U.S. tax exposure: broader than you can imagine

A guide to understanding the U.S. tax system

RBC Wealth Management

Table of contents

Setting the scene

Living in Canada, bordering the U.S., is like living next to an elephant. Its shadow is long and wide, and can easily impact on our daily lives. U.S. taxation is a large part of this.

The U.S. tax system extends in directions that many living in Canada would be surprised to learn of. Consider the following examples of people that are likely caught by the U.S. tax system.

- Tim is a U.S. citizen living in Canada
- Hui lives in Canada but was born in the U.S.
- Terrance a Canadian citizen lives in Canada but his mother or father was born in the U.S.
- Julie is a U.S. green card holder living in Canada
- Solomon is a Canadian citizen living in Canada who spent over 182 days in the U.S. last year
- Carole is a Canadian citizen who lives in Canada and spent an average of at least 122 days in the U.S. per year over the last three years
- Mohammed is a Canadian citizen who lives in Canada and owns U.S. stocks and U.S. real estate

Each person in the above examples has a U.S. tax "exposure", a connecting factor to the U.S. that can lead to U.S. tax filing and/or reporting obligations. The failure of which to follow could result in significant costs and consequences.

U.S. tax exposure can occur in four different ways. First, the U.S. taxes those who are U.S. citizens wherever they happen to reside. So U.S. citizens living in Canada or other countries will still be subject to U.S. taxation. Second, the U.S. taxes persons who obtain U.S. green cards or spend significant amounts of time in the U.S. Third, the U.S. taxes persons who receive certain types of income derived from sources within the U.S., and holders of certain kinds of property situated in the U.S., notwithstanding that neither of these has any other exposure to the U.S. tax system. And fourth, the U.S. tax system may even extend to persons who are not U.S. citizens and may not even live in the U.S. but are considered to be domiciled in the U.S. The concept of domicile in essence refers to persons who think of the U.S. as their permanent home regardless of where they reside.

Now consider the U.S. tax system itself. Unlike Canada, the U.S. has two separate tax regimes. The first known as the **U.S. Income Tax system** applies to income earned or received during a tax year, and the second, known as the **U.S. Transfer Tax system**, applies upon gratuitous transfers of property during one's lifetime and at the time of death. Persons that reside in the U.S. permanently, or for extensive periods in a year or series of years, and in some cases, who are frequently present in the U.S. are caught by the former tax system. U.S. citizens, whether they live in the U.S. or not, are subject not only to the former, but are also caught by the latter tax system. Green card holders are subject to the U.S. income tax system and likely also subject to the transfer tax system if they live in the U.S. Persons domiciled in the U.S., even if they spend little or no time in the U.S., are still potentially subject to the U.S. transfer tax system.

Therefore it is entirely possible that Canadian citizens, U.S. citizens residing in Canada, and persons that are not Canadian or U.S. citizens but are simply residing in Canada, can have U.S. tax obligations. It is important to note that filing obligations in the U.S. may include not only sending in annual tax returns, but filing annual information returns as well, the penalties for non-filing of which can be exorbitant.

Throughout this paper we will be pointing out situations where you or someone you know could be impacted. In these circumstances, it is very important to obtain tax advice from a U.S. tax expert.

Who is a U.S. citizen?

Tax exposure to the U.S. is most comprehensive for a U.S. citizen, so it is important to identify who this encompasses. While most U.S. citizens are quite aware of their U.S. status, there are numerous people, many of whom reside in Canada, or perhaps in other countries, who are surprised to learn, even shocked in some cases, that they too are citizens of the U.S.

Anyone born in the U.S. is automatically a U.S. citizen. While the vast majority of those born in the U.S. have lived there for their entire lives, there are many people who were born in the U.S. and do not now live, and may never have lived, in the U.S., who nonetheless are (under U.S. law) U.S. citizens. The fact that one does not hold a U.S. passport has no bearing on this status. Being born in the U.S. is all that is needed to obtain U.S. citizen status, regardless of whether you – or the IRS (Internal Revenue Service) – are currently acting upon it.

The key question for those born outside of the U.S. is whether either of your natural parents is themselves a U.S. citizen. If both are U.S. citizens who are married (different rules apply if they were not married and these are not addressed in this paper), then provided that at least one of them had at some time resided in the U.S., you too are a U.S. citizen. If only one of them is a U.S. citizen, then the length of time that he or she resided in the U.S., depending upon when he/she was born, will be determinative.

Finally, it is also important to note that if you are not a U.S. citizen, but at some time obtained, and have not formally relinquished for tax purposes, a U.S. green card (i.e. simply letting the card expire is not sufficient), you are taxed in the U.S. in a similar manner as a U.S. citizen. It is important to speak to a qualified immigration lawyer to determine your U.S. status.

U.S. income tax

Residence defined for U.S. income tax purposes

Exposure to the U.S. income tax system arises for those who are U.S. citizens or those defined as "resident" for U.S. income tax purposes. This definition of U.S. residence covers (1) green card holders regardless of where they live, and (2) persons who are caught under what is referred to in the U.S. as the "Substantial Presence Test".

It should be noted that U.S. green card holders living outside the U.S. in countries such as Canada that have a tax treaty with the U.S. may be able to make an election under the treaty's tie breaker rules to be considered a tax resident of that other country and a non-resident of the U.S. In such cases, this will take them out of taxation as a resident for U.S. income tax purposes, but doing so may jeopardize their green card status and so raises a number of complexities that we will address in detail in this paper.

For purposes of this paper, U.S. green card holders will be considered to be U.S. residents under the U.S. income tax system i.e., they will not have made the treaty election.

Hereinafter in this paper, a U.S. resident for income tax purposes may be referred to as a "U.S. Income Tax Resident".

The Substantial Presence Test is intended to bring within the definition of U.S. Income Tax Resident those who are in the U.S. for more than 182 days in any given year, as well as people who spend at least 122 days per year in the U.S. on average (using a specified formula) over a three year period. This catches many Canadian "snowbirds" including Canadian citizens or residents that own or rent a home or other property in the U.S. and live in it usually over much of the winter. It can also include individuals who live in Canada but travel frequently to work in the U.S. The quick reference box summarizes the Substantial Presence Test and may assist you in determining your status.

U.S. income tax (continued)

quick reference box

You are a U.S. Income Tax Resident

You are considered a U.S. Income Tax Resident (other than a green-card holder) if you spend:

At least 183 days in the current year in the U.S.,

OR

You spend at least 31 days in the current year in the U.S. and you meet the Substantial Presence Test.

Substantial Presence Test – formula:

Add all the days you spent in the U.S. in the current calendar year:

plus

1/3 of the days you spent in the U.S. last year:

plus

1/6 of the days you spent in the U.S. in the year prior to last year

If when using the formula above, your total equals at least 183 days, you are considered a U.S. Income Tax Resident for U.S. tax purposes in the current year.

You are NOT a U.S. Income Tax Resident

You are not a U.S. Income Tax Resident (provided you are not a green card holder) if you spend:

Less than 31 days in the U.S. in the current year,

or

At least 31 days in the current year but you do not otherwise meet the Substantial Presence Test.

By some estimates, there are more than 500,000 Canadian snowbirds in the U.S. If they are caught by the Substantial Presence Test in any given year, they will be considered dual residents of Canada and the U.S., subjecting them to income tax filing and reporting obligations in both countries. This situation can be addressed in any year by timely filing IRS Form 8840 whereby one is in effect agreeing that he or she has met the Substantial Presence Test in that year, but taking the position that a closer connection exists with a country other than the U.S. i.e., in this case, Canada. In such years, U.S. tax filings will not be required. Form 8840 cannot be filed by a person who has spent at least 183 days in the U.S. in the current year or a person who has applied for a permanent resident visa.

Where the Substantial Presence Test is met by spending more than 183 days in the U.S. in a year, it may be possible to claim closer ties to Canada based on the residency tie-breaker rules in the Canada-U.S. Tax Treaty. Claiming the tie-breaker provisions in the Treaty requires filing a U.S. income tax return with significant disclosures.

Similar to Canadian tax rules, anyone who lives in or spends a fair bit of time in the U.S. may be subject to U.S. income tax. However unlike Canada, which taxes only those who reside in our country, U.S. citizens and green card holders remain within the confines of the U.S. income tax rules even if they do not live in or spend any time in the U.S. in any given year. It is therefore critical that the latter stay abreast of and in compliance with, U.S. tax reporting and filing requirements.

Scope of U.S. income tax

U.S. citizens and U.S. Income Tax Residents pay tax in the U.S. not only on their income earned in the U.S., but on income earned from around the world. Income is widely defined to include virtually all sources or types of income, and is taxed at the highest federal income tax rate, currently at 37%. Individual states and local municipalities may levy additional tax on top of this, so combined income tax rates can exceed 40% in some U.S. states.

Since 2013, U.S. citizens and U.S. Income Tax Residents that earn in excess of US$250,000 (for married individuals filing jointly) of income in a year are also subject to an additional tax of 3.8% on their net investment income i.e.,

U.S. income tax (continued)

income such as interest, dividends, capital gains and rents, less deductible investment expenses.

As in Canada, in order to encourage saving and investment, the U.S. taxes certain types of activity at preferential tax rates. The two most common examples are capital gains realized after a year or longer holding period, and qualified dividends, both of which are taxed at the highest rate of 20%. The 3.8% additional tax on investment income applies to these income sources, thereby increasing their otherwise reduced rates of taxation.

U.S. citizens and U.S. Income Tax Residents that live in Canada may well be subject to tax in both countries. In most cases double taxation is not an intended result and is addressed by a system of foreign tax credits. Impacted U.S. persons may claim a credit for tax paid in the country in which the income is earned, thereby generally offsetting tax owing on the same income in the country of residence or citizenship.

A couple of points about foreign tax credit relief should be noted for a U.S. citizen resident in Canada. If for example, the tax rate is higher in Canada than the U.S. on a particular type of U.S. source income that is also taxed in the U.S., Canadian tax will still be payable for the amount owing in excess of the foreign tax credit allowed in Canada for the U.S. tax actually paid. However, if a U.S. citizen pays Canadian tax and only part of that tax is creditable on the U.S. income tax return, the excess amount can be carried back one year or forward for the next ten years. Finally, the U.S. does not allow foreign tax credits to offset the additional 3.8% tax on investment income, in which case double tax will arise.

The bottom line is that while double tax will usually be avoided through the use of foreign tax credits, this is not always the case, and in any event, if one country taxes the same income at a higher rate than the other, the higher rate will end up being the one paid.

U.S. citizens and U.S. Income Tax Residents living in Canada may also be eligible for the U.S. foreign income earned exclusion, which if applicable excludes from U.S. income a certain amount of employment income earned in Canada plus an additional exclusion for housing costs. However, any foreign income taxes paid related to the excluded income will not be allowed as a foreign tax credit. In addition, the exclusions are at the lowest marginal tax rates. Consequently, the exclusions may provide little or no benefit and can actually be a disadvantage. For this reason, many Americans living in high tax countries, such as Canada, do not claim the exclusions.

Canadians owning and renting U.S. real property

Many Canadians (who are not U.S. citizens or green card holders) invest in U.S. real property in the form of a home, condominium or commercial property. In Florida alone, Canadians have spent billions on real estate, the majority used as a vacation property. In cases where rental income is generated and/or a gain is realized upon a sale, both U.S. and Canadian income tax will apply. As discussed below, double taxation will be avoided by claiming a foreign tax credit in Canada for the U.S. taxes paid.

U.S. income tax (continued)

Tax on U.S. based rental income can be paid in one of two ways. Tax can be withheld on gross rent at a flat rate of 30% or one can elect to file a non-resident U.S. tax return on a net rental basis. Once made, this election cannot be changed for future tax years except under limited circumstances. It therefore generally makes sense to file on a net basis when you expect the tax on net rental income to consistently be less than 30% of the gross rental income.

The sale of U.S. real property by a Canadian resident at a profit will result in the imposition of both U.S. and Canadian capital gains tax. Where the property is owned for more than one year, the highest U.S. tax rate will be 20% with possible additional taxes owing in the state in which the property is situated. Canadian tax will usually approach about 24% to 27% of the amount of the capital gain.

Canada generally allows a foreign tax credit for U.S. tax paid on both annual rental income, and on taxable capital gains.

It should be noted that U.S. tax is typically withheld at a rate of 15% of the selling price. This withholding tax is not the final tax. Rather it is an advancement of the actual tax. A U.S. tax return must be filed to report the sale. If the tax is less than the withholding a refund can be claimed. If a large refund is expected, the withholding tax can be reduced to the actual U.S. tax owing by filing IRS Form 8288B no later than the closing date of the sale of the property.

Tax traps for U.S. citizens living in Canada

There are millions of U.S. citizens living abroad. Many of them reside in Canada. In this section they are referred to as “Americans in Canada”.

Just like Canadians, they will own various types of assets, some of which will grow, produce income, and possibly receive preferential tax treatment. The difference for Americans in Canada is that they need to abide by both Canadian and U.S. tax rules, making their tax situation much more complicated.

