New US tax law may negatively affect Canadian retirement plans

Moodys Private Client
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On April 2, 2013, we were in Washington DC to present the Canadian perspective on the proposed regulations under IRC 1411, the provision that implements the 3.8% tax on net investment income that was enacted as part of the US health care overhaul in 2010. The IRS had requested public comments on the proposed regulations issued on December 5, 2012. Moodys submitted a comment articulating a number of our concerns.

Practitioners from a variety of firms and interest groups spoke. (A very good article on the hearing will be publicly available next week, but Tax Notes subscribers can already access it here.) We spoke on issues of interest to Moodys' Canadian clients.

Two areas of greatest concern are the treatment of Canadian RRSPs and pensions and whether foreign tax credits may be used to offset the NII. Unless the proposed regulations are modified a new 3.8% tax will likely apply to US citizens resident in Canada or Canadians who are resident in the US on the following types of income:

1. Income generated in Canadian retirement plans (including RRSPs, DPSPs, LIRAs, TFSAs, etc.), even though this income is not taxable under the Canada-US Treaty;
2. Even if #1 does not apply, distributions from Canadian retirement plans will likely be subject to the tax;
3. Payments made to retirees under the Canada Pension Plan ("CPP"); and
4. Recipients of government pensions.

Further, unless there are changes to the proposed regulations, Canadian snow birds that rely on the Treaty to "tie-break" back to Canada may have their net investment income subject to this tax.

Although the hearing was an opportunity for practitioners to speak to the IRS, rather than the other way around, it was possible to get a sense of where things might be heading based on their follow-up questions and informal discussions before and after the hearing. It appears that the finalization of the regulations is likely to move quickly.

Treasury appeared to be considering a few possible avenues, such as allowing a deduction of foreign taxes against the NII. (It appears that there are two camps of opinion within the IRS as to whether the NII is foreign tax creditable.) The IRS also appears sympathetic to the double-tax concerns that may arise under the interaction of the NII with US tax treaties, but seems uncertain as to how to technically resolve the dilemma.

Moodys will be providing the US Treasury with further analysis on the foregoing and will post that analysis when it is formally submitted.