RBC Wealth Management

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INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

U.S. estate tax – strategies for Canadians with exposure

Planning that may reduce or eliminate your exposure

Please contact us for more information about the topics discussed in this article.

It is important as a Canadian to recognize and understand your potential exposure to U.S. estate tax. This article is intended for Canadian resident individuals living in Canada who are not U.S. citizens or U.S. domiciliaries for U.S. estate tax purposes[1].

This article focuses on explaining various strategies to reduce or eliminate your exposure to U.S. estate tax and maximize the value of the wealth you pass on to your heirs[2]. It builds on a separate article that provides a general understanding of U.S. estate tax for Canadians[3]. You should obtain advice from a qualified cross-border tax, legal, insurance and/or other professional advisor before acting on any of the information in this article.

Note: the information provided in this article is based on U.S. estate tax at the federal tax level, however, some U.S. states may have their own estate tax system, which may apply if you own certain property located in a U.S. state. Also, for Canadian tax purposes, any reference to a spouse includes a married spouse or common-law partner. However, for U.S estate tax purposes, a common-law partner is not considered to be a spouse.

1) If you are uncertain whether you are a U.S. citizen or a person domiciled in the U.S., please ask your RBC advisor for a separate article on this topic.
2) A separate article discussing strategies for ownership of U.S. real estate may be obtained from your RBC advisor.
3) If you would like a copy of the article that provides an overview of the U.S. estate tax system for Canadians, please ask your RBC advisor for one.

2024 U.S. estate and gift tax exemption threshold

For 2024, the U.S. estate tax exemption threshold is US$13.61 million (the "U.S. estate tax exemption threshold"). The annual U.S. gift tax exemption amount is US$18,000 per individual. This exemption amount is increased to US$185,000 if the gift is made to a non-U.S. spouse. A common-law partner is not considered to be a spouse for U.S. gift tax purposes so only the US$18,000 annual exemption would apply to gifts made to them.

Strategies to reduce or minimize your U.S. estate tax exposure

The following is a list of common strategies, which may potentially be used to reduce or eliminate a Canadian's exposure to U.S. estate tax (this is not an exhaustive list):

- Make alternative investment choices with U.S. content
- Keep your worldwide gross estate value below the U.S. estate tax exemption threshold
- Gift U.S. situs property prior to your death
- Sell U.S. situs property prior to your death
- Transfer U.S. situs property to your spouse at fair market value (FMV) on death
- Set up an irrevocable life insurance trust (ILIT) during your lifetime
- Transfer U.S. situs property to a qualified domestic trust (QDOT)
- Sever joint tenancy interests in U.S. situs property (Joint tenants with right of survivorship (JTWROS))
- Own U.S. situs property as tenants in common
- Hold U.S. situs property in a Canadian corporation
- Hold U.S. situs property in a Canadian partnership
- Hold U.S. situs property in a Canadian trust
- Transfer U.S.-based retirement plans to a registered retirement savings plan (RRSP)
- Make charitable donations to U.S. charities

Each of these strategies is discussed in more detail below. You should speak to a qualified cross-border tax or legal advisor to help you evaluate which strategies may be appropriate for you to implement based on your own particular circumstances. As well, to successfully implement certain strategies, a cross-border tax or legal advisor should be consulted.

You can gain exposure to the U.S. market by replacing U.S. situs property with alternative investments that have U.S. content, which are not U.S. situs property.

Note that for Canadian tax purposes, implementing some of these strategies may result in a disposition of your property, which may trigger Canadian capital gains tax on unrealized accrued gains. However, if you have unused capital losses from prior tax years (i.e. capital loss carryforwards), you may use them to offset any capital gains that are triggered when a strategy is implemented. If you don't have any capital loss carryforwards, your RBC advisor (working together with a qualified tax advisor) can assist you in reviewing possible tax-loss selling strategies to help you minimize your Canadian taxes.

Make alternative investment choices with U.S. content

Consider reducing the value of U.S. situs property (i.e. certain property located in the U.S. or considered to have a U.S. connection) held in your portfolio. Examples of U.S. situs property include shares in publicly traded U.S. corporations, some U.S. bonds or U.S. listed Exchange-Traded Funds (ETFs).

