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U.S. estate taxes challenging for some Canadians

Fortunately some relief possible

Canadian residents, who die owning assets such as vacation properties in the United States or stocks in U.S. companies, may be subject to U.S. estate taxes. For tax purposes, assets include real and tangible personal property situated in the U.S., shares of U.S. securities and units of U.S. mutual funds, certain U.S. debt obligations, deposits in a brokerage account in the U.S., assets of a business carried on in the U.S., and U.S. retirement plans and annuities.

Under the Canada-U.S. Tax Treaty, Canadian residents with worldwide assets valued at US\$5.34 million or higher will be required to pay U.S. estate tax as high as 40% on the fair market value of U.S. situs assets. Fortunately, some relief is possible. Canadian residents may be able to claim a unified credit exemption equal to the greater of US\$13,000 or a pro-rated amount based on a formula using the value of U.S. assets relative to total worldwide assets.

For example, a Canadian resident with a total estate value of \$10 million, owning \$1 million of U.S. assets, will be subject to US\$345,800 in estate tax. Claiming the unified credit exemption reduces the U.S. estate tax liability to US\$137,620.

Other credits are available. A marital credit is provided to those leaving U.S. assets to a spouse on death. Foreign tax treaty relief may be available in the form of a credit against Canadian

income tax. Small estate relief exempts Canadians from estate tax if their worldwide gross estate does not exceed US\$1.2 million at death, subject to conditions.

There are other ways to further minimize or defer U.S. estate tax. The most obvious would be to reduce the estate value to less than US\$5.34 million as this would completely eliminate U.S. estate tax on deaths in 2014. Similarly, gifting U.S. situs property to certain U.S. charities on death will exempt those assets from U.S. estate tax.

Those who own U.S. real estate may wish to use a non-recourse mortgage to finance it. This effectively allocates the liability directly against the value of the U.S. real estate, thereby reducing the value subject to U.S. estate tax.

Regarding U.S. equities, Canadians might use a Canadian corporation to own U.S. securities. However, although it excludes the U.S. situs assets on death, it may not always result in tax savings as the taxes on investment income and capital gains could be more than would have been payable through the U.S. estate tax.

Others may elect to re-structure their U.S. equity investments altogether. For instance, they may choose a Canadian mutual fund focused on U.S. equities instead of buying them directly. Such investments are not considered to be U.S. situs

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property because the mutual fund is essentially considered to be a corporation.

Another planning tool is to use life insurance to fund any U.S. estate tax liabilities, but this can be tricky because of some of the rules applying to the unified credit exemption calculation. Clearly, when planning for an integrated solution to U.S.

estate tax liabilities, it is wise to work with a qualified U.S. tax expert proficient in cross-border issues.

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