CANADA-U.S.
TAX PLANNING FOR INDIVIDUALS

Selected Tax Issues

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CANADIAN, U.S. AND INTERNATIONAL TAX SPECIALISTS
Outline

• Canada Tax System Comparison
• Canadian persons with U.S. beneficiaries
• U.S. persons with Canadian beneficiaries
• Canadians holding U.S. situs assets
• U.S. persons holding Canadian assets
• Canadians moving to U.S.
• U.S. persons moving to Canada
• U.S. citizens living in Canada
## Canadian Tax System

<table>
<thead>
<tr>
<th></th>
<th>Canada</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Residency</strong></td>
<td>Ties Presence</td>
<td>Presence Green card Citizen</td>
</tr>
<tr>
<td><strong>Treaty</strong></td>
<td>Treaty overrides domestic law Normally followed by provinces</td>
<td>Treaty overrides except citizen Not binding on states Last in time rule</td>
</tr>
<tr>
<td><strong>Treaty Scope</strong></td>
<td>Income tax</td>
<td>Income tax and estate tax not gift tax</td>
</tr>
<tr>
<td><strong>Gift</strong></td>
<td>FMV sale FMV basis (no gift tax)</td>
<td>Gift tax Donor’s basis + gift tax</td>
</tr>
</tbody>
</table>
# Canadian Tax System

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<tr>
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<tr>
<td><strong>Death</strong></td>
<td>FMV sale</td>
<td>Estate tax</td>
</tr>
<tr>
<td></td>
<td>FMV basis</td>
<td>FMV basis</td>
</tr>
<tr>
<td></td>
<td>No estate tax</td>
<td></td>
</tr>
</tbody>
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## Canada Tax System

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<tr>
<td>U.S. LLC</td>
<td>Foreign corporation</td>
<td>Flow through entity</td>
</tr>
<tr>
<td>Canadian ULC</td>
<td>Canadian corporation</td>
<td>Flow through entity</td>
</tr>
<tr>
<td>Tax rates personal</td>
<td>Graduated to 50%</td>
<td>Graduated to 48%</td>
</tr>
<tr>
<td>Tax rates corporate</td>
<td>25%</td>
<td>40%</td>
</tr>
</tbody>
</table>
Canadian Tax System

Status of a Trust

Resident (trustee in Canada)
Deemed Resident
Non-resident (default)
Canadian Tax System

Non-Resident Trust

Old rules (pre-2007)

Non-resident trust deemed resident if:

a) Canadian resident contributor
   AND
b) Related Canadian resident beneficiary
Canadian Tax System

Non-Resident Trust

New rules (2007 onwards)

Non-resident trust deemed resident if:
Canadian resident contributor
(irrespective of who beneficiaries are)
Canadian Tax System

Pre 2007 – not taxable in Canada

2007 and after – deemed resident in Canada and taxable
Immigrant Trust
Exemption from trust being deemed resident for contribution by Canadian resident until resident 60 months.
Withdrawn February 11, 2014.
Existing trusts deemed resident January 1, 2015 (except if contribution after February 11, 2014 in which case January 1, 2014).
Canadian Tax System

Non-Resident Trustee

Trust

Non-resident or resident less than 60 months

Canadian resident beneficiary

Trust not deemed resident

This is the only remaining structure
Canadian Tax System

Non-Resident Trust

- Trust not taxable except on certain Canadian source income
- Trust distributions to Canadian beneficiary
  - Taxable – if income
  - Tax-free – if capital
- No U.S. style UNI rules
U.S. Persons, Canadian Beneficiaries

U.S. family wishes to benefit Canadian persons (family members in Canada)
How to best do this?
U.S. Persons, Canadian Beneficiaries

Canada

U.S.

children

parent

assets or income
U.S. Persons, Canadian Beneficiaries

- Gift during life v. on death
- Leave direct or to a trust
- Which assets to leave
Canadian Implications

- Canadian resident obtains FMV basis for assets gifted or left by Will
- But taxable on future income and gains
- Consider use of non-resident trust
U.S. Persons, Canadian Beneficiaries

Canada

beneficiaries

parent

non-resident trustees

offshore

U.S.