You can gain exposure to the U.S. market by replacing U.S. situs property with alternative investments that have U.S. content, which are not U.S. situs property. Examples of property with U.S. content that are generally not considered U.S. situs property include:

- Shares of Canadian mutual fund corporations that invest in the U.S. market (even if denominated in U.S. currency)
- Units of Canadian mutual fund trusts (including ETFs) trading on the Toronto Stock Exchange or another exchange that invest in the U.S. market
- Canadian-issued notes that are linked to a U.S. index
- American Depository Receipts - these are exempt from U.S. estate tax because the underlying share holdings are not U.S. corporations
- U.S. bank chequing or savings deposits, as long as they are not effectively connected with a U.S. trade or business (this would apply also to U.S. dollars in chequing and savings deposits in a Canadian bank that are not connected with a U.S. trade or business)
- U.S. Treasury Bills or U.S. certificates of deposit
- U.S. corporate and government bonds that are subject to the portfolio interest exemption (generally the portfolio

interest exemption applies to U.S. debt obligations that were issued after July 18, 1984 that are not used in a U.S. trade or business. Interest paid on these investments are not subject to U.S. withholding tax.).

- Canadian-issuer U.S. pay bonds that provide exposure to the U.S. dollar

When deciding how much of your U.S. situs property to replace, keep in mind that if you don't want your executor/liquidator to have to file a U.S. estate tax return, the value of your U.S. situs property must not exceed US$60,000. Also, changing your investments could trigger Canadian capital gains tax.

Keep your worldwide gross estate value below the U.S. estate tax exemption threshold

U.S. estate tax will not apply if the value of your worldwide gross estate is below the U.S. estate tax exemption threshold. Therefore, during your lifetime, consider rebalancing the ownership of all property you own (including both U.S. situs property and other property) between you and your spouse and/or other family members in order to bring your worldwide gross estate value below the threshold. Also, your worldwide gross estate value should be taken into consideration when deciding who should own new property your family intends to purchase.

It is important to keep apprised of the U.S. estate tax exemption threshold and any changes to it. If the U.S. estate tax exemption threshold decreases in a future year, you may have to do further rebalancing at that time to bring your worldwide gross estate below this new threshold.

Keep in mind, for Canadian tax purposes, transferring property to a family member, other than a spouse, could trigger Canadian capital gains tax to the transferor. In addition, the Canadian income attribution rules may apply. These rules require the transferor to be taxable on income and capital gains earned on the property that was transferred.

If the property transferred is U.S. tangible property there may be U.S. gift tax. An overview of the U.S. gift tax rules is the topic of a separate article that you may obtain from your RBC advisor. When U.S. gift tax applies, it may result in double tax because you are unable to claim a foreign tax credit on your Canadian return to recoup it and reduce your Canadian tax liability.

It is also important to note that if your worldwide gross estate value is below the U.S. estate tax exemption threshold for your year of death, there will be no U.S. estate tax liability. However, your executor/liquidator will still need to file a U.S. estate tax return if the value of your U.S. situs property exceeds US$60,000.

When deciding how much of your U.S. situs property to replace, keep in mind that if you don't want your executor/liquidator to have to file a U.S. estate tax return, the value of your U.S. situs property must not exceed US$60,000.

Gift U.S. situs property prior to your death

Reducing the value of your U.S. situs property by gifting the property during your lifetime may reduce or eliminate your U.S. estate tax exposure. However, if the U.S. situs property gifted is considered to be U.S. tangible property, U.S. gift tax will apply if the value of the gift exceeds the annual gift tax exemptions. Examples of U.S. tangible property include real estate, art, cars and jewellery located in the U.S. It also includes cash in a U.S. safety deposit box and gifts of cash made from a bank or brokerage account held at a U.S. financial institution. On the other hand, a gift of U.S. intangible property, such as U.S. stocks or bonds, is not subject to U.S. gift tax.

With this in mind, you may consider gifting U.S. intangible property first. Note that if you make a gift of cash from a Canadian bank account to a family member (which is normally not subject to U.S. gift tax), with the intention that the family member use the gift to purchase U.S. tangible property from you, you may be considered to have made a gift of the U.S. tangible property that the family member purchased from you. This transfer may be subject to U.S. gift tax based on the value of the U.S. tangible property that exceeds the annual gift tax exemption.

