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FOCUS PARTNERS CANADA



# Options for U.S. IRA Account Holders When Living in Canada



## **Challenges After Moving to Canada**

At Cardinal Point, one of the most frequent inquiries we receive is from prospective clients asking what they should do with their U.S. retirement accounts after a move to Canada. These individuals are often caught off-guard by their U.S.-based financial advisor or institution after learning that their investment accounts must go into restricted status or be permanently closed. The reason they are often given is that their U.S.-based advisors and related custodian can no longer maintain accounts registered to a Canadian address.

## **Why Many Advisors Cannot Service Canadian Residents**

Many advisors and/or firms in the U.S. – even some of the largest – are not properly registered and licensed to provide investment advice for a client living in Canada (even if the client is a U.S. citizen). In fact, there are few U.S.-based firms that carry the proper licenses and registrations to be able to service taxable, IRA or 401(k) accounts held by Canadian residents. And because of the additional rules and compliance requirements associated with servicing a client physically living outside of the



United States, many U.S.-based firms have policies against providing services to non-U.S. residents.

The situation is equally troubling when an individual looks to a Canadian financial advisor to help. Yes, these advisors carry the proper Canadian securities licenses and they can manage accounts domiciled in Canada. But because they are not registered in the United States, Canadian advisors cannot oversee a U.S.-based retirement account. The situation leaves the Canadian resident frustrated and with few options for what to do with their U.S.-based retirement account.



### **Common Cross-Border Planning Mistakes**

Unfortunately, some advisors have tried to find workarounds that are not only illegal, but not in the best interest of the client. Over the years, prospective clients have shared with us the “advice” that they have received from both U.S. and Canadian advisors.

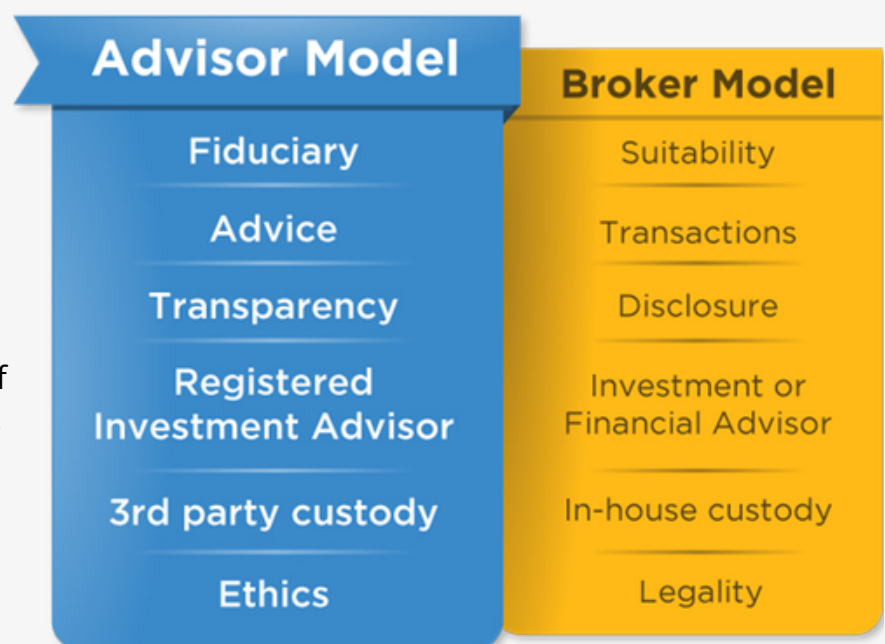
In the United States, these suggestions include leaving an old U.S. address on file or using a friend’s or family’s U.S. home address. To the advisor’s compliance officer and firm, it makes it appear as if the client is still residing in the United States. Not only is this illegal under U.S. securities laws and very likely against company policy guidelines, it could also suggest to the U.S. state in which the account is held, that the client is still a tax resident of that state. Given some of the fiscal challenges facing many U.S. states, we have seen state tax authorities use this as a phishing expedition to generate or pursue more tax revenue.

In Canada, frequently given advice includes selling out the U.S. retirement account and moving the proceeds to Canada so that the Canadian-based advisor can manage the assets. Simply following this advice without fully understanding or determining the tax impact of such a move can be costly and harmful.



So what options are there for Canadian residents with U.S. retirement assets? While it may seem like a no-win situation, there are options available. The first step is to find a qualified Canada-U.S. cross-border advisor that is registered and licensed to provide investment and financial planning advice in both countries. Although there are very few who meet these requirements, these cross-border advisors can not only legally manage your investment and retirement accounts in both countries, but can also provide the accompanying financial, tax and estate planning services that are required for those individuals with investment assets and interests in both Canada and the U.S.

To take it a step further, when choosing a cross-border financial advisor, make sure that they are bound by the fiduciary standard and not the less strict suitability standard used by most Canada/U.S. investment and bank owned firms. The fiduciary standard is the highest standard of care in the investment industry. As a fiduciary, the advisor must operate in a way that puts the client's needs ahead of his or her own through a transparent and conflict-free service model.