While the system of foreign tax credits and rules under the Canada-U.S. tax treaty are often helpful, there are numerous tax traps that Americans in Canada can easily fall into, sometimes with very serious consequences.

Since TFSAs and RESPs may be trusts, American contributors or beneficiaries may have to file complex U.S. trust information forms annually.

Registered plans

Canadian tax rules permit a range of tax advantaged registered plans including Registered Retirement Savings Plans (“RRSPs”), Registered Retirement Income Funds (“RRIFs”), Registered Education Savings Plans (“RESPs”), and Tax-Free Savings Accounts (“TFSAs”), that can be structured as trusts, each of which can create cross border tax complexities.

In general, RRSPs and RRIFs work for Americans in Canada as the tax deferral that Canadians enjoy until funds are withdrawn, equally apply under U.S. income tax rules. However, there is no U.S. tax deduction for Americans in Canada upon contributions to RRSP plans (except for contributions to certain group RRSP plans).

TFSAs may not work for Americans in Canada as the U.S. will tax the annual income. If Americans in Canada have excess foreign tax credits on passive type income i.e., carried forward from previous years when their foreign tax burden was higher than in the U.S., such credits may offset the U.S. tax arising from the income earned in the TFSA.

RESPs funded by Americans in Canada do not work well because income earned in the plan is taxed annually in the U.S. in the hands of the Americans in Canada that are subscribers.

Since TFSAs and RESPs may be trusts, American contributors or beneficiaries may have to file complex U.S. trust information forms annually.

Canadian retirement plans

Americans in Canada that participate in a number of incentive, severance, non-qualified retirement income plans and deferred compensation plans offered by Canadian employers must consider whether these plans are subject to punitive U.S. tax rules contained in Section

U.S. income tax (continued)

409A of the U.S. Internal Revenue Code. These rules generally apply to plans considered to be "nonqualified deferred compensation plans" with certain exceptions. The rules are complex and will not be discussed in this paper; however, it is important to point out that failure to meet the requirements of Section 409A may result in immediate U.S. taxation of the deferred compensation, an interest charge and an additional tax equal to 20% of the amount included in income.

Transferring U.S. retirement plans to Canada

Americans in Canada may have contributed to Roth IRAs, IRAs, and 401(k) retirement plans, and upon their move to Canada, wish that these plans receive the same tax treatment as Canadian registered retirement plans. Roth IRAs are similar to TFSAs as there are no deductions for contributions to the plan and the income and contributions may be withdrawn from the plan tax-free, if certain requirements are met. Canada will provide the same tax treatment if no contributions are made while the owner of the Roth IRA is a resident of Canada and by making a one-time election under the treaty in the first year in which you move to Canada.

U.S. 401(k)s and IRAs can in many cases be transferred to Canadian RRSPs on a tax-neutral basis. Although withdrawals from these accounts are subject to U.S. taxation and potentially an additional 10% early withdrawal tax, it may be possible to obtain full foreign tax credit relief in Canada, resulting in tax neutrality. For Americans in Canada, the process involves making a lump sum withdrawal from the U.S. plan and paying U.S. tax and an early withdrawal penalty (if applicable), contributing the full taxable amount into the RRSP, and claiming foreign tax credits in Canada against other Canadian income. It is important to do an analysis to ensure tax neutrality since this strategy does not work for everyone.

Assets held in legal structures

Americans in Canada often hold assets in Canadian based trust and corporate legal structures. These can be in the form of RRSPs and TFSAs, which we already addressed, but they can also be held in family trusts and family investment holding corporations. In these latter cases, the U.S. views these trusts and corporations as foreign legal structures, and notwithstanding that these structures are generally taxable in Canada, the U.S. may tax these structures differently, potentially resulting in double taxation.

U.S. based anti-deferral rules

U.S. anti-deferral rules cover interests of U.S. taxpayers in both foreign companies and trusts, with the intention of ensuring that U.S. taxpayers are paying annual income tax on earnings generated in these structures. In some cases, the U.S. allows a foreign tax credit for tax paid in relation to these earnings in the foreign country, although this can be complicated by the fact that the U.S. taxpayer and the foreign trust or company are different taxpayers and therefore income earned in a year will not always match up.

We will address companies first and then turn to trusts.

U.S. income tax (continued)

> One simple solution for Americans to avoid the PFIC problems is to invest directly in stocks and bonds...

Foreign companies

There are two anti-deferral tax regimes in the U.S. dealing with interests that Americans in Canada might have in foreign companies. The first regime is concerned primarily with investments in foreign investment companies such as: mutual funds, pooled funds, minority interests in private investment companies and ETFs, and is referred to as the Passive Foreign Investment Company ("PFIC") rules. The second addresses interests that Americans (including those residing in Canada) have in foreign companies controlled by U.S. shareholders. These are referred to as the controlled foreign corporation ("CFC") rules.

PFICs are foreign (non-U.S.) corporations that meet one of two tests: (1) At least 50% of the assets of the corporation are held to produce passive income, or (2) at least 75% of the income of the corporation is passive income. In essence a PFIC is comprised of investments made by Americans (including those residing in Canada) in non-U.S. corporations (including business trusts) that earn their income primarily from passive assets such as investments in stock and bonds. The rules will be easily triggered by foreign mutual and pooled funds structured through corporate or trust vehicles, resulting in taxation at the top U.S. federal tax rate (plus a possible interest charge) on excess distributions (greater than 125% of average distributions) and on any gain from the sale of the shares of the PFIC itself.

One simple solution for Americans (including those residing in Canada) to avoid the PFIC problems is to invest directly in stocks and bonds rather than through pooled or fund type investment vehicles. Some foreign investment companies will provide PFIC Annual Information Statements with information enabling the investor to treat a fund as a Qualifying Electing Fund (QEF) to avoid PFIC issues.

PFICs held in RRSPs and RRIFs are generally exempt from the PFIC rules.

The CFC rules come into play when a foreign corporation is controlled by one or more U.S. shareholders (including those residing in Canada) that collectively own more than 50% of the voting shares or value of the company. A U.S. shareholder is a U.S. person that owns directly or indirectly (through other entities) at least 10% of the voting shares or value of the company.

U.S. shareholders (including Americans that reside in Canada) of a CFC may be subject to the deemed dividend provisions of the CFC rules (referred to as Subpart F regime), which requires the shareholder to personally report passive income, such as dividend and interest earned in the CFC, in the year that it is earned even if this income is not distributed. This can result in double taxation as there can be a timing mismatch under Canadian rules where the income is only personally reported upon receipt of a distribution.

Where both the PFIC and CFC rules apply to a shareholder, the CFC rules supersede the PFIC rules unless the PFIC rules applied before it was a CFC or before 1998. However, if you own directly or indirectly 50% or more of the votes or value of a CFC that invests in PFIC stock, you will be subject to the PFIC rules in relation to the PFIC stock the CFC holds. This is due to U.S. tax rules that attribute ownership of the PFIC stock in the hands of the shareholder for PFIC reporting purposes.

There are many exceptions to the Subpart F regime. For example, passive income subject to a Canadian corporate tax rate exceeding 90% of the highest U.S. corporate tax rate (21% X 90% = 18.9%) will not result in a deemed dividend if an election is made. Given that the Canadian tax rates on passive income exceeds this rate, a U.S. shareholder in general will not have a deemed dividend and will be taxable when distributions are made from the foreign corporation at dividend tax rates.

Active business income of a CFC is not subject to the Subpart F regime. However, another tax regime, referred to as the Global Intangible Low-Taxed Income (GILTI regime), taxes U.S. shareholders personally on the value of the profits of a foreign corporation that exceed a 10% return on its depreciable trade or business assets even though the corporation has not made a distribution.

U.S. income tax (continued)

Since this income is only personally taxable in Canada, when the corporation makes a distribution, there is a risk of double taxation. Those most impacted are U.S. shareholders of foreign corporations that are not plant, property or equipment intensive, such as medical or other professional businesses, as most of the profits will be subject to the GILTI regime.

The Subpart F and GILTI regimes may effectively deny the deferral of income from personal taxation and substantially increases the annual U.S. tax cost to U.S. shareholders. Therefore, unless there are good business reasons for being a shareholder in a CFC, the simpler solution is for Americans in Canada not to own shares in a CFC where the potential for double taxation exists.

There are a couple of additional tax rules that may apply in these situations that you should be aware of. First, unlike under Canadian tax rules, U.S. tax rules do not permit tax-free dividends to be paid from a corporation's capital dividend account to a U.S. individual. Such dividends are therefore taxable upon receipt in the U.S.

Second, corporate reorganizations completed on a tax deferred basis under Canadian rules may trigger U.S. income or gift tax, and possible penalties when not properly reported. Such reorganizations often occur when Canadians engage in estate freeze planning to move future gains in assets that are expected to increase over time to other family members.

Third, there can be advantages for Americans in Canada holding assets in an unlimited liability company ("ULC"). This type of structure is best used as a corporate holding company or to own passive assets as the typical protection under a corporation from creditors does not apply. The reasons to consider ULCs are largely because they avoid the double tax problems and they are not considered to be either CFCs or PFICs. While Canada taxes ULCs as corporations, a ULC is considered a disregarded entity for U.S. tax purposes if owned by one person or a partnership if owned by more than one person. Hence, a ULC is not subject to the potentially adverse U.S. tax consequences of being a foreign corporation. However, all income and expenses of the ULC flow through to the U.S. shareholder, eliminating the potential for tax deferral.

Foreign trusts

There is widespread use of trusts in Canada for estate and tax planning purposes. These include income splitting with family members, as well as holding the growth shares of a family business or commercial real estate in an estate freeze plan.

Americans in Canada involved in these structures need to consider how U.S. tax rules that deal with foreign trusts may impact their planning. This depends upon whether the trust is considered by the U.S. to be a foreign or domestic trust, and whether the trust is considered to be a grantor or non-grantor trust under U.S. tax rules. The latter is dealt with later in this paper under the section called "Other Planning Points to Consider in Designing a Dynasty Trust Strategy".

The U.S. considers a trust to be a foreign trust if U.S. courts cannot exercise primary supervision over the administration of the trust or where U.S. persons do not have the authority to control all substantial decisions of the trust. Income earned in a foreign trust that is considered a grantor trust is taxed directly in the hands of the grantor for U.S. tax purposes. If the grantor is a U.S. person, all the trust income of a grantor trust would be taxed to that U.S. person, even if Canada taxes trust distributions to the beneficiaries. Income distributed from a foreign non-grantor trust (often the U.S. classification of a trust after the settlor of the trust dies) that was earned in years prior to the year in which the income is distributed is subject to the U.S. income accumulation rules, also discussed in the section noted above.

Being mindful of these U.S. tax rules as they apply to foreign trusts can be critical in avoiding potential U.S. interest and penalty charges down the line.

U.S. income tax (continued)

U.S. tax filing and reporting

There a number of U.S. tax filing requirements that an American in Canada needs to make in addition to their annual IRS Form 1040. The most common examples of situations and reporting forms required are set out in the following table:

Examples	U.S. reporting form	Filing late penalties
A tax filing requirement may arise when an American owns (whether solely or jointly) an indirect interest in, or has signing authority over, a non-U.S. bank or financial account when the aggregate value of all these accounts exceeds US$10,000 at any time during the year. Examples of non-U.S. bank and foreign accounts include Canadian bank or brokerage accounts, Canadian registered retirement and education savings accounts, Canadian locked-in retirement accounts and Canadian tax-free savings accounts.	Report of Foreign Bank and Financial Accounts (FBAR)- (FinCen Report 114)	$10,000 penalty for each account or higher civil and criminal penalties for willful failure to file
A tax filing requirement may arise when an American invests in certain non-U.S. financial assets (referred as specified foreign financial assets) and the aggregate value of these assets exceeds certain thresholds. Examples of specified foreign financial assets include Canadian bank or brokerage accounts, Canadian registered retirement and education savings accounts, Canadian locked-in retirement accounts and Canadian tax-free savings accounts. For Americans living in Canada who do not file a joint tax return with their spouse, the threshold is US$200,000 at the end of the calendar year or US$300,000 at any time during the calendar year. For Americans living in Canada who file a joint tax return with their spouse, the thresholds are US$400,000 at the end of the calendar year or US$600,000 at any time during the calendar year.	Statement of Foreign Financial Assets (Form 8938)	$10,000 penalty or higher civil or criminal penalties for willful failure to file
A tax filing requirement may arise when an American has transactions with a foreign trust (e.g., Canadian trust) or an interest in a foreign trust and/or is responsible for reporting certain transactions associated with the foreign trust. Examples include an American who is the settlor of, contributor of property to, or the beneficiary of a non-U.S. trust. A tax filing requirement may also arise when an American is in receipt of gifts or bequests of more than US$100,000 from non-Americans and gifts from a non-U.S. corporation or partnership that exceeds certain thresholds.	Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (Form 3520) Information Return of Foreign Trusts with a U.S. Owner (Form 3520-A)	At least $10,000
A tax filing requirement may arise when an American directly or indirectly owns a non-U.S. investment that qualifies as a Passive Foreign Investment Company (PFIC) for U.S. income tax purposes. In general, a PFIC is a non-U.S. corporation, or an investment that is categorized as a non-U.S. corporation that primarily invests in passive assets or earns passive income. Examples include Canadian mutual funds, Canadian Exchange Traded Funds (ETFs) and Canadian Real Estate Investment Trusts (REITs)	Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund (Form 8621)	No penalty but no statute of limitation on entire return
A tax filing requirement may arise when an American is an officer, director or shareholder of certain non-U.S. corporations. Examples include an American who is a shareholder of a Canadian corporation that qualifies as a Controlled Foreign Corporation (CFC) under U.S. income tax laws. In general, a CFC is a non-U.S. corporation that is controlled by Americans by votes or value.	Information Return of U.S. Persons with Respect to Certain Foreign Corporations (Form 5471)	$10,000 per form filed late
A tax filing requirement may arise when an American owns an interest in an investment that is classified as a non-U.S. partnership for U.S. federal tax purposes, or has an interest in a partnership formed in a foreign country that meets certain conditions. Examples include an American who owns 10% or more of a Canadian partnership while it is controlled by Americans or an American who has contributed property to a partnership with a value of more than US$100,000.	Return of U.S. Persons With Respect to Certain Foreign Partnerships (Form 8865)	At least $10,000 penalty

Reference: https://www.irs.gov

U.S. income tax (continued)

As indicated in the table, failure to file any of these forms can lead to significant penalties. As a result of the enactment by the U.S. of the Foreign Account Tax Compliance Act ("FATCA") the IRS may have an easier time locating non-compliant Americans in Canada. This is because financial institutions around the world are required to report financial account information to the U.S. in relation to such persons.

