American Institute of CPAs
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March 4, 2016

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Robert Stack
Deputy Assistant Secretary
International Tax Affairs
Department of the Treasury
1500 Pennsylvania Avenue, NW
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Mr. J. Mark Iwry
Senior Advisor to the Secretary and
Deputy Assistant Secretary
Retirement and Health Policy
Department of the Treasury
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RE: Proposed Tax Relief for Various United States and Canadian Equivalent Purpose Deferred Tax Savings Plans

Dear Messrs. Mazur, Stack, and Iwry:

The American Institute of CPAs (AICPA) requests that the United States Department of the Treasury ("Treasury") provide relief to United States (U.S.) and Canadian citizens who have contributed to and maintain various cross-border deferred and tax-exempt savings accounts, from double taxation and current inclusion in income of amounts saved in these accounts. We also request that Treasury work with the Canadian Department of Finance to provide similar relief as appropriate.

These comments were developed by the AICPA CPA Canada Cross-Border Tax Committee Task Force of the AICPA International Tax Technical Resource Panel and approved by the AICPA Tax Executive Committee. The Chartered Professional Accountants of Canada (CPA Canada) plans to submit a similar request for relief from the Canadian Department of Finance. In addition, the American Chamber of Commerce in Canada (AmCham Canada) plans to submit a similar request to Treasury and the Canadian Department of Finance.

The AICPA is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

CPA Canada represents and supports more than 190,000 members consolidating the operations of three national accounting bodies: The Canadian Institute of Chartered Accountants, the Certified General Accountants of Canada and the Society of Management Accountants of Canada. AmCham Canada with seven chapters located throughout Canada is committed to promoting trade opportunities, advancing economic growth, and facilitating the mobility of people, goods and services across the longest undefended border in the world. AmCham Canada is a proud member of the United States Chamber of Commerce, the largest global and international business organization in the world.

Background

Both the U.S. and Canada maintain tax provisions allowing individuals to establish tax-deferred and/or tax-exempt savings accounts which support various social and economic goals of their respective governments. Article XVIII of The United States-Canada Income Tax Convention and associated protocols ("the Treaty") provides bilateral deferral of tax or inclusion in income for various qualified or registered pension or retirement plans. However, the Treaty does not provide any relief from double taxation or current inclusion in income for other plans and accounts such as:

- Education savings plans such as Registered Education Savings Plans (RESP) in Canada and Qualified Tuition Program (529) Plans in the United States.
- Disability savings plans such as Registered Disability Savings Plans (RDSP) in Canada and Qualified ABLE (Achieving a Better Life Experience) Plans in the United States.
- Generally tax-exempt savings accounts such as Tax Free Savings Accounts (TFSA) in Canada and Roth individual retirement accounts (IRAs) in the United States (under certain circumstances).

Over one million Americans live in Canada and a similar number of Canadians live in the U.S. The lack of tax relief from double taxation or current inclusion in income provided under the Treaty for these plans and accounts has adverse tax consequences for:

- Americans living in Canada.
- Canadians living in the United States.
- Americans living in the United States who contributed to one of the Canadian plans while living in Canada.
- Canadians living in Canada who contributed to one of the United States plans while living in the United States.

Frequently, a cross-border move will result in adverse tax consequences such as unanticipated inclusion in income of amounts saved in a tax-deferred or tax-exempt account which may require the cross border individual to liquidate the accounts to avoid the adverse tax consequences. Often, the forced liquidation itself can result in unanticipated taxable income. Furthermore, the U.S.

imposes complex reporting requirements, such as those regarding foreign trusts and Passive Foreign Investment Companies (PFIC), for individuals participating in Canadian plans. These tax implications can adversely impact the individuals and their families, the social objectives of the countries and cross-border mobility.

Recommendations

The AICPA recommends that Treasury implement the following measures in order to reduce the tax and reporting burdens associated with various cross-border deferred and tax-exempt savings accounts:

1) Provide U.S. citizens and residents tax-deferred or tax-exempt treatment, comparable to that offered by Canada to its citizens and residents, for their contributions, income and withdrawals from properly established Canadian RESP, RDSP and TFSA.

