CALIFORNIA LAWYERS ASSOCIATION
TAXATION SECTION
INTERNATIONAL TAX COMMITTEE

ADVOCATING FOR THE CANADIAN REGISTERED EDUCATION SAVINGS PLAN AND REGISTERED DISABILITY SAVINGS PLAN TO BE EXEMPT FROM ANNUAL FOREIGN TRUST REPORTING REQUIREMENTS (IRC §§ 6048, 6677)

This proposal was written by Marsha Laine Dungog, a member of the Tax Section of the California Lawyers Association,[1] and Liguo Cooper Xu. The authors wish to thank Allen B. Walburn, Higgs Fletcher & Mack LLP, for his helpful comments and insights, and would also like to thank Robert Davis and Radel Lloyd, IRS LB&I WIIC Outbound I Practice Networks, for their helpful feedback.[2]

Contact Persons:

Marsha Laine Dungog JD, LLM (US TAX)[3]
Moodys Gartner Tax Law LLP
210, 2020 4 Street SW
Calgary, AB T2S 1W3 Canada
(403) 693-5107
mdungog@moodysgartner.com

Liguo Cooper Xu EA, CPA, CGA, MST[4]
Moodys Gartner Tax Law LLP
210, 2020 4 Street SW

[1] The comments contained in this paper are the individual views of the author(s) who prepared them, and do not represent the position of the California Lawyers Association or of the Los Angeles County Bar Association.

[2] Although the authors and/or presenters of this paper might have clients affected by the rules applicable to the subject matter of this paper and have advised such clients on the applicable law, no such participant has been specifically engaged by a client to participate on this project.

[3] Ms. Dungog is a U.S. tax lawyer admitted to practice in California and Michigan. She received her undergraduate degree from the University of the Philippines; law degree from Golden Gate University School of Law; and Master of Laws in taxation from Georgetown University Law Center.

[4] Mr. Xu is a Charted Professional Accountant (CPA) in Canada and an Enrolled Agent before the Internal Revenue Service. He practices at Moodys Gartner Tax Law LLP in Calgary, Canada. Mr. Xu received his Bachelor's in Commerce (B.Comm) with a major in accounting from Concordia University in Montreal, Quebec and Master of Science in Taxation (MST) from Golden Gate University in San Francisco, California.

Calgary, AB T2S 1W3 Canada
(403) 693-5117
cxu@moodysgartner.com

EXECUTIVE SUMMARY

The U.S. taxation of contributions, accruals and distributions from foreign plans that are structured as foreign trusts ("**Foreign Plans**") with U.S. person[5] ("**USP**") owners or beneficiaries remains a controversial area of U.S. tax law that requires definitive guidance as both the number of USP residing outside and foreigners relocating to the United States increases. The complexity arises in part because many Foreign Plans do not fit squarely with the types of plans available to U.S. residents in the United States. Until the U.S. tax classification and treatment of such Foreign Plans is addressed by the U.S. Congress in the Internal Revenue Code of 1986, as amended[6] (the "**Code**") or by the Department of Treasury by administrative or legislative regulations, the annual U.S. tax reporting of USP outside the United States (collectively, "**U.S. expats**") and foreign persons who are tax residents in the U.S. with respect to their interests in certain Foreign Plans remains fraught with proverbial "*traps for the unwary*."

Many Foreign Plans that are foreign trusts would generally fall within the parameters of Code § 6048 which would cause USP owners and beneficiaries of such Foreign Plans to file the 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*. In the absence of specific guidance from federal tax authorities on many Foreign Plans, tax practitioners have defaulted to reporting Foreign Plans owned by USPs (either directly or beneficially) as foreign trusts subject to U.S. foreign trust reporting requirements as well as under the Report of Foreign Bank and Financial Accounts ("**FBAR**") and Foreign Account Tax Compliance Act ("**FATCA**").

Yet, not all Foreign Plans that are foreign trusts are subject to reporting requirements under Code § 6048 itself. For example, certain Foreign Plans that constitute Code § 402(b) nonqualified deferred compensation trusts are exempted from § 6048 reporting requirement under § 6048(a) (3) (B) as nonqualified foreign trusts under a plan that provides for pensions, profit-sharing, stock bonus, sickness, accident, unemployment welfare and similar benefits.

The Treasury Department should reconsider whether Code § 6048 applies to the Canadian Registered Educational Savings Plan ("**RESP**") and Canadian Registered Disability Savings Plan ("**RDSP**"). The Internal Revenue Service ("**IRS**") has precedent for exempting other Canadian plans from this requirement, specifically with respect to USP owners and beneficiaries of a Canadian Registered

[5] For purposes of this paper, we limit the definition of U.S. Person to a U.S. citizen or U.S. lawful permanent resident (a "green card holder") as defined in Code § 7701(a).
[6] Title 26 of the United States Code.

Retirement Savings Plan ("**RRSP**") and Registered Retirement Income Fund ("**RRIF**"). Consequently, USP owners and beneficiaries of Canadian RESPs and RDSPs should have no affirmative obligation to file Form 3520 or Form 3520A because these plans also arguably fall within the exemptions to Code § 6048(3)(B)(ii) as plans that provide for unemployment welfare and similar benefits.

Moreover, there are sound administrative reasons for exempting RESPs and RDSPs from foreign trust reporting. At the risk of stating the obvious, requiring all foreign trusts to file information reporting returns simply because they are a foreign trust with a USP owner or USP beneficiary only increases the complexity of U.S. tax return administration and compliance and unduly strains IRS resources with arguably decreasing results in terms of the revenue generated from such foreign trust filings.[7]

As a case in point, in May 21, 2018, the IRS Large Business and International ("**LB&I**") division launched six campaigns which included a campaign to improve Form 3520/Form 3520-A compliance which includes a variety of approaches to noncompliance through examinations and penalties assessed by the IRS Campus when the forms are received late of incomplete. This campaign is only one of 40 active campaigns launched by the IRS since January 31, 2017 to make the best use of IRS knowledge and resources by focusing on compliance issues that represent a high risk of non-compliance among taxpayers.

With respect to the Form 3520/3520-A campaign, the intent was to improve the taxpayer's and practitioner's knowledge of a U.S. person's requirement to report ownership of, and transactions with, foreign trusts; decrease the percentage of late filed and incomplete Forms 3520/3520 and as a corollary, increase the number of properly filed Forms 3520/3520-A. The IRS scope for implementing the campaign includes IRS outreach and education; the issuance of soft letters; the conduct of examinations and issuance of Campus Penalty Assessments.

