Cross-Border Workshop: U.S./Canada

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Agenda

1. Brief introduction to Canadian tax law
2. Fact scenarios:
   a. US resident inherits real estate in Canada
   b. Canadian with Florida condo
   c. US person is beneficiary of Canadian estate
   d. Americans moving to Canada
   e. Canadians moving to the US
3. Cross-border Philanthropy
4. US issues with Canadian estate freezes

This presentation may contain general comments on legal issues of concern to organizations and individuals.
These comments are not intended to be nor should they be construed as legal advice. Please consult a legal professional on the particular issues that concern you.

Introduction to Canadian Tax Law

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Background – Key differences

- 1. Taxation based on residency, not citizenship
  - Residents taxed on world-wide income
    - Disclosure requirement for foreign assets >$100,000
  - Two types of residency
    - Factual resident
    - Deemed resident – 183 days
  - Departure tax on emigration
    - On capital gains of certain assets

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The Canadian *Income Tax Act* (ITA) taxes Canadian residents on worldwide income and non-Canadian residents only on certain types of income derived from Canadian sources (e.g., Canadian dividends, Canadian employment income and sale of real estate in Canada). Canadian residency should not be confused with Canadian citizenship. The *ITA* does not specifically define the term residence. Under Canadian domestic tax laws, you may have established residency in Canada for tax purposes in two ways: as a "factual resident" or a "deemed resident."

You are a factual resident as a result of establishing substantial residential ties in Canada; you are considered a deemed resident simply based on the length of time you are present in Canada.

Factual Resident:

- You may be a factual resident of Canada as a result of moving to Canada and establishing substantial ties in Canada.
- The term "resident" is not defined in the ITA; instead, a factual resident status is determined based on assessing practices of the CRA and common-law rules and court cases that have evolved over the years.
- Therefore, one's residency status is based on facts and circumstances that must be reviewed on a case-by-case basis to assess whether an individual is a factual resident of Canada for tax purposes.

Ways to Establish "Factual" Ties to Canada:

- Having a home in Canada;
- Bringing your spouse or common-law partner and dependents to Canada to live with you;

- Bringing personal property, such as a car or furniture, to Canada;
- Having social (e.g. club memberships or applied for a driver's license and Canadian hospitalization and medical coverage) and other ties (e.g. opening bank accounts, applying for credit cards, and purchasing automobiles and furniture) in Canada.

No one tie established in Canada is used to determine factual residency, but rather the combination of all the facts and circumstances are taken into account.

The Canada Revenue Agency (CRA) will also consider whether ties in the foreign country have been severed. For example, the sale of a former residence in another country reinforces the presumption that Canadian residency has begun. The CRA has indicated that there must also be a degree of permanence to an individual's stay in Canada, and they will look at regularity and length of visits to Canada.

Deemed Residency:

- You may be a deemed resident of Canada as a result of temporary stays (i.e., sojourning in Canada) that total 183 days or longer in a calendar year.
- To "sojourn" means to make a temporary stay in the sense of establishing a temporary residence; although the stay may be of a very short duration (e.g. you are sojourning when you vacation in Canada).

Tax difference of Deemed vs. Factual Residence

- Deemed residents are taxed on worldwide income for the entire calendar year, no matter which day in the year they met the condition for deemed residency; whereas, factual residents are taxed on worldwide income from the day they establish factual residency.
- Deemed residents are generally not resident in a particular province (except in certain cases under Quebec tax laws) and thus are subject to a federal surtax, unless they earn specific income that is subject to tax in a province.
- The surtax rate may be higher than the provincial tax rate.

2. Taxation on death

- No estate tax in Canada
  - Deemed disposition of capital property on death
    - Accrued gain becomes taxable (50% of gain included in deceased's income)
    - Some exceptions:
      - Rollover to spouse or qualifying spouse trust
      - Exemption for principal residence (one/couple)
      - Deduction for portion of gain of certain small business corporation shares, farm property, fishing business

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Generally, when a Canadian resident individual dies, he or she is deemed to have disposed of all of his or her property immediately prior to death. As a result of the deemed disposition, the following taxes are payable:

- **Capital gains** - 50% of the capital gain (i.e. fair market value of capital assets minus their adjusted cost base) is taxed at the individual's marginal income tax rate.
  - e.g. if a BC resident passes away with income in the highest tax bracket, the gain is taxed at 24.9%, whereas if an Ontario resident passes away with the same income level, the gain would be taxed at approximately 26.76% and in Quebec at 26.6%.
  - There are a limited number of exemptions available:
    - Unlimited exemption for gains on the principal residence
      - Does not have to be primary home – could be vacation property;
      - Does not have to be in Canada;
    - $800,000 Indexed exemption for qualifying small business corporation shares; and
    - $1,000,000 exemption for qualifying farm property, fishing operations
- **Income Tax on Registered Plans** (RRSP/RRIF/LRSP/LRIF) - the fair market value of these plans is included in his or her income in the year of death, and they are taxed at the deceased's marginal rate (BC maximum rate is 49.8%, Ontario-53.53% and Quebec-53.31%; the top bracket starts at $205,843 in BC, $220,001 in Ontario and $205,842 in Quebec).

