

U.S. Federal Estate Tax Implications for Canadians: Determining if You Have Any Liability

Many Canadians are unaware that they may be subject to U.S. estate tax. Even if they don't have any connections to the U.S. (i.e. not a U.S. citizen, resident or green card holder), but own U.S. property (for example, U.S. stocks or real estate) at the time of death, they may be liable for U.S. estate tax. This article outlines the circumstances under which Canadian residents may be subject to U.S. estate tax and provides a sample U.S. estate tax calculation.

Notes: The following analysis: 1) is in U.S. dollars; 2) assumes that the taxpayer is a Canadian resident who is not a U.S. citizen or green card holder; and 3) discusses only the impact of U.S. federal estate tax. Many states within the U.S. also have their own estate tax but their impact is not discussed in this article.

What is U.S. Federal Estate Tax?

U.S. federal estate tax is a tax levied by the U.S. government on large transfers of wealth between individuals at the time of death.

For U.S. citizens and residents, this tax applies to their worldwide assets in excess of a certain threshold at the time of death. For Canadians, U.S. estate tax will only apply to that portion of their assets deemed to be situated in the United States (U.S. situs assets) if the cumulative amount of these assets, or their worldwide assets, exceeds a certain threshold.

The U.S. federal estate tax can be quite burdensome especially when you consider that it is based on the value of the property itself, and not only on the increase in the value of the property from the time it was acquired. The maximum tax rate that is applicable for 2011 and 2012 is 35%. Effective January 1, 2013, the maximum federal estate tax rate is increased to 40%.

U.S. Federal Estate Tax Changes

On January 2, 2013, President Barack Obama signed into law the American Taxpayer Relief Act of 2012. This legislation makes permanent the maximum federal estate tax rate at 40% with an annually inflation-adjusted \$5 million exemption amount, for estates of decedents dying after December 31, 2012.

Table 1 U.S. Estate Tax Rates and Exemptions		
Calendar Year	Maximum U.S. Federal Estate Tax Rate	Applicable Exemption Amount (indexed for inflation for calendar years after 2011)
2010*	35%	\$5,000,000
2011	35%	\$5,000,000
2012	35%	\$5,120,000
2013	40%	\$5,250,000

* Subject to special considerations not discussed in this article.

Note that for Canadians, the exemption amount is prorated based on the value of the U.S. situs assets divided by the value of the worldwide estate at the time of death.

The following analysis is based on the rules applicable for the 2013 taxation years.



Which Canadians are Subject to U.S. Estate Tax in 2013?

Generally, there is no U.S. estate tax liability, if, at the time of death, the deceased had less than:

- 1) \$60,000 of U.S. situs assets; or
- 2) \$5,250,000 (\$5,120,000 in 2012) of worldwide assets

What Assets are Considered to be U.S. Situs Assets?

For U.S. estate tax purposes, the following assets are generally considered as U.S. situs assets:

- 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 an RSP, RIF, and locked-in plans.
- U.S. real estate (e.g. Florida condo).
- Tangible personal property located in the United States (e.g. cars, boats, jewellery, artwork).
- U.S. mutual funds acquired directly from the United States (and not Canadian mutual funds that invest in the U.S.).
- U.S. pension plans and annuity amounts (including IRAs and 401K plans).

The following assets are not considered as U.S. situs assets for U.S. estate tax purposes:

- Stocks of a non-U.S. corporation, regardless of where its assets are situated, and regardless of where the stock certificates are situated.
- U.S. government and corporate bonds that qualify for the U.S. portfolio interest exemption (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).
- Tangible personal property that is merely "in transit" in the U.S., for example, jewellery and other personal effects of a Canadian resident who dies while on a journey through the U.S.

Determining U.S. Estate Tax Liability for 2013

Example One:

Mr. Moreau, a Canadian citizen and resident, owns a non-U.S. investment portfolio worth \$1.25 million. He also owns a condo worth \$300,000 in Florida where he likes to spend the two coldest months every year.

Would U.S. estate tax apply if Mr. Moreau died in 2013?

Answer:

No. There is no U.S. estate tax since Mr. Moreau's worldwide estate is under \$5,250,000 million.

Example Two:

Ms. Winfrey, a widow, owns a non-U.S. investment portfolio worth \$3.4 million. She also owns a home in Canada worth \$1 million In addition, she has:

- An RSP worth \$500,000, of which \$250,000 is invested in shares of Microsoft and Google;
- A vacation property in Florida worth \$1 million where she likes to stay for two months every year; and
- A bank account in the U.S. in which she has \$100,000.

Would U.S. estate tax apply if Ms. Winfrey died in 2013?

Answer:

Ms. Winfrey may be liable for U.S. estate tax since her worldwide estate is not less than \$5,250,000 million and the value of her U.S. situs assets is greater than \$60,000. A calculation is required to determine her actual estate tax liability.

Sample U.S. Estate Tax Calculation

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 Ms. Winfrey's U.S. situs assets - which in this case is \$1.25 million, comprising the Microsoft and Google shares held inside her RSP as well as her vacation property in Florida. Her U.S. bank account is not considered a U.S. situs asset.

Next refer to Table 2 the U.S. Estate Tax Rate table for 2013 to determine the U.S. estate tax liability on the \$1.25 million of U.S. situs assets.

U.S. estate tax	<u>\$445,800</u>
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Step 2: Determine the pro-rated unified credits available to reduce the U.S. estate tax liability.

Canadians who pass away in 2013 are entitled to a unified tax credit of up to \$2,045,800 (\$1,772,800 in 2012) which can be applied to reduce their U.S. estate tax owing.

The \$2,045,800 value happens to correspond to the amount of U.S. estate tax payable on \$5.25 million of U.S. situs assets. This explains why a Canadian who pass away in 2013 can own up to \$5.25 million in worldwide assets before their estate is subject to U.S. estate tax.

The unified tax credit must be prorated to account for those assets that are not U.S. situs assets, and therefore not subject to U.S. estate tax.

The pro-rated unified tax credit = U.S. situs asset/worldwide assets x \$2,045,800

The pro-rated unified tax credit for Ms. Winfrey is calculated to be \$426,208 ($\$1,250,000/\$6,000,000 \times \$2,045,800$).

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

Ms. Winfrey's net U.S. estate tax liability can be calculated by subtracting her pro-rated unified tax credit from her U.S. estate tax liability. This is calculated as follows:

Net U.S. estate tax liability:

US estate tax liability before credits	\$445,800
Less: pro-rated unified credits	<u>\$426,208</u>
Net U.S. estate tax	<u>\$19,592</u>

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 \$60,000 of U.S. situs assets at the time of death, regardless of whether an actual U.S. estate tax liability existed or not. The return must be filed within 9 months from the date of death unless an extension is granted. This can result in added time, cost and complexity to the 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 assets.

The above information is provided for general information purposes only. U.S. gift and estate tax law is complex, thus readers should consult a qualified tax advisor for professional advice on their U.S. estate tax situation. This update is not tax advice and is not intended or written to be used, and cannot be used, to (1) avoid penalties under the U.S. Internal Revenue Code or (2) promote, market or recommend any transaction.

Table 2 U.S. Estate Tax Rate Table for 2013 (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
\$ 0	\$ 10,000	\$ 0	(Percent) 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	1,250,000	345,800	40
1,250,000	1,500,000	445,800	40
1,500,000	2,000,000	545,800	40
2,000,000	2,500,000	745,800	40
2,500,000	5,000,000	945,800	40
5,000,000	5,250,000	1,945,800	40
5,250,000	-----	2,045,800	40

Source: TD Waterhouse Products, Services and Strategy

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