To date, we are aware that USPs who are resident in Canada who have filed Form3520s/3520-As to report their respective RESPs and RDSPs have already received letters from the IRS under the above-mentioned campaign initiative. We query the effectiveness of such assessments, given that RESPs and RDSPs are low-balance depositary accounts that would be an unlikely offshore vehicle for U.S. tax

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[7] As a case in point, in May 21, 2018, the IRS Large Business and International ("**LB&I**") division launched an additional six campaigns which included a campaign to improve Form 3520/Form 3520-A compliance which includes a variety of approaches to noncompliance through examinations and penalties assessed by the IRS (Austin) campus when the forms are received late of incomplete. This campaign is only one of 40 active campaigns launched by the IRS since January 31, 2017 to deploy IRS knowledge and resources to address compliance issues that represent a high risk of non-compliance among taxpayers. The goal of the campaigns is to make the greatest use of the IRS' limited resources by focusing on high-risk tax issues. With respect to the Form 3520/3520-A campaign, the scope of IRS approaches included IRS outreach and education; the issuance of soft letters; the conduct of examinations and issuance of Campus Penalty Assessments.

avoidance by USPs resident in Canada. Further, these accounts have already been specifically excluded from the definition of a Financial Account and therefore not treated as a U.S. Reportable Account for purposes of the Foreign Account Tax Compliance Act ("**FATCA**") reporting requirements for Canadian financial institutions.[8]

[8] See Annex II, Non-Reporting Canadian Financial Institution and Products, Section IV (F) and (G) of *The Agreement Between the Government of the United States of America and the Government of Canada to Improve International Tax Compliance through Enhanced Exchange of Information under the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital* dated June 27, 2014.

DISCUSSION

I. CURRENT CROSS-BORDER TREATMENT OF USP INTERESTS IN AN RESP AND/OR RDSP

A. U.S. Foreign Trust Reporting Under Code § 6048

In general, Code § 6048(a) provides that a USP grantor, transferor, or executor must provide a written notice of a "*reportable event*" with the IRS on or before the 90th day of occurrence of such event, or such later date as the Secretary may prescribe.[9] A reportable event means (a) the creation of a foreign trust by the USP *inter vivos*; (b) the transfer of money or property to a foreign trust by a USP (either directly or indirectly) and (c) the death of a USP citizen or resident if the trust was a foreign grantor trust or any portion of such trust is included in the decedent's gross estate.[10] However, transfers of property to a trust within the context of a sale for fair market value ("**FMV**")[11] or as contributions made to a nonqualified deferred compensation under a plan that provides for pensions, profit-sharing, stock bonus, sickness, accident, unemployment welfare and similar benefits (as in Code § 402(b), 404(a)(4), or 404A) or a charitable trust under Code § 501(c)(3) are not required to be reported under Code § 6048.[12]

Current U.S. tax laws do not provide any definitive guidance on whether Canadian registered educational savings plan ("**RESP**") and registered disability savings plan ("**RDSP**") that have a USP grantor, transferor or beneficiary would constitute foreign trusts exempt from the foreign trust reporting requirements under Code §§ 6048 and 6677. As the statutory "*responsible party*" for such filings, USP owners, beneficiaries and executors of RESPs and RDSPs are subject to the same requirements or risk incurring civil penalties directly. This reporting requirement persists notwithstanding previous requests made by various interests groups in Canada to the U.S. Department of the Treasury to seek relief from this reporting requirement for RESPs and RSPDs.[13]

Failure to file the report under Code § 6048 would trigger the imposition of penalties under Code § 6677. The statute of limitations for assessment of penalties under Code §§ 6677(a) and 6677(b) ends three years only after a complete and accurate Form 3520/3520-A is filed. The penalties are severe if a Form 3520 is not filed on or before the due date (including extensions) of the USP's income tax

[9] See also Notice 97-34, 1997-2 C.B. 422 (June 2, 1997).
[10] Code § 6048(a) (3) (A).
[11] Code § 6048(a) (3) (B) (i).
[12] Code § 6048(a) (3) (B) (ii).
[13] See CPA Canada (Feb. 25, 2016); AICPA (March 4, 2016) and American Chamber of Commerce in Canada.

return, or the Form 3520-A is not filed on or before the 15th of the 3rd month after the end of the trust year (including extensions), or if the applicable form does not include all the information required or includes incorrect information.[14] Failure to file Form 3520 may subject a USP transferor to a penalty equal to thirty-five percent (35%) of the amount transferred, and for reported filed after December 31, 2009, there is a minimum penalty of USD $10,000 not to exceed the gross reportable amount.

B. Canadian Treatment of RESP as a Domestic Trust

Prior to 1998, RESPs were mere product offerings between private sector providers and client subscribers. However, in 1998, the Canadian parliament enacted the *Canada Education Savings Act* ("**CESA**") which introduced CES grants to incentivize deposit-taking financial institutions to enter the RESP market such that lower-income families already saving for a child's education could do so using an RESP as a savings vehicle.[15] In 2004, the Canadian Federal Budget announced the creation of the Canada Learning Bond ("**CLB**") and the A-CESG to kick-start education savings for post-secondary education for low-income families.[16] In 2017, RESP assets reached CAD $55.9 billion, compared to CAD $23.4 billion in 2007. However, of these amounts, only CAD $4.67 billion constituted personal contributions from families. The remaining assets comprised of federal and provincial educational savings incentives and accumulated earnings.[17]

The Canadian tax rules offer other tax-deferred or even tax-free treatment for savings vehicles created pursuant to CESA. The confusion arises because these same savings vehicles are not entitled to the same treatment for U.S. tax purposes when a USP grantor, transferor or beneficiary is involved.

1. Canadian RESP is structured as a domestic trust

An RESP is a contract between an individual (the "**Subscriber**") and a person or organization (the "**Promoter**") to provide funds for post-secondary

[14] https://www.irs.gov/pub/int_practice_units/FEN9434_02_05R.pdf . The initial and continuation penalties range as follows: (a) For filings due before January 1, 2010: from 35 percent of the gross reportable amount (for Form 3520) or 5 percent of the gross reportable amount (for Form3520-A); (b) For filings due after December 31, 2009: the greater of $10,000 or 35% of the gross reportable amount (Form 3520, Parts I and III); the greater of $10,000 or 5 of the gross reportable amount (Form 3520, Part II and Form 3520-A).
[15] See Discussion paper prepared for Canada Education Savings Program, Employment and Social Development Canada by Dr. Jennifer Robson, "Enhancing Access to Canada Learning Bond", submitted December 2, 2016 (Final Report).
[16] Id. at p. 12.
[17] Canada Educational Savings Program, 2017 Statistical review.

education financial assistance to another individual, usually the children and grandchildren of the Subscriber, who must be a resident of Canada. Under the contract, the Subscriber agrees to make lifetime contributions of up to CAD $50,000 for each designated Beneficiary, and the Promoter agrees to pay educational assistance payments (**EAP**) to the Beneficiaries. A Subscriber may relocate to the United States and continue making contributions to the RESP as long as the Beneficiary is resident in Canada.

The Canadian federal and provincial governments also contribute to the funding of an RESP. Government funds are however limited to a maximum lifetime amount of CAD $7500. If the RESP is revoked by the Subscriber or the Beneficiary fails to enroll in post-secondary educational institution, a portion of the RESP that is allocable to government contributions revert to the Canadian government; while earnings on Subscriber contributions are distributed back to the Subscriber and taxed accordingly.

