U.S. Estate Tax for Canadians in 2016

Understand your exposure and strategies to minimize it

Did you know Canadians who die owning U.S. assets – such as stock of a U.S. corporation, a yacht in Florida or a ski chalet in Colorado – may be subject to U.S. estate tax?

When a Canadian dies owning U.S. property with a value exceeding US$60,000, the executor/liquidator of the estate is required to file a U.S. estate tax return. The estate tax is calculated based on a graduated tax rate system. The tax (before applying certain credits) begins at a rate of 18% on the value of all U.S. situs assets and quickly moves to a top federal tax rate of 40% on the value that exceeds US$1 million.

This article discusses the following topics regarding U.S. estate tax for Canadians:

- Assessing whether you have exposure
- U.S. situs assets
- Assets with U.S. content that are not U.S. situs assets
- Assets included in your worldwide estate
- Estimating your potential U.S. estate tax liability
- Claiming foreign tax credits
- Strategies to minimize your U.S. estate tax exposure
- Filing requirements and penalties

The following appendices are also included in this article:

Appendix A – Table of U.S. estate tax exclusions, unified credits and top tax rates from 2001 to 2016

Appendix B – Table of graduated U.S. estate tax rates for 2016

Appendix C – Sample calculation of U.S. estate tax for a Canadian resident in 2016

Note: U.S. estate tax is one of three types of U.S. transfer taxes that may apply to Canadians. The other two, U.S. gift and U.S. generation skipping transfer tax (GSTT), are not discussed in detail in this article. In this article we discuss U.S. estate tax as it applies to Canadian residents who are not U.S. citizens, green-card holders or U.S. domiciled residents. Only U.S. estate tax at the U.S. federal tax level and the application of Canadian-U.S. Income Tax Treaty (Treaty) will be covered. It is important to note that some U.S. states may levy an estate/inheritance tax on Canadians owning property located in the state (which is not covered in this article).

The information provided in this article is not intended to provide legal or tax advice. While several strategies are outlined, not all of them will apply to your particular financial circumstances. The calculation of U.S. estate tax can be complex and the information provided to calculate it is presented in a very simplified format. Changes in your net worth and/or the U.S. estate tax laws can significantly impact your exposure; therefore, it is recommended that you assess your exposure annually. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified cross-border tax advisor before acting on any of the information in this article.

Assessing Whether You Have Exposure

Canadian residents are only subject to U.S. estate tax on the value of "U.S. situs assets" they own on their death.

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U.S. estate tax applies at an individual level, but keep in mind that the U.S. situs assets you transfer to your heirs may be included in determining your heirs' exposure to U.S. estate tax.

The following quick reference table will help you determine whether you may have U.S. estate tax exposure if you were to die in 2016:

Quick Reference Table: U.S. Estate Tax Exposure for 2016

You must satisfy both of these conditions to have U.S. estate tax exposure:

US$60,000	If the value of your U.S. situs assets on death is greater than US$60,000, your estate representative must file a U.S. estate tax return regardless of whether there is an estate tax liability. If the value of your U.S. situs assets is lower than US$60,000, you will not be subject to U.S. estate tax regardless of the size of your worldwide estate and no estate tax return filing is required.
US$5,450,000	If the value of your worldwide estate is greater than US$5.45 million, you will need to determine if your U.S. situs assets are greater than US$60,000 and you may have exposure to U.S. estate tax. If the value of your worldwide estate is not greater than US$5.45 million, you will not be subject to U.S. estate tax even if the value of your U.S. situs assets is greater than US$60,000 and you must file a U.S. estate tax return.

If you meet both of these conditions, you may have exposure to U.S. estate tax. However, since there are certain credits you may claim, you must perform a calculation to estimate your potential estate tax liability. Your RBC advisor has access to a tool to help you estimate your potential liability.

Note: The term "value" generally means the fair market value at the date of death, but an alternate acceptable valuation method can be chosen using the fair market value six months after the date of death. The valuation method that is chosen must be used to value all property included in the worldwide estate. These values are calculated on a per individual basis and not per family or per couple. The terms "U.S. situs assets" and "worldwide estate" are defined in the sections that follow.

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U.S. Situs Assets

U.S. situs assets are assets that have a U.S. location or connection. Examples of U.S. situs assets include, but are not limited to:

