

Estate Tax Update

Temporary Uncertainty in U.S. Estate Tax Regime Hinders Planning

This *Estate Tax Update* Is Affected

Estate tax uncertainty

The attached *Estate Tax Update* assumes that the 2009 U.S. estate tax regime is extended to 2010 and beyond. However, **the U.S. did not pass legislation in 2009 to extend the 2009 federal estate tax rate and exemption level to 2010. As a result, the federal estate tax has been temporarily repealed from January 1, 2010, through December 31, 2010.**

Unless legislation is passed in 2010, the federal estate tax will be reinstated in 2011, with:

- an exemption of only \$1,000,000 (indexed for inflation); and
- a maximum tax rate of 55% (60% on the portion of the estate between \$10,000,000 and \$20,000,000).

Speculation that in 2010 the U.S. will pass estate tax reform legislation retroactive to January 1, 2010, has sparked uncertainty in respect of the federal estate tax.

These changes affect U.S. citizens. They also affect Canadians because the relief provided under Article XXIX-B of the Canada-United States Income Tax Treaty is tied to the U.S. exemption.

Gift tax unaffected

Unlike the estate tax, the federal gift tax has not been repealed in 2010. The lifetime exemption from gift tax continues to be \$1,000,000 and is not indexed for inflation. Therefore, a person may make up to \$1,000,000 of aggregate lifetime gifts. For 2010, the top marginal gift tax rate drops from 45% to 35%.

Extra caution required

The current state of affairs in the U.S. makes planning extremely difficult. This *Estate Tax Update* is to be relied on only in the event that the 2009 regime is reinstated. As always, but especially in light of the current uncertainty, you should contact your tax adviser before proceeding with any U.S. estate planning.

Estate Tax Update

U.S. Estate Tax Exposure for Canadians

(Revised Edition, April 13, 2009)

This *Estate Tax Update* sets out the current potential exposure of Canadians to U.S. estate tax.

Canadians may be subject to U.S. estate tax

Canadian residents (who are not U.S. citizens) may be subject to U.S. estate tax if they die owning U.S. situs assets. U.S. situs assets include such things as shares of U.S. corporations, U.S. real estate and U.S. business assets.

Under the Canada-U.S. Tax Treaty ("the Treaty"), Canadian residents will have a U.S. estate tax liability only if their worldwide assets are valued at more than US\$3.5 million.

If your worldwide estate exceeds US\$3.5 million

If the value of your worldwide assets exceeds US\$3.5 million, you will be required to pay U.S. estate tax based on the value of your U.S. assets. For 2009, the tax rate starts at 18% and can reach as high as 45% for estates exceeding US\$1.5 million. You can reduce your estate tax liability by claiming a tax credit (referred to as the unified credit) equal to the greater of:

- US\$13,000; and
- US\$1,455,800¹ x (the value of your U.S. assets ÷ the value of your worldwide assets).

Therefore, if your U.S. assets represent 15% of the value of your worldwide estate, you will be entitled to a unified credit of US\$218,370 (US\$1,455,800 x 15%).

U.S. estate tax rates and unified credit amounts

Under current U.S. legislation, the estate tax is scheduled to be repealed entirely in 2010. However, the U.S. government is expected to extend the 2009 exemption and rates beyond 2009.

To illustrate, consider the following example: Mr. Brown, a Canadian resident (who is not a U.S. citizen), owns a Florida condominium worth US\$1,000,000. The gross value of Mr. Brown's worldwide estate is US\$5 million. The following table shows the estate taxes payable by Mr. Brown in 2009.

1. Equals the US estate tax on assets of \$3.5 million.

Mr. Brown's Year of Death	U.S. Estate Taxes Owning Before Unified Credit (\$US)	Unified Credit Amount (\$US)	Net U.S. Estate Taxes Owing (\$US)
2009	\$345,800	\$291,160	\$ 54,640

Marital credit

The Treaty provides a marital credit if the U.S. assets are bequeathed to a spouse. In the above example, if Mr. Brown left the Florida condominium to his wife, also a Canadian resident (who is not a U.S. citizen), his net U.S. estate tax liability would be completely eliminated.

U.S. estate tax is often greater than Canadian tax

On death, a taxpayer will pay Canadian tax on the accrued gain in the U.S. asset and will also be subject to U.S. estate tax on the full value of the asset. Canada may provide a foreign tax credit for U.S. estate tax paid on the U.S. assets. In the end, an individual generally pays the higher of the two taxes.

Because Canadian capital gains rates are significantly lower than the top U.S. estate tax rate, the individual likely will pay tax at the U.S. estate tax rate. For example, the top U.S. estate tax rate currently is 45%, while the top capital gains rate in Ontario is only about 23%.

In addition, the provinces generally do not allow a foreign tax credit for U.S. estate tax paid. As a result, the deceased may be subject to some double taxation at the provincial level.

When do you need to file an estate tax return?

Even if no U.S. estate tax is due, you may still be required to file a U.S. estate tax return along with a Treaty statement. In many instances the transfer agents will not agree to the transfer of U.S. property until the estate can provide proof of IRS clearance. The filing deadline for a U.S. estate tax return is nine months after the date of death.

Your holdings can be structured to minimize your exposure to U.S. estate tax. Please call or e-mail us for help with this complex issue.

For More Information

If you have any questions about your exposure to U.S. estate and gift tax, please call or e-mail us.

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