2) Exempt properly established Canadian RESP, RDSP and TFSA from classification as grantor trusts. We further recommend that Treasury exempt U.S. citizens and residents from various onerous statutory filing requirements for foreign trusts and PFICs which can currently exist for these plans.

3) Work with their Canadian counterparts at Finance Canada to provide similar relief from taxation and burdensome reporting requirements for Canadian citizens and residents who hold and contribute to properly established 529 Plans, qualified ABLE accounts and Roth IRAs in the United States.

We describe below specifically how our recommendations relate to each type of plan or account.

I. Canadian Plans

Registered Education Savings Plans (RESP)

Recommendations

The AICPA recommends that Treasury implement the following measures with regards to RESPs:

1) Exempt RESPs from the grantor trust rules (making the beneficiary the person subject to tax on the income) and allow tax deferral of plan income until it is distributed to beneficiaries; this treatment is comparable to the Canadian tax provisions, described below.

2) Tax the beneficiary (if a U.S. person) on the distribution when it is received.

3) Exempt a U.S. subscriber or beneficiary of an RESP from the complex foreign trust information reporting rules if the RESP is considered a foreign trust for U.S. tax purposes.

> This relief might require modifying Article XVIII of the Treaty to specifically include RESP in the definition of pensions.

Description of Plan

An RESP is a Canadian registered plan designed to provide tax deferred savings for post-secondary education by allowing the contributions to grow tax-free. Additional key elements of an RESP are as follows:

- The subscriber of an RESP, typically a parent or grandparent, makes contributions to the plan/account and specifies who they would like as the beneficiaries of the funds.
- There is a lifetime limit of C$50,000 of contributions a subscriber can make for a beneficiary.
- The subscriber is not allowed a tax deduction for the amount of contributions they make to the plan.
- Distributions of subscriber contributions to the beneficiary are tax-free, and are allowed only if used for education-related expenses of the beneficiary while enrolled in a qualifying program.
- The Canadian federal and provincial governments provide additional benefits to an RESP. The Canada Education Savings Grant is money paid by the Government of Canada into the plan up to a maximum of C$7,200, to encourage families to save early for their children's post-secondary education. Additional amounts are sometimes provided to the RESP under the Canada Learning Bond program (for children of families with modest incomes) and under various provincial plans.
- The total amount of accumulated income, grants and bonds is available for payment to the beneficiaries of the RESP (i.e., the post-secondary students). These payments are called Educational Assistance Payments (EAPs) and are taxable to the beneficiary when received. EAPs are used for eligible education expenses, such as books, housing and tuition provided the beneficiary is enrolled in a qualifying program.
- If the contributions are not distributed to the beneficiaries for educational expenses, the contributions are returned on a tax-free basis to the subscriber. However, any undistributed income returned to the subscriber is subject to tax and penalties.
- Any government grants not distributed to the beneficiaries for educational expenses are returned to the government.

Analysis

If a U.S. person establishes an RESP for a child, the RESP is potentially considered a foreign grantor trust of the subscriber (not the child) for U.S. tax purposes, since the subscriber can reclaim his contribution to the plan, if the funds are not used for education purposes. As a result, the income earned by the RESP is subject to double taxation. The U.S. person who contributes to the account is taxed by the U.S. on the income as it is earned within the plan. Additionally, the

Canadian beneficiary is taxed by Canada when the income is distributed by the plan to cover qualified educational expenses.

Furthermore, if an RESP is considered a foreign trust for U.S. tax reporting purposes, the U.S. subscriber must file Forms 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts,* and 3520-A, *Annual Information Return of Foreign Trust With a U.S. Owner*. In addition, a U.S. beneficiary must file Form 3520 upon receipt of a distribution. The regulations relating to foreign trusts and their reporting requirements are complex and often unclear to unsophisticated taxpayers. Correctly preparing the forms usually requires the services of a professional tax return preparer. Inadvertent and unintentional failures to follow the regulations often results in the assessment of substantial penalties for failing to file these forms timely.

Registered Disability Savings Plans (RDSP)

Recommendations

The AICPA recommends that Treasury implement the following measures with regards to RDSPs:

1) Exempt RDSPs from the grantor trust rules and allow tax deferral of plan income until it is distributed to beneficiaries; this treatment is comparable to the Canadian tax provisions, described below.

