Sun Life

Retiring in Canada with U.S. benefits

If you've worked in the United States, you may have earned U.S. Social Security credits. You may also own U.S. retirement accounts or be entitled to a U.S. pension. This article provides general tax guidance to help you plan for your retirement.

U.S. Social Security

Most U.S. workers contribute to the U.S. Social Security system. Like the Canada/Quebec Pension Plan (CPP/QPP), the system provides retirement, survivor, and disability benefits.

Full benefits require forty quarters (i.e. 10 years) of work in the United States. If you've worked in the U.S. for a shorter time, you may be entitled to prorated benefits.

Canada and the United States have signed agreements to help fill the gap for workers who have divided their careers between the two countries.[1]

If you've earned credit for at least six quarters of work in the U.S., but fewer than forty, periods of work in Canada will count towards your eligibility for U.S. Social Security benefits. This is a noteworthy benefit. Without this agreement, if you spent nine years working and contributing in the U.S., you still wouldn't get any benefits from the program. You would also have missed contributing to CPP/QPP, and would get a reduced CPP/QPP pension. You may also have a reduced Old Age Security (OAS) pension.

Canada similarly gives you credit for periods of U.S. employment to evaluate your eligibility under the CPP/QPP. Your time spent working in the United States may further count towards qualifying for an OAS pension.[2]

Credits are combined solely for eligibility purposes. The quantum of your benefits is proportional to your actual contributions in each country. Upon reaching retirement age, you'll be entitled to receive prorated benefits from both countries.

Social Security benefits are taxable only in your country of residence. As a resident of Canada, you won't pay tax to the U.S. government on your U.S. Social Security benefits.[3] You'll pay tax to the Canadian government. To mirror the U.S. inclusion rate of 85%, you're entitled to claim a 15% deduction on your Canadian tax return.[4]

Review your most recent statement outlining your accrued benefits and share it with your financial advisor. Your advisor can help you decide when to start taking your Canadian and U.S. Social Security pensions. If you're the widow(er), minor or disabled child, or dependent parent of a person who accrued benefits under the U.S. Social Security system, you may be entitled to benefits. Contact the Social Security Administration to find out.

U.S. retirement accounts

Traditional accounts

There are many types of U.S. retirement accounts. They include Individual Retirement Accounts (IRAs), 401(k) plans and 403(b) plans, to name a few. The Canadian tax authorities recognize these U.S. plans as tax-deferred vehicles. You don't need to report them on your Canadian tax returns, while invested inside the plan.

You shouldn't contribute to these accounts while you reside in Canada. Contributions aren't tax-deductible. In certain cases, you may transfer these U.S. funds to an RRSP. See our article entitled **Strategies for Canadians with U.S. Retirement Funds**, for details.

Distributions from U.S. retirement accounts are subject to U.S. taxation. If you're a U.S. person,[5] you'll report distributions as pension income on your annual U.S. tax returns. You'll compute U.S. tax at U.S. graduated rates. If you're a nonresident, distributions will be subject to U.S. tax withholding at the rate of 15% or 30%.[6] In some cases, you should file a U.S. nonresident tax return. Please consult your tax advisor for details.

You should report distributions as pension income on your Canadian tax returns as well. Canada will grant you credit for the tax you paid to the U.S. government. You shouldn't have to pay double-tax on the same income.

It isn't advisable to convert a traditional account into a Roth account while you reside in Canada. The entire account balance will be subject to Canadian tax. In addition, future growth will no longer be tax-deferred for Canadian tax purposes.

Roth accounts

U.S. plan sponsors often extend Roth account options to participants. Contributions aren't tax-deductible. However, growth and withdrawals are tax-free.[7] Their essence is thus like the Canadian Tax-Free Savings Account (TFSA).

U.S. Roth accounts aren't automatically tax-deferred under the Canadian tax system. When you become a resident of Canada, you must elect to defer Canadian tax on your Roth accounts.[8] Failing the election, the growth in your Roth account is taxable in Canada annually. The exact treatment varies based upon the structure of the Roth account: custodial account, trust, annuity, or endowment contract.[9]

You shouldn't contribute to a U.S. Roth account while you reside in Canada. Contributions nullify the Canadian deferral election outlined above. If you make inadvertent contributions or miss the deadline to file the Canadian deferral election, we recommend you speak with your tax advisor.

