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Income Tax Folio S5-F3-C1, Taxation of a Roth IRA

Series 5: International and Residency

Folio 3: Cross-border Issues

Chapter 1: Taxation of a Roth IRA

Notice of comments received

To allow for feedback from the tax community, newly published income tax folio chapters have a 3-month comment period. The public comment period for this Chapter ended on January 9, 2021.

We are currently in the process of reviewing the comments we received during this period. Our goal is to address comments received as soon as possible after the end of the comment period. Any changes to the Chapter resulting from this review will be published in an updated Chapter.

Please note that a new chapter is not considered to be draft while the notice of comments received is posted. The Chapter can be relied upon as an accurate summary of the Canada Revenue Agency's interpretation of the law on the date of publication.

Summary

This Chapter discusses the Canadian income tax treatment of **Roth IRAs** and the effect of the **Canada-U.S. Treaty**. It also describes the procedures to file an election under the Canada-U.S. Treaty to defer paying Canadian income tax on income accrued in a Roth IRA.

In general, an individual resident in Canada who owns a Roth IRA should file the election and avoid making any contributions to the Roth IRA after they have become resident. Any questions on these procedures, including the possibility of making a late-filed election, should be directed to the Competent Authority of Canada at the address noted in ¶1.18.

The CRA issues income tax folios to provide a summary of technical interpretations and positions regarding certain provisions contained in income tax law. Due to their technical nature, folios are used primarily by tax specialists and other individuals who have an interest in tax matters. While each paragraph in a chapter of a folio may relate to provisions of the law in force at the time it was written (see the [Application](#) section), the information provided is not a substitute for the law. The reader should, therefore, consider the Chapter's information in light of the relevant provisions of the law in force for the particular tax year being considered.

The CRA may have published additional guidance and detailed filing instructions on matters discussed in this Chapter. See the [CRA Forms and publications](#) web page for this information and other topics that may be of interest.

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Discussion and interpretation

General comments about Roth IRAs

1.1 A Roth Individual Retirement Arrangement (Roth IRA) is an individual retirement plan established pursuant to section 408A of the United States (U.S.) Internal Revenue Code of 1986 (Code). For U.S. income tax purposes, contributions to a Roth IRA are not deductible from income, earnings and gains are exempt from tax, and distributions are generally not included in income. For an overview of Roth IRAs see Internal

Revenue Service Publications 590-A, Contributions to Individual Retirement Arrangements (IRAs) and 590-B, Distributions from Individual Retirement Arrangements (IRAs).

1.2 For Canadian income tax purposes, the income accrued in a Roth IRA is generally taxable on a current, annual basis. An individual resident in Canada who owns a Roth IRA must determine:

- the legal characterization of the Roth IRA and resulting taxation of income accrued in and distributions from the Roth IRA pursuant to the Act (see ¶1.3 to 1.7); and
- whether the relief provided in the Canada-U.S. Treaty for Roth IRAs is available (see ¶1.8 to 1.14).

Taxation of Roth IRAs in Canada

1.3 A Roth IRA does not enjoy the income tax deferral benefits afforded under the Act to Canadian registered plans and traditional IRAs. As a result, the income accrued in a Roth IRA is generally taxable in Canada on a current, annual basis.

1.4 Under the Code, a Roth IRA can take the form of a custodial account, a trust, or an annuity or endowment contract. To determine the Canadian income taxation of a particular Roth IRA, it is necessary to identify its legal characterization. This is fact specific and will depend on the terms of the arrangement. Although providing an exhaustive list of potentially applicable taxing provisions would be impractical, ¶1.5 to 1.7 provide general comments that are intended to assist readers in determining the legal characterization and resulting taxation in Canada of a particular Roth IRA. A tax professional may provide assistance in this regard.

Custodial account

1.5 A Roth IRA that is a custodial account can take various forms. Typically, the CRA understands that a Roth IRA custodial account is a savings or investment account (other than a trust account) at a financial institution, brokerage firm, or mutual fund company. A common characteristic of such a Roth IRA is that the owner of the Roth IRA is considered to own the assets held in the account by the custodian. In such a case, one must look to the nature of the income and gains derived from the specific assets held in the account to determine the Canadian income tax treatment.

Example 1

Irina owns a Roth IRA bank account that pays interest on a monthly basis. The interest credited in the account each year is included in Irina's income for that year under paragraph 12(1)(c), which is the general taxing provision for interest.

Example 2

David owns a Roth IRA brokerage account that holds shares, bonds, and other securities. David is required to include any interest, dividends, and other investment income, as well as any taxable capital gains and allowable capital losses, derived from the assets in the account in computing his income each year in accordance with the relevant applicable provisions of the Act.