U.S. voluntary disclosure rules

In the interest of encouraging all U.S. taxpayers to be compliant with their U.S. income tax and information return filing requirements, the U.S. has implemented various voluntary disclosure programs over the years. Such programs provide methods by which noncompliant taxpayers, whether they live in the U.S. or not, can get up-to-date on their U.S. income tax and other filings. Depending on the program(s) in effect at the time, a certain number of previous year's U.S. income tax returns and other U.S. tax reporting returns must be filed with the IRS.

While, there may be little or no U.S. income tax owing on your annual U.S. tax return due to the deductions and FTCs discussed earlier, there may be substantial penalties and, in some cases, criminal proceedings associated with willful failure to comply with your U.S. tax and filing obligations.

If you are not filing annual U.S. income tax returns or other required filings, you should speak to a qualified tax or legal advisor regarding your options.

U.S. transfer tax

Residence defined for U.S. transfer tax purposes

Exposure to the U.S. transfer tax system arises for those who are defined as "resident" for U.S. transfer tax purposes. This definition of U.S. "residence" is not the same as the definition of "residence" for U.S. income tax purposes. It covers U.S. citizens as well as those who are domiciled in the U.S., in all cases regardless of whether or not they live in the U.S. A person who is a resident for income tax purposes is not necessarily a resident for transfer tax purposes.

Having a green card indicates an intent to reside permanently in the U.S., and therefore implies that they are domiciled. But the green card by itself would not result in domicile status unless there are other factors such as having a home available in the U.S.

Hereinafter in this paper, a U.S. resident for transfer tax purposes may be referred to as a "U.S. Transfer Tax Resident". This definition excludes those whose only U.S. tax exposure is the ownership of U.S. situs property. The latter will be referred to as "Non-U.S. owners of U.S. situs assets", and are discussed below.

Scope of U.S. transfer tax

U.S. transfer tax residents

U.S. transfer tax is triggered upon gratuitous transfers of property whether these occur upon one's death or at any point during one's life. This effectively ensures that U.S. transfer tax applies to all gratuitous transfers made by U.S. Transfer Tax Residents.

U.S. transfer tax is comprised of a unified system of "gift" and "estate taxes", the former applicable during one's lifetime and the latter upon one's death. The system applies to every gratuitous transfer by a U.S. Transfer Tax Resident as gifts and transfers on death are covered no matter where the property is located in the world.

The system is therefore not confined to transfers of property that is located in the U.S. – it applies to one's worldwide assets.

U.S. transfer tax (whether gift or estate tax) applies at marginal rates that begin at 18% on taxable transfers

U.S. transfer tax is triggered upon gratuitous transfers of property whether these occur upon one's death or at any point during one's life.

and quickly move to a top federal tax rate of 40% on transfers that exceed US$1,000,000. Based on the current exemptions available, most U.S. residents and their families will never pay U.S. gift or estate tax.

For the years 2018 to 2025 (unless any other legislative changes are made) the first US$10 million (subject to indexation) of transfers of one's personally owned wealth is exempt. Starting in 2026 the exemption amount is reduced to US$ 5 million subject to indexation. For 2024, the indexed exemption amounts to US$13.61 million. This exemption can be applied to make tax-free gratuitous transfers during one's lifetime or upon death, up to the level of the exemption. In effect then, a married couple who are both U.S. Transfer Tax Residents, each of whom owns property equal to or above the exemption threshold can together transfer to their beneficiaries property valued up to double the exemption amount before U.S. transfer tax will apply.

In addition to the exemption, there are a number of gratuitous transfers that are excluded from U.S. transfer tax. These include for 2024 only (1) annual gifts of up to US$18,000 to anyone other than your spouse; (2) annual gifts of up to US$185,000 to your non-U.S. citizen spouse; and (3) unlimited gifts to U.S. citizen spouses and charities.

One should be aware that U.S. transfer tax is extremely comprehensive, in that it even applies to gratuitous transfers that are designed to skip a generation, such as a gift under one's Will to a grandchild or transfers to a trust that can make distributions to grandchildren or lower generations. Transfers to a skip person, either directly or through a trust, would incur two levels of transfer tax. If this type of transfer was permitted, it would be possible, and for many affluent families, perhaps advisable, to plan to avoid one layer of transfer tax on transfers to "skip" generations.

U.S. transfer tax (continued)

The actual tax that covers gratuitous “skipping” transfers is called the “generation skipping transfer tax” or “GSTT”. It operates when the U.S. gift and estate tax would apply, and the same level of annual exclusions and lifetime exemption for U.S. gift and estate tax exists for the GSTT. This paper will not address GSTT in greater detail, although mention may be made of its application in certain circumstances.

It should be noted that individual U.S. states may levy additional transfer tax and may allow an additional amount to be added to the applicable federal lifetime exemption.

One other important point to be aware of is that the cost basis of assets included in your estate are bumped to fair market value on the date of death (with a few exceptions). Therefore, capital gains on appreciated property included in your estate totally escape U.S. income tax. The bump in tax basis does not apply to gifts.

The cost basis of property gifted will be the lower of fair market value or the cost basis in the hands of the donor. Where gift tax is incurred, a portion of the gift may increase the basis.

The federal U.S. lifetime gift and estate tax exemption is hereinafter referred to in this paper as the “U.S. Transfer Tax Exemption”.

Non-U.S. owners of U.S. situs assets

Many Canadian residents own assets considered to be situated in the U.S. for U.S. transfer tax purposes, and this fact alone can create an exposure to the U.S. transfer tax system. From a practical perspective, the most common types of U.S. situs assets are real property located in the U.S., debt obligations of U.S. persons and shares of stock of U.S. companies. It should be noted that in the case of the latter, even if they are held in Canadian RRSPs, RRIFs, RESPs, RDSPs or TFSAs, or within an alter ago or joint partner trust, they will qualify as U.S. situs assets and are potentially exposed to the U.S. estate tax.

Non-U.S. owners of U.S. situs assets, whether living in Canada or elsewhere in the world, can be exposed to the U.S. estate and gift tax system upon the gratuitous transfer of such assets. In practice, U.S. gift tax applies only to the transfer of tangible U.S. situs property, and U.S. estate tax applies to the transfer of all U.S. situs assets. Tangible U.S. situs assets include U.S. real estate, personal property located in the U.S. such as cars, boats, artwork, jewelry, collectibles and cash or currency located in the U.S. Intangible U.S. situs property includes stock in U.S. corporations interests in U.S. partnerships or U.S. LLCs, U.S. mutual funds, U.S. brokerage accounts, debt obligations of U.S. persons, fiduciary accounts in the U.S. and U.S. life insurance policies. Non-U.S. Owners of U.S. Situs Assets are not entitled to the lifetime gift tax component of the U.S. Transfer Tax Exemption, although they are able to access the annual exclusions mentioned earlier.

Upon the death of a Non-U.S. Owner of U.S. Situs Assets, the U.S. Transfer Tax Exemption is available, but is limited to US$60,000. U.S. transfer tax is therefore not applicable upon the transfer of U.S. situs assets whose collective value is less than US$60,000. As a result of a treaty provision discussed in the next paragraph, it also does not apply when the value of a Canadian resident owner’s worldwide estate is less than the U.S. Transfer Tax Exemption. Therefore, most Canadians will not be exposed to U.S. transfer tax as their net worth will be less than the amount of the U.S. Transfer Tax Exemption.

Where U.S. transfer tax is applicable to a Canadian resident owner of U.S. situs assets, the Canada-U.S. tax treaty provides for an exemption that is generally in excess of US$60,000. This results by allowing such persons to exempt a fraction of the amount of the U.S. Transfer Tax Exemption that a U.S. Transfer Tax Resident is entitled to. This prorated amount is calculated by taking the U.S. value of one’s U.S. estate and dividing it by the U.S. value of that person’s worldwide estate. From a practical perspective, while this typically means that a fairly low percentage of the U.S. Transfer Tax Exemption is available to most Canadians – because the value of their U.S. situs assets is only a small fraction of their worldwide net worth – this is often sufficient to significantly reduce one’s U.S. transfer tax exposure.

Canadian resident owners of U.S. situs assets also have available to them under the Canada-U.S. tax treaty a marital credit that in effect is worth the value of their prorated exemption. This means a Canadian couple will typically be able to transfer on death of one spouse

U.S. transfer tax (continued)

U.S. situs assets to the other spouse valued at twice the amount of their prorated exemption. The marital credit may provide an additional exemption large enough to eliminate U.S. estate tax on the death of the first spouse. However, upon the death of the surviving spouse, the amount of the U.S. Transfer Tax Exemption will be only the latter's prorated amount. Additional planning, discussed later in the section called "Planning for Non-U.S. Owners of U.S. Situs Assets", may therefore be useful to address exposure to U.S. transfer tax faced by the estate of the surviving spouse.

Planning for U.S. transfer tax residents living in Canada

As the exposure to the U.S. transfer tax system applies to U.S. Transfer Tax Residents wherever they live, those living in Canada need to plan in pretty much the same way as U.S. citizens and green card holders that live in the U.S. i.e., as if they themselves are living in the U.S. For ease of reference, we will hereinafter refer in this part only to U.S. citizens or non-U.S. citizens, and not to green card holders (although the latter may be considered to be U.S. Transfer Tax Residents). All references in this part to U.S. Transfer Tax Residents are to those who live in Canada and are therefore also residents of Canada for tax purposes.

As the exposure to the U.S. transfer tax system applies to U.S. Transfer Tax Residents wherever they live, those living in Canada need to plan in pretty much the same way as U.S. citizens and green card holders that live in the U.S.

Such persons find themselves in a myriad of possible family, and therefore, planning situations. For example, some will be married to U.S. citizens, while others are married to non-U.S. citizens. In some cases, their children will be U.S. citizens, and some not. In fact, there are situations where a child of a U.S. citizen or citizens residing in Canada is him or herself a U.S. citizen while another child of the same family is not.

Planning strategies to address the U.S. transfer tax system are impacted by the nature of these varying circumstances. In particular, where children's citizenship status with the U.S. is unclear, or the family is for whatever reason oblivious to it, not only is the planning affected, but the child may have U.S. income tax filing and reporting obligations that they are not in compliance with, leading to possibly very serious U.S. tax consequences.

The key planning objectives to mitigate the impact of U.S. transfer tax for U.S. Transfer Tax Residents living in Canada are:

(1) to ensure that the optimal amount of the U.S. Transfer Tax Exemption available to a U.S. Transfer Tax Resident is ultimately utilized to minimize the transfer tax

(2) where upon death one's net worth exceeds the current value of the exemption, employ tax deferral techniques where one spouse survives the other

(3) to use gifting techniques to:

   a. make use of all available exclusions as well as the U.S. Transfer Tax Exemption

   b. reduce your taxable estate that will be exposed to U.S. transfer tax

U.S. transfer tax (continued)

c. shelter the maximum amount of one's assets that are expected to increase over time from exposure to U.S. transfer tax

We will now briefly review the planning strategies that may be used to achieve the above goals. Most of these work best for legally married couples, and are optimized where there are children and grandchildren that will eventually inherit the family wealth. Those with philanthropic interests can also make use of a number of these techniques.

We will first look at planning for married couples living in Canada who are both U.S. citizens, and then address planning where only one is a U.S. citizen.