No tax to the trust
No tax to Canadian beneficiaries on capital distributions
Permanent tax exemption
U.S. Persons, Canadian Beneficiaries

**U.S. Issues**

- Gift to trust or beneficiaries *inter vivos* → U.S. gift tax
- Assets left by Will → U.S. estate tax

Possibly no real difference. (Give early give often.)
U.S. Persons, Canadian Beneficiaries

Which Assets?

• Preferably assets where income does not attract U.S. tax

• Good assets - cash/investments

• Bad assets - U.S. real estate
  - U.S. LLC or partnership with U.S. business
Canadian Persons, U.S. Beneficiaries

- Canadian family wishes to benefit U.S. persons (say children)
- Do during life or on death?
- Gift or bequest direct or through a trust?
- Trust resident in Canada/U.S./offshore?
## Canadian Persons, U.S. Beneficiaries

<table>
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<tr>
<th>Objectives</th>
<th>Canada</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Divest income and future capital gains to non-resident</td>
<td>Insulation from U.S. estate taxes</td>
<td>Pay no income tax on income and gains</td>
</tr>
</tbody>
</table>


Canadian Persons, U.S. Beneficiaries

Canada

assets

parents

children

Trust

U.S. or international

U.S.

Note: no gift tax or estate tax in Canada
Canadian Persons, U.S. Beneficiaries

- Trust is deemed Canadian resident while parents (contributors) are alive and taxable.
- On death, Trust becomes non-resident (but only if no Canadian resident beneficiary) but has capital gain on assets owned at that time.
- Possible mismatch of tax (Canada and U.S.).
- U.S. UNI rules to consider.
- Other problems – who gets the first right to tax.

Answer – foreign country where trust is resident, then Canada.
# Canadian Persons, U.S. Beneficiaries

<table>
<thead>
<tr>
<th>U.S. Resident Trust</th>
<th>International Trust</th>
</tr>
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<tbody>
<tr>
<td>Canadian tax unless income paid out, withholding tax. If income retained, foreign tax credit</td>
<td>Canadian tax unless income paid out, withholding tax</td>
</tr>
<tr>
<td>No UNI problem</td>
<td>If income retained, UNI problem at future date</td>
</tr>
<tr>
<td>Deemed gain every 21 years, and on death or departure of Canadian contributor</td>
<td>Deemed gain every 21 years, and on death or departure of Canadian contributor</td>
</tr>
<tr>
<td>No need to pay out income to manage Canadian and U.S. tax position</td>
<td>Need to pay out income each year to prevent UNI</td>
</tr>
</tbody>
</table>
Canadian Persons, U.S. Beneficiaries

• Evaluation of U.S. v. international trust is U.S. tax issue

• Trust is valuable for U.S. estate tax sheltering/may be tax neutral for income tax

• Many traps, potential for mismatch of tax (Canada v. U.S.)
Canadian Persons, U.S. Beneficiaries

Canadian Freeze

Canada

Preferred

Canadian Corporation

common

U.S.
Canadian Persons, U.S. Beneficiaries

**Canadian Freeze/U.S. Version**

- **Holdco**
- **Preferred**
- **Canadian ULC**
- **SCorp**
- **Trust**

**a** Estate freeze

**b** 5% withholding on dividends (25% if not carefully managed as treaty issue with ULC)

**c** Trust deemed Canadian resident/various issues flow from this
Canadians with U.S. Assets

• Canadians often own various U.S. assets

• U.S. estate tax issues

• How best to hold the assets (especially U.S. real estate)
Canadians with U.S. Assets

Canadian capital gains tax  23%

U.S. estate tax  40%

Capital gain based on gain

Estate tax based on value, but exemption $5.4 million (2014) (possible for double exemption with spouse and others)
Canadians with U.S. Assets

**U.S. Situs Assets**

- U.S. real estate (personal, rental, business)
- U.S. stocks (U.S. domestic corporation)
- U.S. LLCs with U.S. assets
- U.S. stock options
- Certain U.S. debts (but unusual)
Canadians with U.S. Situs Assets

