

U.S. Estate Tax and High Net Worth Canadians: Determining if You Have Any Liability



If the value of your worldwide assets exceeds US\$11.18 million and you hold more than US\$60,000 in property situated in the U.S. (“U.S. situs assets”) such as U.S. stocks or a U.S. vacation property, you may be liable for U.S. federal estate tax (the “U.S. estate tax”). This applies to Canadians even if they are not U.S. citizens, residents or green card holders.

The information within this article for determining U.S. estate tax liability:

- assumes that the taxpayer is a Canadian resident who is not a U.S. citizen, resident or green card holder; and
- reviews the impact of U.S. federal estate tax. Please note that certain states within the U.S. also have their own inheritance/estate tax, which is not discussed here.

What is U.S. Estate Tax?

U.S. estate tax is levied by the U.S. federal government on large transfers of wealth between individuals at the time of death. For Canadians, U.S. estate tax applies only on the transfer upon death of U.S. situs assets if the value of the Canadian’s U.S. situs assets and worldwide assets exceed certain thresholds. U.S. situs assets are generally assets that have a U.S. location or connection.

The U.S. estate tax is levied on the fair market value of the property, unlike Canadian capital gains tax at death which is levied on the growth in value of the property.

U.S. Estate Tax Rates and Exemptions

The U.S. estate tax is applied on a graduated basis with a maximum rate of 40%. The exemption amount is adjusted annually for inflation. On December 22, 2017, the *Tax Cuts and Jobs Act* (TCJA) became law and it doubled the federal estate and gift tax exemption amounts from US\$5.6 million to US\$11.18 million (adjusted annually for inflation) effective until 2025.

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If new legislation is not enacted, the exemption amount will revert to the exemption amount under prior law (US\$5 million adjusted for inflation for 2026).

For Canadians, the *Canada-U.S. Tax Convention* (the "Treaty") provides an enhanced credit and the exemption amount is prorated based on the value of their U.S. situs assets divided by the value of their worldwide estate at the time of death.

What Canadians are Subject to U.S. Estate Tax?

Generally, Canadians may be subject to U.S. estate tax if, at the time of their death:

- the value of their U.S. situs assets exceeds US\$60,000; and,
- the value of their worldwide assets exceeds US\$11.18 million (for 2018, adjusted for inflation annually).

What Assets are considered U.S. Situs Assets?

For U.S. estate tax purposes, U.S. situs assets may include, but are not limited to the following:

- U.S. real estate (e.g., vacation home in Florida);

- Shares of U.S. corporations regardless of whether they are held in Canada or outside Canada. This also includes U.S. company shares held inside a registered retirement savings plan (RRSP), registered retirement income fund (RRIF), registered education savings plan (RESP), registered disability savings plan (RDSP) or a tax-free savings account (TFSA);
- U.S. listed exchange-traded funds (ETFs);
- Tangible personal property located in the U.S. (e.g., cars, boats, jewelry, artwork);
- U.S. mutual funds acquired directly from the U.S.;
- U.S. pension plans and annuity amounts (including individual retirement accounts (IRAs) and 401(k) plans);
- Debt obligations issued by a U.S. person, corporation or government (unless exempt, as discussed below); and
- Deposits held in a U.S. brokerage account.

The following assets are generally not considered to be U.S. situs assets for U.S. estate tax purposes:

- Canadian mutual funds that invest in U.S. securities;
- Canadian exchange-traded funds (ETFs) that invest in U.S. securities;
- American depository receipts (ADRs);
- U.S. government and corporate bonds that qualify for the U.S. portfolio interest exemption (i.e., generally applies to bonds issued after July 18, 1984 that are not subject to U.S. non-resident withholding tax);
- U.S. bank deposits (excluding those held in a U.S. brokerage account), as long as they are not effectively connected with a U.S. trade or business; and,
- Tangible personal property that is merely "in transit" in the U.S., for example, jewelry and other personal effects of a Canadian resident who dies while travelling through the U.S.

What Assets are Included in Your Worldwide Estate?

A Canadian's worldwide estate is calculated under U.S. estate tax rules as the fair market value of all of the assets that the Canadian owns at death in Canada, the U.S. or elsewhere in the world. It includes property that passes outside of the estate by way of joint ownership or beneficiary designation. It also includes life insurance proceeds payable to the estate or to beneficiaries if the deceased had "incidents of ownership" over the policy.

In general, "incidents of ownership" refers to the right of the insured or his/her estate to access the economic benefits of the policy and includes the power to change the beneficiary, to surrender or cancel the policy, to revoke or assign the policy, to pledge the policy for a loan or to obtain from the insurer a loan against the surrender value of the policy.

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Property held in trust for an individual that is considered to be a grantor trust under U.S. tax rules will also generally be included in this calculation. Grantor trusts may include alter ego trusts, joint partner trusts, RRSPs and TFSA's.

How is U.S. Estate Tax Calculated?

Example:

Mrs. Winfrey, a widow, has the following assets:

- A non-U.S. investment portfolio worth US\$8.4 million;
- A home in Vancouver, B.C., worth US\$2 million;

- An RRSP worth US\$500,000, of which US\$350,000 is invested in shares of Microsoft and Google;
- A vacation property in Arizona worth US\$1.5 million where she stays for two months every year; and
- A bank account in the U.S. in which she has US\$100,000 for her personal use.

Step 1: Determine the U.S. estate tax liability before available credits are applied

Since Canadians are only subject to U.S. estate tax on their U.S. situs assets, the first step is to calculate the total value of Mrs. Winfrey's U.S. situs assets — which in this example is US\$1.85 million, comprising the Microsoft and Google shares held inside her RRSP as well as her vacation property in Arizona. Her U.S. bank account is not considered a U.S. situs asset for purposes of U.S. estate tax.