One important point should be considered before we proceed. Since we are discussing planning for people who are assumedly residents of Canada for tax purposes, transfers of property by or between them will be impacted not only by U.S. transfer tax, but by Canadian tax rules as well. As we are not dealing with Canadian tax rules in detail in this paper, it is simply noted that such transfers, other than to one's spouse or a properly structured spousal trust, may result in a disposition of assets for Canadian tax purposes which can create a taxable capital gain with tax payable in Canada. There may therefore be situations where both U.S. transfer tax and Canadian capital gains tax apply to the same transfer of assets with no mechanism to offset the double taxation, as foreign tax credits are not available where U.S. gift tax has been paid but are available where U.S. estate tax has been paid.

It is also noted that transfers of property between Canadian residents may bring into play the Canadian income attribution rules, particularly in cases where a gift is made during your lifetime to a family member and the transferee is not an adult child i.e., gifts to spouses and minor children are generally problematic. In addition, some of the planning ideas to address U.S. transfer tax can lead to income tax issues in one or both countries that need to be considered.

Planning for U.S. transfer tax residents – both are U.S. citizens

Portability

In smaller estate situations, and where assets are not expected to grow, the portability provisions which were enacted in 2011 are a simple method to ensure that each spouse's U.S. Transfer Tax Exemption is fully utilized. Through an election on the U.S. estate tax return of the first spouse to die, these rules permit that spouse's unused U.S. Transfer Tax Exemption to be transferred to the surviving spouse. These provisions are available between U.S. citizen or U.S. domiciled spouses, and cannot be used to make gratuitous transfers to which GSTT would apply.

Since the portability provisions do not insulate the future growth of assets from U.S. transfer tax, this type of planning is generally for smaller estates. In the case of larger estates, it is basically a last resort where other more effective planning strategies have not been employed.

Tax deferral planning

Where one spouse outlives the other, the ability to delay the imposition of U.S. transfer tax until the death of the survivor can be extremely useful. Not only is the tax payable at a later date, but the surviving spouse is not forced to sell assets to pay the tax in the event of a family situation without ample liquidity to satisfy the tax burden that arises on the death of the first spouse.

U.S. transfer tax (continued)

In the case of U.S. citizen spouses wherever they live, there is an unlimited U.S. transfer tax deferral opportunity available to them in the form of what is referred to as the "marital deduction". The deferral applies in the case of both lifetime gifts and bequests made upon death, such that any U.S. transfer tax owing beyond the couple's combined U.S. Transfer Tax Exemptions will be payable only upon the death of the survivor of them. In the case of bequests made upon death, the transfer must be made directly to the surviving spouse; a transfer into a trust will only qualify for the marital deduction if an election is filed by the executors of the deceased to treat the property as "qualified terminal interest property" ("QTIP"), discussed further in the section on Credit Shelter Trusts below.

We now turn to "gifting techniques" starting with the simplest and easiest to implement strategies, and working towards more sophisticated planning that may achieve greater planning benefits.

Annual exclusions and reducing your U.S. taxable estate

Transfers that can be made on a gift tax-free basis in the form of (1) annual gifts and (2) paying for certain expenses, effectively reduce the amount of your U.S. taxable estate, not only at the time they are made, but in respect of any related growth that would have arisen in the future. The cumulative effect over time is often more than one would think.

The ability to make lifetime gifts that do not need to be covered by, and therefore do not count against, one's U.S. Transfer Tax Exemption, is often overlooked and undervalued. As noted earlier, annual gifts of US$18,000 can be made to an unlimited number of people – this can extend beyond family members – and these gratuitous transfers are completely excluded from U.S. gift tax. The total sum of these annual gifts to children and grandchildren can add up quickly, and this amount, together with all future growth thereon should these gifts be retained and invested by the recipient, will not form part of the gift maker's U.S. taxable estate upon death.

It is also possible for U.S. citizen spouses to elect to split a gift made entirely by one spouse. For example, if only one spouse has sufficient assets available to make an excluded gift i.e., say US$36,000, this election (made on a U.S. gift tax return) results in each U.S. spouse being considered to have made a gift of US$18,000, thereby allowing each spouse to use their annual exclusion in that year.

Gifts made to charities registered in either Canada or the U.S., whether made during one's life or under your Will, do not attract U.S. gift tax, and will reduce the value of your U.S. taxable estate.

Finally, payments made on behalf of children and grandchildren for select health care and education related expenses are generally not considered to be gifts, and can therefore be made over and above the annual exclusion amounts. For example, U.S. citizens can make direct payments on behalf of family members for certain items related to education, medical or dental services.

The amount of these payments can exceed the annual exclusion amounts as they are not defined to be gifts, provided they are not made directly to a child or grandchild.

Charitable giving

Gifts made to charities registered in either Canada or the U.S., whether made during one's life or under your Will, do not attract U.S. gift tax, and will reduce the value of your U.S. taxable estate. The choice of whether to donate to a U.S. or Canadian charity is a personal one, although you should consider the income tax consequences in both countries associated with the donation.

Credit shelter trust

While the unlimited marital deduction allows one to avoid U.S. transfer tax when leaving assets to one's U.S. citizen spouse, it is important to ensure that each spouse's optimal U.S. Transfer Tax Exemption is made use of. Since no U.S. transfer tax will be paid when the marital deduction applies to a transfer of property to a U.S. citizen spouse, the recently enacted portability rules ensure that upon death, the surviving spouse's estate can make use of both his/her own, and his/her deceased spouse's, U.S. Transfer Tax Exemptions.

U.S. transfer tax (continued)

However, as noted above, a drawback in the above combination of planning is that any future growth of the transferred assets continues in the name of the surviving spouse. In cases where the anticipated growth of these assets after the death of the first spouse results in the surviving spouse owning assets that collectively exceed the value of both spouses' U.S. Transfer Tax Exemptions, the excess will be taxed upon the death of the surviving spouse, thereby reducing the inheritance available to one's heirs.

To address this shortcoming, a Credit Shelter Trust ("CST") can be employed as a mechanism to shelter any future growth of assets transferred to it. Upon the death of the first spouse, an amount equal to that spouse's unused U.S. Transfer Tax Exemption is transferred free of estate tax to the CST. The balance of the deceased's estate may be transferred to the surviving U.S. citizen spouse free of estate tax by using the marital deduction.

The beneficiaries of the CST are usually your surviving spouse and may include your children. Your spouse (and should you wish, your children) may receive the annual income of the CST, and access to the capital would typically be for health, education, support and maintenance needs (these reasons to access trust capital are referred to as "ascertainable standards"). The beneficiaries could also be provided with other limited powers to access additional capital.

Upon the death of the second spouse, the value of the assets in the CST, including the full increase in value from the time that the CST was funded, will not be included in that spouse's taxable estate. The second spouse will use her U.S. Transfer Tax Exemption to avoid estate tax on her own assets, and only amounts in excess of their exemption will be faced with an estate tax exposure.

The assets may remain in the CST for the benefit of your children and where your children are U.S. citizens, wherever they live, the continuing protection from U.S. transfer tax gained through the CST will be welcome.

It should also be noted that similar planning with a CST can be employed by the second spouse to die for the benefit of their children.

Assets that are intended to fund the CST must come from the deceased spouse's estate, so it is important that such assets are owned in the name of that spouse and not jointly with rights of survivorship.

In order to ensure that the future growth of the trust assets is not taxed on the death of any of the beneficiaries, no beneficiary should have a general power of appointment. A general power of appointment is such a power exercisable in favour of the holder, the holder's estate, and creditors of the holder and the holder's estate. If any beneficiary has the ability to withdraw funds from the trust, then such funds generally will be subject to

U.S. transfer tax (continued)

U.S. estate tax at the beneficiary's death, even if the power was not exercised. A beneficiary can have a limited power of appointment, such as the ability to withdraw funds for an ascertainable standard. However, if the trust has an independent trustee, then the independent trustee discretion can be exercised without being limited to ascertainable standards. An independent trustee is essentially someone who has not contributed to, and cannot benefit from, the trust, is not a relative or an employee of a beneficiary and is a role often best filled by a corporate trustee that is a financial institution. From here onwards in this paper, unless otherwise stated, we will assume that any trust created for the purpose of U.S. transfer tax protection will either contain ascertainable standard limitations on trustee discretion to distribute capital, or have an independent trustee.

It can be advantageous for the assets that do not go into the CST i.e., those that exceed the deceased spouse's U.S. Transfer Tax Exemption, to be used to fund a second testamentary trust rather than going directly to the surviving spouse. While there continues to be estate tax payable on the testamentary trust's assets upon the death of the second spouse, the trust offers a measure of protection of the assets for the spouse, avoids these assets from being subject to probate, and ensures that one's chosen heirs eventually benefit from the assets held in the trust.

As noted, the trust may be funded free of U.S. transfer tax by using the marital deduction, provided a QTIP election is filed. In this case, the surviving spouse must be paid the annual income of the trust, and is the only beneficiary that can access the capital during her lifetime.

Limitations of the credit shelter trust and marital deduction combination

Expanding upon the theme of gifting techniques to shelter as much of your overall taxable estate as possible from U.S. transfer tax, while the CST is established upon the death of the first spouse, and thereafter insulates the future growth of the assets it holds, settling and funding a trust during one's lifetime for similar purposes can have an even greater effect. To illustrate, let's consider an example where only the CST and marital deductions strategies are employed.

It can be advantageous for the assets that do not go into the CST i.e., those that exceed the deceased spouse's U.S. Transfer Tax Exemption, to be used to fund a second testamentary trust rather than going directly to the surviving spouse.

Assume that a 50 year old U.S. Transfer Tax Resident has a net worth equal to her U.S. Transfer Tax Exemption i.e., presently US$13.61 million. She expects that over time, her net worth will grow and by the time she dies, will be double that of today i.e., US$27.22 million. If she only employs a CST gifting strategy, then at the time of her death, the CST will be funded with the amount that equals her then U.S. Transfer Tax Exemption (which under current rules is indexed annually), and the balance of her estate may be left to her heirs.

The CST will insulate from U.S. transfer tax the growth on the assets held therein.

If she leaves her entire estate to her spouse, the marital deduction will defer the U.S. transfer tax owing on the balance and any growth thereon, whether transferred directly or through a spousal trust, until the time the second spouse dies. Therefore, even if the surviving spouse did not personally own any assets at the time that the first spouse died, under our example, he will inherit US$13.61 million (outside of the CST) and that amount may continue to grow until his death.

Upon the death of the second spouse, any amount of assets he personally owns in excess of the combination of his U.S. Transfer Tax Exemption and her unutilized exemption will be subject to U.S. transfer tax. If in addition to the assets inherited and protected by the marital deduction, the second spouse also owned some assets in his own name at the time the first spouse died, the amount of the excess will be even higher, as will be the transfer tax upon his death. Further, if at age 50 the first spouse to die had owned assets in excess of her U.S. Transfer Tax Exemption, then the amount that the second spouse will inherit (outside of the CST) will be greater still, thereby

U.S. transfer tax (continued)

Trusts intended to protect family net worth from U.S. transfer tax for more than one generation are often referred to as Dynasty Trusts.

increasing his U.S. taxable estate and correspondingly his U.S. estate tax upon his death.

You can see that for families whose net worth exceeds the collective value of the personal U.S. Transfer Tax Exemptions of each spouse, using only the CST and marital deduction results in some degree of U.S. transfer tax liability before the estate reaches the next generation.

Advanced gifting techniques – U.S. transfer tax planning implemented during your lifetime

What if instead of relying solely upon the CST gifting strategy, supported by the marital deduction, the first spouse settles and funds a trust at age 50? Transferring any amount up to her U.S. Transfer Tax Exemption can be accomplished on a tax-free basis, and these assets and all future growth thereon will thereafter be protected from U.S. transfer tax. In our example above, the future growth of these assets reached US$27.22 million, in effect, ***double*** the amount that could have been protected under her current U.S. Transfer Tax Exemption.

By employing this strategy, at the time this spouse dies, there will be no need for a CST or use of the marital deduction, because all of her assets i.e., in our example, initially US$13.61 million, will be held in the trust she created at age 50. The limitations upon the death of this spouse on the amount of assets, and their growth, that could be protected within a CST, and the inability to protect the growth of the assets transferred using the marital deduction, will no longer matter since these mechanisms will not be needed at that time.

Even better, protection from U.S. transfer tax is achieved on the continuing growth of all of the assets transferred to and held in the trust until the death of the surviving spouse, and in many cases beyond this time if the trust continues to operate for the benefit of their children. In our example, the full US$27.22 million at the time of the death of this spouse will be insulated from U.S. estate tax thereby leaving a larger estate to the surviving spouse, if the spouse that created the trust dies first, and if this spouse dies second, to their heirs.

The above example illustrates the potential wealth enhancing benefit of engaging in U.S. transfer tax planning during one's lifetime rather than waiting until death.

In effect, we are looking at a timing issue: if you have the means, should you fund a trust before death, and arguably as soon as possible, or not?