2) Tax the beneficiary (if a U.S. person), on the distribution when it is received.

3) Exempt a U.S. contributor or beneficiary of a RDSP from the complex foreign trust information reporting requirements if the RDSP is considered a foreign trust for U.S. tax purposes. This relief might require modifying Article XVIII the Treaty to specifically include RDSP in the definition of pensions.

Description of Plan

An RDSP is a long-term savings plan designed to assist Canadians with severe and prolonged mental or physical impairment. Additional key elements of an RDSP are as follows:

- The disability requires certification by a doctor or person with special qualifications.
- The plans permit family members and others to contribute funds intended to provide for the future expenses of disabled individuals under the age of 60 who reside in Canada.
- The contributions are not tax deductible to the contributor.
- The lifetime limit for contributions is C$200,000 per beneficiary.
- The government provides matching grants to the RDSP up to a lifetime maximum of C$70,000. Additional government contributions are available for low income beneficiaries.

- The RDSP is established with an "issuer" – typically a Canadian financial institution and is managed by the disabled beneficiary (if over the age of majority), a parent, a legal representative or a public department.
- Income in the RDSP grows tax deferred until distributed.
- Only distributions of earnings, government bonds and government grants are taxable to the beneficiary.
- Distributions to the beneficiary may occur at any time, but must begin by age 60.
- Only the disabled beneficiary or their estate may receive a distribution from a RDSP.
- Under certain conditions, bonds and grants may require full or partial payback to the government.

Analysis

If a RDSP is considered a foreign trust for U.S. tax purposes, the contributor is potentially considered the grantor of a foreign grantor trust for U.S. tax purposes under the following conditions:

- The contributor is a U.S. person and the beneficiary is a U.S. person or a spouse.
- The contributor is not a U.S. person, but becomes one within 5 years of making the contribution, and the beneficiary is a U.S. person or spouse.
- The contributor is a U.S. person who manages the RDSP, the beneficiary is not a U.S. person and the contributor has the power to determine beneficial enjoyment or other specified administrative powers.

In these cases, the income earned by the RDSP is subject to double taxation. If the contributor is a U.S. person, they are subject to U.S. taxation on the trust income as it is earned by the trust. The beneficiary is then subject to Canadian taxation when that trust income is ultimately distributed to them.

If the contributor is not a U.S. person, but the beneficiary is a U.S. person, then a RDSP is possibly considered a foreign non-grantor trust. In this case, the beneficiary is subject to U.S. income tax each year on any distributed net income they receive from the plan. Distributions of undistributed net income from a prior year will trigger the foreign trust throwback provisions and result in an unreasonably high effective U.S. income tax rate on that income.

Furthermore, if a RDSP is considered a foreign trust for U.S. tax reporting purposes, a U.S. contributor must file Forms 3520 and 3520-A annually and a U.S. beneficiary must file Form 3520 upon receipt of a distribution. The regulations relating to foreign trusts and their reporting requirements are complex and often unclear to unsophisticated taxpayers. Correctly preparing the forms usually requires the services of a professional tax return preparer. Inadvertent and unintentional failures to follow the regulations often results in the assessment of substantial penalties for failing to file these forms timely.

<u>Tax Free Savings Accounts (TFSA)</u>

<u>Recommendations</u>

The AICPA recommends that Treasury implement the following measures with regards to TFSAs

1) Exempt a TFSA from the grantor trust rules and exempt distributions from a TFSA in a manner comparable to the Canadian tax provisions.

2) Exempt Canadian mutual funds held within a TFSA from the definition of a PFIC and the associated reporting requirements for PFICs (in the same manner as currently applies to Canadian Registered Retirement Savings Plans).

3) Exempt a U.S. owner of a TFSA from the complex foreign trust information reporting requirements if the TFSA is considered a foreign trust for U.S. tax purposes. This relief might require modifying Article XVIII of the Treaty to specifically include TFSA in the definition of pensions.

