

# Estate Tax Update

## U.S. Estate Tax Exposure for Canadians (Revised Edition, February 2, 2011)

Considers the exposure of Canadian residents to U.S. estate tax.

February 2, 2011

This *Estate Tax Update* sets out the 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\$5 million.

### If your worldwide estate exceeds US\$5 million

If the value of your worldwide assets exceeds US\$5 million, you will be required to pay U.S. estate tax based on the value of your U.S. assets. For 2011, the tax rate starts at 18% and can reach as high as 35% for estates exceeding US\$500,000. Fortunately, Canada's tax treaty with the United States allows you to 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\$1,730,800<sup>1</sup> x the value of your U.S. assets ÷ your worldwide assets.

For example, if your U.S. vacation property accounts for 20% of the value of your worldwide estate, you will be entitled to a unified credit of US\$346,160 (\$1,730,800 x 20%).

### Future estate tax rates and credit amounts

Unless new legislation is enacted, in 2013 the United States is scheduled to return to its former higher rates and lower exemptions.<sup>2</sup> While most practitioners do not expect this to occur, it seems prudent to plan on the assumption that the U.S. estate tax will be around in some form beyond 2013.

	Calendar year	
	2011 and 2012	2013 and after
Unified credit amount	\$1,730,800	\$345,800
Highest estate tax rate	35%	55%

<sup>1</sup> US\$1,730,800 equals the estate tax on \$5 million of assets.

<sup>2</sup> The exemption will fall to \$1 million, which corresponds to a unified credit of \$345,800.

## U.S. estate tax rates and credits

### Unified credit

For example, Mike, a Canadian resident (who is not a U.S. citizen), owns a Florida home worth US\$1 million, 10% of the value of his US\$10 million worldwide estate. As shown in the table below, if Mike dies in 2011, his estate can claim a unified credit equal to US\$173,080 (10% of \$1,730,800), with a resulting estate liability of US\$157,720.

### Marital credit

In addition to the unified credit, the tax treaty provides a marital credit if the U.S. assets pass to a spouse on death. The marital credit equals the lesser of the unified credit and the amount of the estate tax.

If Mike leaves the Florida home to his wife Michelle, also a Canadian resident (who is not a U.S. citizen), his U.S. estate tax liability would be completely eliminated.

#### Estate Tax Consequences if Mike Dies in 2011

U.S. estate tax before credits	\$330,800
Less: Unified credit	\$173,080
U.S. estate tax liability before marital credit	\$157,720
Less: Marital credit	\$157,720
U.S. estate tax liability after unified and marital credits	Nil

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

On death, a taxpayer will pay Canadian tax on any accrued gain on the U.S. asset and will also be subject to U.S. estate tax on the full value of the asset. Canada will allow 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 35%, while the top capital gains rate in Ontario is only approximately 23%, and does not exceed 25% anywhere in the country.

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 have 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 statement claiming the benefits provided under the tax treaty. In many instances the transfer agents will not agree to the transfer of U.S. property until the estate can provide proof of clearance from the Internal Revenue Service. The filing deadline for a U.S. estate tax return generally is nine months after the date of death.

## For More Information

Your holdings can be structured to minimize your exposure to U.S. estate tax. Please contact us for help with this complex issue.

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### How much tax do you owe?

Use our **Income Tax Calculator for Individuals** to estimate your 2010 tax bill and marginal tax rates. Find it at: [www.pwc.com/ca/calculator](http://www.pwc.com/ca/calculator).

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# Estate Tax Update

## Continued U.S. Estate Tax Uncertainty

Highlights estate tax changes, most of which apply only until December 31, 2012.

January 31, 2011

### Temporary U.S. Estate Tax Relief Leaves Future Uncertain

On December 17, 2010, President Obama passed legislation that reinstates estate and generation-skipping taxes for 2010 through 2012. These changes affect:

- U.S. citizens and individuals domiciled in the United States; and
- Canadian citizens and residents who are subject to U.S. estate tax on account of owning U.S. assets (such as U.S. real estate or stock in U.S. corporations) because the relief provided under Article XXIX-B of the Canada-United States Tax Treaty is tied to the U.S. estate tax exemption.

#### Reinstatement of estate tax

The new legislation retroactively reinstates estate tax with a top tax rate of 35% and a \$5 million exemption (indexed for inflation after 2011). For the estates of individuals who died in 2010, the estate's executor may elect to treat the estate as if the new legislation had not been enacted, in which case, the estate would not be subject to estate tax and the modified carryover basis rules would apply. If no election is made, the estate will be subject to the new estate tax regime, which generally provides for a stepped-up basis in property passing from the decedent. The new legislation also allows the executor of a deceased spouse's estate to transfer any unused portion of the exemption to the surviving U.S. citizen or U.S. resident spouse.

#### Changes to gift tax

For gifts made in 2010, the gift tax exemption is \$1 million and the tax rate is 35%. Starting in 2011, the legislation increases the gift tax exemption to \$5 million. Any use of the \$5 million exemption towards a gift will reduce the exemption available for estate tax.

#### Reinstatement of generation-skipping transfer (GST) tax

The new legislation also reinstates GST tax through 2012 for transfers made after December 31, 2009. A top tax rate of 35% and a \$5 million exemption (indexed for inflation after 2011) are provided. Although the GST tax applies retroactively in 2010, the tax rate for any generation-skipping transfer made during the 2010 calendar year will be zero. The GST tax rate will increase to 35% in 2011 and 2012.

#### Caution required

The attached *Estate Tax Update* assumes that the 2010 estate tax regime changes are in effect. However, the U.S. has not passed legislation that extends the 2010 federal estate tax rate and exemption level beyond December 31, 2012. Unless legislation is passed before the end of 2012, 2013 will see reinstatement of:

- 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 \$17,184,000).