While a valid deferral election is in force, distributions you take out of a Roth account are tax-free in Canada. However, the U.S. has restrictions of its own. Distributions you take within the first five years of opening the Roth account will trigger U.S. tax. Distributions you take before attaining 59 ½ years of age may also trigger U.S. tax. Unless the distribution is for an eligible purpose,[10] a U.S. penalty tax of 10% will apply. If the distribution is subject to U.S. tax, Canadian tax may arise also.[11] Roth accounts are complex. Several conditions are required to secure tax-free distributions on both sides of the border.

You can't transfer a Roth account balance to a Canadian RRSP or TFSA. Rather, if you have sufficient RRSP and/or TFSA contribution room you can withdraw the money from your Roth account and deposit it to your RRSP or TFSA.

We recommend you seek tax advice to help you make the right decisions and comply accordingly.

U.S. pensions

You may also be entitled to a U.S. defined benefit pension. These arrangements deliver a fixed, periodic (usually monthly) retirement income for life. They may also include survivor benefits.

Defined benefit plan distributions from U.S. plans are subject to U.S. taxation. If you're a U.S. person,[12] you will report distributions on your annual U.S. tax returns. You will compute U.S. tax at U.S. graduated rates. If you aren't a U.S. person, your pension payments will be subject to U.S. tax withholding at the rate of 15%. You shouldn't need to file a U.S. nonresident tax return if this is your only source of U.S. income.

You must report U.S. pension income on your Canadian tax return. Canada will grant you credit for the tax you paid to the U.S. government. You should not pay double-tax.

U.S. pension entitlements are typically not transferrable. If you have the option to take the commuted value of your U.S. pension as a lump-sum, the tax consequences may differ from above. You may also have the ability to transfer this amount to your Canadian RRSP.[13] We recommend you discuss the tax consequences of these options with your tax advisor. Your financial advisor can in turn help you assess which option best meets your financial goals.

Summary

As a former U.S. worker, you may be entitled to U.S. Social Security and pension payments when you retire. Make sure to claim all financial support that is available to you. Work with your tax and financial advisors to help you select the best distribution strategy to meet your financial goals.

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[1] These are often referred to as Totalization Agreements. The Agreement between the United States and Canada harmonizes U.S. Social Security with the Canada Pension Plan. There is a specific agreement with Quebec, to harmonize U.S. Social Security with the Quebec Pension Plan.

[2] Eligibility under OAS is based upon residency in Canada after age 18 and is unrelated to employment. Periods of U.S. residency count to evaluate your eligibility under Canada's OAS program. Contact the Government of Canada for details.

[3] This is true even if you are a U.S. citizen or green card holder.

[4] If you started collecting U.S. Social Security benefits before 1996, you are entitled to a 50% deduction instead.

[5] U.S. persons residing in Canada include U.S. citizens and green card holders.

[6] The 15% rate applies to periodic payments. Lump sum distributions are subject to the 30% rate.

[7] Exceptions apply, some of which are described in subsequent paragraphs.

[8] This election is found in the Canada-U.S. Income Tax Convention (the "Treaty"). It is typically filed in the form of a letter sent to the Competent Authority Services Division of the Canada Revenue Agency (CRA). It must be filed no later than the day that your first Canadian tax return is due, after you become a resident of Canada. Please refer to Income Tax Folio S5-F3-C1 for details.

[9] These concepts are beyond the scope of this article. Please consult your tax advisor for advice relating to your particular Roth accounts.

[10] These include first-time home purchase, education, birth and adoption, and a few others. You should consult your tax advisor to determine of an exception applies to your particular circumstances.

[11] This is because under the Treaty election (see note 8 above), Canada agrees to treat distributions as tax-free provided they are also U.S. tax-free.

[12] See note 5 above.

[13] See our article entitled **Strategies for Canadians with U.S. Retirement Funds** for insights on this opportunity, then consult with your tax advisor.