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## **IRS Provides Reporting and Penalty Relief for Canadian RESP and RDSP Arrangements, As Well As Other Foreign Retirement and Non-Retirement Plan Trusts**

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In 2014, the Internal Revenue Service exempted U.S. citizens and residents from certain reporting obligations to which their interests in Canadian Registered Retirement Savings Plans (“RRSPs”) and Registered Retirement Income Funds (“RRIFs”) were subject.<sup>1</sup> The relief was retroactive and premised on Article XVIII(7) of the Convention Between the United States and Canada With Respect to Taxes on Income and on Capital (the “Canada-U.S. Tax Treaty”). Article XVIII(7) was added to the Canada-U.S. Tax Treaty by the Protocol signed March 17, 1995 and subsequently amended by the Protocol signed September 21, 2007. Article XVIII(7) provides for elective deferrals of U.S. taxation of income accrued in trusts, companies, and other arrangements operated to provide pension or employee benefits and exempt from Canadian taxation until distribution to citizens or residents of the United States (“U.S. persons”). Rules for making the election were set out in Rev. Proc. 2002-23.<sup>2</sup> Starting in 2004, the IRS provided Form 8891 for beneficiaries of RRSPs and

RRIFs to make the election under the Treaty.<sup>3</sup> The 2014 relief was the culmination of the earlier guidance allowing beneficiaries of RRSPs and RRIFs to elect the benefit of the Canada-U.S. Tax Treaty.

On March 2, 2020, the IRS extended information reporting relief to a broad array of foreign retirement and non-retirement plan arrangements, including Canadian Registered Education Savings Plans (“RESPs”) and Registered Disability Savings Plans (“RDSPs”).<sup>4</sup> Rev. Proc. 2020-17 relieves U.S. persons of reporting obligations imposed by §6048 and satisfied by filing Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, and Form 3520A, *Annual Information Return of Foreign Trust with a U.S. Owner*, as well as penalties imposed by §6677 for reporting failures.<sup>5</sup> Unlike the prior relief targeted at beneficiaries of specific Canadian retirement plans, Rev. Proc. 2020-17 relieves the beneficiaries of tax-favored foreign retirement trusts and non-retirement savings trusts (collectively “tax-favored foreign trust”) established in any country from filing Forms 3520 and 3520-A, as long as the tax-favored foreign trusts and their beneficiaries satisfy the requirements of the Revenue Procedure. However, consistent with prior relief provided for RRSPs and RRIFs, U.S. persons are not relieved from the obligation to undertake information reporting with respect to the accounts owned by tax-favored foreign trusts as imposed by §6038D and 31 U.S.C. §5314.<sup>6</sup> Thus, it will still be necessary to report accounts owned through tax-favored foreign trusts on Forms 8938 and FinCEN Form 114.

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<sup>1</sup> See Rev. Proc. 2014-55, 2014-44 I.R.B. 753.

<sup>2</sup> 2002-1 C.B. 744.

<sup>3</sup> See generally Notice 2003-75, 2003-2 C.B. 1204.

<sup>4</sup> See Rev. Proc. 2007-17, 2007-12 I.R.B. 539. Canadian Tax Free Savings Accounts will not qualify.

<sup>5</sup> All section references herein are to the Internal Revenue Code of 1986, as amended (Title 26 of the U.S. Code), and the regulations thereunder, unless otherwise indicated.

<sup>6</sup> Rev. Proc. 2020-17, §3.

Tax-favored foreign trusts do not have to be common law trusts, but may, instead, be any type of “plan, fund, scheme, or other arrangement” operated solely or substantially to provide pension, retirement, medical, disability or educational benefits in satisfaction of the laws of the jurisdiction to which the trust is subject.<sup>7</sup> Extension of prior relief to a significantly broader array of tax-favored foreign trusts is premised on the conclusion that the foreign trusts to which relief is provided “are subject to written restrictions, such as contribution limitations, conditions for withdrawal, and information reporting, which are imposed under the laws of the country in which the trust is established, and because U.S. individuals with an interest in these trusts may be required under §6038D to separately report information about their interests in accounts held by, or through, these trusts, . . .”<sup>8</sup> It will no longer be necessary for U.S. persons with interests in tax-favored foreign trusts or transactions involving such trusts to file Forms 3520 and 3520-A. Failures to file Forms 3520 will no longer subject the responsible party to the \$10,000 or 35% penalty imposed by §6677(a). Further, abatement of previously assessed penalties is available in certain circumstances.

