The Navigator

RBC WEALTH MANAGEMENT SERVICES

U.S. Estate Tax for Canadians in 2012

Understand your exposure and strategies to minimize it

The U.S. has a wealth transfer tax regime that imposes taxes on your right to transfer your assets upon your death. Did you know that even Canadians who die owning U.S. assets – such as stock of a U.S. corporation, a yacht in Florida, or a ski chalet in Colorado – may be subject to U.S. estate tax even though they are not U.S. residents, citizens or green card holders?

This article discusses the U.S. estate tax exposure that may exist for Canadian residents should they die in 2012 owning U.S. property, and highlights common estate planning strategies that you may be able to use to minimize or eliminate your exposure. This article will address the following questions:

- How do I assess whether I have exposure to U.S. estate tax?
- Which assets are subject to U.S. estate tax for Canadians?
- Which assets are not subject to US estate tax for Canadians?
- Which assets are included in my worldwide estate?
- If I have exposure, how do I estimate what my U.S. estate tax liability will be?
- How can I minimize my exposure to U.S. estate tax?
- Does my estate need to file a U.S. estate tax return after I die?
- What changes are on the horizon for U.S. estate tax after 2012 and how do they affect my estate planning?

Note: U.S. estate tax may be levied at the U.S. federal and/or state level. This article addresses U.S. estate tax levied at the U.S. federal tax level only. Any reference to Canadian tax rules in this article is to Canadian tax rules at the federal level only and may not apply to taxation at the provincial level. For example, Canadian provinces may not allow the same deductions or credits (such as foreign tax credits – discussed later in the article) relating to U.S estate taxes, which may be permitted for Canadian federal tax purposes under the Canada-U.S. tax treaty. Therefore, you are advised to consult with a professional cross-border tax advisor regarding your particular circumstances with respect to both U.S. and Canadian tax rules at the Federal or provincial/state levels.

Planning for U.S. estate tax can be complex. It is a good idea to review your exposure to U.S. estate tax annually to assess the impact of any changes in U.S. estate tax legislation. Appendix A is a schedule of the maximum U.S. estate tax rates, exemption amounts and corresponding unified credits for the years 2001 to 2013. The information provided in this article with respect to calculating your U.S. estate tax is presented in a simplified format. The strategies, guidance and technical content in this publication are intended for the exclusive benefit of our clients and are for information purposes only. This article is not intended to provide legal or tax advice. Speak to a professional cross-border advisor specializing in tax and estate planning before acting on any of the strategies discussed in this article to ensure your specific circumstances are taken into account.

How do I assess whether I have exposure to U.S. estate tax?

For Canadians, the exposure to U.S. estate tax only applies on the right to transfer "U.S. situs assets" upon your death. U.S. situs assets are those assets that have a U.S. location or connection (refer to section on U.S. situs assets for examples). You will only be exposed to U.S. estate tax if you meet two thresholds in the year of your death. The first threshold is based on the value of your U.S. situs assets and the second threshold is based on the value of your worldwide estate. The following quick reference guide may help you determine whether you could be exposed to U.S. estate tax.

Quick reference guide: U.S. Estate tax thresholds for 2012

For deaths in 2012, you may be exposed to U.S. estate tax if you meet the following thresholds (in U.S. dollars):

$60,000	If the value of your U.S. situs assets is US $60,000 or less upon your death, then you will not be subject to U.S. estate tax regardless of the value of your worldwide assets.
$5,120,000	(a) If the value of your worldwide estate is US $5.12 million or less upon your death, then you will not be subject to U.S. estate tax regardless of the value of your U.S. situs assets. (b) If the value of your worldwide estate is greater than US $5.12 million upon your death, and the value of your U.S. situs assets at this time is greater than US $60,000, then you may be subject to U.S. estate tax, but not necessarily so. A calculation is required to determine whether U.S. estate tax would be levied. Ask your RBC advisor about our U.S. estate tax calculator for Canadians. This tool may assist you in estimating possible exposure to U.S. estate tax.