- U.S. real estate
- Assets of a trade or business conducted within the U.S. such as shares of a non-publicly traded U.S. corporation
- Shares in publicly traded U.S. corporations, whether held in a brokerage account in Canada or outside Canada and whether purchased on a U.S. exchange or foreign exchange
- Bonds, debentures and other debt obligations issued by U.S. corporations and U.S. governments, unless they are specifically exempt under the portfolio interest exemption (generally, the portfolio interest exemption applies to U.S. debt obligations that were issued after July 18, 1984, and are not subject to U.S. non-resident withholding tax on interest payments)
- Tangible property situated in the U.S. (e.g. vehicles, art, boats, jewellery)
- U.S. retirement plans (e.g. Roth and traditional IRAs, Simple and SEP IRAs, 401(k)s, 403(b)s and annuities)
- Deposits in a U.S. brokerage firm (however, please note that deposits at a U.S. bank are not U.S. situs assets)
- Gifts of U.S. situs assets made during your lifetime if you have retained a life interest in them or your gift was revocable i.e. you have a right to income, possession or enjoyment, the right to designate who will enjoy the assets or the right to take them back (e.g. U.S. situs assets held in Canadian registered plans such as RRSPs, RRIFs, RESPs, RDSPs or TFSAs, in an alter-ego or joint partner trust, or in a revocable trust that is caught by the Canadian income attribution rules)
- Any of the U.S. securities mentioned above that you have been given a general power of appointment over which is a right that you can exercise to dispose of the U.S. situs assets in favour of yourself, your creditors, your estate or your estate's creditors or the power to change the trust (e.g. assets of a trust where you are the beneficiary and you have the power to have assets in the trust transfer to your estate or to use the trust assets to pay your creditors or the creditors of your estate upon your death or the power to change the trust)
- Any of the above U.S. situs assets held in discretionary managed accounts (whether held in a brokerage account in Canada or outside Canada and whether purchased on a U.S. exchange or foreign exchange) even though the buy and sell decisions are not made by you
- All U.S.-listed Exchange-Traded Funds (ETFs) (e.g. iShares) including those that are legally structured as a Regulated Investment Company (RIC). Note: There was U.S. legislation that applied to deaths up to December 31, 2011 that excluded an RIC, or a portion of the value of an RIC that was attributable to non-U.S. property from U.S. situs status (i.e. an iShare that was an RIC fully invested in the European or Asian market was not U.S. situs). However, no further legislation was introduced to extend this treatment to subsequent years.

Assets With U.S. Content That Are Not U.S. Situs Assets

Examples of property with U.S. content but are generally not considered U.S. situs assets include:

- Shares of Canadian mutual fund corporations that invest in the U.S. market (even if denominated in U.S. currency)
- Units of Canadian mutual fund trusts (including ETFs) trading on the TSX or another exchange that invest in the U.S. market
- Canadian-issued notes that are linked to a U.S. index
- American Depository Receipts (ADRs) – These are exempt from U.S. estate tax because the underlying share holdings are not U.S. corporations

The value of your worldwide estate for U.S. estate tax purposes is the fair market value of all your assets on the date of your death (or other acceptable valuation date) net of non-recourse debt on your U.S. situs assets.

- U.S. bank chequing or savings deposits, as long as they are not effectively connected with a U.S. trade or business
- U.S. Treasury Bills or U.S. Certificates of Deposit
- U.S. corporate and government bonds that are subject to the portfolio interest exemption (this means that there is no U.S. requirement to withhold tax on the interest paid to a non-resident of the U.S. and the investments are not used in a U.S. trade or business)
- Canadian-issuer U.S. pay bonds that provide exposure to the U.S. dollar

Assets Included in Your Worldwide Estate

The value of your worldwide estate for U.S. estate tax purposes is the fair market value of all your assets on the date of your death (or other acceptable valuation date) net of non-recourse debt on your U.S. situs assets.

Non-recourse debt is collectable only against the U.S. situs property itself and not against any other assets of the estate.

Your worldwide estate value is used to calculate the prorated amount of regular debts and expenses that may be deducted and the prorated unified credit you may claim. These concepts are explained next in the section that discusses how to estimate your estate tax liability.

In addition to assets you own directly, here are examples of property that is also included in your worldwide estate:

- Proceeds payable to beneficiaries of any life insurance policy you owned upon your death where you had "incidents of ownership" on the policy (this generally means that you had the ability to name or change beneficiaries, borrow against the policy, access the cash value or assign or cancel the policy)
- 100% of the value of the property you owned as a joint tenant with the right of survivorship (JTWROS), unless you can prove that the other joint tenant contributed capital
- Any property you have gifted during your lifetime where you have retained a life interest or where your gift was revocable
- Any property that you have been given a general power of appointment

Estimating Your Potential U.S. Estate Tax Liability

To estimate your U.S. estate tax liability you must determine your taxable estate value, apply the graduated estate tax rates to arrive at a tentative U.S. estate tax, and claim a prorated unified credit and the marital credit (where applicable).

Taxable Estate Value

The taxable estate value is the fair market value of your U.S. situs assets (net of non-recourse debt) on your death less allowable deductions.

Allowable deductions include the value of U.S. situs assets donated to qualified U.S. charities, estate tax paid to a U.S. state and a prorated portion of regular debts and expenses (including funeral costs, administrative expenses and regular debts). For example, if you have a regular mortgage on a U.S. real estate property, you can deduct only a prorated portion of the value of the mortgage. However, if you have a non-recourse mortgage on the U.S. property, you can deduct the entire value of the mortgage from the value of your U.S. situs assets. This is because a non-recourse mortgage is collectable only against the U.S. real estate

Under the Treaty a foreign tax credit for U.S. estate tax may be claimed on your Canadian return to reduce federal tax attributable to income, profits or gains on U.S. situs assets.

property itself and not against any other assets.

The deductible prorated portion is calculated by multiplying the amount of the regular debt and expenses by the ratio of your U.S. situs assets (net of non-recourse debt) to your worldwide estate value.

