



U.S. Estate Tax: Don't Just Throw Your Vacation Home into a Trust

Too little attention is paid to cross-border tax traps. Even when advice is sought, the response is often incomplete or simply wrong because it is restricted to the jurisdiction—and residents of that jurisdiction—in which the particular tax advisor happens to practise. As a result, many step blindly into that space where jurisdictions intersect, specialized domestic rules apply, and treaties govern.

A situation commonly encountered by Canadians in their personal lives is the application of U.S. estate tax. While it is generally known that this tax applies to Florida vacation properties, it is not so well known that: (i) this tax applies to many other assets besides; and, (ii) a treaty exemption is often available. As a result, U.S. estate tax issues are too often missed, and time and money is wasted on unnecessary or ineffective trusts.

What Canadians should understand about U.S. estate tax is this: U.S. taxpayers are subject upon death to an estate tax on the total value of their worldwide assets. This tax applies at graduated rates ranging from 18 to 40% currently subject to an exemption for the first \$5,340,000 of asset value. Non-U.S. taxpayers are also subject to this tax in respect of U.S. real estate, U.S. securities, certain U.S. debt obligations, U.S. business assets (unless held through a corporation), U.S. mutual funds, and interests in certain trusts such as RRSPs, RRIFs, RESPs, and TFSA's that hold U.S. assets. Unlike U.S. taxpayers, Canadians are entitled under U.S. law to an exemption of only \$60,000 of asset value. U.S. estate tax therefore extends well beyond the Florida condo. But does this mean that all U.S. assets should be thrown into a trust?

In many cases, the Canada-U.S. tax treaty provides Canadians with a full exemption from U.S. estate tax. Specifically, the treaty provides that Canadian taxpayers are entitled to the same \$5.34 million exemption as U.S. taxpayers *in proportion to the percentage of worldwide assets located in the U.S.* In other words, if 50% of your estate value is attributable to assets otherwise subject to U.S. estate tax then you are entitled to 50% of the \$5.34 million exemption.

Since the application of U.S. estate tax is determined by both the estate value and the percentage allocation to the U.S., one cannot make generalized assumptions. These rules must be understood and the analysis performed in each case. If, having done the analysis, one concludes that U.S. estate tax does apply, then and only then should one consider placing ownership in a trust. And, here again, one must be wary since the trust must be drafted to accommodate both Canadian and U.S. tax and legal considerations. Any old trust will not do. Only a trust prepared by Canadian and U.S. lawyers in collaboration will avoid U.S. estate tax without triggering unexpected legal or tax consequences on either side of the border. There is no such thing as a one-size-fits-all trust.

When, therefore, you seek advice on any matter involving more than one jurisdiction, ensure that your advisor is well-versed in the legal and tax issues on both sides of the border as well as in the possible application of treaties. If necessary, consult counsel in the other jurisdiction—because the world is not as small as it was and the cost of ignorance will always exceed the cost of proper planning.

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