Note: The term "value" generally means the fair market value at the date of death, but an alternate acceptable valuation method can be chosen using the fair market value 6 months after the date of death. When a valuation method is chosen to value all U.S. situs assets, that method must be used to value all property included in your worldwide estate. The value of your U.S. situs assets and the gross value of your worldwide estate must be calculated on a per individual basis not per family or per couple.

Which assets are subject to U.S. estate tax for Canadians?

U.S. situs assets

Examples of U.S. situs assets (located or deemed to be located within the U.S.) may include, but are not limited to the following:

- U.S. real estate;
- Assets of a trade or business conducted within the United States (e.g. shares of a U.S. private corporation);
- Shares in publicly traded U.S. corporations, whether held in a brokerage account in Canada or outside Canada, whether purchased on a U.S. exchange or a foreign exchange;
- Bonds, debentures and other debt obligations issued by U.S. corporations and U.S. governments, unless they are specifically exempted under the portfolio interest exemption. Generally, a portfolio interest exemption means that these U.S. debt obligations were issued after July 18, 1984, and are not subject to U.S. non-resident withholding tax on interest payments;
- Tangible property situated within the U.S. (e.g. vehicles, art, boats, jewellery, etc.);
- U.S. retirement plans (Roth and traditional IRAs; Simple and SEP IRAs; 401(k)s; 403(b)s and annuities);

- Deposits in a U.S. brokerage account (U.S. bank deposits are not U.S. situs);
- Any of the above U.S. securities held in Canadian registered plans such as RRSPs, RRIFs, RESPs, RDSPs or TFSAs;
- Any of the above U.S. securities held in an alter-ego or joint partner trust.
- Any of the above U.S. securities held in discretionary managed accounts (whether held in a brokerage account in Canada or outside Canada, whether purchased on a U.S. exchange or a foreign exchange) even though the buy and sell decisions are not made by the individual owner;
- All U.S. listed ETFs (iShares) including those that are legally structured as a "Regulated Investment Company (RIC)" will be considered U.S. situs assets. (Note: for deaths up to December 31, 2011 there was U.S. legislation which stated that an RIC, or a portion of the value of the RIC attributable to non-U.S. property, would not be considered a U.S. situs asset. An example is an iShare structured as an RIC that is fully invested in the European or Asian market. There was no legislation introduced to extend this treatment beyond December 31, 2011).

U.S. situs assets include U.S. securities held in Canadian registered plans such as RRSPs, RRIFs, RESPs, RDSPs or TFSAs.

Which assets are not subject to U.S. estate tax for Canadians?

Assets not considered U.S. situs

Assets that are not located or deemed to be located in the U.S. are not considered to be U.S. situs even if they have U.S. content. Examples of property with U.S. content that is generally not considered to be U.S. situs and therefore, not subject to U.S. estate tax include:

- Shares of Canadian mutual fund corporations (i.e. capital class funds) that invest in the U.S. market (even if denominated in U.S. currency);
- Units of Canadian mutual fund trusts (including Exchange Traded Funds (ETFs) trading on the TSX or another exchange), that invest in the U.S. market. This may not be the case where the mutual fund trust represents in its U.S. filings that it is to be treated as a trust under U.S. rules;
- Canadian issued notes that are linked to a U.S. index;
- American depository receipts (ADRs). These are exempt from U.S. estate tax because the underlying share is of a non-U.S. corporation;
- U.S. bank chequing or savings deposits, as long as they are not effectively connected to U.S. trade or business;

- U.S. Treasury Bills or U.S. Certificates of Deposit;
- U.S. corporate and government bonds that are subject to the portfolio interest exemption. This means that there is no U.S. requirement to withhold tax on the interest paid to a non-resident alien of the U.S. and the investments are not used in a trade or business;
- Canadian issuer U.S. pay bonds that provide exposure to the U.S. dollar.

Which assets are included in my worldwide estate?

