STATE OF CALIFORNIA
FRANCHISE TAX BOARD
Legal Branch
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March 21, 2003 Information Letter No. 2003-0040

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Dear **********:

Thank you for your recent inquiry regarding the Franchise Tax Board's treatment of a Canadian Registered Retirement Savings Plan (RRSP). As I understand your question, you were concerned with an article in the May 2001 issue of Spidell's California Taxletter that explained that the Franchise Tax Board was: (1) treating the RRSP as the functional equivalent of an Individual Retirement Account (IRA); (2) providing in-bound California residents a stepped-up basis in their RRSP at the time they established California residency; and, (3) allowed the taxpayer to recover basis in the RRSP before the distributions were taxable. You are concerned that California law does not provide for any of these treatments for a RRSP.

As explained in Revenue Procedure 89-45, a Canadian RRSP is not an IRA because "these plans do not meet the requirements for qualification as individual retirement accounts under section 408(a) of the Internal Revenue Code. As a result, the earnings of such a plan are includable currently in the gross income of the beneficiary of the plan for United States income tax purposes."[1] Because California also conforms to federal law regarding the treatment of IRAs,[2] a RRSP does not qualify as an IRA for California income tax purposes.

Revenue Procedure 89-45 then explains that for federal income tax purposes, a taxpayer may elect to defer the taxation of earnings on contributions made while the beneficiary is a resident of Canada, until the earnings are distributed from the RRSP. This special treatment is provided in accordance with a treaty between the United States and Canada, and does not apply to California.

The State Board of Equalization has previously held that tax treaties between the United States and other countries which expressly limit their application to federal income taxes do not prevent California from taxing persons otherwise covered by such treaties.[3] The United States Supreme Court noted that "the tax treaties into which the United States has entered do not generally cover the taxing activities of subnational governmental units such as

[1] Rev. Proc. 89-45; superceded by Rev. Proc. 2002-23.
[2] Rev. & Tax. Code, § 17501.
[3] *Appeal of M.T. de Mey van Streefkerk*, 85-SBE-135, Nov. 6, 1985.

States…"[4] and if the treaty does apply to the States it will be specified in the treaty itself. Accordingly, the federal election to defer taxation on earnings of the RRSP is inapplicable for California income tax purposes.

Basically, the Franchise Tax Board considers a RRSP to be similar to a savings account. The Franchise Tax Board will treat a taxpayer's original contributions to the RRSP, made while a Canadian resident, as a capital investment in the RRSP. A California resident must include any earnings from their RRSP in their taxable income and pay taxes on this income in the year earned. After a taxpayer pays tax on these earnings, the earnings will also be treated as capital invested in the RRSP. Therefore, when a taxpayer receives a distribution from their RRSP, the amount consisting of the contributions and the previously taxed earnings is considered a nontaxable return of capital.

Please be aware that this information is being provided to you for informational purposes only and may not be construed as "written advice from the Board" within the meaning of Revenue and Taxation Code section 21012. You should also be aware that our response is subject to change, in the event of a change in relevant statutory authority, judicial or administrative case law, or a change in federal interpretation of federal law, where our opinion is based on such interpretations.

Sincerely,

Jeanne M. Sibert

[4] *Container Corp. v. Franchise Tax Board* (1983) 463 U.S. 159, 196.