Tentative U.S. Estate Liability

Once you determine the taxable estate value, a tentative U.S. estate tax liability may be calculated using the graduated tax rates in effect in the year of your death. Refer to Appendix B for a table of the graduated U.S. estate tax rates for 2016.

U.S. Estate Tax Liability

Under the Canada-U.S. tax treaty (Treaty), your tentative U.S. estate tax liability may be reduced by two non-refundable credits: 1) a "prorated unified credit" and 2) a "marital credit".

Prorated Unified Credit

In 2016 the unified credit before proration (based on the US$5.45 million U.S. estate tax exclusion) is US$2,125,800. The prorated unified credit is calculated by multiplying the unified credit by the ratio of your taxable U.S. estate value to your worldwide estate value.

Marital Credit

The marital credit is available when U.S. situs assets are transferred to a surviving Canadian citizen or resident spouse who is not a U.S. citizen. A spouse for this purpose is considered to be someone you are legally married to; therefore, common-law partners may not qualify for this credit.

The marital credit is calculated as the lesser of:

1) the prorated unified credit; and,

2) the U.S. estate tax that would otherwise be payable on the particular U.S. situs property transferred to your spouse (i.e. the tentative U.S. estate tax on the taxable estate before transfer less the tentative U.S. estate tax on the U.S. situs property not transferred to your spouse).

The marital credit may effectively double the prorated unified credit.

Refer to Appendix C for a numerical example that illustrates a step-by-step calculation of U.S. estate tax for a Canadian resident who dies in 2016. Your RBC advisor also has access to a calculator that can be used to help you estimate your potential liability. You will need to provide your RBC advisor with an estimate of your "taxable estate value" and your "worldwide estate value". You should obtain assistance from your professional tax advisor to estimate these values.

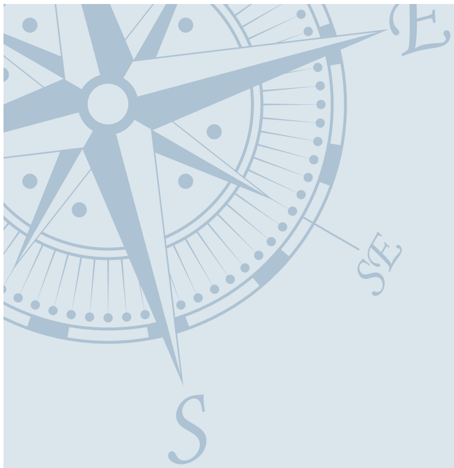
Prorated Unified Credit:

$$\frac{\text{Taxable estate value}}{\text{Worldwide estate value}} \times \text{Unified credit for the year of death}$$

Claiming Foreign Tax Credits for U.S. Estate Tax

Under the Treaty a foreign tax credit for U.S. estate tax may be claimed on your Canadian return to reduce federal tax attributable to income, profits or gains on U.S. situs assets. However, the maximum foreign tax credit you can claim is limited to your Canadian tax liability, which may be much smaller than your U.S. estate tax liability. In addition there may be double tax since Canadian provinces generally do not permit foreign tax credits for U.S. estate tax.

For Canadian tax purposes when a person dies, there is no estate tax; however, the Canadian "deemed disposition rules" may trigger Canadian income tax. Only 50% of net capital gains (accrued gains less losses) on assets in your non-registered accounts are taxable. Also, if there are no accrued gains on the assets or you transfer the assets to your spouse, it is possible there may be no Canadian income tax. For registered accounts such as your RRSP/RRIF, the fair market value of the plan is subject to Canadian tax, however, there is a tax-free rollover if the plan is transferred to a qualifying beneficiary such as your spouse. When there is no Canadian



You may invest in the U.S. market without creating exposure to U.S. estate tax by choosing investments with U.S. content that are not considered U.S. situs.

tax, double tax arises because your estate pays U.S. estate tax but you cannot claim a foreign tax credit on your Canadian return to recoup it. In the future when your spouse or other beneficiary pays Canadian tax on the U.S. situs assets, they will be unable to claim an offsetting foreign tax credit based on the U.S. estate tax previously paid by you. A potential strategy to avoid double tax requires transferring assets to your spouse at FMV. This strategy is discussed in the next section.

Strategies to Minimize Your U.S. Estate Tax Exposure

The following is a list of common strategies (not an exhaustive list) that may reduce or eliminate your exposure to U.S. estate tax. You should speak to a professional cross-border tax or legal advisor to discuss which strategies are appropriate to implement in your own particular circumstances.

- Make alternative investment choices
- Keep worldwide estate value below US$5.45 million
- Gift U.S. situs assets prior to your death
- Sell U.S. situs assets prior to your death
- Transfer U.S. situs assets to your spouse at FMV
- Set up an Irrevocable Life Insurance Trust (ILIT)
- Set up a Qualified Domestic Trust (QDOT) or claim the marital credit
- Consider severing U.S. situs property held in JTWROS
- Hold U.S. situs property through a tenancy in common
- Hold U.S. situs assets in a Canadian corporation
- Hold U.S. situs assets in a Canadian trust
- Transfer U.S.-based retirement plans to an RRSP
- Make charitable donations to U.S. charities

Note: For the ownership of U.S. real estate, our separate article titled U.S. Estate Tax: Canadians Owning U.S. Real Estate discusses the impact of U.S. estate tax if you own U.S. real estate and the strategies you may wish to consider to reduce your exposure. Ask your RBC advisor for a copy of the article if you would like more information.

