
Masters Series

This is one of a series of articles prepared for CIBC Private Wealth Management™. The series is written by professionals in such fields as taxation, trusts, and estates.

CROSS-BORDER TAX PLANNING

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If you are a Canadian citizen who owns assets in the U.S., you may be subject to U.S. estate tax under the Canada–U.S. tax treaty — even if you are not resident in the U.S. With U.S. federal estate taxes ranging from 18% to 49% of the value of the estate, the potential tax exposure can be significant. State estate taxes may also apply.

This article is intended to help you assess your potential exposure to U.S. estate taxes so you can consider appropriate tax planning strategies.

What's taxable

If you are neither a resident nor a citizen of the U.S., you will be subject to U.S. estate tax on U.S. real estate and stock in U.S. corporations that you own directly.

U.S. estate tax may also apply to:

- works of art located in the U.S. (unless they have been imported solely for exhibition);
- the full value of U.S. property you hold jointly with a spouse who is not a U.S. citizen (exceptions may apply if your spouse contributed to the purchase of the property);
- debts issued by U.S. persons, with some exceptions; and
- your interests in trusts that hold U.S. property if “retained interest trust” rules apply. (In some situations, “retained interest trusts” allow the

settlor of the trust to retain benefits for a specified period of years to reduce the value of the gift to the beneficiaries.)

U.S. estate tax does *not* apply to bank deposits and life insurance proceeds.

Tax relief

U.S. law provides a tax credit to non-residents that effectively exempts the first US\$60,000 of an estate's value.

For Canadians, the credit amount is increased to a pro rata portion of the credit allowed to U.S. citizens, which is US\$345,800 for 2003. This credit against estate tax effectively exempts US\$1 million of property value. The credit is based on the ratio of the deceased's U.S. estate to the deceased's worldwide estate.

In addition, a Canadian resident (who is not a U.S. citizen) whose worldwide estate is less than US\$1.2 million is exempt under the Canada–U.S. Protocol from U.S. estate tax on certain U.S. property that would otherwise be taxable. The exemption applies primarily to U.S. stocks and securities. Investments in U.S. real estate and U.S. partnerships and limited liability companies generally do not qualify.

For Canadian residents, U.S. estate tax paid in the year of death can be claimed as a credit on the federal Canadian terminal tax return, but only up to the

amount of the Canadian federal tax on income, profits, or gains arising in the U.S. for that year.

Strategies for minimizing tax

While the enhanced credit will help shield assets from U.S. estate tax, Canadians who have significant assets may still face some exposure. For these individuals, there are a number of strategies available that may reduce U.S. estate tax:

Non-recourse mortgages. If your property is subject to non-recourse debt that is not enforceable against your estate or any of your other property, only your net equity in the property is included in the value of your gross estate. This is an advantage over regular mortgages, where the full value of the property is usually included in the gross estate, with only a *portion* of the mortgage amount (equal to the percentage of the deceased's worldwide assets located in the U.S.) deductible from the gross estate.

The question of residency

The test for determining residence, or "domicile," for U.S. estate tax purposes is not the same as the tests that are used for determining residence for income tax purposes.

If you live in the U.S., however briefly, with the intention of permanently residing there, you are a resident, and may be subject to additional estate tax.

Some of the factors the U.S. Internal Revenue Service (IRS) may look at to determine intention include length of presence in the U.S., location of family and friends, and location of social and business ties.

For resident aliens and U.S. citizens, U.S. estate tax applies to property wherever it is located. Taxation is based on your worldwide gross estate, including:

- real property;
- tangible personal property;
- stocks, bonds, and other securities;
- mortgages, notes, or cash;
- debts owing to you;
- interest in partnerships, patents, and copyright;
- contract rights and interests; and
- annuity interest payable to someone other than you as a result of your death.

Inter vivos transfer of intangibles. A U.S. non-resident can transfer intangibles, including stocks, bonds, and notes, without gift tax, provided that the transfer is not deemed to take effect at death.

Inter vivos gifts. Both residents and non-residents can make annual gifts of up to US\$11,000 without U.S. gift tax applying. If the gift is to your spouse, and your spouse is not a U.S. citizen, the annual exemption amount is increased to US\$110,000.

Joint ownership. U.S. law presumes that property owned by non-resident spouses is not owned jointly, but rather is owned by the first to die unless the estate trustee can prove each spouse contributed to its purchase. In that case, the property is considered to be owned proportionately based on each spouse's contribution to the property. You and your spouse should therefore purchase U.S. property that is to be jointly held with separate contributions, evidenced by separate cheques, so as to accurately apportion its value between your separate estates. While you can create a joint interest in a property by making a gift to your spouse, the transfer may be subject to U.S. gift taxes.

Use of a Canadian holding company. Stock held in a Canadian corporation is not considered U.S. property. Therefore, owning U.S. property through a Canadian holding company can be an effective way to minimize U.S. estate tax. Such companies are often used to hold U.S. residential real estate, such as Florida condos or ski chalets, or stock in U.S. operating corporations.

Life insurance. You may want to purchase life insurance to fund any anticipated U.S. estate tax liability. While this won't reduce the tax exposure, it will preserve estate assets for your beneficiaries.

What to do

In many situations, advance planning is the key to reducing U.S. estate tax exposure. If you have or are planning to acquire significant U.S. assets, consider obtaining professional tax advice on how best to structure your property holdings.

This article presents general information about U.S. estate tax. It is not intended as specific tax planning advice. For advice pertaining to your individual situation, please consult a professional tax advisor.

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