

U.S. Estate Tax

Planning Considerations for Canadian Residents

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Estate Tax – Generally

- Canada: deemed disposition on death of capital property at FMV
- U.S.: estate tax is imposed on death on the value of worldwide estate
 - Applies to:
 - U.S. citizens
 - U.S. domiciliary
 - Non-resident aliens on the value of U.S.-situs property

U.S. Estate Tax – Inclusions

- U.S. citizens subject to U.S. estate tax on worldwide assets
- Includes life insurance owned by deceased, property over which there is a power of appointment, retirement funds, personal articles, etc.
- Top rate of tax for 2016 is 40%
- Exemption for U.S. citizens allows \$5.45 m. U.S. before U.S. estate tax payable plus a \$5.45 m. U.S. marital credit for spousal transfers

U.S. Estate Tax – Rates

2017 Federal Estate and Gift Tax Rates			
Column A	Column B	Column C	Column D
Taxable amount over:	Taxable amount not over:	Tax on amount in column A	Rate of tax on excess over amount in column A
--	\$10,000	--	18%
\$10,000	20,000	\$1,800	20%
20,000	40,000	3,800	22%
40,000	60,000	8,200	24%
60,000	80,000	13,000	26%
80,000	100,000	18,200	28%
100,000	150,000	23,800	30%
150,000	250,000	38,800	32%
250,000	500,000	70,800	34%
500,000	750,000	155,800	37%
750,000	1,000,000	248,300	39%
1,000,000	--	345,800	40%

Annual Gift Tax Exclusion	\$14,000
Annual Gift Tax Exclusion to a Non-US Citizen Spouse	\$149,000
Estate Tax / Lifetime Gift / GST Exemption	\$5,490,000



U.S. Estate Tax – Deductions/Credits

- For 2016 \$5.45 m. U.S. exemption per person indexed for inflation (\$5.49 m. U.S. for 2017)
- U.S. Gift tax imposed on inter vivos gifts
- Lifetime gift tax exemption unified credit of \$ 5.45 m. U.S. per person indexed for inflation (U.S. citizens only; reduces U.S. estate tax exemption)
- Annual Gift tax exemption of \$14,000 U.S. for U.S. and non-U.S. citizens

U.S. Estate Tax – Exemptions

- \$147,000 U.S. (increasing to \$149,000 in 2017) exemption for gifts by U.S. citizen to a non-citizen spouse
- No gift tax on transfers between 2 U.S. citizen spouses
- Annual gift tax exempt gifts are in addition to the lifetime gift tax exemption of \$5.45 m. U.S. and do not reduce the lifetime exemption or the U.S. estate tax exemption

U.S. Estate Tax – Non-resident Aliens

- Non U.S. citizens resident outside the U.S. subject to U.S. estate tax on U.S.-situs assets
- Includes real property in the U.S., stock of U.S. corporations, personal articles in the U.S., etc.
- Certain allowable deductions for debts, funeral, medical and charitable donations
- Typically an issue only for those Canadian residents having a worldwide estate greater than the U.S. estate tax exemption threshold

U.S. Estate Tax – Non-resident Aliens

Treaty

- U.S.-Canada Tax Treaty (“Treaty”) provides some relief to Canadian residents
- Generally, no U.S. estate tax if value of worldwide estate less than \$5.45 m. U.S.
- In addition, the marital credit under the Treaty for assets left to a spouse or spousal trust is the lesser of the prorated unified credit and the amount of estate tax assessed – essentially doubles the unified credit available under Treaty to \$10.9 m. U.S.

U.S. Estate Tax – Non-resident Aliens

Treaty

- U.S. Estate tax may be applicable if the U.S. situs assets are valued at more than \$60,000 U.S. and worldwide assets valued at more than 5.45 m. U.S.
- If a Canadian citizen/resident's worldwide estate is worth less than \$1.2 million, U.S. estate tax applies only to U.S. situs real property and to personal property that's part of a business in the United States

U.S. Estate Tax – Non-resident Aliens

Treaty

- Modified tax credit relief for U.S. estate tax paid by Canadian residents may be available in respect of those assets also subject to Canadian tax on capital gains in the same year
- No relief for double taxation in respect of U.S. gift tax and tax on capital gains arising in respect of the same property

Treaty Relief Example

- If William dies leaving Florida condo worth \$2 m. U.S. to children, with a worldwide estate of \$10 m. U.S.:
- Gross U.S. estate tax owed: \$745,000
- Unified credit under Treaty is = greater of
 - \$13,000 and
 - $\$2,125,000 \times \frac{\text{value of the U.S. assets } (\$2 \text{ m.})}{\text{worldwide assets } (\$10 \text{ m.})} = \$425,160$
- Net U.S. estate tax owing after Treaty relief applied is \$320,640