"Spousal Rollover" Exception- If property is transferred to a spouse (or a spousal trust) realization of capital gains or registered plan income inclusion triggered by the deemed disposition at death (and the resulting tax liability) can be deferred until the death of the surviving spouse (or transfer/sale by the surviving spouse).

Graduated Rate Estates (GRE)

- Generally, trusts are taxed at highest marginal rate in province in which they are resident
  - Ontario: 53.53%
  - British Columbia: 49.8%
  - Quebec: 53.31%
- Graduated rate estates taxed at marginal rates for first three years following death
- Certain testamentary trusts for people with disabilities are taxed at graduated rates
- Philanthropy on death – affected by the GRE rules

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New ITA legislation effective Jan. 1, in 2016 introduced significant change to the taxation of estates and testamentary trusts:

Testamentary Trusts

- income left in the trust is now taxed at the highest marginal rate (in the past they were taxed at graduated marginal rates).

Graduated Rate Estate (GRE) – since 2016

- A GRE is an estate that arises on, and as a consequence of, an individual's death.
- No more than 36 months can have passed from the date of death.
- The estate must designate itself as the deceased individual's GRE in its first taxation year that ends after 2016.
- The estate will be deemed to have a year-end when it ceases to be a GRE and is then required to select a December 31 fiscal year-end.

Philanthropy on death – Where a Will includes a bequest to a registered charity, in order for an estate to be able to use the charitable tax receipt in the year of death or first year of the estate, the bequest must be delivered while the deceased's estate is a GRE and during the first 36 months from the date of death (a bequest delivered in the 4th or 5th year of the estate may also be eligible for a charitable tax receipt that is usable in the donor's year of death).

3. Who is a spouse?

- For federal tax purposes – includes common law spouse (after one year), same-sex spouses recognized
- Provinces have different definitions and rights for common law relationships
  - For support, division of property, intestacy
  - BC – common law and married have the same rights
    - Division of property on marriage breakdown, variation of Wills, support, intestacy etc.
  - Currently in Ontario:
    - Common law-3 years for support claim on marital breakdown or death
    - Legally married for division of property, intestacy
  - Quebec – must be legally married to claim support, division of property, on intestacy

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- **Federal ITA Definition (for tax purposes) -** "Spouse" is defined as:
- A person of the same or opposite sex whom you are married to (ceases upon divorce); and
- A "common law spouse" is a person of the same or opposite sex whom you have been living in a conjugal relationship with
  - for >1 year; or
  - Is the parent of your child (i.e. can be living together less than a year in this case)
  - A common law relationship ceases upon living separate and apart (with the intention to continue to do so) for 90 days;
  - "Conjugal" is not a defined term, but is based on a preponderance of evidence
    - Some factors the courts use to determine if two people are in a conjugal relationship include living arrangements, exclusivity, level of intimacy, performance of household chores, community attitude and conduct, financial interdependence, and attitude and conduct towards children. Partners do not have to be in a sexual relationship to be considered as conjugal.
- Federally can have more than one spouse (i.e. a person you are married to and one you have lived with for > 1 year)
- **BC Definition** –Spouse is defined as someone you are:
  - Married to
    - Ceases upon separation or divorce
  - Living with in a "marriage like relationship" for .>2 years
    - Ceases upon one party terminating
    - Same considerations as ITA (i.e. court determines based on evidence).
- **Ontario *Family Law Act*** differentiates between legally married and common law spouses (after 3 years, or have a child together) for certain rights and obligations
- **Quebec -** For family law and related purposes – either married or in a "civil union", not a "de facto" spouse - *A.G. Quebec* v. *A.* (aka *Eric* v. *Lola)*, 2013, SCC - upheld as not unreasonably infringing equality rights under the Canadian Charter of Rights and Freedoms

Testamentary "Qualifying Spouse Trust"

- Subs. 70(6) of the *Income Tax Act*
- Testator normally must be resident in Canada at time of death
  - Canada-US Treaty exception – Art. XXIX-B Para. 5
    - US resident testator and spouse deemed resident for purposes of subs. 70(6)
- Established by Will or otherwise on death of testator
- Property vests indefeasibly in the trust within 36 months of death
- Trust must be resident in Canada immediately after the property vests indefeasibly in the trust
  - Treaty exception – apply to Competent Authority
- The spouse is entitled to all of the income during his or her lifetime
- Only the spouse is entitled to capital during his or her lifetime

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Testamentary Qualifying Spousal Trust - combines the tax-deferral advantages of leaving assets to a spouse, with the ability to protect family interests.

- In order to qualify for rollover treatment, the trust must be resident in Canada; if rolling over directly to spouse, the spouse must be resident in Canada
- Residence of trust based on where the management and control of the trust is carried out
  - *Fundy Settlement* v. *Canada* 2012 SCC 14 (often referred to as *Garron*)
  - Often, this is where the trustees reside, but not necessarily
- Canada-US Treaty exception - Paragraph 5 of Article XXIX B allows the trustees of a United States trust that is similar to trusts described in subsection 70(6) of the Act to request that the Canadian Competent Authority to treat the United States trust as a resident of Canada for the purposes of the *Income Tax Act*, such that, subject to the agreement with the Competent Authority, the trust may be eligible for the rollover.

