

# Estate Tax Update

## U.S. Estate Tax Exposure for Canadians (Revised Edition, January 15, 2008)

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\$2 million (US\$3.5 million in 2009).

### If your worldwide estate exceeds US\$2 million

If the value of your worldwide assets exceeds US\$2 million, you will be required to pay U.S. estate tax based on the value of your **U.S.** assets. For 2008, 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\$780,800\* 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\$117,120 (US\$780,800 x 15%).

\* Equals the US estate tax on assets of \$2 million.

### U.S. estate tax rates and unified credit amounts

The good news is that the unified credit is increasing. As shown in the table below, the unified credit will rise to US\$1,455,800 in 2009 (which equals the U.S. estate tax on assets of \$3.5 million).

Under current U.S. legislation, the estate tax is scheduled to be repealed entirely in 2010. However, in 2011 the U.S. will return to the 2001 estate tax rates and unified credit amount, unless new legislation is enacted at that time.

To illustrate the effect of the changes, 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 table on page 2 compares the estate taxes payable by Mr. Brown, in 2008 and 2009.

Calendar Year	Unified Credit Amount (\$US)	Highest Estate Tax Rate
2007	\$780,800	45%
2008	\$780,800	45%
2009	\$1,455,800	45%
<b>2010</b>	<b>N/A (taxes repealed)</b>	<b>0%</b>
2011 and after	\$345,800	55%

Mr. Brown's Year of Death	U.S. Estate Taxes Owning Before Unified Credit (\$US)	Unified Credit Amount (\$US)	Net U.S. Estate Taxes Owning (\$US)
2008	\$345,800	\$156,160	\$189,640
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 reduced to about US\$33,000 in 2008 and completely eliminated in 2009.

## 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.

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