



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D. C. 20224

OFFICE OF THE CHIEF COUNSEL

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Dear _____ :

This letter responds to your inquiry to John Harrington, dated March 29, 2010, in which you note that you hold interests in several Canadian trusts through your U.S. Individual Retirement Account (IRA). The trusts make distributions to your IRA from which they withhold and remit to Canada a 15 percent tax. You question Canada's right to tax these distributions.

U.S. tax law provides that an individual does not pay U.S. taxes on amounts in an IRA until distributed.

Generally, an individual is not liable for U.S. taxes on amounts earned through an IRA until distributed. However, U.S. tax law only defers U.S. tax and does not affect the ability of a foreign country to impose tax on income of the IRA that is sourced in that country. Distributions from Canadian income and royalty trusts are Canadian-source income and may be subject to tax in Canada, depending on Canadian tax law and the terms of the U.S.-Canada income tax treaty (the Treaty).

The Treaty determines whether Canada can tax the Canadian-source income of a U.S. resident.

Certain U.S. entities that are generally exempt from taxation in a taxable year in the United States (such as IRAs) are exempt from taxation on dividend income arising in Canada in that same taxable year (Article XXI (Exempt Organizations) of the Treaty).

Based on a 2005 change in Canadian tax law, Canada began imposing a 15 percent withholding tax on distributions from income and royalty trusts to U.S. residents. Canadian tax law did not initially treat these distributions as "dividends," however, and thus they were not exempt from Canadian tax under Article XXI of the Treaty.

In 2007, Canada amended its domestic law again and began taxing certain of these trusts as corporations and treating distributions from these trusts as dividends. Canada and the United States signed an exchange of diplomatic notes in 2007 that confirms, among other things, that distributions from income and royalty trusts that are treated as dividends under Canadian law will be treated as dividends for purposes of the Treaty.

However, Canadian law provides that Canada will not tax income and royalty trusts in existence on October 31, 2006, as corporations until January 1, 2011. Until then, Canadian tax law will not treat distributions from such trusts as dividends, and consequently the Treaty will not treat them as dividends. Thus, such income will not be exempt from Canadian tax under the Treaty until 2011, and Canada can impose its 15 percent tax on such distributions until 2011.

We do not have sufficient information to determine whether the trust interests held in your IRA account are interests in trusts that Canada is already taxing as corporations, or whether those trusts are still making non-dividend trust distributions that Canada may tax at 15 percent. If you do not have this information, we suggest that you contact the trustees or managers of the trusts to resolve your concerns.

Foreign taxes paid by Canadian income and royalty trusts are not creditable against the U.S. taxes owed by IRA owners.

We recognize that you may not claim a foreign tax credit for the Canadian taxes withheld on the income paid to your IRA by the Canadian trusts. This is consistent with the general rule that foreign tax credits may not be credited against an individual's tax liability unless the individual himself is liable for the tax. Nor can the IRA make use of a foreign tax credit, because it is exempt from tax in the United States. Ultimately this may result in some double taxation, but not until the IRA distributes this income to you. The 2007 change to Canadian tax law, when fully implemented in conjunction with the Treaty, will generally eliminate the 15 percent Canadian withholding tax on amounts that income and royalty trusts pay to IRAs.

This letter has called your attention to certain general principles of the current law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2010-1, §2.04, 2010-1 I.R.B. 7 (Jan. 4, 2010). You may wish to contact the Canada Revenue Agency at (800) 267-5177 for more information about the Canadian tax law discussed in this letter. If you have any additional questions, please contact _____, Identification Number _____, at _____.

Sincerely,

M Grace Fleeman
Senior Technical Reviewer, Branch 1
(International)