For Canadian tax purposes, you may trigger a tax liability if you gift property with accrued gains to someone other than your spouse. If the property gifted is U.S. tangible property, this may result in double taxation as you cannot claim a foreign tax credit on your Canadian income tax return for the U.S. gift tax paid and reduce your Canadian tax liability. Also, a gift of property to a spouse or minor child that is used to earn income or capital gains may be subject to the Canadian income attribution rules discussed earlier.

Sell U.S. situs property prior to death

Selling U.S. situs property prior to your death may reduce or eliminate your U.S. estate tax exposure. This planning primarily applies where you become terminally ill and still have the capacity to sell your U.S. property before you pass away. In the event you no longer have mental capacity, this strategy may be available if you have appointed a Power of Attorney for property/Mandatary, who is authorized to sell the property before your death.

Transfer U.S. situs property to your spouse at FMV on death

In general, for Canadian tax purposes, you are deemed to dispose of your capital property upon death at FMV, triggering any unrealized capital gains. Half of these gains are taxable on your final Canadian income tax return. If you are also subject to U.S. estate tax on any U.S. situs property that you own on death, your executor/liquidator may claim a foreign tax credit for federal income tax purposes on your Canadian income tax return for U.S. estate tax incurred on this property. Note that Canadian provinces generally do not allow foreign tax credits for U.S. estate tax. The foreign tax credit reduces only your federal capital gains tax payable. This minimizes the risk of double tax since for both Canadian and U.S. tax purposes, your heirs generally acquire the property at an adjusted cost base (ACB) equal to the FMV of the property upon your death.

Keep in mind, since only 50% of the capital gains are taxable on your final Canadian income tax return, your U.S. estate tax liability may still exceed your Canadian federal income tax liability. Accordingly, the foreign tax credit may not recoup all of your U.S. estate tax liability.

An exception to the Canadian deemed disposition rules occurs when your capital property is inherited by a surviving spouse. In this case, the property is deemed to rollover to your spouse at your ACB, and any capital gain is deferred until the property is disposed of by your spouse or until your spouse's death. This tax deferred rollover may create a timing difference between when Canadian and U.S. taxes are paid, and may result in double taxation. For example, your estate may be subject to U.S. estate tax on U.S. situs property inherited by your spouse upon your death; however, for Canadian tax purposes, no tax is payable on any property with accrued gains that is left to this spouse. When your spouse disposes of this property in the future (e.g. by sale), they may be subject to tax in Canada on any accrued capital gains. They will not be able to claim a foreign tax credit for the U.S. estate tax that was incurred by your estate on this property, and reduce the taxes payable on the capital gain. This would result in double tax.

Fortunately, your executor/liquidator has the option to elect to transfer your U.S. situs property to your surviving spouse at FMV, rather than at your ACB. This may trigger capital gains tax on your final Canadian income tax return. Your executor/liquidator will then be able to claim for federal tax purposes a foreign tax credit for U.S. estate tax paid by your estate on your U.S. situs property. As a result, when drafting or updating your Will, you may want to consider giving your executor/liquidator the flexibility to choose whether to transfer U.S. situs property with accrued gains in your non-registered account to your spouse at ACB or FMV.

An exception to the Canadian deemed disposition rules occurs when your capital property is inherited by a surviving spouse. In this case, the property is deemed to rollover to your spouse at your ACB, and any capital gain is deferred until the property is disposed of by your spouse or until your spouse's death.

There is also the potential for double taxation where you hold U.S. situs property in your RRSP or Registered Retirement Income Fund (RRIF) and your RRSP/RRIF is left to your surviving spouse. For U.S. estate tax purposes, U.S. situs property includes U.S. property held in Canadian registered plans, such as an RRSP/RRIF. For Canadian tax purposes, the FMV of your RRSP/RRIF at the time of death is included as income on your final income tax return. An exception to this rule applies where your RRSP/RRIF is left to your surviving spouse (i.e. the property may roll-over on a tax deferred basis to your surviving spouse's RRSP/RRIF or used to purchase an eligible annuity). As a result, there is the potential for double tax if your RRSP/RRIF holds U.S. situs property and is transferred on a tax deferred basis to your surviving spouse's RRSP/RRIF (in a similar manner discussed above with respect to bequests of capital property to your surviving spouse upon your death).