Make Alternative Investment Choices

Review your current portfolio and replace some or all of your U.S. situs assets with alternative investment choices. You may invest in the U.S. market without creating exposure to U.S. estate tax by choosing investments with U.S. content that are not considered U.S. situs (listed earlier). Speak to your professional tax advisor and your RBC advisor before changing your investments.

Keep Worldwide Estate Value Below US$5.45 Million

U.S. estate tax will not apply if your worldwide estate value is below the U.S. estate tax threshold. Therefore, consider rebalancing the ownership of existing assets between you and your spouse and/or other family members during your lifetime. When purchasing a new asset, carefully consider who the owner should be. Keep in mind that if you are transferring assets between family members, capital gains and losses may be triggered on assets transferred to someone other than your spouse and the Canadian income attribution rules may apply to income earned on the assets.

Also note that, the estate tax threshold is indexed to inflation; therefore, you will be able to increase the value

Making gifts of your U.S. situs assets while you are alive will reduce your worldwide estate value.

of your worldwide estate each year. Speak to your professional tax and legal advisor and RBC advisor before rebalancing your investments. They can help you determine whether creditor issues, U.S. gift tax and Canadian deemed disposition and income attribution rules will have an impact on this planning.

Gift U.S. Situs Assets Prior to Your Death

Making gifts of your U.S. situs assets while you are alive will reduce your worldwide estate value. Beware that gifts of U.S. situs assets that are U.S. tangible property may be subject to U.S. gift tax or U.S. generation skipping transfer tax (GSTT). U.S. gift tax is levied at the same graduated tax rates that apply for U.S. estate tax (for 2016 the maximum tax rate of 40% is reached when the value of tangible property exceeds US$1 million). When GSTT applies a flat tax based on highest U.S. gift or estate tax rate (40% for 2016) is levied on the value of the taxable gift or inheritance.

Canadians who are not U.S. citizens, green-card holders or U.S. residents domiciled in the U.S. are subject to U.S. gift tax on gifts of U.S. situs property that is tangible property. This includes gifts of U.S. real estate, art, cars or jewellery located in the U.S. A gift of U.S. stocks or bonds is not considered a gift of U.S. tangible property; however, a gift of cash from a U.S.-based financial institution is. Also, a gift of cash to a relative that is used by the relative to purchase U.S. tangible property from you may be considered to be a taxable gift.

If the total value of all U.S. tangible property gifted each year is US$14,000 (year 2016 exclusion) or less, the gift will be exempt from U.S. gift tax. Where the gift of U.S. tangible property is made to a non-U.S. citizen spouse, you can gift up to US$148,000 (year 2016 exclusion) each year. An unlimited amount of gifts of U.S. tangible property can be made to a U.S. citizen spouse without gift tax. Unfortunately, when a taxable gift is made, Canadians do not qualify for the US$5.45 million lifetime gift tax exclusion that is available to U.S. citizens, green-card holders and U.S. residents domiciled in the U.S.

Generation skipping transfer tax (GSTT) will apply when U.S. gift tax applies to taxable gifts or U.S. estate tax applies to taxable bequests made to "skip persons". A skip person includes a grandchild or great grandchild. Fortunately, Canadians may use a lifetime GSTT exemption (US$5.45 million for 2016) to offset taxable gifts or inheritances to skip persons.

Keep in mind, a gift of assets to a spouse or minor child that are used to earn income may be subject to the Canadian income attribution rules. Also, for Canadian tax purposes you may trigger a tax liability if you gift assets with accrued gains to someone other than your spouse.

Sell U.S. Situs Assets Prior to Your Death

Selling U.S. situs assets just before your death will reduce your U.S. estate tax liability. However, this approach is generally only available if you become seriously ill and have the opportunity and mental capacity to execute the sale before your death or someone with a power of attorney/mandate can act on your behalf. While you can sell your assets while you are healthy, this may trigger accrued gains and a premature tax liability unless you have capital loss carryovers or you trigger accrued losses to offset the gains. Your RBC advisor can assist you with reviewing possible tax-loss selling strategies where accrued gains will be triggered.

Transfer U.S. Situs Assets to Your Spouse at Fair Market Value

To maximize the amount of foreign tax credits for U.S. estate taxes paid that may be claimed upon your death on your final Canadian return, you should draft your Will to allow your executor/liquidator the ability to trigger Canadian tax on U.S. situs assets transferred to your spouse. Your executor/liquidator can elect to transfer U.S. situs assets in your non-registered account to your spouse at fair market value (triggering net capital gains) on your return. This will bump the tax base of these assets for Canadian tax purposes without

When you own the policy on your life outright, you are considered to have incidents of ownership in the policy. As a result, the value of the death benefit paid is included in your worldwide estate for purposes of calculating your U.S. estate tax liability.

triggering a Canadian tax liability to the extent of offsetting foreign tax credits. They can also bring into your taxable income the value of U.S. situs assets in your RRSP/RRIF and rollover only the value of non-U.S. situs assets to your spouse's RRSP/RRIF. In order to execute this strategy with your RRIF, your spouse should not be named as the successor annuitant of your plan; however, they can be designated as a beneficiary.