Next, refer to the 2018 U.S. Estate Tax Rate Table (Table 1), to determine the U.S. estate tax liability on the US\$1.85 million of U.S. assets. The U.S. estate tax is calculated to be US\$685,800 (40% of US\$850,000 plus US\$345,800).

Step 2: Determine the pro-rated unified credit available to reduce the U.S. estate tax liability

Under the *Treaty*, Canadians who pass away are entitled to a unified credit of up to US\$4,417,800 (in 2018) which can be applied to reduce their U.S. estate tax owing.

The amount of US\$4,417,800 represents the amount of U.S. estate tax payable on assets with a fair market value of US\$11.18 million of U.S. situs assets. Therefore, Canadians who pass away in 2018 can own up to US\$11.18 million in worldwide assets before their estate is subject to U.S. estate tax.

Under the *Treaty*, the unified credit must be prorated to account for those assets that are not U.S. assets, and therefore not subject to U.S. estate tax.

The pro-rated unified credit = (U.S. situs assets / worldwide assets) x US\$4,417,800.

The pro-rated unified credit for Mrs. Winfrey is calculated to be US\$653,834 (US\$1,850,000/US\$12,500,000 x US\$4,417,800).

Step 3: Determine the net U.S. estate tax liability

Mrs. Winfrey's net U.S. estate tax liability can be calculated by subtracting her pro-rated unified credit from her U.S. estate tax liability before available credits as follows:

U.S. estate tax liability before available credits	US\$685,800
Less: pro-rated unified credit	US\$ <u>653,834</u>
Net U.S. estate tax liability	US\$ <u>31,966</u>

Marital Credit under the Treaty

In addition to the unified credit, the *Treaty* provides for a marital credit if U.S. assets pass to a non-U.S. citizen spouse on death. To qualify for the marital credit, the spouse must have been legally married to the decedent (as defined by U.S. law). The marital credit is calculated after applying the unified credit. If there is a balance owing after deducting the pro-rated unified credit, the marital credit is equal to the lesser of the deceased's prorated unified credit and the amount of U.S. estate tax attributable to the qualified property transferred to the surviving spouse. The marital credit effectively doubles the pro-rated unified credit, and could result in significant tax savings.

There are a number of conditions which must be satisfied in order to qualify for the marital credit. For example, the executor or personal representative of the estate of the first spouse to die must elect to take the marital credit under the *Treaty* and waive any marital deduction that would otherwise be available under U.S. domestic law (such as through the use of a qualified domestic trust (QDOT)).

Table 2 (below) provides some examples of the amount of U.S. estate tax payable at varying levels of U.S. assets and worldwide assets, after taking into account the available pro-rated unified credit and marital credit under the *Treaty*.

Foreign Tax Credit under the Treaty

Under Canadian tax rules, Canadians are deemed to have disposed of all of their capital property immediately before death and must pay tax on any accrued gains on these properties. This includes any accrued gains on their U.S. situs assets.

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Under the *Treaty*, the estate can claim a foreign tax credit on the deceased's final Canadian tax return to reduce the Canadian tax liability on U.S. situs assets. Canadian provinces and territories generally do not allow a foreign tax credit for U.S. estate tax paid. Accordingly, the deceased may be subject to some double taxation.

Filing Requirements for U.S. Estate Tax

The executor or personal representative has the responsibility for filing a U.S. estate tax return on behalf of the estate. The executor or personal representative must file a U.S. estate tax return (Form 706-NA) if the deceased had at least US\$60,000 of U.S. situs assets at the time of death, regardless of whether an actual U.S. estate tax liability exists or not. The return must be filed within 9 months from the date of death, unless an extension is granted. This can result in additional time, cost and complexity in settling a Canadian estate.

If the executor or personal representative fails to file a U.S. estate tax return when required to do so, the estate could be subject to significant penalties and the executor or personal representative could face imprisonment. There are also substantial penalties for understating the value of U.S. assets and worldwide assets.

Table 1 — 2018 U.S. Estate Tax Rate Table (all amounts expressed in U.S. dollars)

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 but less than amount in Column B
\$	\$	\$	Percent
0	10,000	0	18
10,000	20,000	1,800	20
20,000	40,000	3,800	22
40,000	60,000	8,200	24
60,000	80,000	13,000	26
80,000	100,000	18,200	28
100,000	150,000	23,800	30
150,000	250,000	38,800	32
250,000	500,000	70,800	34
500,000	750,000	155,800	37
750,000	1,000,000	248,300	39
1,000,000	–	345,800	40

Table 2 — U.S. Estate Tax Liability for 2018: Examples (all amounts expressed in U.S. dollars)

Fair market value of U.S. Assets	Fair Market Value of Worldwide Assets	U.S. Estate Tax liability	
		With Unified Credit	With Unified Credit and Marital Credit
\$	\$	\$	\$
1,000,000	10,000,000	–	–
	12,000,000	–	–
	14,000,000	30,500	–
	16,000,000	70,000	–
	18,000,000	100,500	–
	20,000,000	125,000	–
1,500,000	10,000,000	–	–
	12,000,000	–	–
	14,000,000	72,500	–
	16,000,000	132,000	–
	18,000,000	178,000	–
	20,000,000	214,500	–

The estimates provided above are for illustration purposes only.

Conclusion

As every individual's situation is different, you should obtain professional advice from a qualified tax advisor who specializes in cross-border taxation before acting on any of the information in this article.



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