While there are some tax practitioners who assert that an RESP does not constitute a domestic trust in Canada, we respectfully disagree. Firstly, what constitutes a trust in Canada does not control its U.S. tax classification Rather, as the saying goes, "*the proof is in the pudding*." The RESP must undergo the gamut of U.S. tax classification rules to ascertain its U.S. tax treatment. Secondly, the RESP is treated as a trust for Canadian tax purposes, albeit it may not be treated as such in other contexts (such as bankruptcy etc.). A perfunctory review of the process for obtaining RESP status confirm that than RESP can be nothing less than a trust for Canadian tax purposes.

Firstly, the Promoter must obtain approval from the Registered Plan Directorate to offer to the public an Educational Savings Plans ("**ESP**"). To be approved, the Promoter must submit a written a specimen plan that is comprised of many documents, which includes among others, a declaration of trust, contract document or agreement that sets out the terms and conditions of the ESP; a prospectus (if applicable); and a trust agreement between the promoter and the trustee.[18]

Secondly, to obtain "RESP" status, the ESP must be accepted for registration by the Minister of National Revenue for purposes of the *Income Tax Act*.[19] The Promoter applies for the registration of the ESP at the request of the Subscriber.

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[18] See par. 65, https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic93-3r2/ic93-3r2-registered-education-savings-plans.html#s83

[19] See section 146.1(2). To be approved, the ESP must comply with the following conditions under § 146.1(2) of the Act: (a) the plan must provide that the property of any trust governed by the plan (after payment of the trustee and administration charges) is irrevocably held by a corporation licensed or authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as a trustee; and it must hold the property for purposes of the trust as defined in § 146.1 (for the payment of EAP, the payment to or to a trust in factor of designated educational institutions in Canada; or the payment to a trust that irrevocably holds property pursuant to an RESP);…(c)the promoter and all trusts governed by the plan are resident in Canada.

When approval is obtained, the Promoter manages and invests the contributions into the RESP from the Subscriber, the Canadian government (under the Canadian Educational Savings Grant ("**CESG**"), Canadian Learning Bond ("**CLB**")), Canadian provincial grants and accumulated investment earnings (collectively, the "**RESP Property**"). The RESP property is held by a trust company that licensed in Canada to hold the RESP property.

The above formalities for establishing an RESP under Canadian domestic laws shows that an RESP must be structured as a trust to receive contributions from the Subscriber, federal and provincial governments to fund post-secondary education for the RESP beneficiary. The fact that it may not be respected as a trust in substance in other contexts (such as bankruptcy[20]) or other endeavors does not undermine its treatment as domestic trust.

2. Tax Treatment of Canadian RESP as a Trust

RESPs are taxed pursuant its own provision under the Act. Specifically, taxation of RESPs is codified as § 146.1 of Division G, Deferred and Special Income Arrangements of Part 1 (Income Tax) of the *Income Tax Act*.

For Canadian tax purposes, RESPs are treated as a special type of trust that is subject to its own taxing regime and not the tax regime applicable to inter vivos and testamentary trusts under Subchapter K (*Trusts and Its Beneficiaries*) of the Act.[21] Pursuant to § 146.1(5) of the Act, a trust that is governed by a RESP is not subject to tax on its taxable income for any taxable year, unless it holds one or more properties that are not qualified investments[22] for the trust. This trust treatment for tax purposes persists notwithstanding that an RESP does not appear to be consistently treated as a trust for bankruptcy law purposes.[23] An RESP is also not subject to deemed disposition rules when an individual emigrates Canada,[24] nor is it subject to disclosure to foreign tax authorities by the Canadian Revenue Agency ("**CRA**").

Moreover, the Subscriber is not taxable on RESP income after 1971. Contributions made to the RESP by an individual are not tax deductible.[25] Earnings grow tax-deferred within the RESP up to a maximum of 35 years. Withdrawals from the RESP are permitted to fund Beneficiary expenses for post-secondary

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[20] See Notes to § 146.1(5) citing *MacKinnon*, 2007 SKQB 39, *Payne* (2001), 29 CBR (4th) 153 (Alta QB); cf *Vienneau*, 2007 NBQB 332.
[21] See § 108(1) definition of "trust" as excluding among others, an RESP.
[22] See § 146.1(1) definition of "Qualified Investments" include investments for other deferred plans under § 204 of the Act and annuities where the trust is the sole beneficiary.
[23] See Notes to § 146.1(5) citing *MacKinnon*, 2007 SKQB 39, *Payne* (2001), 29 CBR (4th) 153 (Alta QB); cf *Vienneau*, 2007 NBQB 332.
[24] See § 128.10(a) (iii) and Notes.
[25] § 146.1(6).

education. Withdrawals of original Subscriber contributions are not taxable to the Beneficiary, but withdrawals representing RESP earnings and government grants are taxed to the Beneficiary upon withdrawal[26] and reported to the Beneficiary student on Form T4A, *Statement of Pension, Annuity and Other Income*. Payments made to a non-resident Beneficiary would also be subject to withholding taxes on such amounts[27] subject to rates established pursuant to the applicable tax treaty.

If, however, the Beneficiary reaches 21 years of age and does not pursue secondary education, under certain conditions the investment earnings may be paid to the Subscriber as accumulated income payments which would be subject to Canadian tax.[28] As a result, the Subscriber must include this amount into his or her income and is taxed at an additional 20 percent.[29] However, in certain cases, this tax can be reduced by rolling over up to $50,000 into his or her registered retirement savings plan ("**RRSP**") if there is contribution room available or a spousal RRSP.

Generally, the trustee of an RESP files an information return with the Minister disclosing the RESP.[30] A promoter may also be required to file information returns with respect to RESPs but thus far, no regulations have been issued.[31]

3. U.S. Tax Treatment of RESP as a Foreign Grantor Trust

Because the Subscriber to an RESP may reclaim contributions made to the RESP under certain conditions (by a revocation of the registered status of the ESP by the Minister or failure by the Beneficiary to pursue post-secondary education), tax practitioners have reported a USP Subscriber who transfers monies to an RESP as a U.S. owner of a foreign grantor trust under Code § 671 through 679. As a corollary, the USP Subscriber is required to report the RESP annually by filing Form 3520-A pursuant to Code § 6048.