*Who is eligible for relief?* The beneficiary of the tax-favored foreign trust must be a U.S. person who has satisfied all compliance obligations (past and present) with regard to U.S. income tax reporting. U.S. income tax returns filed by such eligible individual must have reported the contributions, earnings, and distributions made to, of, and by the foreign trust. For individuals who have not done so, income tax returns may be amended, subject to the limitations of §6511.<sup>9</sup>

*What trusts are eligible for relief?* Only certain foreign trusts of eligible individuals are no longer subject to 3520 reporting. In the case of foreign retirement trusts, under the laws of the jurisdiction in which the trust is established,

- the trust otherwise must be exempt from income taxation (“tax-favored”) as in
  - contributions to the trust being either tax deductible or excluded from income, subject to a reduced rate of taxation, resulting in a tax credit, or eligible for a government subsidy or some other government-provided tax or financial benefit, and
  - taxation of the trust’s investments being deferred until distribution or subject to foreign tax at a reduced rate;

- the trust is subject to annual information reporting;
- contributions to the trust are limited to income earned from performance of personal services;
- contributions to the trust are limited to either
  - a percentage of the participant’s earned income,
  - a maximum annual contribution limit of \$50,000, or
  - a lifetime limit of not more than \$1,000,000;
- payments from the trust whether in the form of withdrawals or distributions are subject to penalties or are prohibited unless the participant is disabled, dead, or has reached a required retirement age; and
- if the trust is maintained by an employer, the trust must be subject to
  - non-discriminatory eligibility requirements which permit participation by “a wide range of employees, including rank and file employees” or
  - the retirement benefits provided do not discriminate among eligible employees.<sup>10</sup>

Non-retirement foreign trusts are subject to similar requirements in order to be exempt from 3520 reporting. Under the laws of the foreign jurisdiction in which the trust is established,

- the trust must be operated solely or substantially to provide medical, disability, or educational benefits;
- the trust must satisfy the “tax-favored” arrangements to which retirement trusts are subject;
- the trust is subject to annual information reporting;
- contributions to the trust are limited to
  - \$10,000 annually, or
  - \$200,000 over the participant’s lifetime; and
- payments, whether in the form of distributions or withdrawals, are subject to penalties unless applied to pay medical, disability, or educational benefits.<sup>11</sup>

In measuring the contribution limitations, the value of foreign currencies is determined using the U.S.

<sup>7</sup> *Id.* §5.03.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* §5.02.

<sup>10</sup> *Id.* §5.03.

<sup>11</sup> *Id.* §5.04

Treasury Bureau of Fiscal Service conversion rate on the last day of the tax year.<sup>12</sup> Tax-favored foreign trusts which otherwise satisfy the requirements to which retirement and non-retirement savings trusts are subject for relief are not disqualified because they may receive rollovers of assets or funds from other foreign trusts as long as those foreign trusts also satisfy the same requirements set forth above with respect to eligible tax-favored foreign trusts.<sup>13</sup> Otherwise qualifying tax-favored foreign retirement trusts will not be disqualified because they permit in-service loans or distributions for hardship, education, or purchase of a primary residence.<sup>14</sup>

*Relief for past non-compliance.* Eligible individuals who failed to file Form 3520 or 3520-A may request abatement of penalties assessed or refunds of penalties paid as long as the statute of limitations under §6511 has not closed. Penalty relief is requested by filing Form 843, *Claim for Refund and Request for Abatement*. Penalty relief under the Revenue Proce-

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<sup>12</sup> *Id.* §§5.03, 5.04; available at <https://www.fiscal.treasury.gov/reports-statements/treasury-reporting-rates-exchange>

<sup>13</sup> *Id.* §§5.03, 5.04.

<sup>14</sup> *Id.* §5.03(5).

dure is not exclusive and does not preclude the availability of other relief provisions (for example, reasonable cause).<sup>15</sup> Eligible individuals requesting relief should file Form 843 with the Ogden, Utah Internal Revenue Service Center. “Relief pursuant to Revenue Procedure 2020-17” should be inserted on line 7 of the form, and an explanation should be provided as to the manner in which the foreign trust meets the relevant requirements under §5.03 or 5.04 of Rev. Proc. 2020-17 and how the individual who owns or participates in the tax-favored foreign trust satisfies the eligibility requirements under §5.02.

*Conclusion.* Rev. Proc. 2020-17 is a significant expansion of the relief from Form 3520 reporting initially provided in 2014 to U.S. persons who own or benefit from Canadian RRSPs and RRIFs. While it will be of particular interest to U.S. persons owning or contributing to Canadian RESPs and RDSPs, the relief extends to tax-favored arrangements for retirement, medical, disability, or educational benefits established under the laws of other foreign jurisdictions, as well.

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<sup>15</sup> Rev. Proc. 2020-17, §6.01.