Dynasty Trusts

In industry terms, trusts intended to protect family net worth from U.S. transfer tax for more than one generation are often referred to as Dynasty Trusts. The key aspect to such trusts is their long-term nature; CSTs intended to last beyond the passing of the second spouse would meet this definition.

We now turn to trusts that are funded during one's lifetime for U.S. transfer tax planning purposes. These trusts are also intended to last beyond the death of both spouses, possibly for multiple generations. For ease of reference, we will call these lifetime funded trusts "Dynasty Trusts" for the balance of this paper. In many ways, these trusts are similar to CSTs, but there are some differences in how they are constructed as well as some additional benefits, that we will review shortly.

Let's now explore some of the key questions that should be considered in designing and implementing a Dynasty Trust during your lifetime, and identify the potential overall benefits that can be achieved.

In our example above, the 50 year old spouse, who for purposes of this section on "Dynasty Trusts" we will now refer to as "Spouse A" has a net worth of US$13.61 million. This means that theoretically, she could settle and then transfer her entire net worth to a Dynasty Trust without exposure to U.S. gift tax, and if these assets grow, achieve the greatest tax benefits.

U.S. transfer tax (continued)

Choosing the amount to allocate to a Dynasty Trust

It is rarely recommended to allocate all of your assets to any particular planning idea or solution, and we are not suggesting that here. In considering then, how much of one's net worth to deploy to this strategy, the first question should be whether the owner of the assets will continue to have access to them after they are transferred to the Dynasty Trust.

The answer is that Spouse A can be a beneficiary of a Dynasty Trust that she has settled and funded. In the U.S. this is referred to as a self-settled trust, where the settlor, Spouse A, will be one of a group of beneficiaries that are typically comprised of her spouse and their children and perhaps grandchildren.

Certain precautions need to be taken when creating a self-settled trust where protection from U.S. transfer tax is desired. First, the settlor of the trust cannot retain a life interest in the assets of the trust. Second, the trust must be governed by the laws of a jurisdiction that has enacted an exception in the case of self settled trusts to the U.S. "spendthrift trust" rules. The latter are rules that protect the trust assets from the creditors of the beneficiaries of the trust. These rules normally do not apply in the case of self settled trusts. There are a number of foreign jurisdictions, as well as U.S. states including Delaware, Alaska and Nevada, that have enacted this self-settled exception to the U.S. spendthrift trust rules.

Earlier in the section on CSTs we explained the meaning of "ascertainable standards" and the importance of no beneficiary of the trust having a general power of appointment over the trust assets. As noted, with self-settled trusts we must also ensure that Spouse A does not have a retained life interest to avoid the trust assets being included in her estate. This means that Spouse A may not control the trust or its assets, which means she cannot retain any of a number of powers or interests over the trust and its property that would essentially preserve for Spouse A, unlimited use and benefit of the trust assets. U.S. planners often refer to these as "string" interests and they include:

- the power to amend or revoke the trust
- the power as trustee to make discretionary distributions
- the power to name new trust beneficiaries
- the power to remove and replace the trustee with a "related or subordinate" trustee
- a testamentary power to appoint the remainder interest
- a beneficial interest in the trust such that creditors could under local law, reach the trust assets

In practice, so long as Spouse A does not have a "right" to the trust assets, Spouse A can enjoy the "use" of them. This can be a complicated distinction that requires very specific advice from a qualified cross border tax and/or legal professional, and one way of addressing this is through the choice of trustee and the nature of the trustee's powers to make trust distributions.

In the section on CSTs we talked about the choice of using an independent trustee. As noted, if the trustee is independent i.e., has no interest in the trust assets, has not contributed assets to the trust, and is not a spouse of or related to a beneficiary, or subordinate to a beneficiary, that trustee can be given full power to exercise their discretion over trust distributions and the use of the trust assets. If the trustee is not independent, then these trustee decisions should be limited to an ascertainable standard i.e., made for purposes of the beneficiary's needs for health, education, maintenance or support.

U.S. transfer tax (continued)

In light of this need to balance between the notion of beneficial rights and interests, it is preferable that Spouse A retains sufficient assets outside of the Dynasty Trust, in her own name, to maintain her lifestyle for the long-term. These personally owned assets can of course be dealt with as Spouse A wishes, leaving the assets in the Dynasty Trust as primarily destined for other family members, but available to some extent for Spouse A to enjoy as well.

Another factor in deciding how much of Spouse A's assets to allocate to the Dynasty Trust is the extent to which the transfer of these assets to the trust will not attract U.S. gift tax. In our example, Spouse A has a net worth equal to US$13.61 million and therefore can, provided she has not used any of her U.S. Transfer Tax Exemption, gift all of these assets into the trust without paying gift tax.

As just discussed, this may not be a prudent strategy. In this case Spouse A is in a good position, since whatever amount she decides to deploy to the Dynasty Trust will fall below her U.S. Transfer Tax Exemption. In situations where Spouse A's net worth exceeds her U.S. Transfer Tax Exemption, she will be able to contribute an amount up to her exemption on a tax-free basis.

Other planning points to consider in designing a Dynasty Trust strategy

A few other points in relation to the design and implementation of Dynasty Trusts are important to note.

Income tax

Dynasty Trusts are not intended to provide any Canadian or U.S. income tax advantages, but they are impacted by both U.S. and Canadian income tax rules.

To avoid the application of the Canadian non-resident trust rules, these trusts are typically structured as resident in Canada for Canadian tax purposes. Since they are established and funded by a U.S. citizen (albeit living in Canada), invariably for the benefit of U.S. citizens, they will be considered to be "grantor trusts" for U.S. income tax purposes. The income of such trusts is taxable to the grantor i.e., the U.S. citizen, and the U.S. will effectively ignore the trust for income tax purposes. This means that the U.S. citizen will pay the annual income tax on income earned in the trust, effectively allowing the trust to grow notionally "tax-free". An additional benefit is that as the trust is growing free of tax, the tax that is not being paid by the trust can be seen as additional tax-free gifts to the trust by the U.S. citizen.

Dynasty Trusts are not intended to provide any Canadian or U.S. income tax advantages, but they are impacted by both U.S. and Canadian income tax rules.

The good news goes further. Since the beneficiaries of the trust will, in many cases, be U.S. citizens as well, had the trust been characterized as a "non-grantor trust", the U.S. income accumulation, or "throwback", rules will apply. These rules deal with income accumulating in non-U.S. trusts where the grantor is not paying the tax, with the result that U.S. beneficiaries require special planning to avoid the adverse U.S. tax consequences that could arise upon receipt of certain trust distributions.

So the situation works well in a number of ways, but at the time that the grantor dies, under U.S. rules, the trust then automatically becomes a non-grantor trust. To avoid the application of the U.S. throwback rules, it may be necessary to move the trust to the U.S. and change the trustee to a U.S. trustee.

The complexities that arise in relation to Dynasty Trusts from an income tax perspective mean that it is very important to seek the advice of cross-border tax and/or legal professionals.

21 year rule

Another important point is that where the Dynasty Trust is a resident or deemed resident of Canada, the Canadian "21 year" deemed disposition rules will apply. This means that every 21 years from the creation of the Dynasty Trust, the trust will be deemed to have disposed of all of its assets at their then fair market value. In cases where there are unrealized capital gains on assets held in the trust, a decision will need to be made about whether to (1) pay the tax at the 21st year, in effect paying the tax "in advance" and correspondingly increasing the cost base to the trust

U.S. transfer tax (continued)

of its assets, or (2) distribute the trust assets to one or more of its Canadian resident beneficiaries.

The difficulty with this decision is that choosing to avoid Canadian capital gains tax means effectively ending the operation of the trust, and therefore possibly undoing the original intent of the planning which was to avoid the application of U.S. transfer tax on these assets. This will be the case if one or more U.S. Transfer Tax Residents are the persons to whom the assets are distributed.

In such cases, it is suggested that the trust assets be invested so that either (1) capital gains are routinely recognized on an ongoing basis, thereby rendering the 21 year rule far less of a concern as it approaches, or (2) there is an expectation from the outset that if there are no alternatives to distributing the trust assets to one or more U.S. Transfer Tax Residents just before the end of the 20th year of the trust i.e., this is where having a "Canadian only" tax resident could be helpful, the trust will in fact pay any Canadian capital gains tax triggered at that time.

Additional planning benefits of the Dynasty Trust strategy

As noted earlier in the discussion on CSTs, there are planning benefits that extend beyond protection from U.S. transfer tax where using a trust; other benefits may include asset protection, minimization of probate and certainty that one's estate will wind up with those you intend it to. Where the planning is done during one's lifetime, these benefits apply not only to the surviving spouse upon his death, but may apply to the living settlor of the trust as well.

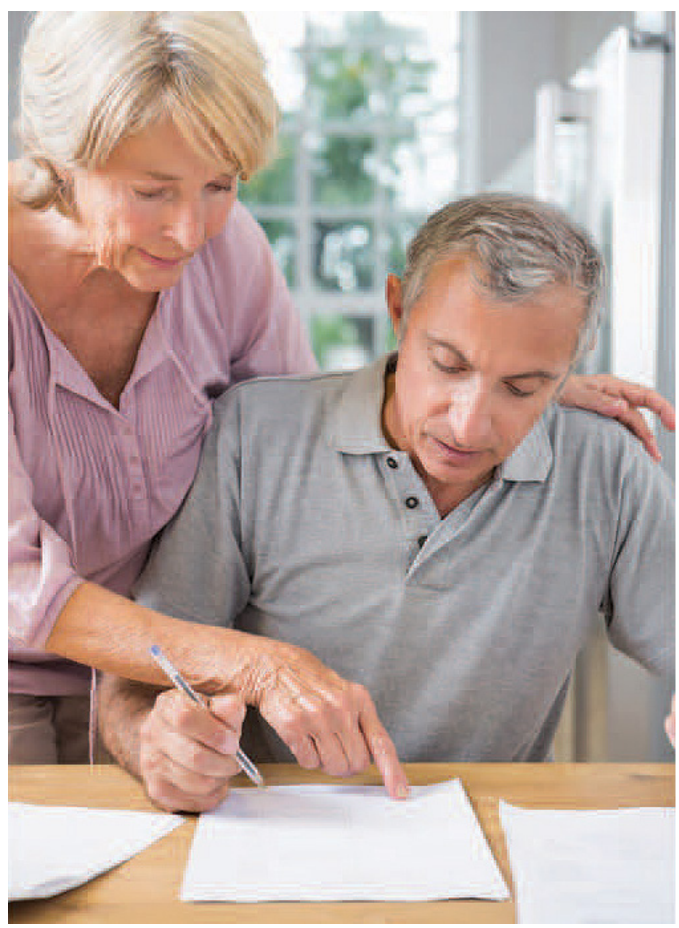
Life insurance

There are many reasons why you might invest funds through a permanent life insurance policy and this paper is not intended to canvass those. However, we do want to consider a few key planning points for U.S. Transfer Tax Residents that hold or are thinking of investing through a life policy.

Permanent life insurance policies are a tax effective means of allocating a portion of one's wealth to a financial product that may, depending upon its terms, grow over time.

The tax effectiveness of investing through permanent life insurance applies similarly in both Canada and the U.S., as each country has generous rules in this regard. Therefore, even though a U.S. Transfer Tax Resident living in Canada may also be a U.S. Income Tax Resident, she will be able to take advantage of tax effective investing through life insurance.

With proper planning, the ultimate amount paid out to your heirs from the policy typically referred to as the death benefit will not form part of your estate. The death benefit will invariably be significantly higher than the amount invested, thereby not only creating additional funds that flow to your heirs upon your death, but funds that will not be subject to U.S. estate tax, and do not rely upon your U.S. Transfer Tax Exemption at death.



U.S. transfer tax (continued)

The key planning point to be aware of is to avoid having the life insurance death benefit included within your U.S. taxable estate, which means that the U.S. Transfer Tax Resident may not own or control the life policy. The policy therefore may be best held in i.e., owned by, a trust, often referred to as an Irrevocable Life Insurance Trust, or an ILIT. The ILIT should also be the beneficiary of the policy.

To avoid U.S. ownership referred to as "incidents of ownership", the insured should not be a trustee or beneficiary of the ILIT, and should not be able to name or change the beneficiaries, borrow against the policy, access the cash value, or cancel the policy.

Funds transferred to the ILIT are generally subject to U.S. gift tax, even if the ILIT uses them to invest in life insurance. The insured therefore can make use of his U.S. Transfer Tax Exemption, but before doing so, can make annual gifts of up to US$18,000 per each beneficiary of the ILIT. So if the insured has a spouse and four children, up to US$90,000 per year can be gifted to the ILIT before gift tax becomes a concern. In order to make gifts to a trust that qualify for the annual gift tax exclusion, the gifts have to provide the beneficiary with a "present interest" in the amount of the gift. Since a transfer to a trust provides a "future interest", the transfer will not qualify unless the trust provides the beneficiaries with the right to withdraw the funds contributed to the trust at the time of contribution. This right is referred to as a "Crummey Power". The Crummey Power can be limited to a period of time, such as 30 days. However, if limited, the amount of the annual exclusion would be reduced.