<u>Description</u>

The TFSA is a flexible, registered, general-purpose savings vehicle that allows Canadians to earn tax-free investment income to more easily meet lifetime savings needs. Additional key elements of a TFSA are as follows:

- The annual contribution limit is C$10,000.
- All Canadian residents, aged 18 or older, can contribute to a TFSA.
- Investment income earned in a TFSA is tax-free.
- Withdrawals from a TFSA are tax-free.
- Unused TFSA contribution income is carried forward and accumulates in future years.
- The full amount of withdrawals is re-contributable to the TFSA in future years. Re-contributing in the same year may result in an over-contribution amount which would subject the taxpayer to a penalty tax.
- Investors may choose from a wide range of investment options such as mutual funds, Guaranteed Investment Certificates and bonds.
- Contributions are not tax-deductible.
- Neither income earned within a TFSA nor withdrawals from it affect eligibility for federal income-tested benefits and credits, such as Old Age Security, the Guaranteed Income Supplement, and the Canada Child Tax Benefit.
- An individual may provide funds to their spouse or common-law partner for investment in a TFSA.
- TFSA assets are generally transferrable to a spouse or common-law partner upon death.

Analysis

Regardless of whether a TFSA is considered a foreign financial account or a foreign grantor trust, a U.S. person who has contributed to one is subject to U.S. taxation on the income of the plan each year.

If a TFSA owned by a U.S. person holds Canadian mutual funds (which they frequently do) the owner of the TFSA is potentially subject to the adverse PFIC tax and reporting rules.

Furthermore, if a RDSP is considered a foreign trust for U.S. tax reporting purposes, a U.S. contributor must file Forms 3520 and 3520-A annually and a U.S. beneficiary must file Form 3520 upon receipt of a distribution. The regulations relating to foreign trusts and their reporting requirements are complex and often unclear to unsophisticated taxpayers. Correctly preparing the forms usually requires the services of a professional tax return preparer. Inadvertent and unintentional failures to follow the regulations often results in the assessment of substantial penalties for failing to file these forms timely.

II. United States Plans

Qualified Tuition Programs (529 Plans)

Recommendations

The AICPA recommends that Treasury work with Canadian authorities to implement the following measures with regards to QTPs:

1) Canada should allow a reciprocal exemption from taxation on any income earned or distributed from a 529 Plan that is exempt from U.S. taxation.

2) Canada should exempt investments in 529 Plans from reporting on Form T1135, *Foreign Income Verification Statement*.

Description

A qualified tuition program (QTP), commonly called a 529 Plan, is an educational savings account or prepaid tuition program maintained by a state or eligible educational institution under which a person purchases tuition credits or makes contributions used to pay qualified higher education expenses of a designated beneficiary. Additional key elements of a QTP are as follows:

- Contributions by a donor are not deductible for U.S. federal income tax purposes, but the investment grows tax-free.

- There are state tax benefits available to donors under certain circumstances.
- The total amount of the contributions may not exceed the amount, determined by actuarial estimates, that is necessary to pay tuition, required fees, and room and board expenses for five years of undergraduate enrollment by the designated beneficiary at the most expensive institution allowed by the program.
- Qualified distributions of both principal and earnings are generally exempt from federal income tax.
- Qualified distributions are those used to pay qualified higher education expenses for the plan's beneficiary. Current U.S. law defines these expenses as tuition, fees, books, supplies, computers, required equipment and reasonable costs for room and board of a beneficiary attending an eligible institution at least half-time. These expenses may also include any necessary special needs services for a special needs beneficiary.

Analysis

Although the donor may select from a type of investment strategy (aggressive growth, conservative income, etc.) neither the donor nor the beneficiary may direct the investment of funds within the plan. The donor does remain in control of the account. With few exceptions, the named beneficiary has no rights to the funds since the donor decides when withdrawals are taken and for what purpose. Most plans allow the donor to reclaim the funds at any time. However, a nonqualified distribution, including one to the donor, is generally subject to income tax and a 10% penalty on the earnings portion.

There is no exemption from taxation provided in Canada for a 529 Plan. If the contributor to the plan is a Canadian resident, the plan (or the portion relating to the donor) is potentially considered a deemed resident trust for Canadian tax purposes or an Offshore Investment Fund Property. In such a case, income designated for qualified education expenses is subjected to Canadian income tax.