Set Up an Irrevocable Life Insurance Trust (ILIT)

Consider purchasing or transferring your life insurance policy to an ILIT. When you own the policy on your life outright, you are considered to have incidents of ownership in the policy. As a result, the value of the death benefit paid is included in your worldwide estate for purposes of calculating your U.S. estate tax liability. Incidents of ownership in the policy include having the ability to name or change beneficiaries, borrow against the policy, access the cash value or assign or cancel the policy.

If you have to include the death benefit in your estate you may increase your exposure to U.S. estate tax. The death benefit may increase the value of your worldwide estate and reduce the amount of the unified credit you are able to claim to reduce your estate tax.

With an ILIT you do not actually own the life insurance policy outright (the trust owns it) and you do not have incidents of ownership. You should also keep the following in mind when using an ILIT:

- You will not have access to the cash surrender value or be able to borrow against the policy. This will pose a problem if you require the life insurance for investment or retirement purposes.
- The ILIT will be considered an inter-vivos trust for Canadian tax purposes and any investment income earned on the proceeds paid into the ILIT after your death will be taxed at the highest marginal tax rates in Canada unless the income is paid or made payable to a beneficiary.
- The transfer of an existing policy to an ILIT will result in a disposition for Canadian tax purposes and may trigger a tax liability.
- The death benefit from an existing policy transferred to an ILIT will be included in your worldwide estate if you die within three years of the date of transfer.

You should perform a cost-benefit analysis to ensure that the estate tax saved using an ILIT is greater than the costs associated with these issues including the trust setup and annual fees involved.

As an alternative to the ILIT, it is possible to avoid U.S. estate taxes by having your spouse (who may have no exposure to U.S. estate tax) or your corporation own the policy on your life. However, there can be issues with these strategies. For example, you should consider the risk that your spouse may predecease you and the transfer of the policy to someone other than yourself may result in a disposition for Canadian tax purposes. Furthermore, if you provide the funds to your spouse to make the premium payments you may still be considered to have incidents of ownership in the policy. If you are a shareholder of the corporation that owns the policy and you own more than 50% of the shares of the corporation, it is possible you will be considered to have incidents of ownership in the policy. Even where ownership in the corporation is less than 50%, the value of your shares, which is included in your worldwide

Your estate may claim a marital credit if U.S. situs assets are transferred to your spouse or to a spousal trust, or it may claim a marital deduction if the assets are transferred to a QDOT.

estate value, may be increased by the proportionate amount of the death benefit paid to the corporation which may in effect increase your U.S. estate tax liability.

Speak to a cross-border tax professional for advice on whether the strategy of implementing an ILIT makes sense for you.

Set Up Qualified Domestic Trust (QDOT) or Claim the Marital Tax Credit

For U.S. estate tax purposes, your estate may claim a marital credit if U.S. situs assets are transferred to your spouse or to a spousal trust, or it may claim a marital deduction if the assets are transferred to a QDOT. It cannot claim both. The marital deduction effectively defers a portion or all of your U.S. estate tax liability. The deferral lasts until distributions of capital are made from the QDOT to your surviving spouse or your surviving spouse dies. At this point the U.S. estate tax liability that was deferred and U.S. estate tax on any growth of the assets becomes payable. The U.S. estate tax is calculated based on the tax rates that existed in the year of your death when the deferral occurred.

A QDOT is an irrevocable trust for the sole benefit of a non-U.S. citizen surviving spouse. There are a number of criteria in order for a trust to qualify as a QDOT. First, the trust must have at least one trustee that is a U.S. citizen or U.S. corporation. If the assets to be transferred to the QDOT have a value of at least US$2 million at the time of your death (or an alternate valuation date, if applicable), additional requirements are necessary. Under a large QDOT, at least one trustee must be a U.S. bank or trust company or a bond or letter of credit must be provided in favour of the Internal Revenue Service (IRS).

Your executor/liquidator may consider using a QDOT strategy where your estate cannot otherwise eliminate or substantially reduce your U.S. estate tax liability by claiming the marital credit and the estate tax cannot be recouped by claiming foreign tax credits on your Canadian tax return. Therefore, it is important to draft your Will carefully to provide your executor/liquidator with the flexibility to direct U.S. situs assets to a QDOT.

A QDOT set-up through your Will may be structured as a testamentary trust. It is possible for the trust to be structured for Canadian tax purposes as a spousal trust (although this is often difficult to do). When it qualifies, the structure will avoid the Canadian deemed disposition rules since assets of the deceased can transfer on a tax-deferred basis to the spousal trust.

Speak to a professional cross-border tax and/or legal advisor for advice on how to structure and incorporate a QDOT in your Will.

Consider Severing U.S. Situs Property Held in JTWROS

Ownership of U.S. situs property in a Joint With Right Of Survivorship (JTWROS) structure may not be advisable where U.S. estate tax exposure exists. JTWROS is a form of co-ownership where on the death of a tenant their interest in the property passes to the surviving tenant(s).