Your worldwide estate includes the fair market value of all your assets, whether you hold these assets in the U.S. or elsewhere in the world, and includes all property listed above as U.S. situs or non-U.S. situs. Examples of property that would be included in your worldwide estate and of which you may not be aware include:

- the proceeds payable to beneficiaries of any life insurance policy you owned upon your death where you had "incidents of ownership" on the policy. This generally means that you had the ability to name or change beneficiaries, borrow against the policy, access the cash value or assign or cancel the policy;
- 100% of the value of property you owned as a joint tenant with the right of survivorship (JTWROS), unless you can prove that the other joint tenant contributed capital; and
- property held in trust for an individual if the trust is considered to be a grantor trust under U.S. tax rules. A grantor trust is a trust where the settlor retains control over the trust property to the extent that the property's income flows out and is taxed in the hands of that person. Examples of a grantor trusts include, RRSPs, TFSAs, alter-ego and joint partner trusts.

If I have exposure, how do I estimate what my U.S. estate tax liability will be?

Estimating your U.S. estate tax liability

The fair market value of your U.S. situs assets on death is the starting point for estimating the value of your U.S. estate tax. This is the value of your gross estate. Note that the fair market value of your U.S. situs assets may be different than what was paid for them or the value at the time you acquired them.

The U.S. estate tax rules allow deductions for debts and certain expenses. For example, funeral costs and administrative expenses are fully deductable in determining your estate tax liability. However, the amount that you can deduct for certain debts and expenses may need to be a prorated amount based on the ratio of your U.S. situs assets to your worldwide assets. For example, you cannot deduct the full value of a regular mortgage on U.S. real estate property; you can only deduct a prorated value. However, you can deduct the full value of your mortgage if it is a non-recourse mortgage, which is collectable only against the property itself and not against any other assets.

When you have made the allowable deductions you arrive at a value that represents your 'taxable estate'. You can then calculate your tentative U.S. estate tax liability, based on the value of your taxable estate, using the graduated tax rates in effect in the year of your death. Refer to Appendix B for the graduated U.S. estate tax rates applicable for 2012.

Your tentative U.S. estate tax liability is reduced by a non-refundable "unified credit" that is available to Canadians under the Canada-U.S. tax treaty. The amount of the unified credit is a prorated amount. For 2012 the unified credit, before being prorated, is US $1,772,800 (this is the amount that would offset U.S. estate tax on the first US $5.12 million of assets using the graduated rate table in Appendix B). The prorated credit is calculated by dividing the value of your U.S situs assets less related liabilities (which may also be prorated if required) by the value of your worldwide estate. This ratio is then multiplied by the unified credit limit for the year of death to determine how much of the unified credit you can deduct.

Non-refundable unified credit:

$$\frac{\text{U.S situs assets less allowable deductions (some possibly prorated)}}{\text{Value of your worldwide estate}} \times \text{unified credit value for the year of death}$$

If you are leaving U.S. situs assets to a non-U.S. citizen spouse who is resident in Canada or the U.S., the Canada-U.S. tax treaty also allows you to claim a non-refundable marital credit to further reduce your tentative U.S. estate tax liability. A spouse is considered to be someone to whom you are legally married and of the opposite sex. Same-sex partners or spouses do not fall within the definition of a spouse and common-law partners may also not qualify for this credit.

The marital credit is limited to the lesser of the prorated unified credit discussed above, and the U.S. estate tax otherwise payable on the qualified property that is transferred to a qualified spouse. This in effect "doubles" the unified credit for married Canadians.

The amount that you can deduct for certain debts and expenses may need to be a prorated amount based on the ratio of your U.S. situs assets to your worldwide assets.

Non-refundable marital credit:

Lesser of:

a) non-refundable prorated unified credit; and

b) tax otherwise payable on the qualified property transferred to the spouse.

Due to the availability of this additional credit, it may be prudent to give the executor of your estate some discretion in choosing which assets to transfer to your surviving spouse. This may help minimize your U.S. estate tax liability.

Ask your RBC advisor about our U.S. estate tax calculator

Talk to your RBC advisor about estimating your potential U.S. estate tax exposure using the RBC U.S. estate tax calculator. You will need to provide your advisor with the value of your taxable estate, as discussed earlier, including the current fair market value of your U.S. situs assets, less any allowable deductions and the value of your worldwide assets. Refer to Appendix C for a numerical example that illustrates a step by step calculation of the U.S. estate tax for Canadians.