In this respect, it would appear that the USP Subscriber is taxed twice: First, contributions made and earnings accrued in the RESP are taxable to such USP Subscriber for U.S. income tax purposes; and Second, distributions made to the Beneficiary (regardless of whether that beneficiary is a USP or not) are taxable to

[26] EAP payments would include an RESP's accumulated investment earnings, CESG, CLB amounts and amounts received from a designated provincial program. An EAP does not include a refund of contributions. See Par. 35 & 53.https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic93-3r2/ic93-3r2-registered-education-savings-plans.html#s83
[27] See § 146.1(7) and Notes referencing § 212(1) (r).
[28] § 146.1(7.1)
[29] See Par. 20, https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic93-3r2/ic93-3r2-registered-education-savings-plans.html#s83
[30] See § 146.1(13.1).
[31] See § 146.1(15).

such Beneficiary by Canada, notwithstanding that the same amounts have already been previously taxed to the USP Subscriber by the United States.[32] Because the USP Subscriber and Beneficiary are not the same individual, there is no ability to offset the Canadian taxes due on distributions to the Beneficiary with U.S. taxes previously paid by the USP Subscriber.

In the instance where the Subscriber is not a USP, but the Beneficiary is, the burden of foreign trust reporting falls on the USP Beneficiary. Specifically, a USP Beneficiary of an RESP would file an annual Form 3520 to report any distributions he or she receives. These distributions would be taxable to the Beneficiary for both U.S. tax and Canadian tax purposes. However, since the RESP is reported as an ordinary foreign trust and not a foreign grantor trust, the USP Beneficiary theoretically has an ability to offset U.S. taxes on distribution amounts with Canadian taxes already paid on the same. The risk that arises, however, with having a USP Beneficiary of a foreign trust is the likelihood that he or she would be subject to throwback taxes for undistributed earnings within the RESP that were prohibited from being distributed to the USP Beneficiary prior to attaining post-secondary education.

4. Canadian RESPs Differ From U.S. Qualified Tuition Plans

While the U.S. Qualified Tuition Program under Code § 529 (the "**529 Plan**") bears some similarities to the Canadian RESP, it is not subject to the same limitations. Indeed, the 529 Plan amounts can be applied to fund not just post-secondary education but also primary and secondary education.[33] More importantly, USP contributors and beneficiaries to a 529 Plan are not subject to the same onerous reporting and taxation of contributions, earnings and distributions from a 529 Plan as explained in detail below:

First, after-tax contributions to a 529 Plan are not capped. There is no specific amount of contribution limit as the Code only directs it not to exceed the amount necessary to provide for the qualified education expenses of the beneficiary.[34] Since the education expenses in the U.S. are generally higher than those in Canada, the contribution limit for a 529 Plan is higher than the RESP's limit of $50,000 CAD. Second, earnings accrued in a 529 Plan are not taxable to either the contributor or beneficiary of such plan if the distributions do not exceed the qualified higher education expenses.[35]

[32] On distribution, the USP Subscriber is deemed to have made a gift of the RESP to the Beneficiary, which would be subject to U.S. gift tax reporting by filing Form 709, regardless of whether the Beneficiary is a USP or not.
[33] Code § 529(c) (7).
[34] See Code § 529(c) (1).
[35] Code § 529(c) (1).

Third, contributions made by a USP to a 529 Plan are already treated as a completed gift[36] to the designated beneficiary for U.S, gift tax purposes, notwithstanding that the contributor may still exercise control over the 529 account. This means that if the contribution exceeds the annual gift tax exclusion of $15,000 USD (the amount for 2019 and subject to inflation adjustment for future years), the contributor can elect to spread it ratably over the five-year period for the gift tax reporting purposes. This mechanism allows a USP to avoid potential U.S. gift taxes on a contribution made to a 529 Plan that exceed $15,000 USD in 2019 (for example, a total contribution of $75,000 USD made in 2019 can be reported as a series of annual gifts of $15,000 USD from 2019-2024 respectively). Consequently, because a 529 Plan contribution is treated as a completed gift in the year made, any financial interest or control retained by the contributor to a 529 Plan is not includible in such contributor's estate for U.S. estate tax purposes.[37]

Based on the above, it would therefore appear that a USP who contributes to 529 Plan would not be subject to current U.S. taxes on income and earnings accruing on the account, while the same income and earnings accruing to an RESP account in Canada would be currently taxable to the same USP and subject to foreign trust reporting requirements for U.S. tax purposes. This begs the question of whether a USP should be subject to such disparate treatment by the Code, given that such USP contributions are intended to provide educational funding for designated beneficiaries (who often would be the USP Holder's children or family).

a) Canadian Tax Treatment of § 529 Plans

Canadian tax laws currently do not exempt § 529 Plans from Canadian income taxes. Therefore, if the USP contributor to a § 529 Plan is a Canadian resident, the 529 Plan is potentially considered a deemed resident trust for Canadian tax purposes or Offshore Investment Fund Property, subject to higher Canadian trust tax rates and information reporting requirements. Further, income designated for qualified education expenses under 529 Plans is subject to Canadian income taxation.

C. Canadian Treatment of RDSP as Domestic Trust

1. Canadian RDSPs are Tax-Deferred in Canada

A Canadian registered disability savings plan ("**RDSP**") is defined by the Canada Income Tax Act § 146.4, and it is intended to help parents and others save for the long-term financial security of a person who is eligible for the disability tax

[36] Code § 529(c) (2).
[37] Code § 529(c) (4).

credit ("**DTC**"). RDSP is a contract between an individual (the "**Holder**") and a participating financial institution (the "**Issuer**") under which the Holder names one beneficiary with disability and agrees to make contributions, and the Issuer agrees to pay disability assistance payment to the beneficiary. In practice, the main features of the RDSP can be summarized as follows:

- Parents or guardians are usually Holders and disabled kids are usually Beneficiaries. If the beneficiary has reached the age of majority and is contractually competent to enter a plan, the beneficiary can open an RDSP for themselves.

- The beneficiary must be eligible for the DTC only if a medical practitioner certifies on Form T2201, *Disability Tax Credit Certificate*, that the individual has a severe and prolonged impairment in physical or mental functions. This form must also be approved by the CRA and the person must be deemed to be eligible for the DTC.

- Issuers are usually participating financial institutions that offer RDSPs.

- The contribution is after-tax money. The life time limit of contributions per beneficiary is only an accumulated of $200,000 CAD, and it can be made in installments or once until the end of the year in which the beneficiary turns 59 years of age. The Canadian federal government may provide Canadian Disability Savings Grants up to a maximum of $70,000 CAD and some provincial governments may provide similar incentive subsidies.

- The earnings accrued in the RDSP account is tax deferred until the distribution is made to Beneficiary.

- The disability assistance payment ("**DAP**") is taxed in the Beneficiary's hands but excluding the Holder contributions. In other words, only the government grants and the accumulated income are taxable.

Because of the Holder's power of control over the RDSP account, tax practitioners have reported the USP Holder's interest in an RDSP as a foreign grantor trust under Code § 671 through 679 and subject to the annual Form 3520/3520-A disclosure requirements under the Code § 6048.

Like the RESP, an RDSP with a USP Holder and/or USP Beneficiary is prone to double taxation on the earnings accrued on such amounts. Specifically, a USP Holder who reports the RDSP as a foreign grantor trust for U.S. tax purposes would include the RDSP earnings accrued as part of his or her taxable income for U.S. tax purposes; and report distributions from the RDSP to a Beneficiary (USP or otherwise) as a gift subject to U.S. gift taxes and reporting of the same by filing

Form 709.

