

U.S. Estate Taxation of Canadian Citizens

By Alan Cranfield

Snowbirds and other Canadian citizens who own property in the U.S. potentially owe estate taxes at the time of death. This tax obligation is based on the fair market value of all U.S. property, which will include the home itself plus furnishings, U.S. pensions, shares of U.S. corporations regardless of where traded, and other tangible property. If your worldwide assets total less than U.S. \$2 million (which rise to U.S. \$3.5 million in 2009), then you won't have an estate tax liability to the IRS.

On the other hand, if your worldwide assets are greater than U.S. \$2 million at the time of death, your estate will owe U.S. taxes on the U.S. portion. For 2008, the rate starts at 18 percent and increases to 45 percent depending on the size of the estate above U.S. \$2 million.

Some Relief with a Tax Credit

- As a non-citizen and non-resident of the U.S., you get a unified credit equal to the larger of U.S. \$13,000
or
- The percentage that U.S. assets represent of your entire assets multiplied by U.S. \$780,800 (the maximum credit given U.S. citizens).

If your total worldwide assets are worth U.S. \$3 million with \$500,000 situated in the U.S., then your holdings there represent 16.67 percent. You can claim a credit of U.S. \$130,026 (U.S. \$780,000 X 16.6 percent = U.S. \$130,026).

For the U.S. \$500,000 portion of your assets your estate would owe \$155,800 minus the unified credit of U.S. \$130,026 for a net estate tax obligation of \$25,774.

As you can see, the portion of assets that your U.S. holdings represent and the total size of your estate can greatly increase or decrease your tax obligation. Using the example above, if the U.S. portion was worth U.S. \$1 million instead of U.S. \$500,000, then the U.S. estate tax would be U.S. \$85,800. In this case, the portion is larger and tax rate is higher.

Using a different example, if your U.S. assets totaled U.S. \$2 million out of a total of U.S. \$5 million worldwide, you'd owe U.S. \$478,000 to the IRS.

As the U.S. estate tax laws now stand, the maximum credit will rise to \$1,455,800 in 2009 for one year, then the tax rate goes to zero for the year 2010. For 2011 and years following, however, the unified credit and tax rates return to the 2001 levels –\$345,800 for the unified credit and a top estate tax rate of 55 percent – unless the U.S. Congress passes new legislation in the coming years.

The Larger U.S. Estate Tax

Fortunately, the CRA doesn't levy an estate tax. It does, however, collect a capital gains tax instead at death, which it considers an event that triggers "deemed disposition" of property, such as investments and real estate. In the case of a married couple, no capital gains tax is due until the second death, since the CRA considers it having a deferred disposition. A Canadian citizen's estate owes Canadian taxes on the accrued gain on U.S. assets, in addition to incurring U.S. estate taxes on the assets' value. While the CRA provides a credit for the estate tax paid to the IRS, some provinces do not, so you may be double-taxed at the provincial level. Please check with your tax advisor.

Some strategies can help you reduce your U.S. estate tax obligation:

Use the Marital Credit

Americans enjoy an unlimited marital credit that allows the transfer of assets between spouses. Canadian citizens can use a special version of this credit that allows them to apply a portion of the U.S. \$780,800 maximum credit given U.S. citizens. At the death of the surviving spouse, the estate distributes the assets, the IRS gets paid the estate tax and the CRA expects the capital gains tax.

Change Ownership

If one spouse could acquire the U.S. assets and still have total worldwide assets of less than U.S. \$2 million, then no U.S. estate tax would be owed.

Create a Trust

If you create a certain type of trust known as a Qualified Domestic Trust (QDOT), which has at least one U.S. trustee (such as a relative who is a U.S. citizen or a U.S. bank), you can potentially postpone the U.S. estate tax until the death of the second spouse. If the first spouse leaves all assets to the QDOT, the surviving spouse can receive lifetime income from the trust. Since the amount of assets wasn't reduced by estate taxes at the first death, the trust has the potential for creating a larger income.

Solving Your Estate Tax Problem

Cross-border planning for Canadian citizens must address numerous issues and requires deep analysis to create the best solution. (When one spouse is a Canadian citizen and the other is U.S. citizen, the regulations reach another level of complexity.) A wealth management approach provides a methodical means of developing tax minimization strategies, wealth transfer, asset protection, business succession, and charitable giving. Only a select group of advisors takes a true comprehensive wealth management approach to creating solutions for clients.

Wealth management breaks away from the typical situation in which clients must contract and manage a range of professionals, each specializing in a single area: the investment adviser managing portfolios, the insurance agent providing life insurance, the accountant addressing taxes, and the lawyer implementing tax and estate planning strategies. You no longer need to coordinate and retain a professional for every aspect of your financial life, thereby eliminating potential planning conflicts that may remain hidden for many years.

A wealth manager serves as the quarterback for a team of experts selected for each client, which might include your lawyer and accountant or outside lawyers, insurance agents, and investment managers, among others.

Perhaps most important, the wealth manager also coordinates and implements the overall plan to eliminate conflicts that can arise when experts work in silos without knowledge of the others' activities. One surprisingly common mistake of coordination, for example, is the failure to adequately address a small-business owner's buy-sell agreement meant to protect business partners and their families. Extra taxes, difficult cash flow, and even undesirable new partners can result.

More than ever, affluent families need a thorough approach to managing and preserving their assets, given the growing levels of legal, regulatory, and financial complexity that come with wealth. A comprehensive wealth management solution aligns your personal goals with a financial plan.

About the Author

Alan Cranfield is a Principal with Stonegate Private Counsel LP. Alan specializes in helping seasoned business executives and entrepreneurs gain financial peace of mind so they can spend more time enjoying their loved ones, maintaining their health and living life to the fullest. Alan has dedicated the past 20 years to helping his clients establish and attain their financial goals. He has earned the professional designations of CERTIFIED FINANCIAL PLANNER® (CFP®) and Registered Financial Planner (R.F.P.). Over the past two decades, Alan has studied advanced counselling, coaching, listening, business management and investment strategies with top industry experts. Alan's practice is limited to fewer than fifty clients who meet not only financial criteria, but who are also compatible in personality. New relationships are created through personal introductions from clients and through social contact, not marketing. This frees Alan's time to be spent developing meaningful, long-lasting relationships with his clients. Outside of work, Alan is a member of the Antique and Classic Boat Society, Muskoka Heritage Society and Muskoka Lakes Association. He is an avid snow skier and has enjoyed a lifelong interest in personal development and business success. Alan has homes in Toronto; Muskoka; and Fort Myers, Florida.

Alan's affiliation with Stonegate Private Counsel LP enables him to offer clients access to a team of experts in money management, asset allocation, portfolio design, rebalancing, tax optimization, estate planning and asset protection.

Alan R. Cranfield

Stonegate Private Counsel LP

151 Yonge Street, Suite 1000

Toronto, ON M5C 2W7 Canada

Tel: (416) 681-7173, (877) 742-3600

Fax: (416) 681-7171

www.alancranfield.com

acranfield@stonegatepc.com

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