How can I minimize my exposure to U.S. estate tax?

Strategies to minimize your U.S. estate tax exposure

The following is a list of common strategies (not an exhaustive list) that may reduce or eliminate your exposure to U.S. estate tax. Your specific circumstances will determine which strategy or combination of strategies would be most beneficial. Speak to your professional cross-border tax or legal advisor about the appropriate strategies for your circumstances before you take any action. If you own or are planning to acquire U.S. real estate in the U.S., ask your RBC advisor for a copy of a separate article that discusses common ownership strategies to minimize or eliminate your exposure to U.S. estate tax.

Claiming foreign tax credits for U.S. estate tax

Under the Canada-U.S. tax treaty, your executor can claim a foreign tax credit on your Canadian final tax return for U.S. estate tax paid. A foreign tax credit will reduce your Canadian tax liability, attributable to U.S. situs assets reported on your final Canadian return, by some or the entire amount of your U.S. estate tax liability.

The amount of the foreign tax credit you can claim cannot exceed the amount of Canadian income tax attributable to income, profits or gains from any U.S. situs assets reported on your final tax return. It is very important for executors to consider this when making decisions that affect the deceased person's final tax return. The foreign tax credit mechanism limits the possibility of double taxation, but it does not limit the possibility that your estate may have to pay U.S. estate tax. For example, if there are no accrued capital gains on U.S. situs assets or if U.S. assets with accrued capital gains are rolled tax free to the surviving spouse, the deceased person's estate may be required to pay U.S. estate tax but it will not receive an offsetting foreign tax credit because, under Canadian tax rules, there is no tax owing on the final Canadian tax return attributable to the U.S. situs assets. This may also occur if RRSPs or RRIFs containing U.S. property are rolled over to a surviving spouse on a tax-free basis. Refer to the section titled, "Transfer U.S. situs assets to a spouse at FMV at death" for a detailed discussion about triggering the Canadian tax attributable to U.S. source income to ensure that foreign tax credits for U.S. estate tax can be used.

Make alternative investment choices

You may wish to review your current portfolio and replace some or all of your U.S. situs assets with other investment choices. If you wish to invest in the U.S. market, you can choose investments with U.S. content that may not be considered U.S. situs. Refer to the earlier section that provided a list of assets not considered to be U.S. situs, for examples of some such investment choices. Always consider your individual circumstances and speak to your professional tax advisor before implementing this strategy.

Keep your worldwide estate under US $5.12 million

If your worldwide estate at death is US $5.12 million or less (for deaths in 2012), U.S. estate tax is not payable, regardless of how much of your worldwide estate is comprised of U.S. situs assets. Consequently, you may wish to consider rebalancing the ownership of worldwide assets between you and your spouse and/or other family members during your lifetime to minimize your worldwide estate at death. When purchasing a new asset, carefully consider who the owner should be in light of the US $5.12 million worldwide estate threshold.

With careful estate planning, you can ensure that the assets you pass to your surviving spouse will not form part of their worldwide estate. For example, you can structure your Will to pass assets to your surviving spouse through a spousal testamentary trust that allows limited encroachment on capital. The income earned in the spousal trust must be payable to your surviving spouse but capital distributions are limited to health, education, support and maintenance. As your surviving spouse will not have free access to the capital in the spousal trust, on their death, the trust assets will not form part of his or her estate for U.S. estate tax purposes.

Before transferring assets to other family members to reduce your potential U.S. estate tax exposure, talk to a professional tax and/or legal advisor. They can help you determine whether creditor issues, U.S. gift tax and Canadian deemed disposition and income attribution rules will have an impact on your planning. Keep in mind that the US $5.12 million threshold will expire after 2012, and a much smaller threshold (as low as US $1 million) may replace it.

Gift U.S. situs assets prior to death

Since U.S. estate tax is determined using the value of U.S. situs assets and the worldwide estate on a per individual basis (not family or couple basis), making gifts may allow for the "rebalancing" of U.S. situs assets between spouses and children to minimize or eliminate your U.S. estate tax exposure.