For U.S. estate tax purposes, the value of U.S. situs property held JTWROS is included in the estate of the first tenant to die unless it can be demonstrated (with appropriate records) that the surviving joint tenant(s) contributed to the purchase of the assets. When this is possible, only the proportionate share of the assets based on the deceased's contributions will be included in the estate.

If you hold assets in JTWROS with your spouse, your share of the assets held JTWROS will automatically transfer to your surviving spouse upon your death. This will not allow your executor/liquidator the flexibility to carry out U.S. estate tax planning such as implementing a testamentary spousal trust that could be structured to protect assets from U.S. estate tax on your surviving spouse's death or a QDOT to defer your own U.S. estate tax liability.

In the event you hold assets in JTWROS with your spouse and your surviving spouse dies within 10 years of your death, they may claim a credit relating

It may be possible for U.S. estate tax purposes for each co-owner to apply a valuation discount when determining the fair market value of their respective share of the property.

to any U.S. estate tax paid by your estate for that asset to reduce the double U.S. estate tax. However, the credit is significantly reduced on a sliding scale after 2 years of your death. The result is that the U.S. property may be subject to U.S. estate tax twice in the same generation.

In addition to the U.S. estate tax issues, differences in Canadian and U.S. income tax rules may result in double taxation. For example, if U.S. real estate held JTWROS is sold and only one spouse contributed all the funds to make the purchase, U.S. income tax law generally requires each spouse to report 50% of the capital gain. However, for Canadian income tax purposes the capital gain is subject to Canadian income attribution rules, which requires the spouse who provided the original capital to purchase the asset to report the capital gain. An individual cannot claim a foreign tax credit for the U.S. income tax paid by their spouse resulting in double tax.

Where these issues exist, you may consider severing the property held JTWROS, based on each tenant's contributions, and hold your interest as tenants in common.

Holding property as JTWROS does offer the benefit of avoiding probate upon the death of the first spouse. The probate process could be costly and take a significant amount of time. Therefore, where the tax issues are not significant, JTWROS may be a viable alternative for titling the property.

Hold U.S. Situs Property Through a Tenancy In Common

Tenancy in common is a form of co-ownership where each tenant may own an equal or unequal share of the property. On the death of a tenant, their interest in the property does not pass to the surviving tenants but rather passes through their estate according to their Will or intestacy legislation. Only the deceased tenant's share in the property is subject to U.S. estate tax, not the full value of the property.

Since assets will pass through each tenant's estate, they are able to implement estate planning for U.S. estate tax purposes such as implementing a testamentary spousal trust that can be set up to exclude U.S. situs assets from a surviving spouse's estate or a QDOT to defer their own U.S. estate tax liability.

Note that for U.S. estate tax purposes, a divided interest in certain types of property such as U.S. real estate may be less marketable than a sole interest. It may be possible for U.S. estate tax purposes for each co-owner to apply a valuation discount (some legal experts suggest a 15-20% discount for U.S. real estate) when determining the fair market value of their respective share of the property.

The same income tax issues (double taxation) discussed earlier for ownership in JTWROS may apply where one spouse provides the funds to the other spouse to purchase the property as tenants in common. There are also other issues to consider when the property is held tenants in common, especially when held with children and other family members. For example, a tenant in common can sell his or her share in the asset to a third party, mortgage his or her interest, use it as collateral for a loan, or gift it to someone else without requiring the consent of the other tenants. In addition, there is exposure to U.S. probate, and without further planning, administrative delays may result in dealing with U.S. guardianship issues in the event that the tenant becomes incapacitated.

To avoid exposure to U.S. estate tax the trust must not allow a life interest to be retained by the person transferring property to the trust and the trust must not create a general power of appointment for the beneficiaries over the assets in the trust.

Hold U.S. Situs Assets in a Canadian Corporation

Assets you hold in a bona fide Canadian corporation (e.g. a holding company incorporated in Canada) are generally not subject to U.S. estate tax. It may therefore be possible to hold certain U.S. situs assets in a Canadian corporation (e.g. shares of U.S. corporations) to insulate yourself from U.S. estate taxes. However, you should consider the costs associated with using a corporation including the additional tax filings and accounting fees. Furthermore, earning income from U.S. assets held in your corporation (such as U.S. dividends) may result in a larger current tax liability versus holding these assets personally due to current Canadian corporate versus personal tax rates that apply to foreign income.

Holding U.S. vacation or rental properties in your corporation may not be advisable due to the tax issues created. These issues are outlined in our separate article that discusses U.S. estate tax and various ownership structures for holding U.S. real estate. Ask your RBC advisor for a copy of the article if you require more information.

Before using a Canadian corporation to hold U.S. situs assets, ensure that the strategy is reviewed by a cross-border tax advisor who can evaluate the risks from both a Canadian and U.S. perspective to determine whether using a Canadian corporation will achieve the desired objectives.

