

# Canada & U.S. Cross-Border [Tax] Affairs

PROFESSIONAL ADVISORY COMMITTEE  
OF THE JEWISH FOUNDATION OF GREATER TORONTO

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# TOPICS....

1. Mixed Marriages;
2. Canadian parents with U.S. children;
3. Canadians buying U.S. real property;
4. Dealing with Canadian Trusts that have U.S. beneficiaries;
5. Canadians with significant U.S. assets;
6. Expatriation – the way out of U.S. taxation;
7. Cross-Border Charitable Giving – The U.S. issues; and
8. Non-tax issues for Snow birds.

# Overview of Cross Border Problems for Canadians with U.S. Connections

- U.S. Gift and Estate Taxes
  - On transfer of worldwide assets of U.S. citizens or domiciliaries
  - On transfer of U.S. situs assets (vacation homes, real property interests, stocks, options, business interests, etc.) of noncitizens/nondomiciliaries
- Reach of U.S. income taxes on U.S. income tax residents or citizens
  - Worldwide income
  - Beneficial interests in non-U.S. estates and trusts
  - Anti-deferral regime for non-U.S. companies

# Effects of Treaty Protocol

- Charitable deduction in full and for Canadian charities
- Prorated unified credit
  - [US situs assets/worldwide estate] x U.S. credit
- Marital credit = additional prorated unified credit
- Canadian capital gains and accrued income tax creditable as foreign death tax (and vice versa)
- Exemption for estates < US\$2,000,000
- **ELECTION REQUIRED**

# TOPIC 1 – MIXED MARRIAGES

One U.S. citizenship spouse; one not;  
both Canadian residents

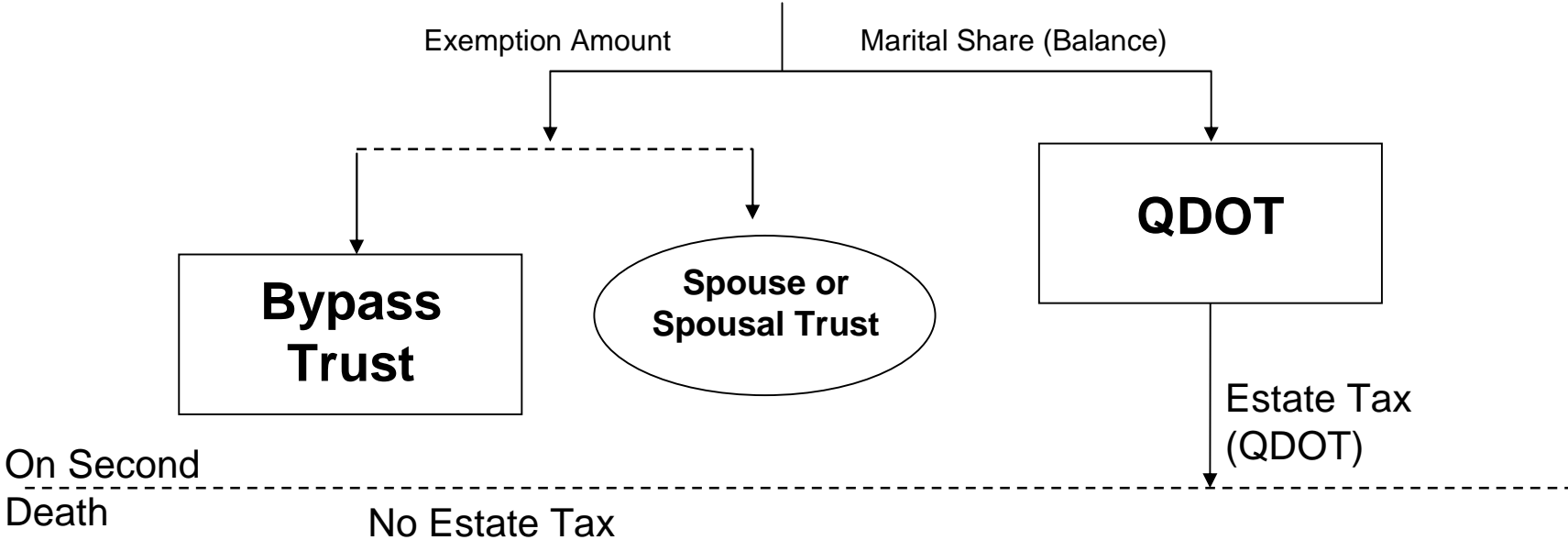
First, pursue allocation of assets:

- U.S. citizen should own U.S. situs assets
- Growth should be in NRA's assets
- Sever joint tenancies (tracing contributions)

# MIXED MARRIAGES – Design of Wills

- Take advantage of Treaty
- Draft for flexible trusts (spousal, QDOT and family)
- Prevent U.S. spouse from getting wealthier

# One U.S. Citizen Spouse, One Non-citizen Spouse



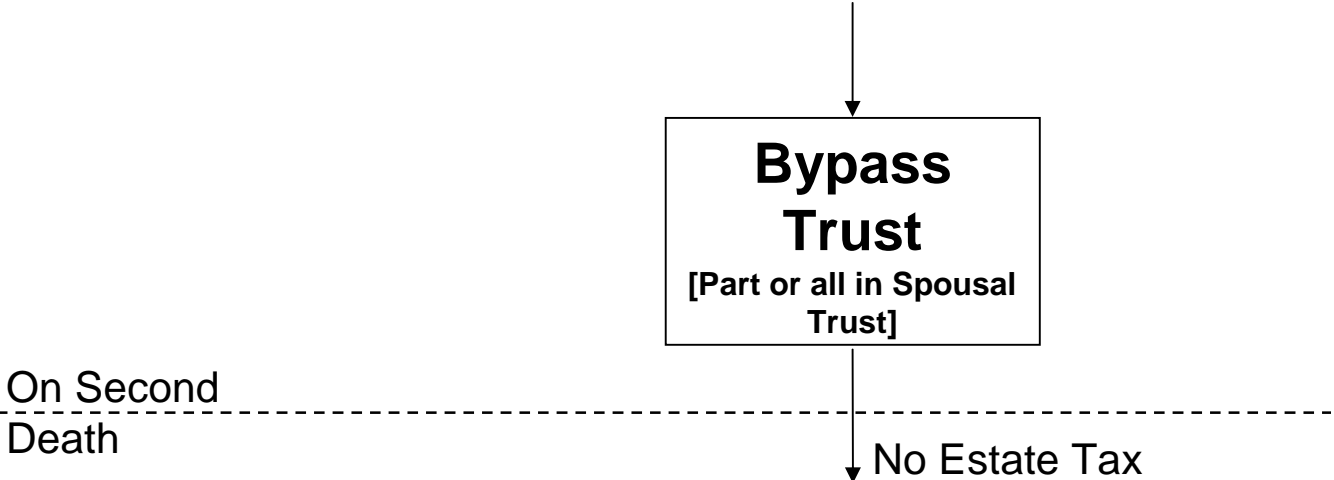
# Features of a Qualified Domestic Trust (“QDOT”)

- Main Marital Deduction Requirements
  - All income to spouse for life, payable at least annually
  - Principal may be invaded only for spouse
  - Remainder on spouse’s death may, but is not required to, be under spouse’s control
- Special QDOT Requirements
  - U.S. trustee and U.S. jurisdiction
  - Security for payment of U.S. estate taxes (due when principal distributed or trust terminates)
  - Election made on estate tax return (Form 706 or 706NA)



# Canadian Dies First

## One U.S. Citizen Spouse, One NRA Spouse (With No U.S. Situs Assets)



# TOPIC 2 – CANADIAN PARENTS WITH U.S. CHILDREN

## GOALS:

- avoid estate tax
- asset protection
- avoid foreign trust income tax rules

# Trust Design Implementation

- Create a Lifetime irrevocable trust [by using an outside U.S. “Settlor”?], with child or U.S. third party as Trustee
- During lifetime trust would only be nominally funded (to avoid any income attribution)
- Parent’s Will would provide that inheritance “pours over” into trust. If beneficiary is living in the US then, the trust would be located there (and need not be a Canadian resident)
- The trust could be moved almost anywhere in the world, from time to time, for any reason
- Where beneficiary resides in U.S. or is a U.S. citizen, however, having trust in the U.S. is the most beneficial arrangement both under U.S. and Canadian income tax rules