To minimize the potential for double tax, your executor/liquidator may choose to rollover only the non-U.S. situs property to your spouse's RRSP/RRIF on a tax-deferred basis. Any U.S. situs property held in your RRSP/RRIF can be paid out to your spouse's non-registered account. This will result in an income inclusion on your final income tax return, equal to the FMV of the U.S. situs property on your death. Your executor/liquidator can then claim a foreign tax credit for any U.S. estate tax paid on the U.S. situs property, reducing any Canadian federal taxes payable on this property. Since the full value of the U.S. situs property is subject to Canadian tax, the foreign tax credit claimed on your Canadian return will recoup all of your U.S. estate tax liability, provided your Canadian federal tax equals or exceeds the U.S. estate tax paid.

Keep in mind, that in order for your estate to elect to transfer property from your RRIF to your spouse directly at FMV, generally your spouse should only be designated as beneficiary of your RRIF (either on the plan documentation or under the terms of your Will) and not as successor annuitant.

Set up an ILIT during your lifetime

Owning life insurance through an ILIT may reduce your exposure to U.S. estate tax. When you own a life insurance

policy on your life outright, or have any other incidents of ownership in the policy at the time of your death, the value of the death benefit is included in your worldwide gross estate for purposes of calculating your U.S. estate tax liability. Incidents of ownership in the policy include having the ability to name or change beneficiaries, borrow against the policy, access the cash value or assign or cancel the policy. When you have to include the value of the death benefit in your worldwide gross estate, this may increase or even create U.S. estate tax exposure. Increases to the value of your worldwide gross estate reduces the amount of the U.S. estate tax exemption that your estate may claim to reduce your U.S. estate tax liability.

If your life insurance policy is held in an ILIT, the life insurance proceeds will generally not be included in your worldwide gross estate. This is because the trust owns the policy and you won't be considered to have incidents of ownership.

You should keep the following in mind when using an ILIT:

- You won't have access to the cash surrender value or be able to borrow against the policy. This will pose a problem if you require the life insurance for investment or retirement purposes;
- The transfer of an existing policy to an ILIT will result in a disposition for Canadian tax purposes and may trigger a Canadian tax liability;
- The death benefit from an existing policy transferred to an ILIT will be included in your worldwide estate if you pass away within three years of the date of transfer; and
- Investment income earned on the proceeds paid into the ILIT after your passing will be taxed at the highest marginal tax rate in Canada unless the income can be paid or made payable to a beneficiary pursuant to the terms of the trust agreement.

You should perform a cost-benefit analysis to ensure that the U.S. estate tax you'll save using an ILIT is greater than the costs associated with having one, including the cost to set up the ILIT and ongoing administration fees.

You may consider having your spouse (who may have no exposure to U.S. estate tax) or your corporation own the policy on your life instead of using an ILT. There may, however, be other tax issues with these options that should be considered. For example, if your spouse predeceases you and the policy is transferred to someone other than yourself, this may result in a disposition for Canadian tax purposes. Furthermore, if you provide the funds to your spouse to make the premium payments, you may still be considered to have incidents of ownership in the policy.

You should perform a cost-benefit analysis to ensure that the U.S. estate tax you'll save using an ILIT is greater than the costs associated with having one, including the cost to set up the ILIT and ongoing administration fees.

If you're a shareholder of a corporation that owns the policy and you own more than 50% of the shares of the corporation, it is possible you will be considered to have incidents of ownership in the policy. Even where ownership in the corporation is less than 50%, the value of your shares, which is included in your worldwide gross estate value, may be increased by the proportionate amount of the death benefit paid to the corporation. This may in effect increase your U.S. estate tax liability.

Given these considerations, a qualified cross-border tax or legal advisor and a licensed insurance representative should be consulted for advice on whether the strategy of implementing an ILIT makes sense.

Transfer U.S. situs property to a QDOT

Transferring U.S. situs property to a QDOT will defer U.S. estate tax on your death; however, there are other tax implications that should be considered before using this strategy.

Under the Canada-U.S. income tax treaty (Treaty), your estate may claim a prorated unified credit to reduce your tentative U.S. estate tax liability on death. The prorated unified credit is a portion of the U.S. estate tax exemption (expressed as a credit against your U.S. estate tax liability) that is otherwise only available to U.S. citizens[4]. The calculation of the prorated credit is based on the value of your U.S. situs property to the value of your worldwide estate. Under the Treaty, your estate may also claim an additional marital credit if your U.S. situs property is transferred to your spouse directly or to a spousal trust. The marital credit may effectively double the prorated unified credit.