Strategies for U.S. Situs Property

- Hold property as tenants in common rather than joint-tenants
- If both spouses are non U.S. citizens, have the spouse with the smaller worldwide estate own the U.S.-situs property and/or reduce the size of the owner's worldwide estate by divesting assets by way of spousal gifts, alter ego/joint partner trusts
- Utilize a trust to purchase U.S. situs property
- Have the U.S. citizen spouse hold the U.S. property



Strategies for Holding U.S. Property

- Gift the U.S. situs property to a spousal trust under the will so it does not form part of the survivor's U.S. taxable estate
- Qualified Domestic Trust ("QDOT") – if the value exceeds the Treaty exemption, a QDOT may defer U.S. estate tax until death of second spouse (who is non-U.S. citizen) – only a deferral of tax
- QDOT requirements include that there be one U.S. resident trustee, and that it be governed by the law of a U.S. state



U.S. Estate Tax – Case Study

- Kate's Assets: (assume all figures are U.S. dollars)
 - \$3 m. Toronto home
 - \$1 m. cottage
 - \$2 m. securities and cash – joint name with William
 - \$1 m. RRSP
 - \$10 m. term life insurance policy payable to William

U.S. Estate Tax – Case Study

- William's Assets:
 - \$6 m. shares in family business
 - \$2 m. earmarked to acquire Florida home
 - \$2 m. securities in joint name with Kate
 - \$1 m. RRSP
 - \$5 m. corporate owned life insurance policy payable to his company

U.S. Estate Tax – No Planning

- If William dies first, leaving all his assets to Kate, she will inherit an additional \$10 m.
- When Kate subsequently dies, her U.S. taxable estate will be approximately \$ 26 m. U.S. (including her life insurance policy) assuming no change in asset values
- U.S. estate tax exemption shelters \$5.45 m. U.S.
- U.S. estate tax is \$10,345,800, less the tax credit of \$2,125,000 leaving \$8,220,000 payable



U.S. Estate Tax – No Planning

- If Kate dies first, leaving all her assets to William:
- In calculating Kate's U.S. taxable estate, jointly held property will be considered 100% owned by Kate for U.S. estate tax purposes (rebuttable presumption)
- Proceeds of life insurance owned by Kate and payable to William forms part of her estate for U.S. tax purposes
- Kate's U.S. taxable estate could be considered to be \$17 m U.S.

U.S. Estate Tax – No Planning

- Unified tax credit and marital exemption should shelter 10.9 m. from tax;
- U.S. estate tax of about \$2,490,000 on the excess will be payable by Kate's estate
- Capital gain realized on the principal residence is not exempt from tax in the U.S.
- Some federal double tax relief under the Treaty but the relevant province or territory may not provide any relief from double tax

U.S. Estate Tax – Better Planning

- Kate should take steps to reduce her taxable U.S. estate value
- Re-conveys to William, all joint assets that he put in her name
- Gift the Toronto house to William, utilizing part of her lifetime U.S. gift tax exemption unified credit
- Consider making annual gifts to the children within the exemption limits (\$14,000 annually)



U.S. Estate Tax – Better Planning

- Kate should hold her life insurance in an irrevocable life insurance trust (“ILIT”)
- She may be able to assign the existing policy to an ILIT, but if she dies within 3 years, the policy will generally form part of her U.S. taxable estate
- Kate should consider establishing a QDOT in her will with discretion for estate trustee to transfer assets directly to William (up to the marital credit limits) with the balance to a QDOT (U.S. unlimited marital deduction)



U.S. Estate Tax – Better Planning

- William’s will should provide a qualifying spousal trust for Kate, including the ascertainable standard “HELM” language
- if Kate acquires the Florida property, (rather than acquiring it through a trust) she should establish a Canadian resident spousal trust in her will for the Florida property to exclude it from William’s U.S. situs assets if Kate predeceases William
- Both spouses should consider leaving assets for their children and their issue to U.S. grantor trusts



U.S. Estate Tax – Conclusion

- Highly complex combined set of rules governing U.S. estate tax and gift tax for Canadian residents
- Steps to avoid 1.5% estate administration tax or creditors claims may increase exposure to U.S. estate tax
- Combined advice of U.S. qualified specialists and Canadian specialists is essential where one (or both) spouse is a U.S. citizen, or where intended beneficiaries reside in the U.S., or are U.S. citizens or green card holders



Questions?



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