Planning Points:

- Can limit spouses access to capital, or not allow them to access capital (so long as no one else has access during their lifetime);
- Income arising in testamentary trusts, including testamentary spousal trusts, will be taxed at highest marginal rate, not GRE rate, so general practice is to allocate out to beneficiaries
  - Must be paid or payable
- Must be drafted carefully – can lose rollover treatment if trust becomes "tainted":
  - Cannot disentitle spouse to an interest in the trust (i.e. if they remarry);
  - Cannot allow trustee to purchase life insurance within the trust (seen as benefitting future beneficiaries, not spouse beneficiary)
  - Cannot allow loans or assignment of interests etc.

4. *Inter vivos* gratuitous transfers

- No gift tax in Canada
  - US gift tax on transfers of US real estate and tangible US property held by non-residents
- Capital gains tax on gratuitous transfers based on FMV less ACB
  - Except to a spouse or qualifying spouse trust
  - Attribution of income to donor in certain cases
    - Spouse
    - Minor children

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5. Probate

- Provincial probate generally required to transfer real estate to beneficiaries
- Will likely require an ancillary grant or re-sealing of probate
- Or, use separate Will for real estate in the province
- Non-resident executors may need to post a bond
  - In Ontario, not required if executor is in a Commonwealth country
  - Application to court to waive requirement
- Probate fees based on value of estate in some provinces
  - BC (1.4%), Ontario (1.5%) and Nova Scotia (1.645%)
  - Planning techniques include use of multiple Wills (in Ontario & BC) and *inter vivos* trusts

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In Canada, probate is payable on real estate in the province where the real estate is located. It is possible to have the executor of a "foreign" Will that has gone through probate in the state or province of domicile of the property owner apply for an "ancillary grant" or "re-sealing" and probate paid on the value of the land in the province where it is located. Alternatively (and possibly a more simple process), property owners can have a separate Will drawn up in the jurisdiction where they own the real property. Financial institutions across the country may accept probate from any province.

There are a few ways to minimize probate fees:

- Both BC and Ontario allow for Multiple Will planning. Essentially this allows for a Testator to have 2 Wills prepared, one for their assets that are required to go through probate (generally, real estate and assets at a financial institution) and one for their "non-probatable assets" (e.g., private company shares, non-secured loans, partnership interests, personal effects that are distributed to beneficiaries – i.e., where transfer agent does not require). In this case, probate fee/tax is payable on the assets dealt with in the first Will.
- Recent Ontario case (*Milne*) has called into question the use of a "basket clause" in the definition of the "non-probate" Will.

- Assets that pass outside of a Will generally avoid probate (i.e. settling assets on an *inter vivos* trust. Naming a beneficiary on a registered plan or insurance policy etc.).
- Notarial Wills in Quebec do not require probate; no probate fees
- In Alberta, there is a flat fee of $400.00
- Some inter-provincial planning may be available if the Testator has an asset in Alberta or Quebec

6. Canada-U.S. Tax Treaty

- Para. 212(1)(c) of the ITA – 25% withholding tax on income of estate or trust
  - Reduced by Article XXII(2) to 15%
- Treaty reduces other types of income
- Article XXIXB assists Canadians holding US real estate:
  - Pro-rated unified credit
  - Marital credit
  - Foreign tax credit – estate tax and capital gains tax
  - Small estate exemption – under US$1.2M

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7. Residency of a Trust or Estate

- Residence of a trust (or estate) for tax purposes is where "central management and control" takes place
  - *Garron* decision
- A non-resident trust may be deemed to be a Canadian resident trust under s. 94 of the *Income Tax Act* if there is a "resident contributor" to the trust or a "resident beneficiary" under the trust
- If the trust is factually or deemed resident in Canada, it will be taxed on its worldwide income
- If the trust or estate does not meet the *Garron* test for residency and does not fall under the deemed resident trust rules, there may be opportunities to make distributions to the Canadian beneficiaries in a tax-efficient manner, particularly if the trust does not hold "taxable Canadian property"

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Fundy Settlement v. *Canada*, 2012 SCC 14 (aka *Garron*) – The Supreme Court of Canada held that the residence of a trust should be determined by the principle that a trust resides for the purposes of the Act where its central management and control actually takes place. The Supreme Court went on to state the residence of the trustee will also be the residence of the trust where the trustee carries out the central management and control of the trust, and these duties are performed where the trustee is resident.

Subsection 94(3) of the Act deems a trust that is otherwise factually non-resident to be resident in Canada for certain purposes of the Act, including liability to Canadian taxation on worldwide income and computing the trust's income for a particular taxation year. A trust will be deemed resident in Canada under subsection 94(3) of the Act if at a specified time there is a "resident contributor" to the trust or a "resident beneficiary" under the trust.

A **resident contributor** to a trust is defined in subsection 94(1) of the Act as a person that is, at that time, resident in Canada and a contributor to the trust.

A **contributor** is defined in subsection 94(1) of the Act as a person that, at or before that time, has made a contribution to the trust. ("Contribution" has a broad

definition.)