Investing through life insurance owned by an ILIT is therefore a very attractive way of not only reducing one's U.S. taxable estate by making tax protected gifts to the trust to fund the policy, but of creating additional value for your family or charitable purposes that will not form part of your U.S. taxable estate.

Planning for U.S. transfer tax residents – only one is a U.S. citizen

Most of the planning ideas that we just covered for two U.S. citizens living in Canada also have application in circumstances where one spouse is a U.S. citizen i.e., a U.S. Transfer Tax Resident, and the other is neither a U.S. citizen nor a U.S. domiciliary. We will now look at variations in these planning opportunities depending upon who is the surviving spouse.

Investing through life insurance owned by an ILIT is therefore a very attractive way of not only reducing one's U.S. taxable estate by making tax protected gifts to the trust to fund the policy, but of creating additional value for your family or charitable purposes that will not form part of your U.S. taxable estate.

As a reminder, the portability provisions discussed earlier only apply where both spouses are U.S. citizens or residents of the U.S. for estate tax purposes, and therefore are not applicable in this section.

Tax deferral and credit planning

The unlimited marital deduction available between U.S. citizen spouses living in Canada that can defer the imposition of U.S. transfer tax until the death of the surviving spouse is also available when only one of the spouses is a U.S. citizen, albeit not necessarily in the simple format described earlier.

As discussed, tax deferral planning is intended to delay the imposition of taxes payable upon gratuitous transfers of assets to one's spouse. While applicable to lifetime transfers, this type of planning is usually most valuable upon the death of the first spouse, for the liquidity and other reasons noted earlier. In the U.S., the tax deferred is gift or estate tax, and in Canada, it would be the tax payable on capital gains upon the deemed disposition of assets.

The ability to defer tax in the simple manner described earlier does not extend to transfers between spouses where the spouse receiving the transfer does not have a close enough tax exposure to the country imposing the tax i.e., the "taxing country". In situations where both spouses are residents of Canada and only one is a U.S. citizen, both spouses will have a close tax exposure with Canada, but only one will have a close tax exposure with the U.S.

U.S. transfer tax (continued)

The reason that the tax deferral is not available in this simple manner when the receiving spouse does not have a close enough tax exposure with the taxing country is largely because when the recipient of assets upon which a deferred tax liability is permitted is not themselves governed by the taxing country, that country cannot be sure that the deferred tax will eventually be collected.

Since we are assuming that both spouses are residents of Canada for tax purposes, both will have tax exposure to the Canadian tax system. Therefore the Canadian tax deferral rules on capital gains transferred between them during life and upon death, will apply. The problem arises under the U.S. tax rules where only one spouse is a U.S. citizen and the recipient spouse is not a U.S. citizen, as the normal rules allowing unlimited U.S. tax deferrals between spouses are treated differently.

U.S. citizen spouse living in Canada predeceases her Canadian non-U.S. citizen spouse

A U.S. citizen spouse who predeceases her non-U.S. citizen spouse has two U.S. transfer tax planning choices. One involves a tax deferral, requiring the use of a special form of U.S. trust, and the other involves a tax credit available specifically under the Canada-U.S. tax treaty. A key point to be aware of is that only one of these strategies can be chosen, and once this choice is made, it cannot be reversed.

QDOT

The U.S. unlimited marital deduction can be accessed when a U.S. citizen spouse dies before her non-U.S. citizen spouse, but only if the deceased's assets are transferred to a specially designed trust called a qualified domestic trust or a "QDOT". U.S. transfer tax will then only be payable upon the death of the surviving spouse, or at such earlier time as capital distributions are made from the trust.

The terms of a QDOT require that the trust is governed by U.S. law, and that one trustee is a U.S. citizen or U.S. corporation. No distributions of capital can be made without the permission of the U.S. trustee. If the assets being transferred to the trust exceed US$2 million, then the trustee must secure the trust assets with a bond or be a U.S. financial institution. The surviving spouse may receive all or part of the annual income, but if any of the capital is paid to him, such capital distributed may be

subject to U.S. estate tax. Upon his death, the trust assets are treated as part of the estate of the first spouse to die, and U.S. estate tax will be due if these assets exceed the first spouse's U.S. Transfer Tax Exemption.

A QDOT can be structured to also qualify as a testamentary spousal trust under Canadian law. This type of trust would be needed to defer any Canadian tax on capital gains of the first spouse to die, until the death of the surviving spouse, or until the property is disposed. It should be noted that while this would seemingly be an ideal tax deferral structure covering both tax systems, it can be fairly complex to implement. It would require that this U.S. based trust be resident in Canada for tax purposes while at the same time having a U.S. trustee as discussed above. Careful consideration and planning advice is therefore required from a cross-border tax and/or legal professional.

Marital credit

The second U.S. transfer tax planning option involves a tax credit rather than a tax deferral. A tax credit actually eliminates tax rather than deferring it, so under certain circumstances, it can be more effective than simply delaying the eventual payment of U.S. estate tax.

U.S. transfer tax (continued)

As noted earlier in the context of Non-U.S. Owners of U.S. Situs Assets, a marital credit is available under the Canada-U.S. tax treaty. It can be utilized if (1) the executors/liquidators of the estate of the first spouse to die choose not to use a QDOT and (2) a number of conditions apply. In essence, the marital credit can be used by a resident or citizen of Canada where at the time of death:

- the deceased is a U.S. citizen or a resident of either Canada or the U.S., and
- the surviving spouse is a resident of Canada or the U.S.

The marital credit may be claimed for tax otherwise payable on property transferred to the surviving spouse (either directly or in trust) to the extent that the transfer would have qualified for the marital deduction if the surviving spouse was a U.S. citizen at the time of death. The marital credit is in addition to the deceased's U.S. Transfer Tax Exemption, and its value is the amount of the estate tax owing up to the deceased's U.S. Transfer Tax Exemption. If the deceased's U.S. Transfer Tax Exemption is the maximum available, then the marital credit may be approximately equal to this amount, thereby providing estate tax protection against just under double that value.

Choosing between the QDOT and marital credit

Under circumstances where there are two Canadian resident spouses and the U.S. citizen spouse dies first, how does one choose between these two U.S. transfer tax planning options?

While there is no one right answer, if the assets of the deceased do not exceed approximately twice the value of her U.S. Transfer Tax Exemption, the marital credit will effectively eliminate the tax owing and would therefore be the better choice. This assumes the deceased intends to transfer all assets to the surviving spouse. It may also be the better choice if her assets exceed twice her U.S. Transfer Tax Exemption, but the question then is by how much?

That is not an easy question to answer, as a cost benefit analysis is needed to compare the value of the deferral on the potential future value of an estate where the actual tax owing upon death could have been eliminated, and U.S. estate tax eventually paid on the excess of the estate beyond the deceased's U.S. Transfer Tax Exemption.

U.S. citizen spouse living in Canada outlives her Canadian non-U.S. citizen spouse

Where a U.S. citizen spouse living in Canada survives her Canadian resident, non-U.S. citizen spouse a simplified version of the tax deferral available with the unlimited marital deduction will come back into play.

As discussed earlier, where the Canadian spouse dies first, his personal exposure to U.S. estate tax will be only in relation to his U.S. situs assets, planning for which is discussed in greater detail in the next section dealing with "Planning for Non-U.S. Owners of U.S. Situs Assets".

Therefore, when looking at tax deferral planning in this context, the use of the unlimited marital deduction in the

U.S. transfer tax (continued)

same manner as is available between two U.S. citizen spouses living in Canada, discussed earlier, will be available.

Annual exclusions and reducing your U.S. taxable estate

As noted earlier, transfers made on a gift tax-free basis reduce the transferor's U.S. taxable estate, thereby reducing the transferor's ultimate exposure to U.S. transfer tax.

In circumstances where only one spouse is a U.S. citizen, the planning needs of the two spouses will be different because only one of them has the tax exposure to the U.S. that qualifies her to be a U.S. Transfer Tax Resident. This means that only the U.S. citizen spouse's U.S. taxable estate will be comprised of her worldwide assets. The non-U.S. citizen spouse's U.S. taxable estate will be limited to his U.S. situs assets.

Another difference in their planning needs stems from the fact that while a U.S. citizen is subject to U.S. transfer tax on all gratuitous transfers i.e., whether during life or upon death, and wherever the property may be located around the world, the non-U.S. citizen is only subject to, on death, U.S. estate tax in respect of his U.S. situs assets, and during life, U.S. gift tax on those U.S. situs assets that are tangible, as discussed earlier.

Therefore, the motivation to transfer assets between spouses will be different depending upon whose point of view we are starting from. U.S. citizens will still want to reduce their U.S. taxable estate, and therefore make use of their annual exclusions, while their non-U.S. citizen spouses will only benefit from their annual exclusions to the extent they can transfer U.S. situs assets.

Let us now look more closely at the ways that spouses, where only one is a U.S. citizen, can reduce their U.S. taxable estates. When the transferor is a U.S. citizen living in Canada, along with the planning benefits reviewed earlier in respect of annual gifts of up to US$18,000 made to any number of people, there is an additional planning advantage in making gifts to one's Canadian non-U.S. citizen spouse. U.S. transfer tax rules permit an annual gift of US$185,000 to such spouses, which not only reduces the transferor's U.S. taxable estate, but provided that the

> Transfers made on a gift tax-free basis reduce the transferor's U.S. taxable estate, thereby reducing the transferor's ultimate exposure to U.S. transfer tax.

gifts are of non-U.S. situs assets, removes these assets, and any future growth thereon, completely from the U.S. transfer tax system.

Turning to a non-U.S. citizen living in Canada married to a U.S. citizen, three key points influence any planning to reduce this person's U.S. taxable estate i.e., comprised of their U.S. situs assets.

First, any assets, whether U.S. situs or not, gifted by a non-U.S. citizen spouse to a U.S. citizen spouse, whether during life or upon the former's death, will increase the latter's U.S. taxable estate, and may take it above (or eventually exceed) that person's U.S. Transfer Tax Exemption. While this will not be a concern when the gift will be used to pay for expenses, where the gift will be retained by the spouse and grow over time, it may be preferable to avoid making the gift directly to the spouse, particularly if the result will be that the U.S. citizen spouse may reach or exceed his U.S. Transfer Tax Exemption. Knowing the purpose for the gift, and how it will be used, is therefore important in these circumstances.

As in the case of two U.S. Transfer Tax Residents living in Canada, planning with the use of properly structured trusts, whether inter vivos or testamentary, can be an effective way for a non-U.S. citizen spouse to gift or bequest assets to a U.S. citizen spouse whose U.S. taxable estate is significant and can be expected to exceed, before or after receiving such gift or bequest, his U.S. Transfer Tax Exemption. This topic is elaborated upon in the upcoming section on "U.S. Transfer Tax Planning Using Trusts".

The second key point is that as noted, the transferor's exposure to U.S. transfer tax is only in relation to U.S. situs assets. Therefore it only makes sense to make gifts of U.S. situs assets, since the transferor does not have exposure to U.S. transfer tax on any other assets.

U.S. transfer tax (continued)

Third and finally, U.S. gift tax does not generally apply to non-U.S. citizens (unless they are U.S. domiciled) so the annual gift tax exclusion rules at first glance do not appear to be relevant. However as noted earlier, U.S. gift tax can apply upon the transfer by a non-U.S. person of tangible property located in the U.S. In such cases, the annual exclusion rules can avoid the imposition of U.S. gift tax and allow the non-U.S. citizen to reduce his U.S. taxable estate.

Charitable giving

The use of charitable gifting to reduce one's U.S. taxable estate is more beneficial to U.S. citizens living in Canada, as non-U.S. citizen spouses will only benefit in this manner if they make charitable gifts of U.S. situs property. Other property owned by them is not subject to U.S. transfer tax.

U.S. transfer tax planning using trusts (where only one spouse is a U.S. citizen)

Earlier in this paper when discussing planning where both spouses are U.S. citizens living in Canada, we looked at the use of CSTs and Dynasty Trusts. Planning with these trusts has a lot in common, as the main objective in both cases is to create a structure to hold assets that together with the growth thereon, will not form part of either the original owner's, or one or more surviving family members', U.S. taxable estate.

Two key decisions in structuring these trusts need to be made at the outset. First, when should the trust be created and funded, and second, how much can or should be contributed to these trusts?

A third decision, which asks how long such trusts should operate, would be answered in both cases "as long as possible" i.e., one or more generations, and certainly past the death of the second spouse where practically feasible for the next generation, to the extent that you want or need continuing U.S. estate tax protection.

Since U.S. gift tax generally applies to property gratuitously transferred to an irrevocable trust, and this is rarely desired, the amount contributed to either of these trusts is normally based on the transferor's U.S. Transfer Tax Exemption. In the case of the CST for a person with a large estate, the full amount representing the transferor's unused U.S. Transfer Tax Exemption would typically be contributed to the CST. In the case of a Dynasty Trust, as discussed earlier, the amount contributed depends upon the overall wealth and financial situation of the transferor, as it is not usually recommended that you commit all or substantially all of your assets to one structure, especially before reaching the latter years of your life.