Meanwhile, the Beneficiary of an RDSP distribution would be taxed by the Canadian government on DAP amounts received (which are comprised of government grants and accumulated income therefore but excluding prior Holder contributions). If such Beneficiary is a USP, this same amount would be concurrently taxed by U.S. government and subject to foreign trust reporting. The U.S. taxes would be triggered because the RDSP would be reportable by the USP Beneficiary as distributions received from either a foreign grantor trust, subject to Form 3520-A reporting, or an ordinary foreign trust, subject to Form 3520 reporting.

Also, while there is a potential foreign tax credit offset available to the USP Beneficiary in this instance, the issue that arises is that Canadian tax amounts would reflect taxes on both government grants and earnings on contributions, while U.S. tax amounts should only be limited to earnings on contributions (and not Canadian government grants). Moreover, a USP Beneficiary would be unable to claim foreign tax credits for U.S. taxes previously paid by the USP Holder on after-tax contributions and earnings which were reported as income from a foreign grantor trust.

2. Canadian RDSPs Differ From U.S. Qualified ABLE Plans

While the RDSP bears some similarities to the U.S. Qualified ABLE program specified under Code § 529A, there are significant differences that support exemption of an RDSP interest from foreign trust reporting by a USP Holder or USP Beneficiary:

Firstly, the annual contribution to the ABLE program is limited to the annual gift exclusion amount of $15,000 USD (the amount for 2019 and subject to inflation adjustment for future years).[38] For an employee beneficiary's own contribution, there is an additional contribution room equal to the lesser of his or her compensation income and the poverty line amount if some conditions are met. As such, the total potential contribution limit could be more than the lifetime limit of $200,000 CAD for RDSP.

Secondly, ABLE distribution amounts taxable to the Beneficiary do not include amounts used for the qualified disability expenses that are broadly defined under Code § 529A (f) (5).[39] These expenses include education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral

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[38] Code § 529A (b).
[39] Code § 529A(c) (1).

and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes of this section. This is in stark contrast to RDSP amounts which are all taxable to its beneficiary.

Lastly, ABLE contributions are treated as complete gifts to the beneficiary notwithstanding the contributor may still have control of the ABLE account.[40] Therefore a USP who contributes to an ABLE account would not be taxed on income and earnings accrued thereon, while the same income and earnings accruing to an RDSP account in Canada would be currently taxable to a USP Holder and subject to foreign trust reporting requirements for U.S. tax purposes. This begs the question of whether a USP should be subject to such disparate treatment by the Code, even if such USP contributions are allocated to provide disability support to the designated beneficiaries (who often would be the USP children).

a) Canadian Tax Treatment of ABLE Accounts

There is currently no exemption provided for a Code § 529A Plan for Canadian tax purposes. Therefore, if the contributor to an 529A Plan is a Canadian resident, the plan is potentially considered a deemed resident trust for Canadian tax purposes or Offshore Investment Fund Property, subject to Canadian information reporting requirements. Further, income designated for qualified education expenses under 529A Plans is subject to Canadian income taxation.

II. U.S. CLASSIFICATION OF RESPS AND RDSPS AS FOREIGN TRUSTS UNDER U.S. DOMESTIC TAX LAWS

Various groups have already previously sought exemption of RESPs and RDSPs from U.S. information reporting requirements under FATCA.[41] None of these prior submissions have asserted that RESPs and RDSPS would not be treated as foreign trusts under U.S. tax laws. In this respect we also concur that an RESP and RDSP arrangement would likely constitute a trust because it satisfies the Code definition of a trust arrangement (as discussed below). In summary, RESPs and RDSPs are trust arrangements primarily because the purpose of these plans is to vest in a third-party financial entity, as trustee, sole responsibility for protecting and conserving contributions made into the RESP/RDSP to provide funds for an individual's post-secondary education (for the RESP) or supplemental income in the case of a disability (for the RDSP). It is important to note, however, that the

[40] Code § 529A(c) (2).
[41] See for example, RESP Dealers Association of Canada Comments on Proposed Rules (REG-1216487-10) on FATCA Information Reporting and Withholding by Foreign Institutions dated July 24, 2012; AICPA letter to U.S. Dept. of Treasury re Proposed Tax Relief for Various United States and Canadian Equivalent Purpose Deferred Tax Savings Plans dated March 4, 2016; RBC Financial Group letter to U.S. Dept. of Treasury re FATCA Provisions in the Hiring Incentives to Restore Employment Act of 2010 dated June 30, 2010.

Subscriber to an RESP or RDSP is not the only contributor to the trust that is established. Various federal and provincial government monies are also contributed to the RESP and RDSP such that treatment of the entire amounts in the RESP and RDSP as solely attributable to the Subscriber for purposes of foreign grantor trust reporting would be erroneous. The individual beneficiaries do not have any participation in the management of contributions made to his or her RESP/RDSP.

A. Code § 7701(a)(30)(E) and (31)(B)

Code § 7701(a) (30) (E) and (31) (B) were enacted in 1996 to create a "*strong statutory bias in favor of foreignness*"[42] with respect to the nationality of a trust. Under these provisions, both conditions are satisfied: (a) a court or courts within the U.S. must be able to exercise primary supervision over administration of the trust (the "**Court Test**"); and (b) two or more U.S. persons have the authority to control the substantial decisions of the trust (the "**Control Test**").

A trust satisfies the Court Test if *"a court within the United States is able to exercise primary supervision over the administration of the trust."*[43] This includes federal, state, or local courts physically located within a state of the United States or the District of Columbia and excludes courts that are located in territories and possessions of the United States and courts in foreign countries.[44] The term "primary supervision" means that the U.S. court must "*have the authority to determine substantially all issues regarding the administration of the entire trust, and the ability to issue orders or judgments related to such administration.*"[45] These include duties imposed by the terms of the trust instrument and applicable law, such as maintaining books and records, filing trust tax returns, managing and investing assets, defending the trust from creditor lawsuits and determining the amount and timing of the distributions.[46] Application of the foregoing considerations to the RESP and RDSP would cause both Canadian registered plans to fail the Court Test.