Canada-U.S. Treaty

- $5.4 million unified credit (2014)(pro rated)
- Additional marital credit (limited to pro rated unified credit)
- Credit in Canada for estate tax against Canadian capital gains tax (federal)
Canadians with U.S. Situs Assets

- Determine which assets are U.S. situs
- Determine U.S. estate tax exposure (note pro-rated exemption)
- Move certain assets to Canadian corporation
- Sell or gift other assets (caution for gift of U.S. real estate due to gift tax)
- Possible use of a trust
- Possible use of foreign corporation as a flow-through and check the box election post death
- Residual exposure, consider insurance and foreign tax credit in Canada for U.S. estate tax, or just live with it
Canadians with U.S. Assets

Normal for Canadians to use holding company

shareholder

Canco

investments
Canadians with U.S. Assets

Portfolio investments move to Canadian holding company

Problem Assets

• U.S. real estate
• U.S. LLCs (private business)
• U.S. securities in retirement plans
• U.S. stock options
Canadians with U.S. Assets

Use a trust to own U.S. real estate assets
Match foreign taxes
Long term capital gain treatment (individual)
No personal benefit (if personal use)
Canadians with U.S. Assets

Foreign Partnership Plan

Canadian Partnership

U.S. Situs assets

Elect post death for partnership to be a corporation
75 days retroactive (to pre-death)
U.S. Persons with Canadian Assets

• After major changes in 2010, main area of exposure is Canadian real estate and Canadian resource properties (taxable Canadian property (TCP))
• Capital gain taxable in Canada for TCP on sale, gift, death, 21-year rule if a trust
• Includes indirect holdings (even shares of foreign corporation if value derived primarily from Canadian real estate)
U.S. Persons with Canadian Assets

Canadian rental income taxable at 25% withholding on gross rent or net election at regular rates

Clearance certificate process on sale or 2% withholding on sale proceeds (like FIRPTA)

Best Structure for personal real estate likely U.S. LLC or S Corp because corporate rate is 25%, personal rate up to 50%.
<table>
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<tr>
<th>Leaving Canada</th>
<th>Arriving U.S.</th>
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</thead>
<tbody>
<tr>
<td>Deemed sale of most assets, capital gains</td>
<td>Step-up in basis (given by Treaty)</td>
</tr>
<tr>
<td>Future liability to tax for Canadian real estate holdings</td>
<td>U.S. estate and gift tax system</td>
</tr>
<tr>
<td>Canadian tax issues of structure ongoing</td>
<td>U.S. tax issues of structure ongoing</td>
</tr>
</tbody>
</table>
Canadians Moving to U.S.

**Deprtature Tax**

- Capital gains tax
- Pay v. furnish security
- Structures to avoid, defer or reduce departure tax
- Needs advance planning
- Potential for double taxation
- Trust interest in Canadian trust not deemed sold on departure; useful for tax planning
Canadians Moving to U.S.

**U.S. Basis of Assets**

- Step-up in basis of assets held direct
- Various ways to arrange step-up for indirect holdings (subsidiaries in group)
- Use of ULCs (step-up corporate assets)
- Use of LLCs
- Use of foreign hybrid and check the box
- Transfer from one retirement plan (eg, RRSP) to another
Canadians Moving to U.S.

**U.S. Estate Tax**

- Transfer assets to a trust (Canadian, U.S., foreign?)
- Best to do pre-arrival in U.S. (possibly shortly after if not U.S. resident for estate and gift tax but depends if hold green card or not)
Canadians Moving to U.S.

Canada

emigrant

assets

Trust

emigrant, spouse or family

U.S.
Canadians Moving to U.S.

U.S. or foreign trust may have ongoing liability to Canada if:

• Property transferred from Canadian resident or

• Property transferred from person now non-resident but Canadian resident in past 60 months and Canadian beneficiaries of trust (or ability to add) (Canadian resident who can only benefit after death of related person is excluded)
Canadians Moving to U.S.

