

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) Americans moving to Canada
 - d) 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 issue that concern you.

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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

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

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

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

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

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

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



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



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"





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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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

S. 116 Clearance Certificate requirements

- 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 may need a s. 116 certificate

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

4. Canadians moving to the US

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

CROSS BORDER CHARITABLE DONATIONS

Charitable Donations

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

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.

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 enrolled³

2. Article XXI, paragraph 7 of the Canada-US Tax Convention. (Caution: Quebec residents cannot claim this relief on their Quebec tax return, according to an unlikely technical 2015 Quebec Court case, *Ernst & Young*, which denied relief because Quebec is not a signatory to the Canada-US Tax Convention.)
 3. Article XXI, paragraph 7 of the Canada-US Tax Convention.

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 20, 2011).



US ISSUES WITH CANADIAN ESTATE FREEZES

















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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Questions?

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