Because there is no one-size-fits-all approach when it comes to addressing Canada-U.S. cross-border financial planning matters, a fiduciary-bound, cross-border advisor will take the time to properly understand your complete and unique situation. The advisor will then develop a comprehensive Canada/U.S. financial plan, including options on how best to address your U.S.-based retirement accounts. In the case of a Canadian



resident holding a U.S. retirement account, some of the factors that must be considered include but are not limited to the following: age of the client, likelihood of the client returning to live in the U.S. one day, size of the IRA/401(k) account, type of IRA (traditional vs. Roth), client tax situation, citizenship, U.S. estate tax exposure, future income needs and residency of beneficiary.

Once a thorough assessment of the client's situation is completed, the advisor will likely recommend one of the following courses of action if the individual holds a traditional or rollover IRA:

➤ **Close the IRA and Withdraw the Funds:**

Under this scenario, if the owner of the account is a Canadian citizen, there would be a 30% U.S. withholding tax applied to the withdrawal. (This tax may be reduced to 15% if a signed IRS Form W-8BEN is on file, although some U.S. institutions may not honor or properly process the form.) Depending on the client's tax situation, the account owner may be able to recoup some, if not all, of the withholding tax applied through the use of foreign tax credits. If the individual is a U.S. citizen, there is no mandatory withholding tax applied. If the plan owner is under the age of 59 ½, an additional 10% early withdrawal penalty will be assessed on the value of the distribution.

A scan of the IRS Form W-8BEN, titled 'Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)'. The form is partially filled out with handwritten information. Key sections visible include: 'Part I - Identification of Beneficial Owner', 'Part II - Status of Beneficial Owner for United States Tax Withholding and Reporting', and 'Part III - Exemptions'. The form is dated 08/18 and includes instructions for completion.

► **Close the IRA and Transfer Proceeds to a Registered Retirement Savings Plan (RRSP):**

If you are not a U.S. citizen or tax resident, under the right circumstances, this might be a worthwhile option to consider.

Under U.S. tax laws, transfers for an RRSP or RRIF cannot be made into a U.S. IRA. However, Canadian tax law does provide for the transfer of proceeds from a U.S. retirement account to an RRSP. With proper planning, Canadian tax rules under the Income Tax Act may allow IRA or 401(k) proceeds to be transferred to an existing or new RRSP without affecting RRSP contribution room. That said, although Canadian tax on the U.S. retirement account distribution can be reduced or eliminated, the U.S. treaty withholding tax of 15% – and the 10% penalty if it applies – cannot be eliminated or reduced. Therefore, if the Canadian wanted to contribute the gross amount from the U.S. retirement asset to a Canadian RRSP, they would have to provide the 15% amount themselves from other financial resources.





▶ **Required Minimum Distribution (RMD) at the applicable IRS-required age.**

For many account owners, this course of action makes the most sense given that the Canada-U.S. Tax Treaty allows a Canadian resident with an IRA to leave the account in the U.S. and receive the same tax-deferred treatment the individual would enjoy if still living within the United States.

Under this scenario, the plan owner could let the account grow until he or she is required to take out the annual Required Minimum Distribution (RMD) at the applicable IRS-required age. At that time, a 30% withholding tax would be applied to each annual distribution received by a Canadian citizen (potentially reduced to 15% with a W-8BEN or recovered through the filing of a U.S. tax return and application of treaty benefit). For a U.S. citizen, no withholding requirements are necessary. The plan holder could continue to receive the RMD each subsequent year the same way the individual receives annual Canadian RRIF minimum withdrawals. Any withdrawals or distributions would be picked up as income for Canadian tax purposes (for Canadian residents) or as income for Canadian and U.S. tax purposes (for U.S. citizens or tax residents). Again, foreign tax credits up to a treaty maximum rate of 15% could be applied to eliminate this double taxation for U.S. citizens.

There are additional benefits to holding the account in the United States. These include continued currency diversification (USDs), and less expensive investment options, as well as more variety of investment options than can be found in Canada.



### **Additional Retirement Account Considerations**

Many of the same tax rules outlined above for an IRA account would also apply to a 401(k) account holder who is a resident of Canada. However, we would suggest that the account owner consider “rolling over” the 401(k) account to an IRA account. The key benefit to completing this tax-free rollover is that an IRA account typically allows for more investment options within the plan.

If an individual is an owner of a Roth IRA account, the options are far greater and easier to navigate. This is because any withdrawal received from a Roth IRA after the account owner turns age 59½ is considered tax-free for Canadian (if a specific first-year election is made when coming to Canada) and U.S. tax purposes. No withholding taxes are applied either. Like the traditional IRA, the account can grow tax-deferred indefinitely for Canadian and U.S. tax purposes. Further, there is no RMD for Roths, meaning the account holder can take out as little or as much as the individual wants once turning 59½ years old.

### **Building a Cross-Border Retirement Plan**

A thoughtful plan should be put in place after a move to Canada, as a cross-border transition can significantly affect long-term retirement and financial planning goals. When choosing an advisor, it is important to work with a qualified professional licensed to provide investment advice in both Canada and the U.S. The advisor should also have experience with cross-border tax and financial planning, along with the appropriate Canada-U.S. investment platform to support the recommended strategy.

Cardinal Point is a Canada-U.S. cross-border advisory firm with offices in both countries. We specialize in helping individuals and families navigate cross-border investment, tax, financial, and estate planning matters, including the management of U.S. retirement accounts for Canadian residents. If you have questions about managing U.S. retirement accounts while living in Canada, speaking with a Cardinal Point cross-border advisor can help you better understand your options.

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