U.S. Estate Taxes for Canadian Residents

More Bark than Bite

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Susan Mallin is a Certified Financial Planner and Chartered Investment Manager with over 17 years of experience. She is also knowledgeable in cross border issues for US citizens living in Canada, as well as Estate Planning for Canadians.
U.S. Estate Taxes for Canadian Residents – More Bark than Bite

In a real life example of the common saying “the long arm of the law”, you may be surprised to find that as a Canadian resident, the American Internal Revenue Service (IRS) could come after your estate for taxes upon your death. Many articles have surfaced lately that have caused fear regarding ownership of US assets. In part this is because the tax law states that even if you have never set foot across the border, all you need to own is $60,000 worth of US assets (including but not limited to common stocks of public American companies) to trigger their interest in your money when you die. It doesn’t matter if the shares are held in a trading account, TFSA, or RRSP. The estate tax rules are outlined as part of the American Tax Payer Relief Act, legislation that resulted to avert the “fiscal cliff”. For Canadian investors, there is no need to panic or take any rash actions. With a little planning and knowledge – the threatening bite of the IRS can be turned into a barely audible bark.

Every person’s situation is different, and cross border financial planning strategies can become very complex for very wealthy individuals, and thus goes beyond the scope of this article. We urge you to contact us directly if your situation requires special attention.

This estate tax is not a reason to sell your US stocks. When a person invests their money in various stocks and bonds, it is important to have a properly diversified portfolio which, by default, manages overall risk. By managing risk, the investor has a better chance for their investment portfolio to achieve expected returns over time. Tax strategies are important when it comes to investing, but they should not be the dominate force when making investment decisions. Canada represents 3% of the world’s wealth as defined by gross domestic product (GDP). In addition, Canada’s investment grade securities are concentrated in only 3 sectors; banks, energy, and materials, making it difficult to diversify by sector. By inference, if an investor restricts their scope to Canada alone they miss out on 97% of the world’s wealth opportunities and are restricted to just 3 of the 10 major investment sectors.

Global diversification can be accomplished through our Global Value Equity Portfolio, or through our High Yield portfolio.

The IRS applies estate taxes to Americans and US residents if their world-wide assets exceed 5.2 million dollars. Canadian residents do not get the direct 5.2 million dollar exemption. However a Canadian/US tax treaty allows for a unified tax credit that works out to be identical to the 5.2 million exemption. Under our tax treaty with the US, the unified tax credit in the amount of $2,045,800 effectively eliminates taxes on a world-wide estate of 5.2 million. It is important to note that the calculation is based on a Canadian’s total assets world-wide, not just US assets. There is also a marital credit and capital gains tax relief. Unless a person has assets with a fair market value exceeding $5.2 million, there shouldn’t be a need to conduct complex cross border planning when owning US assets be they real estate or financial instruments. If the value of your estate is greater than $5.2 million, and you own more than $60K in US assets, it’s a good idea to formulate a financial plan to mitigate potential estate taxes.
For those who would like a general idea of taxes owing here is the formula:

1) \( \frac{\text{US asset Value}}{\text{World-wide assets}} \times \text{unified tax credit} = \text{Prorated tax credit} \)
2) \( \text{US assets} - \$60,000 \times 0.40 \text{ (tax rate)} = \text{Estate taxes} \)
3) \( \text{Estate taxes} - \text{prorated tax credit} = \text{Taxes owing} \)

Example: Sally has a $600,000 US stock portfolio and $7 million in worldwide assets.

1) \( \frac{(600,000/7,000,000)}{2,045,800} = \$175,354 \) which is the prorated unified tax credit.
2) \( (600,000 - 60,000) \times 0.40 = \$216,000 \text{ estate taxes} \)
3) \( 216,000 - 175,354 = \$40,646 \text{ US estate taxes owing} \)

There may be other credits and certain allowable deductions, plus some offsetting credits that could help to reduce this.

**note, this is an estimated calculation as some deductions may apply such as funeral expense, or certain debt.**

Here are a few extra points to consider for Canadian residents, who are also not US citizens or green card holders:

- Transfers of US stocks and bonds to family members (or anybody for that matter) do not trigger the gift taxes in the USA. However, it will trigger a deemed disposition for tax purposes in Canada.

- US tangible property such as houses, boats, art etc. situated in the US have other tax considerations such as capital gains, or taxes on investment income. Transferring this type of property to a fellow Canadian will subject you to gift taxes (including gifts to spouse exceeding a certain amount). If transferring to a non-spouse, Canada will treat the transfer as a deemed disposition. However, under the tax treaties, there will be credits that can be used to avoid double taxation.

- For those with significant assets, the best structure to hold US stocks and bonds is through a Canadian Corporation (passive foreign investment corporation), not a great idea for personal use assets such as a vacation home, as the IRS will “see through” the corporation.

- For those with significant assets, certain trusts could be used, but caution is warranted if you still maintain any “control” of the trust, as it may not pass muster with US tax authorities. Keep in mind that trusts are deemed disposed for tax purposes every 21 years in Canada.

- Vacation property is often best held in personal name. If with a spouse, use tenant in common, not joint with survivorship.

- Avoid the advice to buy your personal use vacation property using a limited liability Corp. – this is great for Americans, but not Canadians, due to double taxation.

- If you have investment property, it may be best to have it in a corporation with limited liability to protect against tenant lawsuits.

- Holding residential property in a cross border trust can be considered if the property is valued at least $750K and greater and is not used for rental/investment purposes.

- When calculating the fair market value of an estate, you cannot deduct debt (it’s not a net value calculation) however you can deduct mortgages if the mortgage is non-recourse (not the type available in Canada). A non-recourse mortgage or loan is where the lender can only access the specific property used as collateral in the event of default. This type of mortgage is more common in the US.

- If you have a US non-recourse mortgage and a Canadian mortgage on Canadian property, and you are deciding on which mortgage to pay off first, pay off the Canadian mortgage.
When owning any property in the US, make sure you have it included in your Canadian Will. The US will accept the Canadian Will, but it will still need to have a separate probate. If your Will is in French and you have US property, you should have a copy professionally translated to English—or they will do it for you, at a snail’s pace and at a high cost.

US estate taxes will be an issue on the settlement of the estates of many Canadians. Proper planning and informed investors will help to alleviate unpleasant surprises. This article is intended to outline some of the broad issues surrounding US estate taxes and hopefully will lead to informed investors and suitably structured solutions.

At Lorne Steinberg Wealth Management, we offer portfolio solutions for investors across Canada (Ontario resident’s must have $150,000 minimum or be an accredited investor, no minimum amounts apply in other provinces. However the regulatory minimum $150,000 for Ontario residents may be eliminated in the near future). We also offer complimentary and continuous financial planning services by Susan Mallin, CIM, CFP, Vice-President of Financial Planning, & Associate Portfolio Manager.


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Those who want to explore new and better options for their investing and retirement needs can start with a complimentary financial plan, simply by contacting me. Financial plans can be done in person or by telephone using a virtual meeting format.

Best Regards,

Susan

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