A **resident beneficiary** is defined in subsection 94(1) to mean a person that is, at that time, a beneficiary under the trust if, at that time, the person is: (A) resident in Canada, **and** (B) there is a "connected contributor" to the trust. A **connected contributor** is someone who contributed to the trust while a resident or during a "non-resident time." A **non-resident time** of a person is within 60 months of moving to Canada or within 60 months of leaving Canada; in respect of a contribution to a trust arising as a consequence of the death of a person the time is shortened to the 18 months before death.

Examples

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Example 1:
US resident inherits real estate in Canada

- Jack and Jill inherited the family cottage in Ontario in 2015 when their father died
- Their mother died in 2007
- Both parents were Ontario residents, but Jack and Jill had moved to the US in the '80s
- The parents bought the cottage in 1967 and held it jointly

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The Ontario cottage

- On first death:
  - Cottage passed to father by right of survivorship (no probate)
  - "Spousal rollover" for tax purposes from mother to father (both Canadian residents)
- On second death:
  - Probate Will in Ontario (Certificate of Appointment of Estate Trustees)
    - Consider tax residency of estate
    - Resident or non-resident executors?
      - Bond may be required
  - Capital gain taxed in Canada
  - Jack and Jill receive at the estate's ACB (FMV at death), even if increases in value post death and prior to distribution - Treaty
  - Section 116 Clearance Certificate may be required

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Probate the Will in Ontario

- Probate fees of 1.5% on the FMV of the land would be payable.

Land Transfer Tax

- Land Transfer Tax exemptions in BC, Ontario and Quebec for transfers from an estate to a named beneficiary. (In Qu – where bequest is to a spouse, descendant or ascendant)
- LTT on subsequent transfers
  - Toronto has additional LTT over the provincial tax
  - Ontario and BC now have tax on non-resident purchasers of property in certain areas
  - BC – beneficial ownership registration in the works

Issues relating to Non-resident executors

- An estate is deemed to be a trust under Canadian ITA.
- Caselaw (*Garron*) – trust resides where management and control carried out
  - if the sole executor is a non-resident of Canada, the estate may be considered non-resident.
  - If there is more than one executor or trustee, the residency of the person who clearly exercises a substantial portion of the management and control of the assets, will determine the residency of the estate or trust.
  - If, however, there is equal management and control, the residency of the estate or trust may be located where the majority of the trustees reside.

Some of the potentially negative tax consequences include the following:

- A non-resident estate would lose the preferred tax treatment for capital gains and Canadian source dividends that are flowed through to the Canadian resident beneficiaries.

- A non-resident estate could be subject to tax in the country where the executor resides. In certain situations, the estate could be considered resident in both countries and subject to tax in both jurisdictions.
- If the executor is a US resident, there are US rules that may limit their ability to deal with Canadian investment accounts. As such, many financial investment institutions will not allow an estate account to be opened where one of the executors is a US resident.
- If they are a US citizen, regardless of residency, they will need to report any assets under their management under the new FATCA rules.

Capital Gains Tax in Canada

- 50% of the gain (FMV-ACB) is brought into the deceased's income (e.g. if the property was worth $500,000 and the cost base was $30,000 their would be an income inclusion of $235,000).
- There is an exemption from capital gains for a taxpayers principal residence (couples are only allowed to have 1 principal residence exemption that they share.
- That said, the cottage can qualify as a principal residence if their parents did not have another principal residence and they regularly used the cottage.
- Jack and Jill may be able to reduce the taxes owing for a portion of the growth (e.g. if the parents had moved to a seniors home and sold their house, if they had downsized and their new home had not gone up significantly in value, or if the cottage had increased significantly compare to their family home).

S. 116 Clearance Certificate

- When a non-resident disposes of Taxable Canadian Property (TCP), generally required to obtain a clearance certificate prior to disposition, unless treaty-protected
- Non-resident beneficiary is disposing of capital interest in estate
  - If real estate makes up majority of value of estate will need a s. 116 certificate

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TCP - essentially = real property, property used in or held in a business carried on in Canada, private company shares where at any time in the previous 60-month period, more than 50% of the fair market value of the shares was derived from one or any combination of:

real or immovable property situated in Canada;
resource property situated in Canada;
timber resource property situated in Canada; and
options or interests in any of the above.

Since March 2010, an interest in a trust is considered TCP (and a s. 116 certificate required) only if in the 60 months prior to the distribution more than 50% of the value of the interest is derived from Canadian real property (or timber or resource properties). The executor does need to consider whether the 60-month look-back applies if, e.g., the executor sold the deceased's home/cottage and is now distributing cash from the estate. In certain circumstances (based on a tax treaty), a s. 116 certificate may not be required.

How should siblings hold cottage?

- Considerations:
  - Probate
  - Land Transfer Tax
  - Canadian capital gains tax
  - US capital gains and estate tax
- Direct ownership – joint or tenants-in-common
- Trust – parents' Wills, *inter vivos*
- Corporation, partnership

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- **Probate fees if Jack or Jill pass away**
  - Ontario probate payable on 50% interest passing if owned as Tenants in Common.
  - No probate fees payable if owned as Joint Tenants.