# TOPIC 3 – CANADIANS BUYING U.S. REAL PROPERTY OR OTHER U.S. SITUS ASSETS

- Individually
- Foreign corporation
- Foreign partnership
- Trust



# Own Individually

- U.S. situs asset for U.S. estate tax purposes
- Canada/U.S. treaty relief
  - Prorated use of unified credit
  - Marital credit

# Own Individually (cont'd.)

- Joint Ownership
  - Not effective for estate tax purposes, but simplifies transfer at death
    - Unified credit available along with treaty benefits (like marital credit)
    - May be appropriate in smaller estates
  - Possible gift at time of purchase
    - No unified credit or treaty benefits
    - Split purchase alternative



# Own Individually (cont'd.)

- Nonrecourse Mortgage
  - A dollar for dollar deduction against value of real property includible in estate
  - Getting easier to obtain
  - May not be respected if obtained from a family member or entity
  - Gives rise to income tax issues on interest

# FOREIGN CORPORATION (HoldCo)

- Increased income taxes
- Deemed income (shareholder benefit)
- Should prevent estate tax but beware IRS “look through” position



# FOREIGN PARTNERSHIP

- “Look-through”
- Tick the box at outset or after death

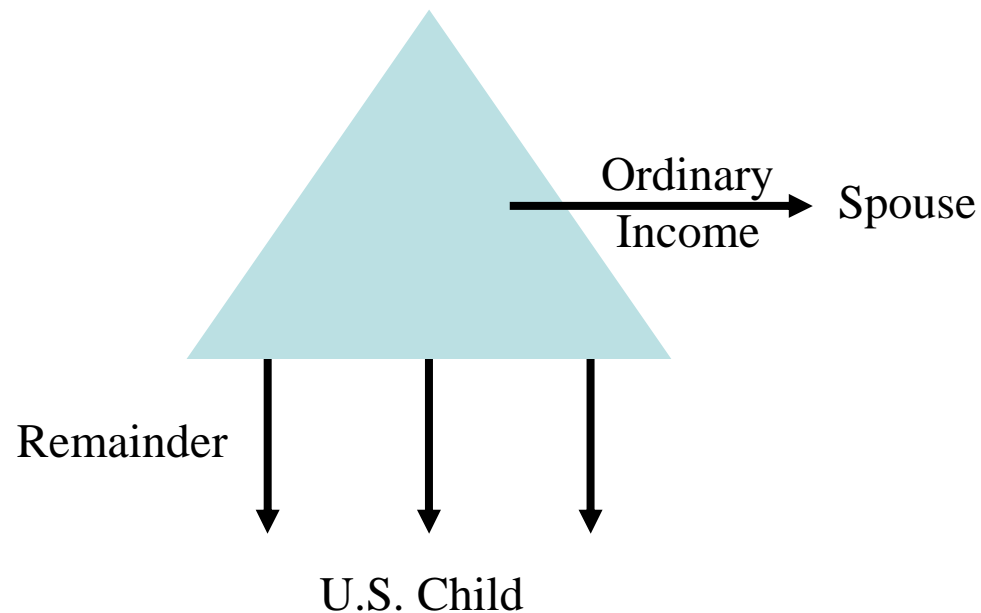
# Trust Alternative

- Form trust for benefit of spouse and descendants, fund with cash, and have trust purchase U.S. real property
  - Should not be in settlor's estate as long as use only at spouse's consent and not as a trust beneficiary
  - May be less likely to be challenged if descendants use property frequently as well
  - If spouse dies, settlor should pay fmv rent to use the property
  - Avoids "shareholder benefit" issue

