EXPERT SERIES

IG PRIVATE WEALTH MANAGEMENT

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In this article we will discuss:

1. What is considered taxable property for US Estate tax purposes
2. How to estimate your US Estate tax liability
3. Tax planning options to consider

US Estate Tax: What Canadians should know

What do US stock, US vacation homes, and vehicles situated in the US have in common?

Answer: They could all expose their Canadian owners to US estate tax, even if they're not a U.S. taxpayer or resident.

Many Canadians do not know that they are subject to US estate tax on certain assets with ties to the United States. These assets, which we will describe in more detail later in this article, are called "**US situs property.**" It is important to know that US Estate tax can result in a tax of up to 40% on the **gross value** of the property held at death. Also, while many Canadians will not have to pay US Estate tax due to generous exemption limits that are in place currently; they may still have US Estate tax filing requirements. As you can imagine, this can have significant unanticipated implications when an estate is left to future generations, and why planning ahead is key.

Please note that while this article provides a brief overview of the US Estate tax regime as it applies to Canadian residents, the information is not intended to represent tax, legal or other professional advice. The tax regimes in both Canada and the US are constantly changing. We recommend that you speak to an experienced cross-border advisor about both the Canadian and US tax consequences of your specific circumstances prior to making any decisions.

The application of the US Estate tax and the planning options that are available will differ for US taxpayers who live in Canada.

What is considered taxable property for US estate tax purposes?

The answer is different depending on whether you are a US citizen, US resident or Green-card holder, or a Canadian resident and **non-resident alien** ("NRA") in the US.

If you are a US citizen, US resident or Green-card holder then US estate tax **can apply to tax on your worldwide assets**.

If you are not a US citizen, US resident or Green-card holder then the US considers you an NRA and US estate tax would only **apply to your US situs assets**.

Note: For the remainder of this article, we'll assume that the individual reading **is an NRA who is a resident of Canada for tax purposes**. The application of the US Estate tax and the planning options that are available will differ for US taxpayers who live in Canada.

WHAT ARE US SITUS ASSETS?

US estate tax applies to real or tangible property that is situated in the US. Some examples of US situs assets include:

- Shares of publicly traded US corporations (even if they are held by a brokerage in Canada or in a registered account)
- US listed Exchange Traded Funds (ETFs) and US mutual funds
- Shares of a non-publicly traded US corporation
- Assets of a trade or business conducted within the US
- Certain US Debt obligations
- US real estate and Tangible personal property situated in the US (for example, vehicles, boats, gold situated in US)
- US retirement plans (such as IRAs and 401(k) plans)

WHAT ARE EXCEPTIONS TO US SITUS ASSETS?

Common examples of assets that **are not** considered US situs assets include:

- Canadian mutual funds that invest in the US market.
- American Depository Receipts (ADRs).
- US bank chequing or savings deposits (provided they are not effectively connected to a US trade or business).
- US Treasury Bills.
- US publicly traded bonds.

The US Estate tax exemption amount is a critical concept and the amount has varied significantly throughout history

How to estimate your US estate tax liability

There is a credit that both US persons and Canadian resident NRAs can receive which effectively results in an amount that is exempt from US Estate tax. The exemption amount is currently set at $11.58 million USD (in 2020) and indexed to inflation until the current legislation sunsets at the end of 2025 at which point the exemption amount will decrease considerably unless further legislation is enacted. The US Estate tax exemption amount is a critical concept and the amount has varied significantly throughout history; therefore, it will be important to consider on an ongoing basis.

If your worldwide assets are less than $11.58 million USD (in 2020), estimating your US Estate tax liability is relatively straightforward. For an NRA who is a resident of Canada, provided your worldwide assets are less than $11.58 million USD (in 2020), there will generally not be any US Estate Tax owing; however, you will still have US estate tax filing requirements if you own more than $60,000 USD in US situs assets.

If your worldwide assets exceed $11.58 million USD (in 2020), determining your US estate tax liability becomes more difficult.

To estimate your U.S. estate tax liability, you will need to determine the following:

1. The gross value of your US situs property in USD
2. The gross value of your worldwide assets in USD
3. The appropriate tax rate to arrive at a tax figure.
4. Credits provided for under the Canada-US tax treaty

HERE'S HOW IT COULD WORK:

Barry and Tracy are married and reside in Alberta. They are not US citizens or green-card holders. Tracy's worldwide estate is valued at $22,000,000 USD including a vacation home in Phoenix worth $2,000,000 USD.

If Tracy dies in 2020, her estate can claim a unified credit equal to $416,164 and her US estate tax liability will be $329,636; however, if the Phoenix property is left to her spouse then the US Estate tax can be eliminated by claiming a marital credit.

Estimated US Estate tax before credits	$745,800
Less: enhanced unified credit ($2,000,000/$22,000,000 x $4,577,800)	$416,164
US estate tax liability before marital credit -	**$329,636**
Less: marital credit (limited to taxes owing) -	($329,636)
US estate tax liability after unified and marital credits	**$0**

A professional advisor with experience in cross border estate planning would need to assist

Barry may be subject to US estate tax if he owns the Phoenix home at his death. Assuming he is not married at the time then he will not receive benefit of the marital deduction on his death. This will likely lead to a US estate tax liability if no further planning is performed.