- **Land Transfer Tax Upon Transfer to Future Owners**
  - In BC Property Transfer Tax (PTT) is payable by the purchaser for any real estate transaction where there is a change in ownership. It is calculated based on the fair market value of the property being transferred. The rate is 1% on the first $200,000, 2% on the value up to $2,000,000 and 3% on the value over $3,000,000
  - BC is now tracking beneficial foreign ownership.
  - In Ontario Land Transfer Tax (LTT) is also payable by the purchaser for any real estate transaction when there is a change of ownership. The rate is 0.5% on the first $55,000, 1% an the value up to $250,000, 1.5% on the value up to $400,000 and 2% on the value over $400,000.
  - Quebec land transfer duty – brackets are roughly indexed to cost of living increases. Currently in Montreal – 0.5% on first $50,400, 1% on excess up to $251,800, 1.5% up to $503,500, 2% - up to $1,007,000 and 2.5% on value over that.
  - Alberta does not have a Land Transfer Tax, but instead charges a registration fee for land and mortgages. The two fees are calculated as follows:
    - *Property registration fee* – $75, plus $6 for every $5,000 of property value (rounded up to the nearest $5,000)
    - *Mortgage registration fee* – $75, plus $6 for every $5,000 of your mortgage amount (rounded up to the nearest $5,000)

  - (e.g. the purchase of a $4,000,000 piece of commercial real estate would attract a registration fee of $4,875 ($75 + $6 per $5,000 ($4,000,000/ $5,000 = 800))

- **Ownership concerns** – if use a Canadian Corporation –
- Is it a PFIC?
- Under the PFIC regime, US citizens who own less than a majority of a foreign corporation are subject to tax at the highest rate applicable to individuals and to a deferred interest charge on excess distributions from a PFIC.
- An "excess distribution" is defined as a distribution in a tax year (as measured in US dollars) that exceeds 125 percent of the average of the prior three years' distributions from the foreign corporation.

Example 2:
Canadian with Florida condo

- U.S. estate tax liability
  - Pro-rated exemption
  - Marital credit
  - Foreign tax credit for estate tax paid
    - But may not match if rollover to spouse → opt out of rollover

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For Canadians, the main issues when deciding ownership focuses on how to minimize:

1. US estate tax
2. capital gains tax on sale (US & Canada)
3. state probate tax
4. complexity and costs to set up
5. double tax due to Canadian versus US tax rules

Rental of property
Two options to pay US tax on US rental income:
1) 30% withholding on gross rent or 2) elect to file return and pay tax on net income at graduated tax rates

- foreign tax credit for US tax on Canadian income tax return
- benefit of electing to file US return: expenses offset rental income, losses can be carried forward to offset gain from eventual sale or property

Sale of real property subject to tax

- US non-resident income tax return required
- initial 15% withholding tax on gross proceeds. No withholding if proceeds < $300k and seller to use property as principal residence or if > $300K there is no taxable gain (if file withholding waiver)
- beneficial long-term US capital gain rate – max 20% for individuals
- US state income tax varies - no individual income tax states – Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming

for Canadian tax purposes, gain or losses includes foreign exchange gain or loss (exchange rates on date

of sale and date of purchase)

Review of US Real Estate Ownership for Canadians

Ownership Structure	Avoids US Estate Tax	Complexity	Other issues
Sole owner	No (1)	Low	Requires US State probate
Joint tenancy	No (1)	Low	Avoids US state probate on first death
Tenants in common	May minimize (1)	Low	Requires US state probate
Revocable trust	No (1)	Medium	Avoids US state probate
Canadian Corporation	Yes (*)	High	US federal tax rate on sale 21% + US state income tax in many US states: shareholder benefit; IRS look through if corporate form is disregarded; can avoid US state probate
Canadian Irrevocable Trust	Yes (*)	High	Settlor loses control; 21 year deemed disposition rule if not spousal trust; can avoid US state probate
Canadian Limited Partnership	Yes (*)	Highest	Does partnership meet business purpose test? "Check the box" issues, can avoid US state probate
US LLC	No (1)	Medium	Double tax, corporation for Canadian tax, flow thru entity for US tax (Form 5472); can avoid US state probate

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(*) Must be structured correctly to avoid IRS look through

(1) Estate tax exposure may be managed through non-recourse mortgage or purchase of life insurance

Possible Structures

•Depends on value, how long will be held, who will use
•Tenants-in-common (not joint) with trust in Wills
•Restrict encroachment to health, education, maintenance and welfare
•Probate
•Life insurance
•Use a trust if will significantly increase value of worldwide estate
•Non-recourse mortgage
•May be difficult for non-resident to obtain
•Canadian corporation – no longer useful
•Canadian trust
•Partnership – more complex

Why the US LLC Structure is NOT appropriate for Canadians

•Considered a partnership or flow through entity for US tax purposes unless election

made (i.e. check the box) to be treated as a US corporation
•Rental income and gain on sale subject to tax on US personal income tax return benefiting from US personal tax rates instead of US corporate tax rates, e.g. long-term capital gain tax rate personally is 20%, for corporations 34%
•Considered a corporation for Canadian tax purposes: if controlling members are residents of Canada, rental income or gains on sale of property subject to Canadian corporate tax, shareholder benefit for use of vacation property for free
•Since US rental income and gain on sale taxed at Canadian corporate tax rates, no foreign tax credit on Canadian personal return for US personal tax on rental income or gains on sale of the property; results in double taxation with no relief in Canada-US tax treaty
•If LLC makes distribution in same year to shareholder/member, some of the US tax (limited to 15%) may be claimed as a foreign tax credit on the Canadian personal income tax return