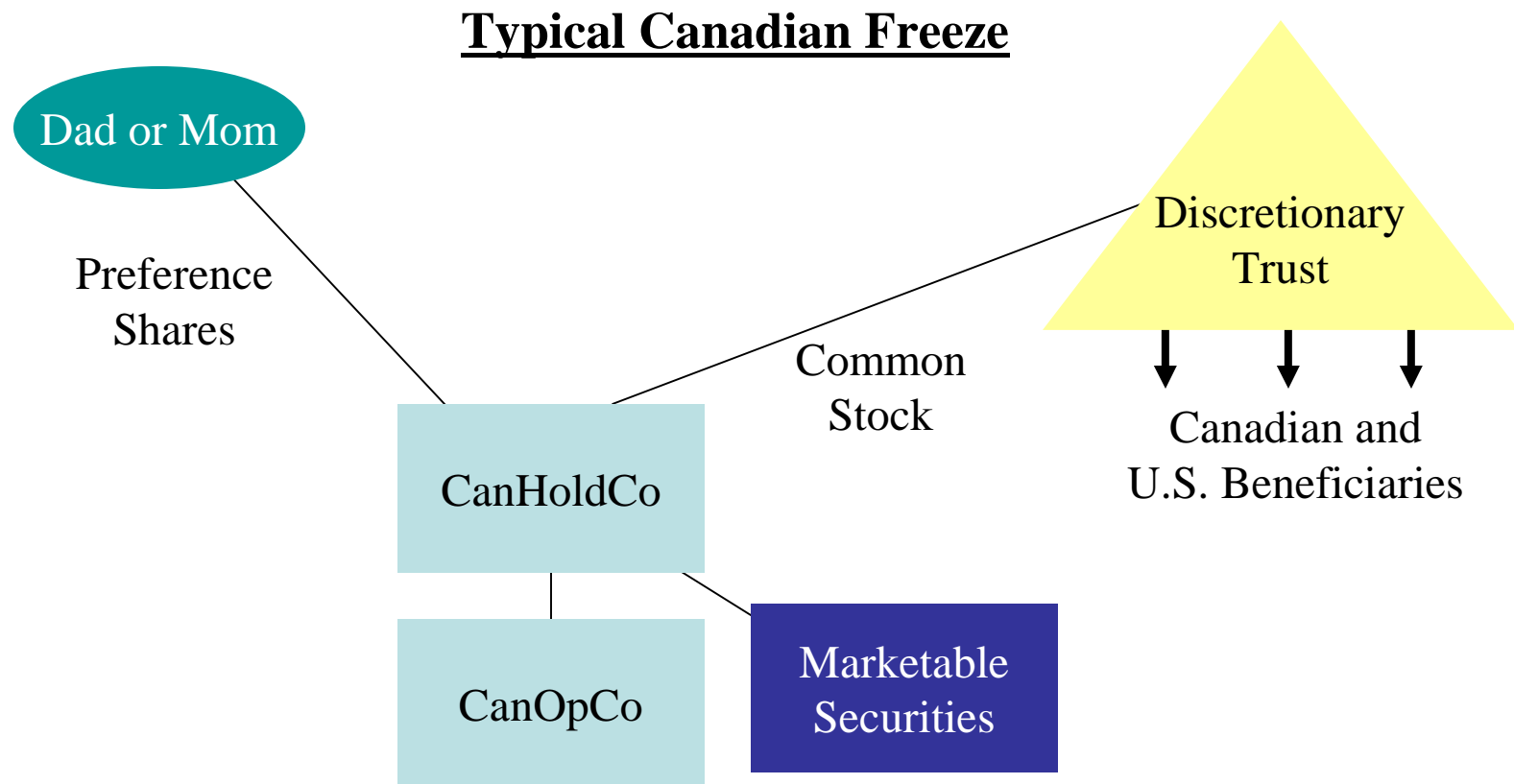
# 4. DEALING WITH CANADIAN TRUSTS THAT HAVE U.S. BENEFICIARIES

# Common Canadian Structures Exposing U.S. Taxpayers to Anti- Deferral Rules

## Spousal Testamentary Trust



# Common Canadian Structures Exposing U.S. Taxpayers to Anti-Deferral Rules



# What is a Foreign Trust for U.S. Income Tax Purposes?

- Trust fails either:
  - Court Test (Primary Supervision of Administration)
  - Control Test (U.S. Fiduciary Control over Substantial Decisions)
- So under Canadian's NRT rules, could be dual resident



# Issues for U.S. Beneficiaries of Foreign Trusts

- Distributions from foreign non-grantor trust (“FNGT”) of prior year income are subject to accumulation distribution rules: taxed at ordinary income rates (up to 35%), plus interest is imposed to reflect deferral
  - What was capital gains in year earned is taxed as ordinary income when distributed in a later year
  - Interest charge may become punitive
  - Complete Form 3520 reporting.