A trust satisfies the Control Test if "*one or more United States persons have the authority to control all the substantial decisions of the trust."*[47] The Treasury Regulations define the term "substantial decision" as any decision permitted or

[42] See, Ellen K. Harrison, Elyse G. Kirschner and Carolyn McCaffrey, US Taxation of Foreign Trusts, Trusts with Non-U.S. Grantors and Their Beneficiaries" in International Trust and Estate Planning 2018 (ALI San Francisco) p. 4 of Outline.
[43] Code §7701(a) (30) (i).
[44] See Treas. Regs. §301.7701-7(c) (3) (i) and (ii).
[45] See Treas. Reg. §301.7701-7(c) (3) (iii) and (iv).
[46] See Treas. Reg. §301.7701-7(c) (3) (v).
[47] See Code §7701(a) (30) (E) (ii). See also, PLRs 200243031, 200311034. Conversely, if the foreign person has the authority to control any substantial decision of the trust, the trust fails the Control Test and will be classified as a foreign trust.

required under the trust instrument that is not a "ministerial decision."[48] Examples of ministerial decisions include decisions related to trust bookkeeping; the collection of rents from trust property; and the execution of investment decisions.[49] These examples support the proposition that a decision is substantial for purposes of the Control Test if it involves an exercise of discretion. The Regulations also provide that the power to remove, add or replace a trustee is a substantial decision, as is the power to appoint a successor trustee subject to certain conditions.[50] Treasury Regulations § 301.7701-7(d)(v)(Ex.1), provides an example of a trust that fails the Control Test, due to having three fiduciaries, one of whom is a non-resident alien. Since the fiduciaries in the example must make unanimous decisions, the trust will fail the control test because U.S. persons do not have control over all the substantial decisions of the trust.[51] Therefore, even if a trust were created by a USP, all of its assets are located in the U.S. and all of its beneficiaries are USP, the trust may be a foreign trust as long as a foreign person has control over one substantial type of trust decision.

Applying the Control Test to the RESPs and RDSP would lead to the conclusion that both should fail the Control Test because both are managed and administered by a Canadian corporate trustee as required under Canadian domestic laws. In this regard, it does not matter that the RESP and RDSP have a USP Subscriber/Holder who may also have authority to make substantial decisions over the investments of the RESP or RDSP. The important factor is the presence of a foreign trustee.

Since both the RESP and RDSPS would fail the Court Test and the Control Test, each of these types of Canadian registered plans would be classified as a foreign trust for U.S. tax purposes.

B. Treasury Regulations § 1.7701-4

Pursuant to Treasury Regulations ("**Treas. Regs**.") § 301.7701-4(a)**,** in an ordinary trust, trustees take title to the trust property with the objective of protecting and conserving it for the benefit of the trust beneficiaries.[52] Specifically, in an ordinary trust, the beneficiaries are not associates in a joint enterprise for the conduct of business for profit.[53] Conversely, there are other arrangements known as "trusts" but they are not classified as trusts for the purposes of the Code because they are not simply arrangements for the protection or conservation of the property

[48] See Treas. Reg. §301.7701-7(d) (1) (ii).
[49] Id.
[50] See Treas. Reg. §301.7701-7(d) (1) (ii) (H) and (I).
[51] See Treas. Reg. §301.7701-7(d) (v) (Ex. 1).
[52] Treas. Regs. § 301.7701-4(a).
[53] Id.

for the beneficiaries.[54] In such circumstances, if the beneficiaries or unitholders of the trust have voluntarily associated for the primary purpose of carrying on business through the trust, with the primary objective of earning profits, the trust is likely to be classified as a business trust and treated as a business entity.[55]

The Treasury Regulations[56] and case law[57] to date on this issue look to the "associates test" and "business purpose test" to determine whether a foreign trust will be classified as a business entity (i.e., as an association taxable as a corporation) rather than an ordinary trust.[58] A foreign trust will only be deemed an association if it has both associates and a business purpose.[59] The presence of associates in the trust structure combined with proof of a business purpose are dispositive factors to determining whether a trust is a business entity rather than an ordinary trust.

The associates test and business purpose test were established in *Morrissey*[60] *Elm Street*[61], and *Coleman-Gilbert Associates*.[62] These cases articulated the need to review the trust deed in order to determine the composition of the trust along with the nature and scope of the activities authorized by the trust deed. In *Morrissey* and *Coleman-Gilbert Associates*, the Court found that a business purpose existed when the trust instrument granted broad powers for the utilization of trust property in an active business. In *Elm Street*, the Court determined that the presence or absence of associates will often be determinative to the classification of the trust. To this end, any beneficiary whose voluntary participation in the trust also involves the active operation of the trust will trigger associate status.[63] Further, broadly authorized activities, even when not acted upon, may trigger associate status.[64] From the standpoint of a business purpose, challenges arise when the trust engages too extensively in business activities. Like with associates, the courts have determined that a business purpose will be identified within the language of the trust deed.[65] As a result, when a trust deed grants to the trust the authority to conduct business with the trust property a business purpose will be established.[66]

Based upon the preceding Treasury Tax Regulations and case law, there are

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[54] Treas. Regs. § 301.7701-4(b).
[55] *Morrissey v. CIR* 296 US 344 (1935). [Morrissey]
[56] Treas. Regs. § 301.7701-2(a) (1), § 301.7701 - (4) (a) and (b).
[57] Morrissey supra note 14; *see* also, *Helvering v. Coleman-Gilbert Associates*, 296 US 365. [Coleman-Gilbert Associates]; *see* also, *Elm Street Realty Trust v. Commissioner*, 76 TC 803 (1981). [Elm Street]
[58] Treas. Regs. § 301.7701; *see* also *Morrissey* supra note 32.
[59] Treas. Regs. § 301.7701-2(a) (2).
[60] Id.
[61] *Elm Street* supra note 34.
[62] *Coleman-Gilbert Associates* supra note 34.
[63] *Morrisey* supra note 32.
[64] Id; *see* also, *Coleman-Gilbert Associates* supra note 34.
[65] Id.
[66] *Coleman-Gilbert Associates* supra note 34.

four factors that are especially relevant when deciding regarding the treatment of a trust as an ordinary or a business entity. Specifically, the following are relevant: (1) reason for creation of the trust; (2) terms and conditions outlined in the trust deed; (3) business purpose behind the trust; and (4) presence of any associates in the trust.

With respect to an RESP, a perfunctory review of the trust arrangement between the Promoter, the Trustee and Subscriber should disclose that the sole purpose of the trust is to provide for payment of EAP for post-secondary education of the beneficiary as these conditions are a requirement to approval of the RESP by the Minister. Further the trust terms and conditions should reflect the provisions for the taxation of the RESP under § 146.1 of the Income Tax Act which reflect the tax-favored treatment of the RESP to the extent the trust is managed and invested to primarily fund the Beneficiary's post-secondary education with Subscriber contribution monies as well as CESG and CLB grants. Because the purpose of the RESP is to provide for post-secondary education, it would therefore appear that there would be no further business purpose for the trust except to generate interest and income on the contributions made by the Subscriber as well as federal and provincial grants made to grow principal sufficient to fund future disbursements. Most importantly, the Beneficiaries of an RESP do not voluntarily participate in the business activities of the RESP and would therefore not be classified as associates to the trust.

We would extend the same analysis above with respect to a RDSP.