Canadian trust to hold property

- Long-term solution; valuable property

How it works

- Settlor transfer funds for purchase to the Canadian trust
- Spouse, children are trustees and beneficiaries
- Settlor can use the property with the permission of beneficiaries
    - But may need to pay rent, trust may have to file US and state income tax returns and withhold or pay US and state income tax
- Ascertainable standard
- 21-year deemed disposition for Canadian purposes
    - Independent trustee can encroach on all of the capital
- Beginning 2021 taxation year, must file Canadian T3 trust return even if no income

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3. US Beneficiary of Canadian estate

- US Opportunity for estate tax planning by Canadian for benefit of US person
  - Testamentary trust for US beneficiary's lifetime can avoid US estate tax on trust assets on beneficiary's death
    - Ascertainable standard
    - Restrictions on decision-making
    - Consider moving trust to US if beneficiary is a US resident (consider Canadian deemed trust resident rules)
    - If remains a Canadian trust – watch for:
      - US accumulation rules
      - Does trust hold a CFC or PFIC
      - 21-year deemed disposition

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4. Americans moving to Canada

- Continual tax filing obligations
  - FBAR and FATCA
  - OECD common reporting standards
- Estate tax planning opportunity if spouse is not a US person
- Pension plans
- Cross-border investing restrictions
- "Granny Trusts" for future inheritances from parents/grandparents who live outside of Canada

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Cost base of Capital Assets

- Timing of residency different for deemed vs. factual residence
- At time of residency, cost base of assets "bumped up" to the current FMV – ensure keep track of this value as it will be used to determine capital gains/ losses in future. Canada only taxes the increase or decrease in value since residency date.

Pension Plans (IRA's, 403(b), 401(k) etc.)

- May be able to consolidate to Canada and contribute to a Canadian RRSP (Registered Retirement Savings Plan)– different rules for what can be contributed for each plan
  - Must be <71 years old and a resident of Canada, and the $ must be a lump sum payment from the pension plan;
  - "Roth IRA's" are not considered a pension plan in Canada, therefore can only contribute to an RRSP if you have taxable income in Canada and contribution room in your RRSP
- withdrawal may be subject to U.S. withholding tax of 10-20%
- the withdrawal must be reported on a U.S. resident income tax return (Form 1040) and is subject to U.S. tax at graduated tax rates.
- If under age 59 ½ when the withdrawal is made then may be subject to a nonrefundable 10% early withdrawal penalty (Form 1040)
- May want to time withdrawal with lump sum payments being made over a number of years in order to maximize FTC

Cross Border Trading

- SEC and various provincial rules can prevent giving instructions on cross-border investments and

trading
- May be some exceptions for registered plans

"Granny Trusts" - Allows for the tax free accumulation of income and capital gains
- A granny trust is an non resident trust (NRT) established by a nonresident of Canada for the benefit of persons who are resident in Canada (typically by an older generation for the benefit of a younger generation).
- The NRT may be established during the lifetime, or in the Will of the non-resident.
- So long as no Canadian resident is a contributor to the NRT and the contributions by non-residents are all made at non-resident times, such an NRT should not be deemed a resident of Canada under the proposed rules.
- The definition of "non-resident time" is complex, but this requirement will be met if the contributor has never been and never intends to be a Canadian resident.

Americans Owning Canadian Real Estate

Structure	Advantages	Disadvantages
Direct Ownership	• Single level of taxation	• Transfer of Ontario real property to successive generations may generate Ontario land transfer tax, but not on death; on death, probate required and estate administration tax payable • Transfer of BC real property will generate BC property transfer tax ("PTT") and, if transferred upon death, probate fees • Transfer of Qu immovable (real) property generates Qu land transfer duties, including on death, subject tp exemptions, • Disposition (or deemed disposition) of Canadian real property is a disposition of TCP, which attracts Canadian income tax and reporting obligations • Canadian reporting and tax obligations upon disposition
Canadian Corporation	• Ability to transfer indirect ownership of Ontario real property to successive generations without EAT or LTT • Ability to transfer indirect ownership of BC real property to successive generations without PTT or probate fees (may change in the future for changes of "foreign beneficial ownership" – for now monitoring if this is an issue)	• Yearly Canadian reporting and tax obligations for Canco • Disposition (or deemed disposition) of shares of Canco is a disposition of TCP, which attracts Canadian income tax and reporting obligations • May attract application of U.S. CFC or PFIC rules
US LLC	• Ability to transfer indirect ownership of Ontario real property to successive generations without EAT or LTT • BC same as for a Canadian Corporation • If more than 50% of assets of LLC are non-TCP, no Canadian taxation or reporting obligation upon disposition of membership interests	• Yearly U.S. reporting and tax obligations for LLC and its members • If LLC files as a disregarded entity, the Treaty will not apply and the membership interests of the LLC will be subject to Canadian taxation and, likely, US taxation, thus giving rise to double taxation • May require bare trustee to be registered on title in Ontario/BC (not Quebec)

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Note that in Toronto, there is an additional land transfer tax payable.
Tax on non-resident purchasers now in place in parts of Ontario and BC.