The use of charitable gifting to reduce one's U.S. taxable estate is more beneficial to U.S. citizens living in Canada...

We now look more closely at trust planning to protect against U.S. transfer tax in the case where only one of two Canadian resident spouses is a U.S. citizen or U.S. domiciliary.

U.S. citizen spouse living in Canada predeceases her Canadian non-U.S. citizen spouse

When a U.S. citizen spouse is the first to die, there is no specific need to plan to avoid having the deceased's assets, and the growth thereon, from being included in the U.S. taxable estate of family members, unless one or more of them is a U.S. Transfer Tax Resident. In this situation, we know that the surviving spouse will not fit that category, but it is possible that one or more surviving children could.

Where no one in the family is a U.S. Transfer Tax Resident, once the deceased spouse makes use of her unused U.S. Transfer Tax Exemption, her assets may flow freely to her spouse and/or children, unless there are non-tax reasons to plan differently. The only tax advantage in having assets transferred to a trust is to defer the imposition of U.S. estate tax on the deceased's assets that exceed her U.S. Transfer Tax Exemption through a QDOT. Asset protection, guarding against estate depletion, and restricting control from beneficiaries who are not ready to assume it, would be other reasons to consider using trusts in your estate planning.

If one or more children of the deceased is a U.S. Transfer Tax Resident, then that child is best not inheriting substantial assets from the deceased directly, especially where this will bring or project the child's net worth

U.S. transfer tax (continued)

towards the amount of the prevailing U.S. Transfer Tax Exemption. A trust for this child's inheritance would be worth exploring with the types of features that CSTs and Dynasty Trusts typically have.

However, if the U.S. citizen spouse owns U.S. situs assets, then short of selling or gifting them away, if the intention is for the heirs to retain these assets, then transferring them to a trust over which the beneficiaries do not have a general power of appointment would be a good way to keep these assets from the U.S. transfer tax net. Whether this planning is warranted depends upon the amount of U.S. situs assets owned by the U.S. citizen spouse, and whether the heirs themselves also own and/or can be expected to own, a significant amount of U.S. situs assets that may exceed the latter's U.S. Transfer Tax Exemption.

Typically, the first US$13.61 million is transferred to a CST or Dynasty Trust free of U.S. estate tax using the deceased U.S. citizen's U.S. Transfer Tax Exemption. If the balance of the assets to transfer is not greater than US$13.4745 million they may be transferred free of U.S. estate tax to the surviving non-U.S. citizen spouse directly or to a separate spousal trust (this trust may be structured to provide U.S. estate tax protection) using the marital credit. Alternatively, where the balance of the assets exceeds US$13.4745 million and the marital credit is not sufficient to offset the U.S. estate tax, the assets may be transferred to a QDOT and U.S. estate tax is deferred using the unlimited marital deduction.

U.S. citizen spouse living in Canada outlives her Canadian non-U.S. citizen spouse

In this circumstance, since we do not want to increase the U.S. taxable estate of a U.S. Transfer Tax Resident, especially where there is the likelihood that the latter will eventually own assets in excess of his U.S. Transfer Tax Exemption, the use of a properly structured trust to protect assets from U.S. estate tax is recommended.

We have discussed the use of these trusts in the earlier sections covering CSTs and Dynasty Trusts, and the planning concepts are essentially the same, so we need not repeat them here. However, it is important to note that when U.S. situs assets are transferred to such trusts the unlimited marital deduction is not available. Therefore, to avoid U.S. estate tax on the death of the non-U.S. citizen spouse who dies first, the U.S. situs assets should be transferred to the surviving U.S. citizen spouse directly or to a qualifying spousal trust not structured as a U.S. estate tax protected trust.

> The most likely U.S. situs assets that a Canadian will own are U.S. stocks and U.S. real estate for personal use...

Life insurance

U.S. Transfer Tax Residents will benefit from U.S. transfer tax protection where assets are invested in life insurance for the reasons discussed earlier. Therefore a U.S. citizen spouse can make use of this planning, even though her spouse and children may not be U.S. Transfer Tax Residents. In these cases, there may be less reason to maintain the insurance proceeds in the ILIT after the demise of the U.S. citizen spouse, as there may be no need for protection against U.S. transfer tax.

If the first spouse to die is not a U.S. citizen, then the trust planning described immediately above for surviving U.S. citizen heirs, would equally apply, whether or not life insurance or other types are left to the surviving spouse.

Planning for non-U.S. owners of U.S. situs assets

As discussed in the section called "Non-U.S. Owners of U.S. Situs Assets" as well as in other parts of this paper, Non-U.S. Owners of U.S. Situs Assets (defined earlier as Canadian residents who are not U.S. Transfer Tax Residents) who own U.S. situs assets whose value exceeds their U.S. Transfer Tax Exemption, may be liable for U.S. transfer tax upon a gratuitous transfer of such assets. In that section we set out the definition of U.S. situs assets, discussed when U.S. gift and estate tax applied, and explained the benefits of being able to access the prorated U.S. Transfer Tax Exemption under the Canada-U.S. tax treaty.

This section looks at planning for Non-U.S. Owners of U.S. Situs Assets focusing in part on planning to reduce or eliminate U.S. transfer tax at the time of the transfer of

U.S. transfer tax (continued)

these assets in the first place. This usually means planning that is implemented at the time the property is purchased.

The planning available to reduce or eliminate the U.S. transfer tax payable upon the transfer of U.S. situs assets ranges from simple to complex. As such, your choice of planning may well be influenced by the extent of your exposure to U.S. transfer tax. Where your exposure is significant, you may want to structure how to hold your U.S. situs assets so that upon death your exposure is minimized. Where the exposure is less significant, simpler planning can be undertaken, including using life insurance to pay your liability.

The most likely U.S. situs assets that a Canadian resident will own are U.S. stocks and U.S. real estate for personal use (the latter hereinafter in this section referred to as "real estate"), so we will concentrate on planning considerations for these two types of property. For ease of reference these types of property may together be referred to in this section as "U.S. situs assets". Real property in the U.S. purchased for commercial reasons involves different planning considerations, some of the income tax issues of which were touched upon in the section called "Canadians Owning and Renting U.S. Real Property". We will briefly discuss options for owning U.S. commercial real property later in this section.

Initial considerations

The first things to consider when purchasing "U.S. situs assets" are (1) the cost, (2) whether you are purchasing with a long-term hold in mind, and (3) your current and projected U.S. dollar net worth.

If you expect to sell the property, then provided you do not die before doing so, you may be faced with U.S., and possibly, Canadian, capital gains tax. U.S. capital gains tax in these circumstances was discussed in the section "Canadians Owning and Renting U.S. Real Property", and would apply in the case of the sale of U.S. real property, but generally not to U.S. stocks.

If you expect to someday sell your "U.S. situs property" but unfortunately die owning it, then instead of U.S. capital gains tax, your estate may be exposed to U.S. estate tax. If you decide to gift rather than sell it, then

you will need to address U.S. gift tax. Although we have already discussed these possible scenarios, it is important to know your intentions, but also plan for unexpected circumstances. This means planning to address U.S. Transfer Tax in any event.

As noted earlier, as a Canadian resident who is not a U.S. Transfer Tax Resident, if your U.S. dollar net worth is less than the prevailing U.S. Estate Tax Exemption at the time of your death, then you will not have a U.S. estate tax liability. In that case, no U.S. transfer tax planning is necessary, but if you own U.S. real property, you should consider updating your Will(s) and looking into U.S. probate planning options to hopefully set up an easy eventual transfer of the property to your heirs.

If your current or projected U.S. dollar net worth is or may exceed your U.S. Estate Tax Exemption, then you may have an eventual U.S. transfer tax exposure. In this situation, the cost of your U.S. situs property, and its expected appreciation over time, combined with the length of time you plan to own the property, allows you to estimate varying levels of exposure to U.S. transfer tax at

U.S. transfer tax (continued)

different points of time. Usually an estimate is done of the immediate exposure if you die tomorrow, as well as the eventual exposure if you die a fair time down the road.

The reason all of these factors are important is that they should influence whether you undertake simpler or more complex planning. If your current exposure to U.S. transfer tax is manageable, and you are not expecting a significant increase in the value of the property, then you may not do any planning specifically to avoid U.S. transfer tax. If your exposure is or will become less manageable or enough that it will create a liquidity problem for your estate, or you simply do not want your estate to be faced with this liability, then planning to avoid U.S. transfer tax is recommended.

It should be noted that at varying points in this paper we have already reviewed a number of planning options in relation to U.S. transfer tax as they impact Non-U.S. Owners of U.S. Situs Property. These are: the use of the marital credit and comparisons with the QDOT, claiming foreign tax credits on U.S. estate tax on U.S. situs assets, reducing your taxable estate through gifts, sale and charitable giving, and the purchase of life insurance to cover some or all of the expected liability.

One other important point to keep in mind is that planning to avoid U.S. transfer tax is invariably much easier to design and implement if it is done before the time that the U.S. situs asset is being purchased. If it is approached after the asset is already owned by you, or a legal structure you are connected with, then you may need to contend with U.S. gift tax should you wish to change the way that the property is owned. In many cases this will be hard to achieve, and a sale of the property, or the purchase of life insurance, may be the most practical ways to deal with the issue.

Personal ownership

If you are considering the purchase of either U.S. stocks or real estate, the first question often is how to take title, and the simplest answer is in your own name, or Joint Tenancy with Right of Survivorship (“JTWROS”). In the case of U.S. real estate in particular, the latter avoids the need for the property to pass through your probate estate and ultimately the local state probate rules upon the first death.

Unfortunately, owning the property JTWROS often does not work well from a U.S. estate tax perspective. Upon the death of the first spouse, unless it can be clearly shown that the surviving spouse, with her own funds, either purchased the property in its entirety, or contributed to the purchase of the property, U.S. tax rules assume that the spouse that died was the person who owns the property for estate tax purposes. The result is that the full U.S. estate tax liability, if any, will be payable at that time.

This means that not only must cash be allocated to the payment of U.S. estate tax at a time when the second spouse is still alive and may need the funds or only

U.S. transfer tax (continued)

have access to illiquid assets, but upon the death of the surviving spouse, if the property is still owned by her, U.S. estate tax will again be payable, on the value of the property at that time. In effect, U.S. estate tax will be paid twice on the same property, each time a spouse dies.

There is a bit of relief as the surviving spouse is entitled to a credit for part of the U.S. estate tax paid on the death of the first spouse, but this credit reduces quickly on a sliding scale starting two years after the first spouse dies with no credit after 10 years.

Also, since owning the property JTWROS leads to the surviving spouse eventually owning the property, probate will be required upon her death if she still owns the property, which means that the costs and delays associated with probate will someday be experienced by your heirs.

Purchasing the property in the name of one spouse leads to almost the exact same disadvantages, including the need to go through the probate system twice, so this is rarely seen as a better solution on its own. If a testamentary trust is used to exclude U.S. situs assets from passing to the survivor's estate, that may be better planning. Another alternative is to use a QDOT to defer the payment of estate tax upon the death of the first spouse, but this only works until the second spouse dies.

If personal ownership is desired, many planners recommend taking title as tenants in common. In this case, both spouses are considered to own an undivided equal or unequal interest in the property, and this interest passes through the Will of each spouse. The result is that only the deceased's interest will be subject to U.S. estate tax, thereby avoiding the possibility that the full value of the property will be exposed to U.S. estate tax upon the death of the first spouse. In addition since holding a divided interest in the property is less marketable than a sole interest, each co-owner may potentially apply a valuation discount when determining the fair market value of their respective share of the property for U.S. estate tax purposes, which will decrease the value of the U.S. taxable estate. However, taking title as tenants in common does not shelter the property from probate unless a portion is transferred into a "revocable trust". However, a revocable trust does not protect from U.S. estate tax, it is primarily used to avoid state probate.

> Planning to avoid U.S. transfer tax is invariably much easier to design and implement if it is done at the time that the U.S. situs asset is being purchased.

The same planning to avoid U.S estate tax twice by using a testamentary trust or QDOT for spouses holding property in sole name mentioned earlier, may be utilized by a couple holding ownership of property as tenants in common.

Be wary of owning property as tenants in common with children, or with spouses in marriages that are not stable, as each co-tenant is able to sell or gift his share of the property, or place a mortgage on it, without the consent of the other co-tenant.

Non-recourse mortgage

Where personal ownership of U.S. real estate is desired, a simple strategy to reduce the value of the property is to place a non-recourse mortgage against it. A non-recourse mortgage may only be realized by the lender upon default against the property, and not the borrower. In this case, the full value of the mortgage may be deducted from the value of the property for U.S. estate tax purposes. The funds borrowed may be invested to earn income, thereby creating a revenue flow and tax deductible interest.