For Canadian residents who are non-U.S. citizens, green card holders or domiciliaries, there is generally no U.S. gift tax when intangible property such as stocks, bonds and cash are transferred to another individual (although, you should be careful of making gifts of cash from U.S. based financial institutions).

However, U.S. gift tax does apply to Canadians when gifts of real estate and other tangible personal property (e.g. vehicles, art, jewellery, etc.) located in the U.S. exceed certain exemption thresholds. If the total value of all gifts of U.S. property to any individual is US $13,000 or less (2012 threshold) in a given year, these gifts will not attract U.S. gift tax. Where the gift is to a non-U.S. citizen spouse, the threshold for non taxable gifts is US $139,000 for 2012. Gifts exceeding these thresholds will be subject to U.S. gift tax. Unfortunately, Canadians cannot benefit from the US $5.12 million lifetime gift tax exclusion (2012 exclusion) that is available only to U.S. citizens, green card holders and U.S. residents domiciled in the U.S.

Keep in mind that a gift of appreciated property to anyone other than a spouse is treated as a disposition at fair market value for Canadian tax purposes and will trigger unrealized capital gains that are taxable in Canada. The exemptions outlined in this section may minimize or eliminate U.S. gift taxes. Any Canadian taxes on capital gains can be deferred on gifts made to a spouse. However, the Canadian attribution rules may apply to any investment income generated on the assets gifted to a spouse or minor children.

Transfer U.S. situs assets to a spouse at fair market value at death

Due to the ability to claim a foreign tax credit on your final Canadian tax return for U.S. estate tax paid, it is wise to draft your Will to give your surviving spouse and/or your executor the power to elect to transfer certain appreciated U.S. situs assets (non-registered assets) to your surviving spouse at fair market value rather than a rollover at cost. This election will trigger U.S. source capital gains on your final Canadian income tax return and make it possible to claim a foreign tax credit for any U.S. estate tax paid. Your surviving spouse will have a higher adjusted cost base on the U.S. situs assets (non-registered assets) that are elected to be received at fair market value. This will result in a lower capital gain or a higher capital loss when your spouse subsequently disposes of those assets.

Your surviving spouse and your executor may also elect not to roll over all the assets in your RRSP or RRIF on a tax deferred basis. Instead, the fair market value of all or a portion of your RRSP/RRIF assets at the date of death can be reported on your final Canadian tax return. This will trigger Canadian tax attributable to RRSP/RRIF income on U.S. assets, and enable you to claim a foreign tax credit for the U.S. estate tax paid. The foreign tax credit allows you to transfer these RRSP/RRIF assets to a non-registered account tax-free. Your executor should also consider the loss of tax-deferred income earned in the RRSP/RRIF. Note that in order to execute this strategy, your spouse cannot be named as "successor annuitant" on your RRSP/RRIF. Consider naming your spouse as beneficiary instead.

Irrevocable life insurance trust (ILIT)

Some Canadian residents purchase life insurance to cover the capital gains tax that arises on their death due to the Canadian deemed disposition rules or U.S. estate tax on their U.S. situs property.

If you currently own or plan to purchase an insurance policy, you should consider the effects this may have on your exposure to U.S. estate tax. Ironically, for purposes of calculating the value of your worldwide estate, you must include the amount of the death benefit if you have "incidents of ownership" with the policy. This generally means you have the ability to name or change beneficiaries, borrow against the policy, access the cash value or assign or cancel the policy. Where this is the case, owning a life insurance policy could potentially increase your exposure to U.S. estate tax. First, it may increase the value of your worldwide estate, which could put you over the US $5.12 million threshold amount for 2012. Second, since the unified credit that can be claimed against your tentative U.S. estate tax is multiplied by the ratio of U.S. situs assets to your worldwide estate, an increase in the value of your worldwide estate will have the effect of reducing the portion of the unified credit you can use.

If owning a life insurance policy will increase your exposure to U.S. estate tax, consider whether it makes sense instead for your spouse (who may not have any U.S. estate tax exposure) to purchase a life insurance policy on your life. Your spouse should use his or her own funds to make the purchase. If you provide the funds there is a risk that the IRS may deem you to have incidents of ownership in the policy. Alternatively, you may consider purchasing or transferring an existing life insurance policy to a special Irrevocable Life Insurance Trust (ILIT). With an ILIT you do not own the life insurance policy outright. Instead, a trust owns the life insurance policy so you do not have incidents of ownership.

