U.S. Residency Issues

- A Non-U.S. Citizen is taxed as a resident (on worldwide income) for U.S. income tax purposes if:
  - He or she holds a U.S. green card
  - He or she spends 183 days or more in the U.S. in a calendar year (regardless of visa status)
  - He or she spends 122 days or more in the U.S. in three or more consecutive calendar years

- Limited exceptions

- Proposed Snowbird Legislation
U.S. Reporting

- **FBAR**
  - Treasury Department
  - $10,000 total threshold

- **Form 8938**
  - IRS
  - Threshold, e.g. Married filing separately outside U.S., $200,000 at year end or $300,000 at any time during the year

- Many others
Canadian Reporting – T1135

- Specific investments
- Cost amounts, highest value
- $100,000 total threshold
U.S. Estate Tax

- Imposed on transfers of property on death
- For U.S. citizens and residents, imposed on worldwide taxable estate
- For non-citizen non-residents, imposed on “U.S. taxable estate”, includes:
  - Real property located in the United States;
  - Shares in a U.S. corporation;
  - Trusts with retained interests; and
  - Tangible personal property located in the United States
Residency based on “domicile”, all others non-resident aliens (NRA)

For U.S. citizens and residents exemption now at $5,340,000 (adjusted for inflation)

For NRA, $60,000 is exempt

Top rate of estate tax is 40%
NRA’s Treaty Credit

- $13,000 credit, shelters $60,000
- Treaty Credit = proportionate credit

\[
\text{U.S. Assets} \times $2,081,800 \ (2014)
\]

Worldwide Assets

Available to every Canadian resident (other than a U.S. citizen)

Also, U.S. estate tax available as a credit against Canadian capital gains tax payable on U.S. asset
Calculation of NRA’s Estate Tax

- Extra Marital Credit
  - Calculated same as Treaty Credit
  - Outright to Canadian Spouse or in qualifying trust for Canadian Spouse
  - Better than QDOT because savings (up to $2,045,800) vs. deferral

- Unlimited Marital Deduction for property passing to a U.S. citizen spouse or qualified trust for U.S. citizen spouse
### Example – U.S. Citizen Deceased

Deceased dual U.S. and Canadian citizen and Canadian resident owned the following assets:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance Proceeds</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>RRSP</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>House</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Canadian Investments</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>U.S. Investments</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>U.S. Condominium</td>
<td>$1,000,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$6,500,000</strong></td>
</tr>
</tbody>
</table>

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**Example – U.S. Citizen Deceased**

**U.S. Estate Tax Calculation:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Estate Tax</td>
<td>$2,545,800</td>
</tr>
<tr>
<td>Less Applicable Credit</td>
<td>($2,081,800)</td>
</tr>
<tr>
<td>Net Estate Tax</td>
<td>$464,000</td>
</tr>
</tbody>
</table>

**Credit for Canadian capital gains tax paid**

**Surviving Spouse a U.S. Citizen?**

- **Unlimited Marital Deduction**
  - Olden Days - Traditional Planning – Shelter Trusts

**Portability**

**Surviving Spouse Canadian Only?**

- **Treaty Marital Credit – Extra $2,081,800 – no tax!**
# Example – Canadian Deceased

Deceased Canadian citizen and Canadian resident owned the following assets:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value (U.S. $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance Proceeds</td>
<td>1,000,000</td>
</tr>
<tr>
<td>RRSP</td>
<td>1,000,000</td>
</tr>
<tr>
<td>House</td>
<td>1,000,000</td>
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<td>Canadian Investments</td>
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</tr>
<tr>
<td>U.S. Condominium</td>
<td>1,000,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$6,500,000</strong></td>
</tr>
</tbody>
</table>

Estate would be entitled to an Applicable Credit of $640,554, as follows:

\[
\text{Applicable Credit} = 2,000,000 \times 2,081,800 = 640,554
\]

\[
\text{Applicable Credit as a percentage of Total} = \frac{640,554}{6,500,000} \times 100 = 9.87
\]
### Calculation of NRA’s Estate Tax