C. Foreign Grantor Trust Treatment

Section III of IRS Notice 97-34 explicitly stated that one of the purposes of the reporting requirements under Code § 6048(a) is to ensure that U.S. transferors comply with § 679. This provision generally treats a U.S. person as the owner of a foreign trust if the U.S. person transfers property to the foreign trust and the trust could benefit a U.S. person. However, a U.S. person will not be treated as the owner of the trust under Code § 679 if, in exchange for the property transferred to the trust, the U.S. person receives property whose value is at least equal to the fair market value of the property transferred.[67]

1. Definition of Grantor

Under Code § 679, a USP is treated as the owner of a foreign trusts' income, gain and loss when he or she is the grantor of a foreign trust even if the trust would not otherwise be a grantor trust under the grantor trust rules. A grantor is a person (individual or entity) who either creates a trust directly or indirectly makes a

[67] Code §679(a) (2) (B).

"*gratuitous transfer*" of property to a trust. [68] In this regard, a person who creates or funds a trust on behalf of another person (an "*accommodation grantor*") will be treated as a grantor, but only a person who makes gratuitous transfers will be treated as the owner of the trust.[69] A "*gratuitous transfer*" means a transfer for other than a transfer made for fair market value.[70]

Applying the definition of grantor to the structure of an RESP and RDSP results in more than one grantor who would be treated as the owner of the RESP or RDSP for U.S. tax purposes. These grantors include the USP Subscriber/Holder who contributes after-tax monies to the RESP/RDSP as well as the Canadian federal and provincial governments that contribute educational and disability assistance program grants to the RESP and/or RDSP. The implication of this is clear: in the situation where a USP Subscriber/Holder is treated as the owner of the RESP/RDSP under the foreign grantor trust rules, not all of the income and earnings accrued under the RESP or RDSP are reportable by the USP for purposes of Form 3520-A and Form 3520. Rather only the portion of the RESP/RDSP that represents the USP Subscriber/Holder's share of income and earnings accrued in the RESP or RDSP and subsequently distributions made to the USP Beneficiary would present computational challenges[71] that would be prone to mistakes and errors reflected on the Form 3520-A/3520 form itself.

2. Who is Not A Grantor

Treasury Regulations § 1.671-2(e)(6) Example 4 illustrates that a person who has the right to withdraw assets from the trust is not a "grantor" although such a person would be treated as an owner of the trust under Code § 678 if he or she were a USP. This brings us to the issue of whether a USP Subscriber to an RESP or RDSP does possess this power under Canadian domestic laws.

III. APPLICATION OF FOREIGN TRUST REPORTING REQUIREMENTS UNDER CODE § 6048 RESULTS IN LIKELY INADVERTENT ERRORS AND MISTAKES.

Application of foreign trust reporting requirements to the Canadian registered plans present complicated and unduly burdensome reporting obligations on a USP Subscriber/Holder or USP Beneficiary given the relatively small amounts of monies that are allowed in these foreign accounts.

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[68] Treas. Reg. § 671-2(e).

[69] Treas. Reg. § 1.671-2(e) (1) and 1.679-3(c); Example 3 of Treas. Reg. 1.671-2(e) (6).

[70] A transfer for FMV means a transfer in consideration for and equal to the value of (i) property received from the trust (other than an interest in the trust); (ii) services rendered by the trust; or (iii) the right to use property owned by the trust. A transfer may be gratuitous without regard to whether it is a gift for gift tax purposes and without regard to whether gain is recognized on the transfer. See page 137, Harrison, Kirschner & McCaffrey.

[71] Treas. Reg. § 1.671-3(a) (2).

1. USP Beneficiary of Foreign NonGrantor Trusts

Generally, a U.S. citizen or resident beneficiary must report his or her interest in a foreign trust to the IRS on Form 3520 under Code § 6048. The Form 3520 must be filed with the IRS Ogden Service Center separate from the USP Beneficiary's individual income tax return. This reporting requirement applies regardless whether the distribution is from a foreign grantor or nongrantor trust.

With respect to a distribution from a foreign nongrantor trust, the USP Beneficiary must receive a "Foreign Nongrantor Trust Beneficiary Statement" that indicates that exact composition of the distribution to treat the distribution as a gift for U.S. tax purposes not subject to income tax. Otherwise, the IRS would presume that the distribution is an accumulation distribution and therefore subject to throwback taxes. In the absence of this statement and sufficient information from the trustee of the foreign trust to make accumulation distribution computations under the rules, the USP Beneficiary must compute throwback tax using the IRS default method.[72] Needless to say, this undertaking is prone to errors and mistakes and would likely trigger inaccuracies reported on the Form 3520 filed by the USP Beneficiary. Such errors and mistakes would be attributable to the fact that RESP/RDSP distribution amounts are comprised to after-tax contributions from a Subscriber/Holder, Canadian government grants and earnings accrued on such amounts. A USP Beneficiary must be able to allocate the contributions to each source and trace earnings attributable thereto to arrive the correct amount of U.S. taxes payable only on the Subscriber contributions and earnings.

Foreign trust reporting for a USP Beneficiary of a foreign grantor trust (with a USP Subscriber/Holder) however would not be plagued with the same complexities. In the case of a distribution from a foreign grantor trust, the USP Beneficiary would be deemed to have received a gift for U.S. income tax purposes and would not implicate any distributed net income ("**DNI**") or undistributed net income ("**UNI**") from the foreign trust to the USP Beneficiary.[73] Further, the deemed gift would not be subject to any federal income taxes to the USP Beneficiary under Code § 102.

2. USP Grantor of Foreign Trusts

A foreign trust that is treated as a grantor trust as to a USP must file an annual to report of the trust's activities and operations for a calendar year with the IRS.[74] The trust must file Form 3520-A each calendar year and attach a "*Foreign Grantor Trust Statement*". The trustee must send a copy of the statement to the USP Subscriber/Holder of the RESP/RDSP and each Beneficiary who received a trust

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[72] See 2017 Instructions IRS Form 3520 at 9.

[73] See Notice 97-34, 1997-1 C.B. 422, Section VI (A).

[74] Code § 6048(b) (1) (A).

distribution in the applicable year. The USP Subscriber/Holder is responsible for ensuring that the RESP/RDSP files a Form 3520-A[75] which must be filed on March 15 of each year. The IRS can impose a penalty of failing to file Form 3520-A of five percent (5%) of the gross value of the trust assets.[76]

The Instructions to Form 3520 also direct the USP Subscriber/Holder treated as the owner of the income, gain and loss of an RESP/RDSP treated as a foreign grantor trust to file an IRS Form 3520 for each year in which the trust is a grantor trust. This is addition to the Form 3520-A requirement. However, unlike the Form 3520-A, the Form 3520 is filed independently and separate from the USP Subscriber/Holder's individual Form 1040 with the Ogden Service Center.