# Issues for U.S. Beneficiaries of Foreign Trusts

- Exempt from tax on distribution when a foreign grantor trust, *e.g.*,:
  - Trust revocable by foreign grantor; or
  - Distributions may be made only to foreign grantor or spouse during grantor's lifetime
  - Grandfather rule





# Administration (Drafting) Solutions

- Distribute out “DNI” currently
- Distribute out accumulations to Non-U.S. beneficiaries
- Keep “American” set of books

# 5. CANADIANS WITH SIGNIFICANT U.S ASSETS

# Planning Tips for Noncitizens/ Nondomiciliaries to minimize U.S. Estate Tax

- Transfer U.S. situs assets other than real property to foreign trusts or corporations (maybe)
- Sell U.S. situs assets
- Give away U.S. stock and debt obligations
- Refinance U.S. real property with non-recourse loan
- Create tenancy-in-common for valuation discounts
- Fund tax obligations via insurance
- Acquire U.S. assets using “tax-free” vehicles.

# TOPIC 6 - EXPATRIATION – THE WAY OUT OF U.S. TAXATION Summary of New Expatriation Rules

- New bright line test: \$2,000,000 asset threshold or 5 year average income tax > \$127,000 [2005]
  - Limited exceptions for dual citizens and minors
  - No ruling process
- Applies to Long Term (over 7 years) Permanent Residents as well

# New Tax Act (cont.)

## Summary of New Expatriation Rules

- Strict disclosure and 10 year compliance
  - Form 8854: at time of expatriation plus each year thereafter
  - Broader categories of U.S. source income
- In any year during 10 year period that expat is in U.S. more than 30 days, taxed as if a citizen in that year
  - Worldwide income [anti-deferral rules]
  - Gift tax
  - Estate tax [don't die in that year]

# TOPIC 7 - CROSS-BORDER CHARITABLE GIVING – THE U.S. ISSUES

Three relevant tax inquiries:

1. May donor deduct the gift for income tax purposes?
2. Is it a taxable gift for gift tax purposes?
3. Upon death is bequest deductible for U.S. estate tax purposes?

# Income Tax Rules

- Generally, no deduction for gifts to foreign charities (because they are not qualified in U.S.)
- Canada/U.S. Treaty gives exceptions [see Kate's slides]
  - Art XXI(5)
  - Okay to extent of Canadian source income (subject to % limitations)
  - Okay to Canadian colleges or universities where family went

# Income Tax Rules (cont'd.)

## Percentage Limitations

- 50% of AGI for cash or “basis” gifts to public charities
- 30% of AGI for appreciated securities to public charities
- 30%/20% to “private foundations”



# Gift Tax Rules

No taxable gift if asset given to a “corporation” organized exclusively for charitable purposes, with no national or geographical restriction. Foreign government units (such as Canadian government-owned hospitals) qualify under case law.

# Estate Tax Rules

Deduction available if asset given to a “corporation” organized exclusively for charitable purposes, with no national or geographical restriction. Foreign government units (such as Canadian government-owned hospitals) qualify under case law. Treaty allows Canadians a full deduction for U.S. situs assets passing to Canadian registered charities.

# TOPIC 8 - NON-TAX ISSUES FOR SNOW BIRDS

- Potential loss of Canadian residency and medical benefits.
- Insurance for high cost of doctors, hospitals and medicine in the U.S.
- Visa and passport requirements
- State-accepted powers of attorney (including health care)
- Financial institution account hassles (tax withholding, etc.)
- U.S. income tax day-test rules (so I lied about non-tax)