Ownership through a legal structure

When the value of the U.S. situs assets you plan to acquire is such that a U.S. transfer tax liability will be created either immediately or over time, you may wish to structure your ownership of the U.S. situs assets such that the assets are not in your, and possibly your spouse's, personal names.

When you structure the ownership of U.S. situs assets through some type of legal structure, the property that you will own upon death will not be the U.S. situs asset itself, but an interest in a legal structure that in turn owns the U.S. situs assets. Some refer to this as indirect ownership.

U.S. transfer tax (continued)

What you are hoping to achieve is that the U.S. transfer tax rules are in line with this position that you do not own the U.S. situs assets at the time of your death. If this view prevails, then U.S. transfer tax should not apply, and your interest in the legal structure will either pass under your Will to your heirs, or the structure itself may act as an estate planning vehicle.

As noted earlier, trying to transfer U.S. situs assets into a legal structure after you already own them, may subject you to U.S. gift tax, a situation that is not easy to work around. The good news is that where the U.S. situs asset is U.S. stocks, there is no gift tax upon a lifetime transfer as the latter are intangible assets, and structuring can therefore be achieved after the fact. Unfortunately U.S. real estate is a tangible asset so structuring is recommended at the outset. It must also be noted that under Canadian tax rules, any transfer of property may result in a disposition that can trigger tax on accrued gains.

We shall now take a brief look at the main legal structures used in these circumstances, with the caveat that some professional advisors offer more complex planning than we will review here, that may combine two or more of these structures. In such cases you need to be comfortable with the added complexity, level of difficulty in understanding how the structure works, and possibly more aggressive nature of the structure, depending upon what the planner is trying to achieve.

The structures we look at below should be sufficient in almost all cases to address your main concern of avoiding U.S. transfer tax upon your death.

Trusts

If you settle and fund a trust before buying your U.S. situs assets, you will find that you have created a legal structure that achieves multiple planning benefits. First and foremost, if the trust is structured as we have described earlier such that it is irrevocable and no beneficiary has a general power of appointment, then the assets it owns will not form part of your or any of the beneficiaries' U.S. taxable estates upon death.

Generally a trust to hold U.S. real property is established by one spouse for the benefit of the other spouse, where

If you settle and fund a trust before buying your U.S. situs assets, you will find that you have created a legal structure that achieves multiple planning benefits.

the beneficiary spouse has the right to use the property during her lifetime. Although the spouse who contributes the assets to the trust should have no retained life interest, the beneficiary spouse can allow her spouse to use the property. If the trust has an independent trustee (as discussed earlier) the trustee can be provided with wide discretion to distribute trust capital to the beneficiaries should this be desired.

There are a number of additional planning benefits that are attained, starting with the fact that the U.S. situs assets owned by the trust will not pass through your estate, and therefore will not need to pass through the U.S. probate. The assets will remain in the trust, and the beneficiaries will remain in the same position as they were before you died. Your Will therefore need not, and in fact should not, cover these assets.

So the second planning benefit is that the need to transfer title of the U.S. situs assets held through the trust to your heirs is avoided entirely. There is no need to transfer title at all. This can be a much easier way for your heirs to continue to benefit from the trust assets than a formal transfer of legal title, and can even extend to multiple generations. Your spouse, children and even further generations could conceivably be beneficiaries of the trust, which leads to a third planning benefit: the GSTT that we touched upon earlier is not a factor.

Finally, holding assets in a trust can be a safer way to keep these assets in the family as creditors of any of the beneficiaries of the trust, be these arm's length creditors or possibly estranged spouses, will find it more difficult to access these assets than if they were owned directly in the name of the beneficiary whom they are pursuing.

There are some disadvantages of using a trust to hold U.S. property. If the trust is resident in Canada (which it would be if a Canadian resident contributed to the trust), the

U.S. transfer tax (continued)

assets in the trust will incur a deemed disposition on the 21st anniversary of the establishment of the trust resulting in the Canadian taxation of any appreciation of assets held in the trust. The deemed disposition can be avoided if the property is distributed to a Canadian resident prior to this date, but this could expose the beneficiary to U.S. estate tax. Another disadvantage occurs if the beneficiary spouse predeceases the contributing spouse. Since the contributing spouse cannot have any retained life interest in the trust assets, that spouse must now rent the property at fair market value, if he wished to use the property, since his deceased spouse is no longer available to provide him access to the property.

The use of an irrevocable trust to hold U.S. real estate, while more complex than personal ownership, is a way to achieve multiple planning benefits.

Trusts can be used to own any kind of U.S. situs asset. When considering the two main U.S. situs assets, U.S. stocks and U.S. real estate, there are some interesting aspects to think about.

In essence, there may be a simpler way to own U.S. situs assets and that is through a non-U.S. corporation. This tends to be ideal for U.S. stocks for reasons that we will discuss below. It is not always as ideal for U.S. real estate, in this case depending upon the use to which the real estate will be put, the reasons for which will also be looked at below.

Corporations

Let's start with the simpler case of U.S. stocks. If a Canadian (or at least non-U.S.) corporation owns these stocks, U.S. transfer tax rules do not deem the U.S. stocks to be owned by you directly. The rules would find that you own stock of a non-U.S. corporation and therefore upon your death there is no U.S. estate tax as you do not own a U.S. situs asset.

Another advantage relates to the fact that U.S. stocks are considered to be intangible assets. You can therefore transfer U.S. stocks that you already own in your name into a Canadian resident corporation without triggering U.S. gift tax. Further, if there are gains on these stocks, the gains need not be realized upon the transfer for U.S. tax purposes, and Canadian tax rules also permit a tax deferred rollover of assets into a corporation.

So owning U.S. stock through a Canadian corporation is a relatively straight forward way to avoid the imposition of U.S. transfer tax on this asset. You should note that your shares in the corporation will form part of your estate so the downside is that these shares need to be addressed in your Will. Since these will be Canadian shares, U.S. succession rules will not be a factor, and in some Canadian provinces, you can use a separate Will to own these shares that will not need to be submitted for probate. This latter topic is beyond the scope of this paper.

U.S. real estate is a more complicated asset to own through a corporation as other factors arise. As there are a number of complexities we will only touch on these at a high level in this paper.

The key issue is the purpose for which the U.S. real estate will be used. If it is going to be used for personal or family purposes i.e., you and/or your family will live in it, then a corporation is not a good structure to avoid U.S. transfer tax. U.S. rules may look through the structure,

U.S. transfer tax (continued)

and consider the real estate to be your own, and Canadian rules may impose annual income tax in relation to the benefit you enjoy by living in a corporate owned asset.

In addition, the gain from the sale of U.S. real estate held in a corporation is subject to a U.S. corporate tax rate of 21% compared to a maximum rate of 20% if held individually and held for at least a year.

Some states, such as Florida, impose a state corporate income tax but not an individual income tax. Therefore, tax arising from the gain on the sale of U.S. real estate can be higher if held in a corporation.

Personal-use real estate is therefore better owned (and purchased) outside of a corporate structure.

If the property is going to be rented out, and you and your family are not going to use it, then a corporation can be a viable structure to use. But, whether there will be a higher tax on sale should be a consideration. In this case the limited liability that comes with corporate ownership of commercial assets will help protect against tenant or other party claims related to the property.

There are two disadvantages to owning a U.S. rental property through a corporation. First, U.S. tax rates on capital gains within corporations are typically higher than the rates on personally owned property, as discussed above. Second, due to the application of both Canadian

Personal-use real estate is therefore better owned (and purchased) outside of a corporate structure.

and U.S. tax rules, higher taxation can result and therefore must be reviewed. However, these downsides must be compared to the upsides just described, which can make it preferable to a trust as you maintain full control over the shares of your corporation.

Partnerships

Some professional advisers suggest the use of partnerships to own U.S. situs assets. You can avoid the higher corporate tax, discussed earlier, that may result from owning U.S. real estate rental property. With proper planning it may be possible to avoid U.S. transfer tax on your death. Partnerships interests also need to be dealt with under your Will, and there are some important tax elections to be made within 75 days of your death, failing which, the planning could be ineffective.

Overall, partnership planning entails a discussion of a number of additional planning issues, complexities and risks that are beyond the scope of this paper, and therefore will not be dealt with herein.

Be wary of U.S. limited liability companies and limited liability partnerships

U.S. limited liability companies ("LLCs") and limited liability partnerships ("LLPs") are often used in planning for U.S. taxpayers, combining the benefits of corporate limited liability protection with flow through taxation to its members.

Unfortunately Canada does not treat U.S. LLCs and LLPs as a flow through. Canada taxes LLCs and LLPs as corporations, creating a myriad of tax complexities and mismatches when a Canadian tax resident is a member of a LLC or LLP. It is therefore highly recommended that anyone resident in Canada, including U.S. Income Tax Residents and U.S. Transfer Tax Residents, avoid holding U.S. assets of any kind within a U.S. LLC or LLP.

Leaving the U.S. tax system

As explained earlier, U.S. citizens and green card holders, wherever they live in the world, are caught under the definitions of U.S. Income Tax Resident and U.S. Transfer Tax Resident. This means that they continue to be subject to the U.S. tax system, both income tax and transfer tax, regardless of the fact that they do not reside in the U.S. For many, this means tax filing and reporting in two countries as in the case of those who live in Canada.

It is noted that U.S. domiciliaries living outside the U.S. also continue to be subject to the U.S. transfer tax system, but may be able to minimize U.S. global income taxation as a resident.

For some, the continuing obligation to file tax returns in the U.S. while no longer living there becomes onerous, and when coupled with the possibility of double tax, especially in relation to the possibly large one-time tax burden that can arise upon death, some begin to think about whether there is a way to sever their U.S. tax exposure.

For others, for one reason or another, they may not be filing and reporting in the U.S., and at some point this realization becomes a concern and they too wonder about their continuing tax responsibilities to the U.S., and the repercussions of not being in compliance with these obligations.

Over the years, the U.S. has had a number of regimes that govern how one can exit the U.S. tax system. These regimes involve the renunciation of U.S. citizenship or green cards, as applicable. In the case of U.S. domiciliaries, it is fairly rare to find someone who would fit this category, and in such a case, the solution would involve choosing a country other than the U.S. to be your permanent home, and seeking U.S. tax and legal advice as to whether the U.S. government should be notified.

Under the most recent regime enacted in 2008, it is possible that an exit tax will be payable if one is considered to be a “covered expatriate”. A covered expatriate would be any U.S. citizen that relinquishes U.S. citizenship, and any green card holder that relinquishes their green card or claims non-residence status, who has held the green card for at least 8 of the past 15 years, if they pass any of the following three tests:

Leaving the U.S. tax system (continued)

- their average annual net income tax in the U.S. was more than US$201,000 (2024 threshold) in the previous five years
- their net worth is at least US$2 million
- U.S. tax returns have not been filed over the previous five years

In the event that you meet any of these tests, if you choose to expatriate, then you will be deemed to have sold your assets at that time and any capital gains in excess of US$866,000 (the 2024 exemption for covered expatriates) will be taxed at current capital gains tax rates.

If you do not meet any of these tests, then you will not be a covered expatriate, and you can renounce your citizenship or relinquish your green card, and from that time, exit the U.S. tax system.

There is an exception for those who meet the above tests if you are a dual citizen at birth and live in the other country i.e., not the U.S., or you have not lived in the U.S. for more than 10 years and have not yet reached 18 ½ years old.

If you are a covered expatriate, there are rules that cover most of the other assets you own, retirement plans that you are part of, or interests in trusts or other legal structures, all of which should be addressed but are beyond the scope of this paper.

One caveat to be aware of is that a covered expatriate who gifts assets either during life or upon death, to a U.S. citizen or green card holder, will subject the latter to U.S. gift tax upon receipt of the gift at a flat tax rate of 40%. This means that before deciding to exit the U.S. tax system, if you will be a covered expatriate, you need to consider the tax status of your heirs and factor this into your overall estate and tax planning.

For those who meet the above tests, with proper planning, the use of many of the strategies discussed in this paper to reduce your net worth may be used to expatriate without falling into the classification of covered expatriate.

Your RBC advisor's role

RBC works with clients and their independent legal or tax advisors to help achieve objectives and maximize overall wealth. Our specialized financial advice includes estate planning solutions, succession planning from a business and personal perspective, borrowing and credit, cash management, wealth management, investment management, financial planning, personal retirement planning, trustee service, philanthropy and insurance. Please contact your RBC advisor for more information or visit http://www.rbcwealthmanagement.com/canada.html for an introduction to an RBC advisor.

Where to start

The U.S. tax system and the tax treaties involved across borders are complicated and cumbersome. Knowing where to start and identifying how it all affects you can be daunting. Each case is truly unique.

We have identified a number of issues and planning strategies for most of the relevant ways the U.S. tax system may affect you, but even this paper is not exhaustive. It is vital you seek professional expertise from qualified cross-border tax and/or legal professionals. We encourage you to engage your RBC advisor to help navigate you through your specific situation and engage the proper professionals as needed.

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