Trust

1.6 The taxation in Canada of a Roth IRA that is a trust is fact specific. Generally, the CRA would expect that a Roth IRA trust for an individual resident in Canada would satisfy the conditions in paragraph (h) of the definition **exempt foreign trust** in subsection 94(1) to be exempted from the application of the non-resident trust rules in section 94. In such a case, and assuming that the individual is the sole beneficiary, the individual will be required to include in income the trust's **foreign accrual property income** pursuant to sections 94.2 and 95.

Annuity or endowment contract

1.7 The taxation in Canada of a Roth IRA that is an annuity contract or endowment contract is specific to the terms of the particular contract.

Application of the Canada-U.S. Treaty to Roth IRAs

1.8 Article XVIII of the Canada-U.S. Treaty includes provisions that can defer or exempt U.S. pensions from taxation in Canada. The term **pension** includes a Roth IRA, as long as no contributions are made to the Roth IRA while the owner is resident of Canada. In most cases, these provisions will result in no portion of a Roth IRA being subject to taxation in Canada.

Deferral of taxation of income accrued

1.9 An individual resident in Canada can file an election under paragraph 7 of Article XVIII (**Election**) to defer taxation in Canada with respect to any income accrued in a Roth IRA, but not distributed. The term **income accrued** means amounts that are included in computing the individual's income under the Act as outlined in ¶1.3 to 1.7.

1.10 The procedures for filing the Election are described in ¶1.15 to 1.21.

Exemption from taxation of distributions

1.11 Pursuant to paragraph 1 of Article XVIII, a distribution from a Roth IRA to an individual resident in Canada is not taxable in Canada to the extent that:

- the payment would not be taxable in the U.S. if the individual was a resident of the U.S; and
- the Roth IRA qualifies as a pension.

Canadian Contribution

1.12 If an individual resident in Canada makes a contribution to their Roth IRA or a contribution is made on their behalf (**Canadian Contribution**), part of the Roth IRA will cease to be considered a pension. This will result in the loss of treaty benefits, as follows:

- any income accrued in the Roth IRA after the Canadian Contribution will cease to benefit from the deferral of taxation afforded by the Election and thus becomes subject to Canadian taxation on a current, annual basis as outlined in ¶1.3 to 1.7;
- any income accrued in the Roth IRA before the first Canadian Contribution will continue to be eligible for tax deferral afforded by the Election; and
- distributions from the Roth IRA will continue to be exempt from taxation to the extent of the balance in the Roth IRA immediately before the first Canadian Contribution.

1.13 Effectively, a Canadian Contribution splits a Roth IRA into two parts – one part consisting of the balance in the Roth IRA immediately before the Canadian Contribution and the other part consisting of the Canadian

contribution (and any subsequent contributions) and all income accrued in the Roth IRA after the Canadian Contribution. The first part continues to be considered a pension and remains exempt from taxation in Canada (if an Election had been filed). The second part ceases to be considered a pension and becomes subject to Canadian taxation.

1.14 A Canadian Contribution does not include a contribution made before 2009, or a rollover contribution from another Roth IRA or a Roth 401(k) arrangement. However, a rollover contribution (or conversion) from a traditional IRA, or from a qualified retirement plan (such as a traditional 401(k) or profit sharing plan), to a Roth IRA is a Canadian Contribution.

Procedures for the Election

Who should file the Election?

1.15 Any individual resident in Canada who wishes to defer taxation in Canada of income accrued in a Roth IRA should file a one-time irrevocable Election for each Roth IRA that they own. In cases where Canadian income tax is not currently owing for a particular Roth IRA, an Election filed on a protective basis may be accepted.

When should the Election be filed?

1.16 The Election should be filed on or before the individual's filing-due date for the tax year in which the individual became resident in Canada. Individuals who did not file an Election within the specified time should contact the Competent Authority Services Division at the address listed in ¶1.18.

How should the Election be made?

1.17 The Election can be made by the individual owner of the Roth IRA in the form of a letter containing the following information:

- individual's name and address, social insurance number, and social security number;
- name and address of Roth IRA trustee or administrator;
- Roth IRA account number;
- date that the Roth IRA was established;
- date that the individual became resident in Canada;
- balance of the Roth IRA on December 31, 2008 or on the date the individual became resident in Canada, whichever is later;
- amount and date of the first Canadian Contribution made to the Roth IRA, if any; and
- a statement signed by the individual indicating that they elect to defer taxation in Canada under paragraph 7 of Article XVIII of the Canada-U.S. Treaty with respect to any income accrued in the Roth IRA for all tax years.