**U.S. Estate Tax Calculation:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Taxable Estate</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Tentative U.S. Estate Tax</td>
<td>$745,800</td>
</tr>
<tr>
<td>Less: Applicable Credit</td>
<td>($640,554)</td>
</tr>
<tr>
<td>Equals: Net Tax</td>
<td>$105,246</td>
</tr>
</tbody>
</table>

- **Credit for Canadian capital gains tax paid (accelerate if necessary)**
- **Surviving Spouse a U.S. Citizen?**
  - Unlimited Marital Deduction
- **Surviving Spouse Canadian Only?**
  - **Treaty Marital Credit – Extra $640,554 – no tax!**
U.S. Gift Tax for U.S. Citizens

- Imposed on transfers of property during lifetime
- Same graduated rates as the estate tax
- Imposed on transfers on a cumulative basis
- For U.S. citizens and residents, Applicable Credit (maximum $5,340,000) applies to gift tax and reduces exemption at death
U.S. Gift Tax for U.S. Citizens (cont’d)

- **Annual Exclusion** – each year an individual is entitled to gift up to $14,000 to each of any number of donees

- Increased to $145,000 for gifts to non-U.S. citizen spouse

- **Direct** payments of medical and tuition expenses are generally excluded from taxable gifts, regardless of amount

- **Marital Exclusion** – unlimited deduction for gifts to a U.S. citizen spouse only
U.S. Gift Taxation of NRAs

U.S. Gift Tax Liability for NRA

- Gifts of U.S. real estate or tangible personal property located in U.S.
  - Gift of vacation property itself; or
  - Gift of cash if gift completes in the U.S.

- 40% top gift tax rate

- Does not apply to shares in U.S. corporations
U.S. Gift Taxation of NRAs

- Treaty credit is **not** available to offset tax on gifts by an NRA
- No foreign tax credit for Canadian capital gains tax and vice versa
  - **Canada treats gifts as disposition at fair market value**
- $14,000 annual exclusion is available
- Deduction for gift to NRA spouse is limited to $145,000 (2014) per year
- Gifts to U.S. citizen spouse qualify
Possible Solutions – U.S. Estate Tax for NRA

**Canadian Corporation**

- Cannot use a Canadian corporation for vacation home because of “shareholder benefit” problem for Canadian income tax purposes
- Higher corporate U.S. tax on sale (35% vs. 20% in 2014)
- Suitable (and simple) for investments in U.S. corporations
Possible Solutions (cont’d)

For the U.S. Vacation Property:

Do Nothing – Pay the Tax

Play the Odds / Sell Before Death!

Asset Allocation and Wills

Canadian Trust

Life Insurance

Non-Recourse Debt

Charitable Gift

Partnership/Hybrid Entity
Planning for Canadian NRA Owning U.S. Situs Property Generally

The Tools

- Treaty Credit
- Treaty Marital Credit
- Lifetime Annual Exclusions ($14,000 and $145,000)
- Unlimited Marital Deduction to U.S. citizen spouses
- No gift or estate tax on certain intangibles
- QDOT
- Charitable exemption
Possible Solutions

Canadian Trust

- Properly drafted trust holds U.S. vacation property (to avoid estate tax)
- Settlor cannot retain any interest
- Typical Canadian family trust will not work (U.S. income tax and estate tax issues)
- Trust to be funded prior to locating property (to avoid gift tax)
- Watch out for mismatch of foreign tax credits on rental income and sale
- Watch out for 21 year deemed disposition
Possible Solutions (cont’d)

Asset Allocation and Wills

- One spouse holds U.S. assets and other spouse holds balance
- Testamentary Trusts with independent Trustee or Ascertainable Standard for distributions
- Consider Gift Tax and Canadian Attribution Issues
Non-Recourse Debt