In addition to the filing date variances between Forms 3520 and 3520-A, a USP Subscriber/Holder who is treated as the owner of an RESP/RDSP that is a foreign grantor trust must keep track of the sources of contributions to such trust and trace earnings accrued on each source. As previously mentioned, an RESP and RDSP as a foreign trust generally has more than one grantor – funds contributed to these accounts are comprised of contributions from a USP Subscriber, the Federal Government of Canada and provincial governments. Accurate foreign trust reporting of an RESP or RDSP account by a USP Subscriber/Holder would require hairsplitting of contributions from each grantor and earnings and distributions apportionable to each such contribution to be able to isolate the correct amounts that would be included in the USP Subscriber/Holder's taxable income for U.S. tax purposes. Given the relatively small amounts that are involved with these accounts, the risk of inaccurate reporting on the Form 3520, 3520-A is high. Many well-intentioned taxpayers would get caught and penalized at such high costs.

E. Code § 1471 and Treas. Regs. § 1.1471-1 *et. seq.*

Currently, RESPs and RDSPs are specifically excluded from the definition of a Financial Account and therefore not treated as a U.S. Reportable Account for purposes of the Foreign Account Tax Compliance Act ("**FATCA**") reporting requirements for Canadian financial institutions.[77] While we cannot definitively state the reason for excluding these Foreign Plans from FATCA reporting, we do note that Canadian institutions wrote letters to the Treasury Department and filed comments with the Service requesting for such an exemption on grounds that RESPs and RDSPs were often low-balance accounts and therefore presented a low-risk vehicle for tax evasion by U.S. taxpayers outside the United States who held interests in such accounts.

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[75] IRS Notice 97-34, 1997-1 C.B. 422 Section IV (A).

[76] Code § 6677(a).

[77] See Annex II, Non-Reporting Canadian Financial Institution and Products, Section IV (F) and (G) of *The Agreement Between the Government of the United States of America and the Government of Canada to Improve International Tax Compliance through Enhanced Exchange of Information under the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital* dated June 27, 2014.

IV. ARTICLE XVIII OF THE TAX TREATY[78] DO NOT PROVIDE ANY RELIEF FOR POTENTIAL DOUBLE TAXATION OF USP INTERESTS IN AN RESP AND/OR RDSP

Article XVIII of the United States-Canada Income Tax Convention ("**Tax Treaty**") has been amended time and again to provide reduced rates of withholding and exemptions from taxation by one country of certain retirement, pensions and savings accounts established by a resident of the other country. Indeed, this Article XVIII has provided bilateral tax deferral of certain qualified or registered pension or retirement plans as well as government assistance payments such as social security, and privately-funded alimony and child-support payments.

However, this provision does not go far enough to provide any relief from double taxation or current income inclusion of contributions, earnings and income accrued to RESPs and RDSPs which serve similar purposes as the § 529 and ABLE Plans in the United States. The result is that a U.S. taxpayer who contributes to a § 529 Plan in the U.S. and an RESP in Canada is taxed currently by the United States on after-tax contributions and earnings accrued to the Canadian RESP while altogether exempted from taxes on contributions, earnings and distributions made from a § 529 Plan. Further, the same U.S. taxpayer risks substantial foreign trust reporting penalties on late-filed, inaccurate or erroneous Form 3520/3520-A filings made to report his or her interests in the Canadian RESP. This disparate tax treatment is a burden that only applies to a U.S. taxpayer with a cross-border lifestyle. Alarmingly, the number if U.S. taxpayers with cross-border activities and interests is increasing. And so, there is a pressing need to address the issues of RESP and RDSP reporting and taxation. The American Chamber of Commerce in Canada has previously requested the Treasury Department to provide tax relief for millions of U.S. taxpayers who reside abroad and are subject to double taxation or current income inclusion for contributions and earnings in Canadian RESPs and RDSPs noting the adverse tax consequences apply to: [79]

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

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[78] Convention between the United States of America and Canada with Respect to Taxes on income and Capital, September 26, 1980, as amended by protocols on June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997 and September 21, 2007.

[79] See, Letter to U.S. Treasury Dept. Secretary Mark Mazur *et. al.* dated March 4, 2016 from Jim Yager, American Chamber of Commerce Canada published in 2016 TNT 51-25 (https://www.taxnotes.com/tax-notes-today/financial-products-and-banking/group-seeks-relief-double-taxation-cross-border-savings/2016/03/16/g3dm?highlight=Canadian%20RESP).

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

Canadians with RESPs and RDSPs looking to relocate to the United States often opt to liquidate these accounts rather face the unfavorable tax treatment of such accounts in the United States. In the same vein, U.S. persons resident in Canada who are deemed to own RESPs/RDSPs for foreign trust reporting purposes have considerable hurdles to overcome to accurate and timely report their respective interests in RESPs/RDSPs or risk incurring substantial penalties. The impact of these actions on cross-border trade and mobility cannot be understated.

CONCLUSION

We note that the U.S. tax treatment and reporting of Canadian tax-deferred plans such as RRSPs provides an example of timely and effective administrative action undertaken by the IRS to clarify and streamline the U.S. taxation and reporting of foreign pensions. Initially, the IRS classified the RRSP as equivalent to a U.S. individual retirement account that did not meet the strict qualifications of Code § 408(a)[80] such that USP owners and beneficiaries of Canadian retirement plan were subject to current U.S. tax on accrued yet undistributed income in the plan.[81] As a consequence, USPs with contributions to, distributions from and ownership of an RRSP, for which an election to defer U.S. tax on accrued income under Article XVIII (7) was available, were previously obligated to file Form 3520 and Form 3520-A returns under Code § 6048.[82]

However, the IRS issued a series of administrative guidance which explicitly exempted USP owners and beneficiaries of Canadian RRSPs and RRIFs from current U.S. tax and foreign employee trust reporting requirements while USP owners and beneficiaries of other similar Canadian registered plans such as the Canadian RESP and RDSP were not included.

Given that the purpose of foreign trust reporting is to effectively monitor the use of offshore trusts as a vehicle for tax avoidance, then we would point out that RESPs and RDSPs present a low risk of facilitating tax evasion due to their lifetime contribution limitation thresholds and strict regulation by Canadian Revenue Agency ("**CRA**"). Therefore, exempting RESPs and RDSPs from annual foreign trust requirements would alleviate administrative burdens and costs to the IRS in administering the foreign trust reporting program.

We would recommend that further administrative guidance should be issued under Treasury Regulations Code § 6048 to clarify that Canadian RESPs, RDSPs and other similar arrangements be excluded from annual reporting on Form 3520 and Form 3520-A.

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[80] *See*, I.R.S. Rev. Proc. 89-45, 1989-2 C.B. 596, *superseded by* I.R.S. Rev. Proc. 2002-23, 2002-1 C.B. 744. Rev. Proc. 89-45 provided guidance for applying former Article XXIX (5) of the Tax Treaty.

[81] *See,* U.S. – Canada Tax Treaty Article XVIII (8). *See also,* I.R.S. Rev. Proc. 2014-55 IRB 753 (Oct. 7, 2014) at § 2.01.

[82] *See* I.R.S. Rev. Proc. 2014-55 at § 2.04.