If the individual owns more than one Roth IRA, the Election should include this information for each Roth IRA.

1.18 Mail or fax the Election to:

Competent Authority Services Division

Canada Revenue Agency

18th Floor, Canada Building

344 Slater Street

Ottawa, ON K1A 0L5

Fax 613-990-7370

1.19 Once an Election is made, there is no requirement to make another Election for subsequent years.

1.20 A copy of the Election, as well as a copy of any applicable U.S. tax forms and records of transactions for the Roth IRA, including records of contributions, conversions, rollovers, income, and withdrawals should be kept. These documents may be requested by the CRA to verify the taxable portion of the Roth IRA, if applicable.

1.21 The procedures regarding the Election are administered by the Competent Authority of Canada. For more information on these procedures, contact the Competent Authority Services Division at the address listed in ¶1.18 or by email at CPMAPAPAG@cra-arc.gc.ca.

Foreign reporting

1.22 If an Election has been filed and no Canadian Contribution has been made to a Roth IRA, the CRA does not require information relating to the Roth IRA to be reported in the following forms:

- Form T1135, Foreign Income Verification Statement
- Form T1141, Information Return in Respect of Contributions to Non-Resident Trusts, Arrangements or Entities
- Form T1142, Information Return in Respect of Distributions from and Indebtedness to a Non-Resident Trust
- Form T1134, Information Return Relating to Controlled and Not-Controlled Foreign Affiliates

1.23 If an Election has not been filed or a Canadian Contribution has been made to a Roth IRA, information regarding the Roth IRA must be included (as applicable) when filing any of the forms listed in ¶1.22. The references in the forms to a **U.S. Individual Retirement Account (IRA)** applies only to traditional IRAs, not Roth IRAs. For more information on the foreign reporting rules, see the instructions on each of the forms.

The Election and other U.S. retirement arrangements

1.24 The Election described in ¶1.9 is also available to an individual resident in Canada who is a beneficiary of any other U.S. retirement arrangement generally exempt from tax in the U.S. that qualifies as a pension under the Canada-U.S. Treaty. However, the Election will be of benefit only where the income accrued in the arrangement is taxable to the individual under the Act on a current basis. Where the income accrued is not taxable under the Act until it is paid out to the individual in the form of a distribution (such as a payment of benefits), there is no benefit in filing the Election.

1.25 The income accrued in a traditional IRA referred to in subsections 408(a), (b) or (h) of the Code is not subject to current taxation under the Act therefore there is no benefit in filing the Election. These arrangements are defined in subsection 248(1) of the Act and section 6803 of the Regulations as a **foreign retirement arrangement** for Canadian income tax purposes.

1.26 There are several other types of U.S. retirement arrangements exempt from taxation under the Code that qualify as a pension under the Canada-U.S. Treaty, but that are not foreign retirement arrangements under the Act. These include, for example, 408(p) SIMPLE IRAs, 408(k) SEP IRAs, 401(a) plans, and 401(k), 403(b) or 457(b) plans (including Roth accounts). Whether an individual should file the Election for such an arrangement depends on whether the income accrued in the arrangement is taxable under the Act on a current basis. This would require a complete review of the facts and terms of the particular arrangement. However, it is the CRA's understanding that employers typically make contributions to such arrangements, in which case the arrangement will be characterized either as an employee benefit plan

(**EBP**) or a retirement compensation arrangement (**RCA**), as those terms are defined in subsection 248(1). Because an individual who holds an interest in an EBP or RCA is not subject to current taxation under the Act on the income accrued in the arrangement, there is no benefit in filing the Election.

1.27 Where no employer contributions are made, the arrangement will not be characterized as an EBP or a RCA. In this situation, the individual might be subject to current taxation under the Act on the income accrued in the arrangement and therefore should consider filing the Election. The procedures for filing the Election for these arrangements are the same as those described in ¶1.15 to 1.21 for Roth IRAs.

Application

This Chapter, which may be referenced as S5-F3-C1, is effective October 9, 2020 and replaces and cancels Income Tax Technical News, Issue No. 43 – September 24, 2010.

Except as otherwise noted, all statutory references herein are references to the provisions of the Income Tax Act, R.S.C., 1985, c.1 (5th Supp.), as amended, all references to a Regulation are to the Income Tax Regulations, C.R.C., 1978, c. 945, as amended, and all references to the **Canada-U.S. Treaty** are to the Canada-United States Tax Convention (1980).

Links to jurisprudence are provided through CanLII.

Income tax folios are available in electronic format only.

Reference

Article XVIII of the Canada-U.S. Treaty.

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