- Recourse only against Real Property
- Netted against value of Real Property
- Does not protect against appreciation
- Must file U.S. estate tax return to claim
  - scrutiny
- Must be bona fide
- Difficult to procure for NRA
- Not often seen in practice
Possible Solutions (cont’d)

Life Insurance

- Consider ownership of policy
- Best used in tandem with Asset Allocation and Wills
- Insurance Trust may be appropriate
Possible Solutions (cont’d)

QDOT with Charitable Gift

- U.S. Vacation Property is held in QDOT for survivor
  - Deferral of U.S. Estate Tax
- Charitable Deduction for U.S. real property gifted to U.S. or Canadian charity
- If no QDOT, no Charitable Deduction for gift to Canadian charity but available if to U.S. charity
Possible Solutions (cont’d)

Partnership / Hybrid Entity

- Limited Partnership in Canada
- Law not 100% clear on situs
- Alternative - Check the Box; treat as Corporation for U.S. purposes – potential risk
- Corporate Tax vs. Personal Tax
- Complex Tax Reporting
- Can be used for all U.S. assets
- Need business purpose
Possible Solutions (cont’d)

Do Nothing

- Powers of Attorney to Facilitate Sale
- Play the odds (e.g. plan to sell before death)
- In many cases exposure is small; do the math first
U.S. Beneficiaries

- If warranted, create a U.S. estate tax protected trust where U.S. beneficiary’s right to receive distributions is limited

- Flexibility to “move” trust to US
Basis Issues

- U.S. Estate tax is 40% on each $1 above $5,340,000
- U.S. Capital Gains tax is up to 20% plus 3.8% (plus State tax if applicable) with foreign tax credit only against U.S. federal capital gains tax
Basis Issues (Cont’d)

- Canadian capital gains tax payable in any case on death (or on surviving spouse’s death)
- The capital gains tax issue will now often drive planning instead of U.S. estate tax
Basis Issues (Cont’d)

- If property is includible in decedent’s estate (regardless of whether estate tax is payable) is entitled to an increase in cost basis for U.S. purposes to fair market value at date of death.

- If property is held in a U.S. estate tax protected manner (e.g. bypass trust) no automatic increase to cost basis to fair market value.
Basis Issues – Case Study

- Canadian husband holds shares in a Canadian corporation with significant potential for continued appreciation, now with $10M
- U.S. wife
- Two children, both dual U.S. and Canadian citizens
- Traditional Planning in husband’s Will – all in U.S. estate tax protected trust for wife
Case Study (Cont’d)

Problem? If husband dies first, kids inherit shares with cost base equal to fair market value on wife’s date of death for Canadian purposes but because trust is U.S. estate tax protected, U.S. cost base is husband’s date of death value
The fix: Flexibility to have certain asset not expected to have significant gain before wife’s death in U.S. estate tax protected trust. Remainder includible in her estate (still in trust). Careful consideration of credits needed and proper allocation powers to avoid undermining U.S. estate tax protection.
Principal Residence Exemption and Planning

- Canadian capital gains exemption – no tax generally
- U.S. capital gains exemption $250,000/$500,000
Principal Residence Exemption and Planning

- Top U.S. capital gains tax rate 20%
  - (if in >$406,750 for single, $457,600 for married filing jointly and $228,800 for married taxpayer filing separately)

- Plus 3.8% Medicare surtax
  - Surtax if adjusted gross income > $200,000 ($250,000 joint or $125,000 married filing separately) → no foreign tax credit
Principal Residence Exemption and Planning

- Planning
  - Annual gifting within $145,000
  - Larger gift in anticipation of sale – the earlier the better, using up lifetime exemption
  - Deed of Gift plus transfer documents
- No deemed disposition on death, so if below U.S. estate tax threshold and not anticipating sale, no problem
Conclusion

Careful Estate Planning creates significant U.S. tax and other savings.

Thank You.

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