These two credits may not be sufficient to eliminate your U.S. estate tax liability entirely. Where this is the case, consider whether it makes sense to transfer your U.S. situs property on death to a QDOT. A QDOT is an irrevocable trust for the sole benefit of a non-U.S. citizen surviving spouse. Transfers to a QDOT allows your estate to claim an unlimited marital deduction, which is a dollar for dollar deduction against the value of the U.S. situs property

4) For more information about the calculation of the unified credit, marital credit and the marital deduction that applies with a QDOT, please ask an RBC advisor for a separate article that provides an overview of U.S. estate tax for Canadians.

transferred to the QDOT. Note that when you implement a QDOT your U.S. estate tax liability is deferred. The deferral lasts until distributions of capital are made from the QDOT to your surviving spouse or your surviving spouse passes away. At this point, your estate is subject to U.S. estate tax based on the value of the property in the QDOT, including any growth of the property. The U.S. estate tax liability is calculated based on the tax rates that existed in the year of your death.

There are a number of criteria in order for a trust to qualify as a QDOT. First, the trust must have at least one trustee who is a U.S. citizen or that is a U.S. corporation. If the property transferred to the QDOT has a value of at least US$2 million at the time of your passing (or an alternate valuation date, if applicable), at least one trustee must be a U.S. bank or trust company, or a bond or letter of credit must be provided in favour of the Internal Revenue Service (IRS).

A QDOT may be set up through your Will and structured for Canadian tax purposes as a qualified spousal trust (although this is often difficult to do). To qualify as a spousal trust, the terms of the trust must provide your spouse with the right to receive all income of the trust during their lifetime. As well, no other person may receive or obtain the use of the income or capital of the trust during your spouse's lifetime. Property transferred to a spousal trust on your death will not be subject to the Canadian deemed disposition rules and will transfer at its ACB.

Your estate can't claim both a marital credit and marital deduction. Keeping this in mind, your executor/liquidator would generally consider using a QDOT strategy where your estate cannot otherwise eliminate or substantially reduce your U.S. estate tax liability by claiming the marital credit, and your U.S. estate tax liability can't be sufficiently recouped by claiming foreign tax credits on your Canadian income tax return. Therefore, you may consider drafting your Will carefully to provide your executor/liquidator with the flexibility to be able to direct U.S. situs property to a QDOT where it is appropriate to do so. You should speak to a professional cross-border tax and/or legal advisor for advice on how to structure and incorporate the flexibility to implement a QDOT through your Will.

Sever joint tenancy interests in U.S. situs property

Owning U.S. situs property as joint tenants with right of survivorship (JTWROS) may result in double U.S. estate tax where U.S. estate exposure exists (i.e. U.S. estate tax upon your death and U.S. estate tax upon your surviving joint tenants' death). Therefore, it may not be advisable to hold property as JTWROS.

JTWROS is a form of co-ownership where on the death of a joint tenant, their interest in the property passes outside of their estate directly to the surviving joint tenant(s). For U.S. estate tax purposes, the entire value of U.S. situs property held in joint tenancy is included in the estate of the first joint tenant to pass away, unless it can be demonstrated (with appropriate records) that the surviving joint tenant(s) contributed to the purchase of the property. When this is possible, only the proportionate share of the property based on the deceased joint tenant's contributions will be included in the deceased joint tenant's estate.

For U.S. estate tax purposes, the entire value of U.S. situs property held in joint tenancy is included in the estate of the first joint tenant to pass away, unless it can be demonstrated (with appropriate records) that the surviving joint tenant(s) contributed to the purchase of the property.

Keep in mind, if you hold property as JTWROS with your spouse, your interest in the property will automatically transfer to your surviving spouse upon your death. Your executor/liquidator will not have the flexibility to carry out U.S. estate tax planning, such as transferring your interest in the property to a testamentary spousal trust that is structured to protect property from U.S. estate tax on your surviving spouse's death, or to a QDOT to defer your own U.S. estate tax liability.

