PRACTICE GEMS:

Administration of Estates 2018:

Foreign Administrations and Administrations Under Multiple Legislations:

Estates with Foreign Ties

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Estates With Foreign Ties[1]

Nearly every estate planning and estate administration file coming across our desks today has an international component – whether it's the country of origin or family ties of the testator or deceased or the location of assets in foreign jurisdictions. Advisors to executors and beneficiaries need to be cognizant of the many potential pitfalls where an estate has a multi-jurisdictional component. The following canvasses some of the issues that can arise in the course of administering an estate with foreign ties.

Residency of a Trust

The first question that should concern the administration of an estate with foreign connections is the residency of the estate itself. Under subsection 104(1) of the *Income Tax Act*,[2] an estate is deemed to be a trust for the purposes of the ITA. In *St. Michael Trust Corp., as Trustee of the Fundy Settlement* v. *Her Majesty the Queen*,[3] the Supreme Court of Canada confirmed that the residence of a trust is determined by the principle that for the purposes of the ITA, a trust resides where its central management and control actually takes place. If the trustee carries out the duties of the trust in the place he or she resides, then residence of the trustee will also be the residence of the trust – but it is not always the case that the residence of the trustee (or executor) is the same as the residence of the trust/estate.

Deemed Resident Trust

Further, subsection 94(3) of the ITA includes a rule that deems a trust that is otherwise factually non-resident to be resident in Canada for certain purposes of the ITA, 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 ITA if at

[1] An earlier version of this paper was presented at the STEP Canada 2018 National Conference.
[2] R.S.C. 1985, c.1 (5th Supp.), referred to as the "ITA."
[3] *Fundy Settlement* v. *Canada* 2012 SCC 14 (often referred to as *Garron*).

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 ITA 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 ITA as a person that, at or before that time, has made a contribution to the trust – and the term “contribution” is broadly defined.

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 person who made a contribution to the trust either in Canada or at a “non-resident time” – i.e., within 60 months of moving to Canada or within 60 months of leaving Canada. In the case of an estate, the 60 month period is shortened to 18 months.

Non-Resident Executor

Does the estate become a non-resident if the executor is a non-resident? What if the non-resident executor is one of several executors?

Considering the principles set out in *Garron,* one must consider where the management and control of the estate resides. For example, if there are two executors, does the non-resident executor come to Canada for meetings with the other executor? (She should if the estate is to remain a Canadian estate). Even if the estate is considered a non-resident because the management and control is outside of Canada, you should still consider whether it is a deemed resident under s. 94 – and, if so, tax filings in Canada may be required.

And, as many are now aware, where the executor or trustee is a US person (whether by virtue of residency or citizenship), he or she will likely have reporting requirements in the US with respect to the Canadian assets under his or her control.

Most of the provinces require a non-resident executor to post a bond in order to be appointed. In Ontario, section 6 of the *Estates Act*[4] provides for the posting of a bond by executors applying

[4] R.S.O. 1990, c. E.21.

for a Certificate of Appointment where the executor is not resident in Ontario or elsewhere in the Commonwealth. There is a procedure to request that the Court dispense with the requirement for a bond; the endorsement of Justice Brown in *Re Henderson Estate*[5] sets out the information that should be included in the affidavit in support of the order to dispense with the administration bond.

Given the cost (and intrusiveness) of obtaining a bond, and the potential uncertainty (and cost) of obtaining the waiver of the bond, it may be advisable that a non-resident executor renounces his or her appointment if there are others named. It is preferable for this to be considered at the estate planning stage, where for example, the non-resident is named as a trustee of the testamentary trusts established in the Will but not as executor.

On winding-up the estate, the bond will need to be cancelled. Sections 42 and 43 of the *Estates Act* deal with the procedures to cancel a bond, which will generally require a passing of accounts and/or production of evidence to the Court that the "debts of the deceased have been paid and the residue of the estate duly distributed."

Non-Resident Beneficiary of a Canadian Estate

Often, there will be at least one beneficiary of a Canadian-resident estate who lives outside Canada. The executor must consider the Canadian tax requirements when making a distribution of income and capital, and the differing financial consequences to the beneficiaries.

Under the ITA, withholding tax on distributions of income is 25%, however the percentage may be reduced by a tax treaty with the country where the beneficiary resides. For example, there may not be withholding tax on interest income paid to a US resident beneficiary. The executor will need to obtain confirmation of the beneficiary's tax residency.[6] The withholding tax is due to be on (or before) the 15th day of the following month the tax was withheld; the remittance of the withholding tax is the responsibility of the executor (not the beneficiary).

[5] (2008), 45 E.T.R. (3d).
[6] See, e.g., CRA Forms NR301, NR302, and NR303 https://www.canada.ca/en/revenue-agency/services/forms-publications/information-on-forms-nr301-nr302-nr303.html). Executors should obtain advice from tax counsel with respect to the application of a treaty.