Hold U.S. Situs Assets in a Canadian Trust

U.S. situs assets held in a properly structured trust may not be subject to U.S. estate tax for the settlor and/or the beneficiaries. A Canadian trust is sometimes used to purchase U.S. real estate; however, it may also be used to purchase intangible property such as shares of a U.S. company. The planning using a Canadian trust to purchase U.S. real estate is discussed in our separate article. Ask your RBC advisor for a copy of the article if you require more information.

Here we discuss the use of a trust to hold U.S. situs assets such as U.S. securities. For example, you may set up a family trust for income splitting purposes. You may fund the trust with cash to purchase U.S. securities or transfer U.S. securities to the trust. Alternatively, in your Will you may set up a testamentary trust upon your death that is funded with cash or U.S. securities.

To avoid exposure to U.S. estate tax the trust must not allow a life interest to be retained by the person transferring property to the trust and the trust must not create a general power of appointment for the beneficiaries over the assets in the trust.

For the settlor, this means the trust is structured as an irrevocable trust and the settlor does not have a right to the income of the trust, to possession or enjoyment of the property, a right to have the property revert back, a right to designate who will enjoy the property, or the power to change the trust.

For the beneficiaries, this means they cannot direct the assets to their estate or use them to pay their creditors or the creditors of their estate upon their death. For example, a testamentary spousal trust may be structured with your spouse as the sole beneficiary. The trust provides income to your spouse for their lifetime, but encroachment of capital is permitted by your spouse in limited situations and the assets in the trust revert to your children upon your spouse's death. If the trust is set-up in this manner, your spouse would not have a general power of appointment over the property in the trust.

A power is not general if its exercise is limited by an ascertainable standard. For example, instead of structuring a testamentary spousal trust where the spouse has no encroachment powers over the capital you can allow a limited encroachment on the capital where the capital distributions are limited to health, education, support and maintenance. As your surviving spouse will not have free access to the capital in the spousal trust on their death, the assets in the trust are protected from U.S. estate tax. There are other exceptions for accessing the capital of the trust by the beneficiary that do not result in a general power

If the value of your U.S. situs assets on death exceeds the US$60,000 threshold, a U.S. estate tax return (IRS Form 706-NA) must be filed within nine months of the date of death.

of appointment, which are beyond the scope of this article.

If you are the settlor or beneficiary of a trust, it is important to review the trust to determine whether you have exposure to U.S. estate tax. This may result in U.S. estate tax on the value of the U.S. situs assets of the trust or the inclusion of the trust assets in your worldwide estate value.

You should speak to a cross-border tax advisor for further information and assistance when setting up a properly structured trust to avoid U.S. estate tax. You should also ask the tax advisor to review existing trusts for U.S. estate tax exposure.

Transfer U.S.-Based Retirement Plans to an RRSP

If you have accumulated funds in a U.S.-based retirement plan (such as a 401(k), a traditional Individual Retirement Account (IRA) or another U.S. retirement plan) you may be able to reduce or eliminate your exposure to U.S. estate tax by transferring the plan to your Registered Retirement Savings Plan (RRSP). For U.S. estate tax purposes, the entire value of your U.S.-based retirement plan is a U.S. situs asset regardless of whether the particular assets in the plan are U.S. situs. However, with an RRSP, only those assets within the RRSP that are U.S. situs assets would be exposed to U.S. estate tax.

Transferring assets from a U.S. retirement plan to an RRSP will result in a U.S. tax liability. However, you may be able to claim a foreign tax credit on your Canadian income tax return for U.S. taxes paid, possibly making the transfer tax neutral.

Ask your RBC advisor for our separate article that discusses the transfer of a U.S.-based retirement plan to an RRSP.

Make Charitable Donations to U.S. Charities

When U.S. situs property, on which U.S. estate tax would otherwise be payable, is given or bequeathed to a U.S. charitable organization, the bequest reduces the amount of U.S. situs property on which U.S. estate taxes are calculated. The U.S. charitable organization must be operated exclusively for religious, charitable, scientific, literary or educational purposes and your Will must contain specific provisions for the donation of the U.S. situs property.

Filing Requirements and Penalties

If the value of your U.S. situs assets on death exceeds the US$60,000 threshold, a U.S. estate tax return (IRS Form 706-NA) must be filed within nine months of the date of death. This filing is required even though you may not have a U.S. estate tax liability (e.g. the value of your worldwide estate is below the US$5.45 million threshold).

The IRS can impose penalties for both late filing and for late payment unless there is reasonable cause. It may also impose penalties for valuation understatements that cause an underpayment of the tax. In addition, if your estate is trying to transfer U.S. real estate property, many transfer agents may not agree to transfer the property without proof of clearance from the IRS.

Consider Your Exposure and Plan Accordingly

Whether you own U.S. property for investment or for enjoyment, understanding your potential exposure to U.S. estate tax and implementing the appropriate strategies to minimize it is key to maximizing the value of your wealth you pass on to your heirs.

