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Memo: Estate Tax Exposure For Canadians

It's relatively common knowledge that Canada doesn't have an estate tax on a deceased individual's assets¹. Yet, what may not be as widely known is that high-net-worth Canadian residents² could be subject to U.S. estate tax on their death.

U.S. estate taxes

A Canadian resident who's not a U.S. person may be subject to U.S. estate tax on their U.S. situs property (aka U.S.-situated assets) if the value of the person's worldwide estate at the time of death is above a certain threshold.³ U.S. situs property includes, but isn't limited to, U.S. real estate (e.g., a vacation home in Florida) and shares of a U.S. corporation (e.g., shares of Apple Inc.), even if held in a Canadian brokerage account, including registered accounts such as a registered retirement savings plan (RRSP) or tax-free savings account (TFSA). However, it's important to note that an investment in shares of a Canadian mutual fund corporation or units of a Canadian mutual fund trust, exchange-traded fund (ETF), or segregated fund contract isn't considered U.S. situs property, even where the fund invests in U.S. securities.

Canada-U.S. tax treaty relief

For 2022, when the value of an individual's worldwide assets exceeds US\$12,060,000, they'll be required to pay U.S. estate tax based on the value of their U.S. assets. The U.S. estate marginal tax rates begin at 18% and can be as high as 40% when U.S. assets exceed \$1,000,000 (see Table 1).

Table 1:

The following table illustrates graduated United States estate taxes and marginal tax rates for 2018. All figures shown are listed in U.S. dollars

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Taxable U.S. Property	Estate Tax	Marginal Tax Rate
< \$10,000	\$0	18%
\$10,000	\$1,800	20%
\$20,000	\$3,800	22%
\$40,000	\$8,200	24%
\$60,000	\$13,000	26%
\$80,000	\$18,200	28%
\$100,000	\$23,800	30%
\$150,000	\$38,800	32%
\$250,000	\$70,800	34%
\$500,000	\$155,800	37%
\$750,000	\$248,300	39%
\$1,000,000	\$345,800	40%

The Canada-U.S. tax treaty provides Canadian residents three forms of relief from U.S. estate tax that can reduce their U.S. estate tax liability:

- unified credit
- marital credit
- foreign tax credit

Unified credit

The unified credit allows a U.S. citizen to gift a certain amount of their assets to other parties without having to pay gift or estate taxes. Article XXIX B of the tax treaty allows a Canadian resident to claim a pro rata (proportionate) share of the U.S.

unified credit amount against any U.S. estate taxes payable. For 2022, a Canadian resident's estate can reduce its U.S. estate tax liability by claiming the unified tax credit equal to the greater of:

$$\text{\$13,000 or \$4769,800}^4 \times [\text{Value of U.S. assets} / \text{Worldwide assets}]$$

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The above is a calculation to illustrate the unified credit. For 2018, a Canadian resident estate can reduce its United States estate tax liability by claiming the unified tax credit which is equal to the greater of: A) \$13,000 or B) \$4,425,800 multiplied by the ratio of your taxable United States estate value to your worldwide estate value.

Marital credit

The marital credit is an additional credit under the Canada-U.S. tax treaty and is available when a surviving spouse inherits U.S. property on death. The marital credit is equal to the lesser of the unified credit and the amount of the U.S. estate tax owing.

Example: Take for example a Canadian resident who, at death, has an estate with worldwide assets valued at \$15,000,000, of which \$2,000,000 is determined to be the value of the U.S. assets. The deceased's spouse inherits the U.S. assets. The amount of the U.S. estate tax liability is calculated as:

The following is an example to show how to calculate the United States estate tax liability. This example demonstrates how the unified credit and marital credit can reduce the United States estate tax liability.

In this example, if the U.S. assets didn't pass on to the deceased individual's spouse, the U.S. estate tax liability would be \$109,827, as the marital credit wouldn't have been available.

U.S. estate tax on \$2,000,000	\$745,800
Unified credit	(\$635,973)
Net U.S. estate tax	\$109,827
Marital credit	(\$109,827)
Final U.S. estate tax	\$0

Foreign tax credit

The Canada-U.S. tax treaty allows U.S. estate tax payable by a Canadian resident to be claimed as a foreign tax credit on their Canadian federal income tax return for the year of death. The ability to claim a foreign tax credit has the potential to reduce or eliminate the Canadian tax on assets subject to U.S. estate tax. In the end, an individual generally pays the higher of the two taxes.

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However, with non-registered assets such as real estate or shares, Canadian tax only applies to any capital gains on death rather than their fair market value. Given that Canadian capital gains tax rates are typically significantly less than the top U.S. estate tax rate, the estate will likely pay tax at the U.S. estate tax rate (i.e., the top marginal capital gains tax rates in Canada are approximately 25%, whereas the top marginal U.S. estate tax rate is 40% when U.S. assets exceed \$1,000,000). Furthermore, the provinces and territories generally don't provide a foreign tax credit for U.S. estate taxes paid. Therefore, there's the potential for double taxation to occur at the provincial or territorial level.

Filing requirement

A U.S. estate tax return must be filed with the Internal Revenue Service (IRS) if a deceased Canadian resident (who's not a U.S. citizen) owned U.S. assets with a fair market value greater than US\$60,000 at death. It's important to note that there's a requirement to file a U.S. estate tax return even if the application of the Canada-U.S. tax treaty results in no taxes owing. A Canadian resident must file a non-resident U.S. estate tax return ([Form 706-NA](#)) to claim their treaty position (i.e., the unified credit) and to make sure their beneficiaries receive a stepped-up basis to fair market value at the time of the decedent's death. If Form 706-NA isn't filed, then there's a zero basis in the asset in the hands of the beneficiaries, which results in double tax when they dispose of it or pass away.

Summary

It's important to consider the income tax, estate tax, gift tax, and potential probate tax implications of owning significant worldwide and U.S. assets. Each situation should be dealt with based on the particular facts involved. Speak to your advisor to determine if U.S. estate tax may apply in your situation and what planning opportunities may be available.

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Footnotes: 1 On death, a Canadian resident is deemed to have disposed of all assets at fair market value. Any capital gain or loss is included in income on the deceased's final T1 tax return, except in cases where a qualifying transfer is available to a spouse or spousal trust. Further, for all provinces and territories except Quebec, probate may also apply. The reference to resident means "resident for Canadian income tax purposes." 2 This is applicable to Canadian residents and isn't applicable to U.S. persons—including U.S. citizens, U.S. residents, and lawful permanent residents (green card holders)—or individuals who are substantially present in the U.S. and don't meet requirements for the Closer Connection Exception Statement for Aliens. U.S. persons, even if residing in Canada and/or are Canadian citizens, face significantly different tax consequences. Accordingly, individuals should speak to their cross-border tax specialist about their specific situation. 3 In 2017, the Tax Cuts and Jobs Act, H.R.1, doubled the base exclusion amount for estate and gift tax to US\$10 million per U.S. person (to be indexed for inflation). For 2022, the basic exclusion amount is US\$12,060,000 per U.S. person. The estate and gift tax base exclusion amount will sunset (no longer apply) after December 31, 2025. Sunset provisions will revert to the \$5,000,000 exclusion amount, indexed for inflation. New legislation will be required to make sunset provisions effective beyond 2025. 4 \$4,769,800 is the equivalent U.S. estate tax liability on \$12,060,000 of assets

<https://www.manulifeim.com/retail/ca/en/viewpoints/tax-planning/us-estate-tax-exposure-for-canadian-residents-who-are-not-us-citizens>