• Ongoing capital gains tax liability to Canada for Canadian real estate (or shareholdings where real estate is over 50% of value)
• Stock option benefits (employments)
• Retirement plans (withholding tax)
• Withholding tax on removing assets form Canadian corporation post departure
• Special tax credit if shares redeemed and TCP for withholding tax (section 119)
Canadian Persons Moving to U.S.

Reducing Departure Tax

Reduce value of Canco by paying out dividends pre-departure
Consider possible liquidation of Canco
Consider converting Canco to a ULC
Double tax issues within Canco withholding on dividend payment if no section 119 credit
U.S. Persons Moving to Canada

• U.S. family moving to Canada
• Various assets, sources of income
• U.S. citizen/long term green card holder/short term green card holder/other
### U.S. Persons Moving to Canada

<table>
<thead>
<tr>
<th>Arriving in Canada</th>
<th>Leaving U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step-up in basis except Canadian real estate holdings</td>
<td>No departure tax unless expatriation U.S. citizen or green card holder still taxed</td>
</tr>
<tr>
<td>Foreign trust taxable form January 1 (possibly even</td>
<td>Otherwise no ongoing capital gains tax except for U.S. real property and U.S. business assets</td>
</tr>
<tr>
<td>deemed resident and taxable up to 5 years prior if</td>
<td></td>
</tr>
<tr>
<td>Canadian resident beneficiaries)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>But beware special rules on grantor trusts</td>
</tr>
</tbody>
</table>
U.S. Persons Moving to Canada

Step up in basis in Canada
Grantor trust for U.S. purposes (tax neutral)
Trust taxable in Canada from January 1 (possibly back 5 years if pre-existing Canadian resident beneficiaries)
U.S. Citizens Living in Canada

- U.S. citizen and family living in Canada
- Wishes to do estate planning
- What structures are available?
U.S. Citizens Living in Canada

- Many do not comply, no U.S. filings
- What happens on death?
- Canadian income tax/U.S. estate tax
- Often spouse is NRA
- Catch-up filings?
- Expatriation?
- Are children U.S. citizens
- CFC rules
- PFIC rules
Canadian Estate Planning

Estate freeze for capital gains purposes, pass growth to children

* frozen preferred

* non-cumulative dividends, usually not paid
U.S. Citizens Living in Canada

Canadian Estate Planning

- Use of insurance, often corporate-owned
- Use of corporation for investment assets
- No need to gift or deal with unappreciated property (no tax on death)
U.S. Citizens Living in Canada

**U.S. Estate Planning Concepts**

- Own investment assets personally
- Gifting program with limits
- Use of insurance non-corporate form, beneficiary the estate
- Use insurance trust
- Estate freeze, intentionally defective grantor trust
- U.S. estate tax is dominant issue
U.S. Citizens Living in Canada

Mr. A, Canadian resident, U.S. citizen

Grantor Trust

Mr. A, wife and children

assets

note

U.S. style estate freeze
## U.S. Citizens Living in Canada

<table>
<thead>
<tr>
<th>Canada</th>
<th>U.S.</th>
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<tbody>
<tr>
<td>Trust reversionary</td>
<td>Trust reversionary</td>
</tr>
<tr>
<td>Income and gains taxed to Mr. A</td>
<td>Income and gains taxed to Mr. A</td>
</tr>
<tr>
<td>Capital gains tax on transfer to trust (but exceptions)</td>
<td>No tax on transfer to trust</td>
</tr>
<tr>
<td>No tax on Mr. A’s death (but exceptions)</td>
<td>Estate tax on Mr. A’s death on value of note</td>
</tr>
<tr>
<td>Taxable rollout from the trust to children</td>
<td></td>
</tr>
<tr>
<td>Deemed capital gains every 21 years</td>
<td></td>
</tr>
</tbody>
</table>
U.S. Citizens Living in Canada

• Canadian estate planning and U.S. estate planning are different

• Need to carefully coordinate all aspects to avoid a disaster and monitor regularly
Canada-U.S. Estate Planning

Conclusions

• Very complex
• Big benefits from planning long term
• Huge traps
• Plan early/Plan often
• Get expert advice in both countries