Appendix A

Table of U.S. Estate Tax Exclusions, Unified Credits and Top Marginal Rates from 2001 to 2016

Year	Exclusion Amount (US$)	Unified Credit (US$)	Max / Top Tax Rate
2001	$675,000	$220,550	55%
2002	$1,000,000	$345,800	50%
2003	$1,000,000	$345,800	49%
2004	$1,500,000	$555,800	48%
2005	$1,500,000	$555,800	47%
2006	$2,000,000	$780,800	46%
2007	$2,000,000	$780,800	45%
2008	$2,000,000	$780,800	45%
2009	$3,500,000	$1,455,800	45%
2010	$5,000,000 or NIL with special election	$1,730,800 or n/a	35% or NIL
2011	$5,000,000	$1,730,800	35%
2012	$5,120,000	$1,772,800	35%
2013	$5,250,000	$2,045,800	40%
2014	$5,340,000	$2,081,800	40%
2015	$5,430,000	$2,117,800	40%
2016	$5,450,000	$2,125,800	40%

Reference: (https://www.irs.gov)

Appendix B

Table of Graduated U.S. Estate Tax Rates 2016

Column A: Taxable Amount Over	Column B: Taxable Amount Not Over	Column C: Tax on Amount in Column A		Column D: Rate of Tax on Excess Over Amount in Column A
$0	$10,000	$0	Plus	18%
$10,000	$20,000	$1,800	Plus	20%
$20,000	$40,000	$3,800	Plus	22%
$40,000	$60,000	$8,200	Plus	24%
$60,000	$80,000	$13,000	Plus	26%
$80,000	$100,000	$18,200	Plus	28%
$100,000	$150,000	$23,800	Plus	30%
$150,000	$250,000	$38,800	Plus	32%
$250,000	$500,000	$70,800	Plus	34%
$500,000	$750,000	$155,800	Plus	37%
$750,000	$1,000,000	$248,300	Plus	39%
$1,000,000	$5,450,000	$345,800	Plus	40%
$5,450,000	unlimited	$2,125,800	Plus	40%

Reference: (https://www.irs.gov).

Appendix C

Sample calculation of U.S. Estate Tax for a Canadian Resident in 2016

This calculation applies to Canadian residents (who are not U.S. citizens, greencard holders or U.S. residents domiciled in the U.S.)

Mrs. C, a Canadian resident owns U.S. situs assets valued at US$2.5 million and has a conventional mortgage of $500,000 (no other liabilities). Her worldwide estate is valued at US$12.5 million. Does Mrs. C have U.S. estate tax exposure?

STEP 1: Verify whether the value of her U.S. situs assets and worldwide estate exceed the U.S. estate tax thresholds

Since the value of Mrs. C's U.S. situs assets is greater than US$60,000 and the value of her worldwide estate is greater than US$5.45 million, exposure to U.S. estate tax may exist. A calculation is required to quantify the exposure.

STEP 2: Estimate her taxable estate value and calculate the tentative U.S. estate tax using the table in Appendix B

Taxable estate value: US$2.5 million worth of U.S. situs assets less US$100,000 prorated deduction (calculated below) for the mortgage = US$2.4 million taxable estate

Prorated deduction: US$500,000 mortgage x (US$2.5 million U.S. situs asset value divided by US$12.5 million worldwide estate value) = US$100,000

Tentative U.S. estate tax: Using Appendix B, the tentative U.S. estate tax on US$2.4 million taxable estate value is US$905,800*

* US$345,800 (which is the U.S. estate tax on the first US$1 million in taxable estate value found in column C of the graduated tax rate table in Appendix B) plus US$560,000, which is 40% (tax rate in column D in Appendix B) of the excess of US$1.4 million (i.e. US$2.4 million less US$1 million from column C)

STEP 3: Estimate the prorated U.S. estate tax unified credit that can be deducted

The value that may be deducted is calculated by taking the value of your taxable estate (i.e. U.S. situs assets less allowable deductions) divided by your worldwide estate value and multiplying by the unified credit for the year (i.e. US$2,125,800 for 2016).

Ratio of taxable estate value to worldwide estate:
US$2.4 million ÷ US$12.5 million = 19.2%

Prorated U.S. estate tax unified credit:
US$2,125,800 x 19.2% = US$408,154

STEP 4: Subtract the prorated unified credit in step 3 from the tentative U.S. estate tax from step 2

Net U.S. estate tax payable before applying the marital credit (if applicable):
US$905,800 – US$408,154 = US$497,646

If Mrs. C is not married, US$497,646 would be her U.S. estate tax liability if she died in 2016.

STEP 5: If she was married to a Canadian non-U.S. citizen (common-law partners may not be considered spouses) and she leaves her assets to her spouse, she can deduct an additional non-refundable marital credit

The marital credit is US$408,154, calculated as the lesser of:

1. the prorated unified credit (i.e. US$408,154); and,
2. the U.S. estate tax that would otherwise be payable on the U.S. situs property transferred to her Canadian spouse before any credits (i.e. US$905,800).

STEP 6: Subtract the marital credit in step 5 from the U.S. estate tax payable from step 4

Mrs. C's U.S. estate liability if all her U.S. situs assets are inherited by her spouse is US$89,492*

*(U.S. estate tax before marital credit US$497,646 less marital credit US$408,154 = US$89,492)

Note: Mrs. C's executor/liquidator may be able to recoup the U.S. estate tax by claiming a foreign tax credit on her Canadian tax return to reduce any Canadian tax payable that is attributable to U.S. situs assets.

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

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