Accordingly, holding U.S. situs property as JTWROS may result in the property being subject to U.S. estate tax twice in the same generation. Note that in the event that you hold U.S. situs property as JTWROS with your spouse and your spouse passes away within 10 years of your death, your spouse's estate may claim a credit relating to any U.S. estate tax paid by your estate based on your interest in the property that was held as JTWROS. This will minimize the potential for double U.S. estate tax. However, the credit is significantly reduced on a sliding scale after 2 years of your death.

In addition to double U.S. estate tax, double income tax may also result from differences in the Canadian and U.S. income tax treatment of income and gains earned from jointly owned U.S. tangible property such as U.S. real estate. For example, for Canadian income tax purposes when one joint tenant contributes all of the funds to purchase a property, that joint tenant might be subject to Canadian income tax on all income and gains earned from the property due to the Canadian income attribution rules discussed earlier. However, for U.S. income tax purposes both joint tenants report the income and gains earned from the property equally. In such a case, a foreign tax credit cannot be claimed on the joint tenant's Canadian

income tax return for U.S. income tax incurred by the other joint tenant, resulting in the potential for double tax.

Owning property as JTWROS does offer the benefit of avoiding probate upon the death of the first joint tenant. The probate process can be costly and take a significant amount of time. Therefore, where the U.S. estate exposure is not significant, owning property as joint tenants may be a viable option. Where there is exposure, you may consider severing the joint tenancy.

If the property held as JTWROS is U.S. tangible property, severing the joint tenancy interests may result in a taxable gift for U.S. gift tax purposes. This could occur for example, when only one joint tenant contributed to the acquisition of the property. Consequently, care should be exercised when severing joint tenancy interests in U.S. tangible property. As well, if only one joint tenant contributed to the acquisition of the property, severing title to the property may have Canadian tax consequences.

Own U.S. situs property as tenants in common

Tenancy in common is a form of co-ownership where each tenant may own an equal or unequal share of the property. On the death of a tenant, their interest in the property does not pass to the surviving tenants but rather passes through their estate according to their Will or, if they have no Will, intestacy legislation.

For U.S. estate tax purposes, if U.S. situs property is owned as tenants in common, only the deceased tenant's share in the property is subject to U.S. estate tax, not the full value of the property. If the U.S. tax laws in place at the time of death permit, the value of the deceased tenant's share of property held as tenants in common may potentially be determined by applying a certain discount that would reflect a lower market value of the property because it is partially held by another tenant. A discounted market value will result in a lower U.S. estate tax exposure.

Since each tenant's interest in the property will pass through their estate, they are able to implement estate planning for U.S. estate tax purposes, such as transferring their interest in the property to a testamentary spousal trust that is structured to protect the property from U.S. estate tax on the surviving spouse's death or to a QDOT, thereby deferring their own U.S. estate tax liability.

Due to the Canadian income attributions rules (discussed earlier), the same income tax issues (double taxation) with respect to owning a U.S. tangible property as JTWROS may apply where, one individual for example, gifts some funds to another family member to purchase U.S. tangible property and the property is held as tenants in common.

If the property held as JTWROS is U.S. tangible property, severing the joint tenancy interests may result in a taxable gift for U.S. gift tax purposes. This could occur for example, when only one joint tenant contributed to the acquisition of the property. Consequently, care should be exercised when severing joint tenancy interests in U.S. tangible property.

There are also other issues to consider when title to the U.S. situs property is held as tenants in common, especially when held with children and other family members. For example, a tenant can sell their share of the property to a third party, mortgage their interest in the property, use it as collateral for a loan, or gift their interest in the property to someone else without requiring the consent of the other tenants. In addition, there may be exposure to U.S. probate. As well, without further planning, there could be administrative delays in dealing with U.S. tangible property in the event a tenant becomes incapacitated without having appointed a legal representative to act on their behalf.

There is also the U.S. gift tax rules to consider. For example, if you own U.S. tangible property and change ownership to tenants in common, you may be subject to U.S. gift tax to the extent the interest given to the other tenant exceeds your annual gift tax exclusion. Similarly, where you purchase U.S. tangible with your own funds and at the time of the purchase you register ownership of the property as tenants in common with someone else, you may be subject to U.S. gift tax on the interest transferred to the other tenant, and to the extent the interest exceeds your annual gift tax exclusion.