There may be specialized will planning with a restricted spousal trust that can be implemented in advance of Tracy's death to eliminate Barry's future US estate tax liability in this scenario. The terms of the will and trust would need to meet specific conditions. This type of planning can be beneficial if US Estate tax does not occur until the second to die. A professional advisor with experience in cross border estate planning would need to assist with the implementation of this potential option.

Tax planning options to consider

If you think US estate tax may apply to you, the following are some potential planning options to consider with your cross-border tax advisor:

REAL ESTATE: FOUR KEY CONSIDERATIONS

1. **Spousal Ownership –** If there is a difference in the net worth between spouses, consider having the spouse with lower net worth purchase the property. If the spouse with the lower net worth passes away first, then US estate tax may be avoided on the first death.
2. **Personal Ownership with Non-recourse Mortgage –** For US estate tax purposes, a non-recourse mortgage is netted against the value of the property when determining the value of the US situs property. Therefore, a non-recourse loan/mortgage can reduce liability for US estate tax. Keep in mind, that this idea will need to be considered holistically as interest rates for the loan and whether the loan is attainable will need to be considered.
3. **Canadian Discretionary Trust –** Holding the property in an irrevocable Canadian discretionary trust could be an alternative option. There are both US and Canadian considerations to manage in implementing this ownership structure, however, if the trust is setup prior to purchase and structured correctly then US estate tax may not be payable when either spouse dies. The key draw back is that the person funding the purchase through the trust is essentially giving the property away to family members and will lose all control over future decisions relating to the trust and the property.
4. **Personal Ownership with Life Insurance –** If planning cannot be implemented to limit US estate tax, then consider purchasing a life insurance policy to cover the individual's US estate tax liability upon death.

REAL ESTATE: WHAT TO AVOID

1. **Avoid Gifting US Real Estate –** For US tax purposes, US gift tax would apply to a gift of US real estate and gifting US real estate is not a recommended strategy.
2. **Avoid Joint Ownership –** Joint ownership with rights of survivorship is often not a recommended form of US property ownership for non-resident aliens for the following reasons:
   a. It can cause unintended US estate and gift tax consequences on creation or termination.
   b. The entire value of jointly held property may be taxed for US estate tax purposes on the first to die and the entire value may again be taxed for US estate tax purposes on the second to die.
   c. The above tax consequences may be limited if enough proof is provided to show that each spouse contributed towards the purchase of the property; however, proving this fact may be difficult. Joint ownership may still be considered when no exposure to US Estate tax is expected and each spouse contributes equally to the purchase of the property, however, keep in mind that US Estate tax exemptions and therefore exposure may change in the future. Alternatively, sole ownership or, if each spouse has contributed towards the purchase, then tenants in common may be considered.

US PORTFOLIO ASSETS

1. **Canadian Mutual Funds –** A practical solution for an NRA may be using Canadian mutual funds which invest in the US market to gain US stock exposure. Canadian mutual funds are not subject to US estate tax.
2. **Canadian Corporation –** An NRA with US stock can decrease their US estate tax exposure by holding their US stocks inside a Canadian corporation. If the assets are held personally, then they can potentially be transferred to a Canadian corporation on a tax deferred basis. However, keep in mind that foreign dividends earned inside a Canadian corporation can be inefficient from a tax perspective resulting in higher overall tax paid for the dividends received, therefore, you will want to weigh the pros and cons of this solution in your personal situation.
3. **Gifting US Portfolio Assets –** Gifting shares in publicly traded US corporations can decrease or even eliminate US Estate tax exposure. For Canadian tax purposes, gifts will trigger a deemed disposition at fair market value and the transferor will need to pay tax on any accrued gains unless the shares are transferred to a spouse. Canadian attribution rules will need to be considered with a transfer to a spouse or minor. These rules may require the transferor to report future income and gains on the assets transferred to a spouse and future income on the assets transferred to a minor. Gift tax does not apply to gifts of US portfolio assets from an NRA.

“Canadian attribution rules will need to be considered with a transfer to a spouse or minor.”

It will be important to continually monitor the exemption amount and how it applies to you in the future.

Conclusion

The US Estate Tax exemption limit has changed significantly since its been introduced. The current exemption is set to decrease significantly if permanent legislation is not introduced prior to the end of 2025, bringing with it a markedly lower exemption and higher US estate tax exposure for US taxpayers and for Canadians with US situs property. It will be important to continually monitor the exemption amount and how it applies to you in the future.

If you believe that you may have US estate tax exposure, we encourage you to plan accordingly with your cross-border advisor to ensure that you protect your wealth and the legacy that you pass along to your future generations. For more information on this topic, please speak with your IG Consultant.

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Mathew is responsible for providing advanced taxation and estate planning support for high net worth clients. His goal is to ensure that clients receive the highest quality tax and estate planning tailored to their goals and circumstances. His areas of expertise include tax and estate planning for individuals and private businesses and providing guidance on international taxation matters.

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