Americans Owning Canadian Real Estate

Structure	Advantages	Disadvantages
US S-Corp	• Ability to transfer indirect ownership of Ontario real property to successive generations without EAT or LTT • BC – same (i.e. treated the same as a Canadian Corporation) • CRA has taken the position that the <u>Treaty applies</u> to an S-Corp, so any gain from a disposition of shares of an S-Corp that holds Canadian real property from Canadian taxation should be exempt from Canadian taxation • A flow through entity (single taxation: profits and losses are passed directly to the shareholder) while maintaining separate entity from its shareholders, who cannot normally be held liable for any fiscal obligations	• Yearly U.S. reporting and tax obligations for S-Corp • Board meetings and shareholder meetings • Fewer than 100 shareholders • Shareholders must be U.S. citizens or residents, and must be natural persons, so corporate shareholders and partnerships are generally excluded. However, certain trusts, estates, and tax-exempt corporations are permitted to be shareholders • Only one class of stock permitted
US C-Corp	• Ability to transfer indirect ownership of Ontario real property to successive generations without EAT or LTT • BC – same (i.e. treated the same as a Canadian Corporation) • <u>Treaty applies</u> to exempt any gain from a disposition of shares of a C-Corp that holds Canadian real property from Canadian taxation • Unlimited number of shareholders, institutional investors, corporations, partnerships and non-US shareholders permitted • Profits are taxed at the corporate rate	• A stand-alone entity that is subject to separate taxation from its shareholders (so may give rise to double taxation to the extent integration is imperfect) • Yearly U.S. reporting and tax obligations for S-Corp • Board meetings and shareholder meetings
ULC/LLC Structure	• Ability to transfer indirect ownership of Ontario real property to successive generations without EAT or LTT • BC – same (i.e. treated the same as a Canadian Corporation) • If more than 50% of assets of LLC are non TCP, no Canadian taxation or reporting obligation upon disposition of membership interests	• Careful tax structuring required in order to ensure Treaty applies • Canadian/US tax/reporting obligations. Ongoing obligation to ensure that at least 50% of assets of LLC are not TCP (portfolio/US real RP)

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5. Canadians moving to the US

- Severing ties for tax purposes
- Departure tax planning
- Registered pension plans
- RESPs, TFSAs and RDSPs

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- CRA taxes Canadian residents on worldwide income and non-Canadian residents only on certain types of income derived from Canadian sources (e.g., Canadian dividends, Canadian employment income and sale of real estate in Canada).

- To cease tax residency, need to "sever primary ties":
    - Disposing of or renting your personal residence in Canada to non-related individuals and establishing a permanent home in another country; and
    - Having your spouse and dependents leave Canada with you or soon after.
    - In addition to primary residential ties, certain secondary residential ties should be severed – see slide 4 for a summary of the evidence looked at.

Upon departure:

- need to file stub year income tax return for the portion of the year you are resident;
- **Departure tax** - there is a deemed disposition of assets on the date you cease residency, and capital gains (or losses) are brought into income;
- **Exemptions:**
    - Canadian real estate
    - Assets in registered plans (e.g., RRSP, RRIF, RESP, registered pension plans)
    - Assets in a Tax-Free Savings Account (TFSA)
    - Employee stock options
    - Interest in life insurance policies other than segregated funds
    - If you were a resident of Canada for five years or less during any 10-year period, assets that you either owned before you became a Canadian resident or inherited after you

became a Canadian resident, so long as you did not dispose of these assets before your Canadian residency ended
- it is possible to defer paying this tax until the assets are actually disposed of, provided an election is filed and adequate security is posted with the CRA

After Departure:

- Registered Pension Plans (& RRSP/RRIF)– cannot roll over into a foreign pension plan.
  - Can maintain in Canada, or deregister and pay a "non-resident withholding tax" of 15 – 25%
- TFSA's – still tax free growth in Canada (but not in US), additional contributions can only be made if resident in Canada.

CROSS BORDER CHARITABLE DONATIONS

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Charitable Donations

- **The US rules are more flexible:**
  - Easier for Americans to send funds North than Canadians to do the reverse

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Donations by Canadians

- **Within Canada, or to listed non-Canadian universities:**

  The ITA provides Canadian tax credits/deductions when the donation is to a "qualified donee" (mainly, a Canadian registered charity, or a "listed and prescribed" non-Canadian college or university that ordinarily has some Canadian students enrolled (about 525 of which are in the US)[1]

1 Section 149.1 ITA definition of qualified donee (which is exempt from income tax per paragraph 149(1)(f) ITA)
Section 118.1 ITA non-refundable tax credit when an individual donates
Section 110.1 ITA tax deduction when a corporation donates