Hold U.S. situs property in a Canadian corporation

U.S. situs property held in a bona fide Canadian corporation (e.g. a holding company incorporated in Canada) is generally not subject to U.S. estate tax. It may therefore make sense to hold certain U.S. situs property in a Canadian corporation (e.g. shares of U.S. corporations) to insulate yourself from U.S. estate tax. However, you should consider the costs associated with using a corporation, including the additional tax filings and accounting fees. Furthermore, earning U.S. sourced income in your corporation (such as U.S. dividends) may result in a larger current tax liability than if this income was earned personally due to the current combined Canadian corporate and personal tax rate that applies to foreign income.

Hold U.S. situs property in a Canadian partnership

It is unclear whether U.S. situs property held in a Canadian partnership is exposed to U.S. estate tax. It is possible you may be considered to own the underlying U.S. situs property. However, for U.S. income tax purposes, it is possible for a partnership to elect (referred to as a "check the box" election) to be treated as a corporation. If the partnership is treated as a Canadian corporation, you will be considered to own shares of a Canadian corporation, rather than the underlying U.S. situs property. Therefore, you may not be subject to U.S. estate tax on this property.

Even though a partnership can make such an election, there is still a risk that U.S. estate tax may apply to the U.S. situs property held by the partnership. A check the box election for a partnership is generally recognized by the IRS if the partnership is a business entity separate from its owners. The IRS may disregard the elected classification as a corporation if it does not have a business purpose. It may be possible to reduce the risk of the IRS disregarding this structure by holding some business or investment property in the partnership and respecting the legal partnership structure.

A check the box election does not trigger Canadian tax. The partnership continues to be treated as a flow-through vehicle for Canadian tax purposes and each partner continues to be subject to Canadian tax on the income that is allocated to them by the partnership. A check the box election may, however, trigger U.S. income tax implications if the partnership owns a U.S. real property interest (such as U.S. real estate). For U.S. tax purposes, the election results in a disposition of any U.S. real property interest owned by the partnership, which may result in taxable capital gains for U.S. income tax purposes. Accordingly, if the partnership owns a U.S. real property interest, you may want to consult with a qualified cross-border tax advisor about whether it is advisable to make this election retroactively on your death.

Due to the complexities, you should proceed with caution when using a Canadian partnership as a strategy to manage your exposure to U.S. estate tax and not without advice from a qualified cross-border tax or legal professional.

Hold U.S. situs property in a Canadian trust

U.S. situs property held in a properly structured Canadian trust may not be subject to U.S. estate tax for the settlor and/or the beneficiaries. A Canadian trust may be used to hold U.S. real estate or U.S. intangible property, such as shares of a U.S. company.

If you already own U.S. situs property prior to setting up the trust, you must consider the potential tax implications

It is unclear whether U.S. situs property held in a Canadian partnership is exposed to U.S. estate tax. It is possible you may be considered to own the underlying U.S. situs property.

of transferring the property to the trust. From a Canadian tax perspective, the transfer of property to a trust will generally result in a disposition of the property, triggering any unrealized capital gains. These gains will be taxable to you in the year of transfer at your marginal tax rate. From a U.S. tax perspective, if the property is considered to be U.S. tangible property, such as U.S. real estate, you may be subject to U.S. gift tax. This may result in double tax since you cannot claim a foreign tax credit on your Canadian return for U.S. gift tax. A transfer of U.S. intangible property, such as U.S. securities, to a Canadian trust is not subject to U.S. gift tax.

If you are considering purchasing U.S. situs property, you may consider funding the Canadian trust with cash and then having the trustee purchase the property inside the trust.

To ensure the U.S. situs property held by the trust is not subject to U.S. estate tax in the hands of the person who transfers property to the trust (i.e. the settlor or contributor), the terms of the trust must not allow a life interest to be retained by these persons. This means that the trust must be structured as an irrevocable trust. The settlor cannot have a right to the income of the trust, possession or enjoyment of the trust property or a right to have the property revert back to them. They also cannot have a right to determine who will enjoy the trust property or the power to change the terms of the trust after the trust has been settled.

To ensure the U.S. situs property held by the trust is not subject to U.S. estate tax in the hands of the trust beneficiaries, the trust must not provide the beneficiaries with a general power of appointment over the trust property. A general power of appointment authorizes the holder to direct the trust property to anyone, including themselves, their heirs or the creditors of their estate.