When the executor is distributing capital to a non-resident beneficiary, there are a number of additional tax considerations:

- Generally, assets of an estate or trust cannot be "rolled out" on a tax-deferred basis to a non-resident beneficiary, so if the assets have increased in value since the date of death, there may be tax payable by the estate on the capital gain.

- If the asset being transferred is real estate, then it generally can be rolled out to the non-resident beneficiary, because the beneficiary will be taxed in Canada on a subsequent sale or transfer.

- If the distribution is of cash, such that the tax was already paid by the estate on the liquidation of the assets, there should be no further Canadian tax.

However, non-resident beneficiaries may have reporting obligations in their home country and certain countries may tax the beneficiary on the receipt of the distribution ("accessions tax"),[7] potentially resulting in double tax where capital gains tax is also payable in Canada – with no treaty relief.

Where there are both resident and non-resident beneficiaries, the executor should consider how the different tax consequences of distributions should be taken into account. For example, capital dividends are received tax-free by resident Canadian beneficiaries, but would be subject to withholding tax (and potentially additional tax in the country of residence of the beneficiary). As noted above, where distributions of capital are made to a non-resident, there may be additional capital gains tax payable if the assets have increased in value since the date of death. Should the beneficiary or the estate be responsible for this tax. The Will may contemplate this situation, but if not, this may be the responsibility of the estate.

Transfers to a Non-Resident – S. 116 Certificates

Under section 116 of the ITA, a clearance certificate is required for the transfer of taxable Canadian property (TCP) to a non-resident. Prior to March 2010, an interest in a trust that was resident in Canada was considered TCP and a s.116 clearance certificate was generally required

[7] See Catherine Brown's article, "Death as a Taxable Event" *ET&PJ* 2011, v. 31.

(the beneficiary is considered the vendor as she is disposing of her capital interest in the trust). This made for a cumbersome distribution process – but 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 and is now distributing cash from the estate. In certain circumstances (based on a tax treaty), a s. 116 certificate may not be required.

Citizenship of the Deceased – US Issues

For Canadian tax purposes, we are usually concerned with the residency of the individual, not his or her citizenship. However, as many are now aware, for the United States, citizenship matters. Where the deceased was a US person (citizen, green card holder, or resident), his estate falls into the US estate tax regime. With the increase in the exemption to $11.2M for 2018, fewer Americans in Canada will be subject to the estate tax – although for purposes of calculating the estate tax liability, the value of life insurance and pensions may be included.

However, even if no estate tax is payable because the value of the estate is below the exemption in the year of death, the return must be filed in order to ensure the cost base of the assets of the estate receive a "step-up" and in order to transfer the unused portion of the exemption to the surviving (US Person) spouse.[8] The executor must be aware that the US estate tax return is due **9 months** after death – which can be earlier than the Canadian return. The executor will also need to determine whether the deceased had used any portion of his exemption while alive by making gifts and whether the deceased had been filing US tax returns and whether they are up to date.

If US estate tax is payable, the Canada-US Tax Treaty does allow a foreign tax credit to be used against the Canadian capital gains tax payable on the deemed disposition on death.[9]

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[8] This is referred to as "portability."
[9] Article XXIX-B of the Treaty.

Assets

Canadian estate with foreign assets

Many of us have clients with US vacation property or other assets in the US and elsewhere. Hopefully, care was taken at the planning stage to minimize tax and estate administration issues. On the tax side, there is a potential for double taxation – in Canada, capital gains tax was paid in the terminal tax return of the deceased as a result of the deemed disposition on death; in the other jurisdiction, there may be an inheritance tax (e.g., in the UK) or a capital gains tax only at the time of sale by the beneficiary. There is some relief available under the Canada-US Tax Treaty, where the US estate tax (if any) is creditable against the Canadian capital gains tax, but this relief is not generally available under other treaties.

With respect to administration issues, it may be necessary to obtain an ancillary grant of probate in the foreign jurisdiction for the executor to be able to deal with the assets. While we have found that US financial institutions will often accept a Canadian grant, in order to deal with real estate, an ancillary grant is required. Preparing a Will that deals only with the foreign assets may be helpful to speed up the probate process.

Foreign estate with Canadian assets

Unlike the US financial institutions, our experience with Canadian banks holding assets for non-Canadian estates is that the financial institution will insist on ancillary grant or re-sealing of the probate. And, an ancillary grant will likely be required in order to deal with real estate. As noted above, this entails obtaining an administration bond or court-order waiving the necessity of the bond.

The taxation of the Canadian assets of a foreign estate can be complex and requires an analysis of whether the estate holds TCP or not.

Summary

In this paper, we have looked at the issues that may arise in planning and administering estates with foreign ties. The residence of a trust is determined for the purposes of the ITA by looking at where the central management and control of the trust takes place. If conditions under section 94 of the ITA are met, a non-resident trust may be deemed a Canadian-resident trust for certain purposes of the ITA. Estate professionals must be cognizant of the additional reporting requirements and tax implications for non-resident executors and beneficiaries, and whether the interest in a trust is considered TCP (if so, a s. 116 clearance certificate may be required). In addition, we have highlighted the relevant considerations for estates of US citizens.