

RRSP Assets: No US Estate Tax

In a Chief Counsel Advice released on January 22, 2010, the IRS ruled that a Canadian decedent's RRSP is not included in his gross estate for US federal estate tax purposes, because the RRSP's Canadian mutual fund holdings were most likely classifiable as corporations for US tax purposes.

At death the decedent, who was not a US citizen or domiciliary, owned US-situs real property that was included in his estate for US estate tax purposes. His RRSP held shares of Canadian mutual funds that owned shares in US corporations. The estate's executor timely filed a US estate tax return that did not include any of the RRSP's value in the gross estate. The estate tax return was selected for audit, and the IRS auditor asked the chief counsel for an opinion on whether any of the RRSP was includible in the decedent's gross estate. If at death the decedent had directly owned the USco shares, as US-situs assets they would have been included in his gross estate.

Because the decedent could withdraw funds at any time from the RRSP and designate a beneficiary of the plan's proceeds at death, the IRS concluded that the decedent possessed sufficient control over the RRSP to satisfy the first prerequisite to including it in his gross estate (under Code section 2036 or 2038 if the RRSP was a trust or other entity for US tax purposes, or under other sections if it was a retirement annuity). However, the RRSP's assets must also have US situs at the time of death.

The IRS looked to sections 2104 and 2105 to determine the assets' situs and determined that it must first evaluate the US tax classification of the Canadian mutual funds in which the decedent had an interest. The IRS concluded that the RRSP's mutual funds were apparently corporations and not trusts for US tax purposes even though they were trusts under Canadian law. Thus, the mutual fund shares were essentially shares of a foreign corporation and were not US-situs property (section 2014(a)).

For US federal income tax purposes, under the entity classification rules a trust is an arrangement created either by a will or by a lifetime declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries do no more than accept the trust benefits and are not its voluntary planners or creators (Treas. reg. section 301.7701-4(a)). Generally, an arrangement is a trust if it can be shown that its purpose is to vest responsibility in the trustees to protect and conserve the property for beneficiaries who cannot share in the discharge of that responsibility and are thus not associates in a joint enterprise for the conduct of business or profit such as a corporation or partnership.

Certain business arrangements cast in trust form are not recognized as trusts for US federal tax purposes; this is true when title is conveyed to trustees for the benefit of beneficiaries, but the arrangement is not simply intended to protect or conserve the property for the beneficiaries. These business trusts are generally created by the beneficiaries as a device to carry on a profit-making business normally carried on through a business organization that is a corporation or partnership, and they are thus classified as such for US federal income tax purposes. The Chief Counsel Advice does not elaborate on its entity classification analysis or the mutual fund's specific characteristics, but it concluded that trust classification was not appropriate.

Once the IRS determined that the mutual funds were business entities rather than true trusts, it had to determine whether the mutual funds were properly classified as partnerships or corporations. Generally, unless a foreign eligible entity with two or more members elects otherwise, it is classified as a partnership if at least one member does not have limited liability, and as a corporation if all members have limited liability. Presumably the IRS arrived at corporate classification for the mutual funds based on this liability analysis. Because the RRSP's mutual funds were classified as corporations, the RRSP was deemed to own foreign corporation shares, and its entire value was excluded from the decedent's gross estate.