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Donations by Canadians

- **To US charities:**
  - The Canadian tax credit/deduction is also available to a Canadian resident donating to a US charitable organization, but the credit/deduction can only be offset against US source income of the Canadian (ex.: US dividends)[2]
  - This US source income proviso does not apply if the donation is to a US college or university at which the donor or a member of the donor's family is or was enrolled[3]

2. Article [illegible] paragraph [illegible] of the Canada-US Tax Convention (caution: Quebec residents cannot claim this relief on their Quebec tax return according to an unduly technical 2015 Quebec Court case *[illegible]* which denied relief because Quebec is not a signatory to the Canada-US Tax Convention)
3. Article [illegible] paragraph [illegible] of the Canada-US Tax Convention

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Donations by Canadians

- **To US charities:**

  A Canadian charity which has received donations can also operate wherever it has "*direction and control*" over activities, therefore a Canadian "Friends" charity can operate in the US or elsewhere so long as by agreement it controls activities and use of funds, such that the Canadian charity is seen as itself operating in the foreign country.[4] This is well beyond just writing a cheque (a check) into the US.

4. This principally is set out at two CRA guidances: (1) Canadian registered charities carrying out activities outside Canada (CG-002, July 8, 2010) and (2) Using an intermediary to carry out a charity's activities within Canada (CG-004, June 30, 2011)

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Donations by Americans

- **Within the US:**

  A donor donating for example cash to a qualified organization (ex.: a US created organization organized and operated exclusively for charitable, religious, educational, scientific or literary purposes (IRC Sec. 501(c)(3))[5] is generally entitled to a US tax deduction for the face amount.

5 IRC Sec. 170 Income tax deduction in general
IRC Sec. 2522 Gift tax deduction in general
IRC Sec. 2055 Estate tax deduction in general
IRC Secs. 501-509 Rules regarding income tax exemption of various not-for-profit organizations

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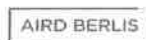
Donations by Americans

- **To Canadian charities:**
  - [Mirror image in above "donations by Canadians"] the tax deduction is also available to a US citizen or resident donating to a Canadian charitable organization, but the deduction can only be offset against Canadian source income of the US person (ex.: Canadian dividends)[6]
  - [Mirror image in above "donations by Canadians"] the Canadian source income proviso does not apply if the donation is to a Canadian college or university at which the donor or a member of the donor's family is or was enrolled[7]

6 Article XXI, paragraph [illegible] of the Canada-US Tax Convention
7 Article XXI, paragraph 6 of the Canada-US Tax Convention



Donations by Americans

- **To Canadian Charities:**

  [Different from above in "donations by Canadians"] US community foundations and "Friends" organizations (public charities) and non-operating foundations (private foundations) which receive donations from US persons, can then make *grants* (compare to "direction and control" in above "donations by Canadians") to a foreign charitable organization such as a Canadian charity. The US charity must maintain control over the use of the funds in the foreign country[8], but it is a sending of funds outside of the US, the US charity need not itself be seen as operating outside of the US.

8 • Regarding US public charities principally, for example they enter into an agreement with the foreign charity about the use of the funds; [illegible]
• [illegible]

US ISSUES WITH CANADIAN ESTATE FREEZES

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Canadian Estate Freeze

- Generally, used to lock in the current value of a capital property and attribute the value of future growth of that capital property to another person
- *Inter vivos* trusts often used in an estate freeze for family business
  - Deemed disposition of the assets every 21 years
    - Planning includes rolling assets out of trust prior to 21st anniversary
    - Cannot transfer to a non-resident on a tax-deferred basis
      - Use of Canadian corporate beneficiary called into question by CRA

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US person is beneficiary of Canadian trust or estate

- *Inter vivos* family trust to hold growth shares of family business
  - If "freezor" is a US citizen – gift tax issues
  - US Person as beneficiary
    - Tax-free capital dividends would not be tax-free to a US Person
    - No "roll out" of trust prior to 21st anniversary if non-resident
      - Use of corporate beneficiary – recent CRA views
    - CFC reporting and possible tax payment requirements for underlying holding company
    - PFIC reporting requirements and exposure to excess distribution tax and interest unless QEF election is made
    - "Throwback tax" and interest charge on distributions
    - Accumulation of income if trust doesn't distribute DNI currently
      - For Canadian trust law purposes, income does not include realized capital gains so may not be permitted to distribute

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Planning point:

- Canadian Unlimited Liability Corporation (ULC) for Americans
  - This type of structure is best used as a corporate holding company or to own passive assets as the typical protection under a corporation from creditors does not apply.
  - The reasons to consider ULCs are largely because they avoid the double tax problems and they are not considered to be either CFCs or PFICs.
  - While Canada taxes ULCs as corporations, a ULC is considered a disregarded entity for U.S. tax purposes if owned by one person or a partnership if owned by more than one person (and thus not a CFC or PFIC).
  - However, all income and expenses of the ULC flow through to the U.S. shareholder, eliminating the potential for tax deferral.

  - I have a client that owned a rental real estate empire in Canada, but had two US children. In this case, we are discussing converting her holdco (which is a PFIC) into a ULC to minimize the children's exposure to adverse tax consequences on her death.
  - ULCs can currently be incorporated in BC, Alberta and Nova Scotia.

Questions?

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