Qualified Section 529A[1] Disability Benefit Plans (ABLE Program)

Recommendations

The AICPA recommends that Treasury work with Canadian authorities to implement the following measures with regards to ABLE programs:

1) Canada should allow a reciprocal exemption from taxation on any income earned or distributed from an ABLE Account that is exempt from U.S. taxation.

2) Canada should exempt investments in ABLE Accounts from reporting on Form T1135.

[1] All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated thereunder.

Description

Certain disabled individuals can participate in a program established and maintained by a state, or one of its agencies or instrumentalities, to provide a tax-exempt account for meeting the disability expenses of those individuals. Additional key elements of an ABLE program are as follows:

- Contributions are made to an account (an “ABLE account”), established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account.
- An ABLE account may not receive aggregate contributions from all donors during a taxable year of more than the annual gift tax exemption (currently $14,000).
- The program must limit a designated beneficiary to one ABLE account.
- The program must maintain a separate accounting for each designated beneficiary.
- The program must provide that beneficiaries are not allowed to direct the investment of any contribution (or any earnings thereon) to an ABLE program more than two times during any calendar year.
- The program must provide that any interest in its program (or any portion thereof) is not available for use as security for a loan.
- The program must meet certain other requirements.

Analysis

Distributions are not subject to U.S. income tax if they do not exceed qualified disability expenses of the designated beneficiary. Distributions of income in excess of qualified disability expenses are subject to U.S. income tax plus an additional 10% tax.

There is currently no exemption provided in Canada for an ABLE Account. If the contributor to the plan is a Canadian resident, the plan is potentially considered a deemed resident trust for Canadian tax purposes or an Offshore Investment Fund Property. In such a case, income designated for qualified disability expenses is subjected to Canadian income tax.

Roth IRA

Recommendations

The AICPA recommends modification to the Treaty to include a Roth IRA in the definition of pensions in Article XVIII(3)(b) without the qualification related to contributions on behalf of a resident of Canada.

Description

Roth IRAs are a specialized category of retirement account available to U.S. taxpayers. Unlike traditional retirement accounts, there is no tax deduction for funds at the time they are contributed into the account. Contributions are allowed to grow tax-free over time and distributions taken after retirement are generally tax-exempt. Additional key elements of a Roth IRA are as follows:

- The total contributions allowed per year to all of a taxpayer's IRAs (both Roth and traditional) is the lesser of one's taxable compensation and a defined limit. The current limit is $5,500.
- The limit is increased to $6,500 for taxpayers age 50 and above.
- A person is allowed to convert taxable amounts from a qualified pension or Traditional IRA to a Roth IRA.
- A person pays U.S. income tax on the taxable conversion amount, but no additional early withdrawal tax.
- There is no limit on the amount that is eligible for a rollover to a Roth IRA.
- Higher-income taxpayers have their annual contributions to a Roth IRA reduced or eliminated, if their income exceeds certain thresholds each year.
- Distributions taken after the account holder turns 59 ½ are entirely tax-exempt.
- Early distributions are generally subject to tax plus a 10% penalty on any portion attributable to the account's earnings.

Analysis

Article XVIII(3)(b) of the Treaty provides that a Roth IRA is considered a pension for purposes of the Treaty. However, if the owner of a Roth IRA relocates and becomes a resident in Canada, any subsequent contribution to the Roth IRA (including conversions or rollovers from qualified employer plan accounts) will cause the Roth IRA to lose its treaty protection. All future earnings within the account are subject to Canadian tax during the period the person is resident in Canada. Future distributions in excess of the account balance on the date of the "disqualifying" contribution are also subject to Canadian tax, if received while resident in Canada. Furthermore, the assets in the Roth IRA are subject to the Canadian deemed disposition provisions when the person terminates Canadian residence to the extent of the appreciation of assets in the Roth IRA related to contributions on behalf of a resident.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. Please feel free to contact me at (801) 523-1051, or tlewis@sisna.com; Blake Vickers, Chair, AICPA International Taxation Technical Resource Panel, at (713) 753-5493 or blake.vickers@kbr.com; or Jonathan Horn, AICPA Lead Technical Manager – Tax Policy & Advocacy, at (202) 434-9204, or jhorn@aicpa.org.

Respectfully submitted,

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