A power is not general if its exercise is limited by an ascertainable standard. An ascertainable standard is a standard that restricts the power of the trustee to make distributions to a beneficiary to an extent measurable by the beneficiary's need for health, education, maintenance or support. For example, it is possible that property held by a testamentary spousal trust, where the surviving spouse as the trustee has been given a limited power to encroach on the capital of the trust for expenses related

to health, education, maintenance and support, may be sheltered from U.S. estate tax. The trust can also provide other limited powers that allow a beneficiary to request a trustee to distribute, annually, up to 5% of trust property or $5,000, whichever is greater.

If you are the settlor or beneficiary of a trust, it's important to draft or review the existing trust document to determine whether the property held by the trust would be included as part of your estate for U.S. estate tax purposes. If the trust property is included as part of your estate, you will need to consider whether this increases your exposure to U.S. estate tax.

Having a qualified cross-border tax/legal advisor to help you set up the trust will reduce the risk of U.S. estate tax exposure. If you are already connected to a trust, they can also help you assess whether the trust as structured exposes you to U.S. estate tax and may suggest how to modify the trust to minimize it.

Transfer U.S.-based retirement plans to an RRSP

For U.S. estate tax purposes, the entire value of a U.S.-based retirement plan such as a 401(k) or a traditional Individual Retirement Account (IRA) is considered U.S. situs property, regardless of whether the particular property in the plan is a U.S. situs property. However, in an RRSP, only property that is U.S. situs property is exposed to U.S. estate tax. There is a strategy to transfer property in a U.S. retirement plan such as an IRA or 401K to an RRSP on a tax-neutral basis. Please ask your RBC advisor for a separate article that discusses the strategy.

Make charitable donations to U.S. charities

You can reduce your exposure to U.S. estate tax on U.S. situs property by gifting this property to a qualified charitable organization during your lifetime or leaving this property to a qualified charitable organization through your Will. These gifts or bequests may reduce the amount of U.S. situs property you own, upon which U.S. estate tax is calculated, and the gift may not be subject to U.S. gift tax.

When making a charitable gift through your Will, only gifts to a qualified U.S. charitable organization operated exclusively for religious, charitable, scientific, literary or educational purposes will reduce the value of your U.S. situs property for U.S. estate tax purposes. You may want to ensure that your Will contains specific provisions for the donation of the U.S. situs property to such a charity.

When making a charitable gift during your lifetime, gifts of U.S. tangible or intangible property to either a Canadian or U.S. qualified charity will reduce the value of U.S situs assets you own for U.S. estate tax purposes. However, a gift of U.S. tangible property, such as U.S. real estate, to a Canadian charity may be subject to U.S. gift tax if the value exceeds your annual gift tax exemption. One exception to this tax treatment is if the Canadian charity uses the gift within the U.S. exclusively for U.S. charitable purposes. In such a case, there would be no U.S. gift tax. You would also not be subject to U.S. gift tax if the gift of U.S. tangible property is made to a U.S. charity.

Having a qualified cross-border tax/legal advisor to help you set up the trust will reduce the risk of U.S. estate tax exposure. If you are already connected to a trust, they can also help you assess whether the trust as structured exposes you to U.S. estate tax and may suggest how to modify the trust to minimize it.

From a Canadian tax perspective, if you donate the U.S. situs property in kind to a Canadian or U.S. charity, you may have a Canadian capital gains tax liability. You may be able to claim a donation tax credit for the gift to reduce or eliminate any taxes payable on this capital gain. If you are subject to U.S. gift tax, you will not be able to claim a foreign tax credit on your Canadian income tax return for any gift tax that was incurred.

Summary

The strategies discussed in the article may help Canadians reduce or eliminate their exposure to U.S. estate tax. While minimizing U.S. estate tax exposure may be one of your estate planning objectives, it is important to consider any Canadian or U.S. tax implications associated with each strategy as well as the investment merits of a particular strategy. These strategies might not be suitable to all individuals. Therefore, they should not be implemented without advice from a qualified cross-border tax/legal advisor.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax, or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified cross-border tax, legal, and/or insurance advisor before acting on any of the information in this article.

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