) nonexempt employees' trusts that would be exempt from Form 3520 reporting until distributions from the RCA are received by a USP who is a beneficiary of an RCA trust. Consequently, distributions from the RCA trust to the USP would be subject to U.S. tax under IRC section 72 with contributions and earnings accumulated in the RCA trust before attaining U.S. tax residency also subject to U.S. tax under IRC section 72(w)(2) and (3).

Rev. Proc. 2020-17 would not be applicable to an RCA or TFSA, and therefore, this area of cross-border tax reporting of trusts that are foreign retirement or savings plans are prone to inconsistent and incorrect foreign trust reporting. This creates complexity for U.S. taxpayers with beneficial interests in these types of Canadian retirement and savings plans. The costly consequences of delinquent Form 3520 and Form 3520-A filings on U.S. taxpayers with beneficial interests in TFSAs and RCAs are in addition to the existing compliance burden on taxpayers subject to duplicative reporting under FBAR and FATCA for such assets. The national taxpayer advocate noted:

> The IRS has exercised its regulatory authority to eliminate duplicative reporting of assets on Form 8938 if the assets are reported or reflected on certain other timely filed international information returns (e.g., forms 3520, 3520-A, 5471, 8621, 8865, or 8891).[142]

TFSAs and RCAs are already subject to foreign financial reporting under FATCA and

[140] *See* ITA subsection 212(1)(c), *supra* note 90.

[141] *See* Ross, *supra* note 91.

[142] *See* National Taxpayer Advocate, "2022 Purple Book" (Dec. 31, 2021).

FBAR. There is no need to exacerbate the issues with annual international information reporting and use IRS resources by requiring that TFSAs and RCAs be subject to Form 3520 and Form 3520-A reporting as foreign trusts when no withdrawals or distributions subject to U.S. tax have been made to the U.S. beneficiary. Both types of Canadian plans are already subject to annual Canadian filings and, in the case of the RCA, substantial Canadian taxes. These are not the types of foreign trusts on which the IRS should be expending its resources.[143] ■

[143]The views expressed herein are those of the authors and do not necessarily reflect the views of anyone else. The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, or tax advice or an opinion provided by the authors to the reader. The reader is also cautioned that this material may not be applicable to, or suitable for, the reader's specific circumstances or needs, and may require consideration of non-tax and other factors if any action is to be contemplated. The reader should contact his or her tax advisor prior to taking any action based upon this information. The authors assume no obligation to inform the reader of any changes in tax laws or other factors that could affect the information contained herein.