



Cross-border investment planning

There are significant investment tax-saving opportunities for Canadians who take up residence in the United States. In order to benefit, it's important for individuals to properly structure their investment portfolios before they leave.

When an individual is leaving Canada, questions often arise about whether their investments can continue "as is", and what the tax implications are for their portfolio. This article offers some investment strategies for individuals planning to reside in the United States.

REGISTERED INVESTMENTS

For U.S. tax purposes, only the income portion of withdrawals from an Registered Retirement Savings Plan (RRSP) is taxable - the capital portion is tax exempt. The capital portion is deemed to be the "original contributions" to the plan and by increasing this amount an individual can reduce the taxable portion of their withdrawals and enjoy significant tax savings. Individuals should consider transferring their RRSPs to a new plan before leaving Canada, as the capital portion will now equal the amount transferred into the new plan. A

fund switch will not accomplish the "bump up" as it would not change the amount contributed to the plan - it would only increase the adjusted cost base (ACB). The Internal Revenue Service is only concerned with the amount contributed to a plan and not the ACB.

MAKING IT WORK

Sandra's RRSP has grown to a market value of \$350,000. She transfers to a new RRSP just before leaving Canada to increase the capital portion for U.S. tax purposes to \$350,000.

If Sandra cashes in her RRSP immediately after her move, the withdrawal would equal the capital portion and be exempt from U.S. tax*. The full value of her RRSP would be subject to a 25 per cent withholding tax in Canada, but these taxes (\$87,500) can be used as a foreign tax credit in the U.S. Compare this to cashing in the RRSP before leaving Canada - If Sandra is in a 45 per cent tax bracket, \$157,500 of her RRSP is lost to taxes.

GIC INCOME

Unlike interest income from a traditional bank Guaranteed Interest Contract (GIC), interest from GICs issued by insurance companies (considered annuity income) is not reported to a non-resident. Because of the tax-deferred growth while outside Canada, it may be advantageous to transfer existing GICs to insurance company issued GICs, before leaving Canada.



TRUST INCOME AND CAPITAL GAINS

Taxable trust income (interest, dividends and foreign income) from mutual funds and segregated funds is reported to non-residents each year as it occurs. Tax withholding on interest and dividend income in the amount of 15 per cent is generally paid by surrendering units from the funds. Taxes are not withheld on capital gains. However, there is a deemed disposition on these types of investments upon leaving Canada, making any gains or losses subject to Canadian tax laws. Because of this, the decision to hold or sell before leaving Canada is not usually based on tax considerations.

TRANSACTION RESTRICTIONS FROM WITHIN THE U.S

Due to securities regulations, U.S. residents are generally limited to redemptions and otherwise prohibited from managing their Canadian investments from U.S. soil. Certain states allow brokers or dealers to apply for exemptions on registered accounts but no exemptions exist on non-registered accounts. Therefore, it is important that individuals who are leaving Canada realign their portfolios for the long term unless they plan to return to Canada on a regular basis.

TIP

The different tax treatment of RRSP withdrawals from within Canada and the U.S. provides an opportunity to reduce taxes with proper planning.

IDEAL CANDIDATES

Individuals planning to take up residence in the U.S., and who hold the following investments:

- RRSPs or locked-in RRSPs
- Non-registered GICs not issued from an insurance company
- Non-registered mutual funds or segregated funds

TAKE ACTION

To maximize the tax-efficiency of their portfolio, investors should:

- Transfer their RRSP assets to a new plan before leaving
- Ensure their non-registered GICs are held with an insurance company before leaving
- Ensure their portfolio has been structured for a long-term holding period, if they plan to keep their current mutual funds and segregated funds

*An election (Revenue Procedure 2002-23) to defer U.S. tax on the undistributed income of a retirement plan until the funds are actually distributed must be attached to the individual's U.S. tax return annually.

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