In addition to performing a cost benefit analysis to ensure that the estate taxes saved using an ILIT more than offset the set-up costs and any annual fees, keep in mind some other potential issues:

1) If you require the life insurance for investment or retirement purposes an ILIT may be problematic. You will not have access to the cash surrender value or be able to borrow against the policy;
2) The ILIT will be considered an inter-vivos trust for Canadian tax purposes so any investment income earned on the proceeds paid into the ILIT after your death will be taxed at the highest marginal rates in Canada unless the income is paid or made payable to a beneficiary; and
3) The transfer of an existing policy to an ILIT will result in a deemed disposition for Canadian tax purposes.

For more information, ask your RBC advisor for a copy of our article that discusses U.S. estate tax planning where life insurance is owned.

Sell U.S. situs assets prior to death

This is one of the least complicated solutions. However, it is generally more appropriate to use this solution when you are seriously ill or just before your death since for Canadian tax

You can defer your U.S. estate tax liability by transferring U.S. situs assets to a Qualified Domestic Trust (QDOT) for the benefit of your non-U.S. citizen spouse.

purposes a capital gain will be triggered as a result of a deemed disposition of your assets upon your death. If you are healthy and implement this solution, the sale of assets long before your death will trigger a premature tax liability in Canada since you will be realizing capital gains on the sale. If you have capital loss carryovers that may offset these capital gains this strategy may still be appropriate.

Your RBC advisor can assist you in reviewing possible tax loss selling strategies. These strategies may involve triggering capital losses to offset the capital gains incurred, transferring a portion of the capital gain to your spouse and strategies involving charitable donations.

Qualified domestic trust (QDOT) or marital tax credit

In the U.S., a marital deduction provides an unlimited deferral of U.S. estate tax on assets left by one U.S. citizen spouse to another. The U.S. estate tax laws in the year of the surviving spouse's death will apply to the remaining assets held by the surviving spouse at that time.

A marital deduction is not available when assets are left to a non-U.S. citizen spouse. However, you can still defer your U.S. estate tax liability by transferring U.S. situs assets to a Qualified Domestic Trust (QDOT) for the benefit of your non-U.S. citizen spouse. With a QDOT the U.S. estate tax is deferred until the U.S. situs assets are distributed from the QDOT (with some exceptions) or if there is any capital remaining in the QDOT upon the death of your surviving spouse.

A QDOT does not avoid U.S. estate tax, it merely defers it. The U.S. estate tax that will be levied when distributions are made from the QDOT will be the same U.S. estate tax liability that would have applied at the time of your death. Therefore, the U.S. estate tax will be based on the estate tax rates and laws that existed in the year of your death, not the estate tax rates that exist when assets are distributed.

There are a number of criteria in order for a trust to qualify as a QDOT. First, at least one trustee must be a U.S. citizen or U.S. corporation. If the assets in the QDOT have a value of at least US $2 million at the date of death (or the alternate valuation date if applicable), additional requirements are necessary. Under a large QDOT, at least one trustee must be a U.S. bank or a bond or letter of credit must be provided in favour of the IRS. While the QDOT helps to defer U.S. estate tax, it can also be structured to defer Canadian capital gains tax for appreciated assets passing to a spousal trust.

As discussed earlier, you may claim a marital tax credit, which may eliminate your U.S. estate tax liability altogether. If you use the marital credit you cannot use a QDOT. Therefore, you might only consider using a QDOT where the marital credit does not eliminate your U.S. estate tax exposure. A cost benefit analysis is generally required to determine which strategy is most appropriate. Therefore, it is important to draft your Will carefully to give your executor the ability to choose between claiming the marital credit or transferring the assets to a QDOT. Consult a cross-border tax or legal advisor to determine if this strategy makes sense for you and to ensure the trust is set up properly.

Consider severing property held in JTWROS

The IRS requires that all property held in JTWROS with your non-U.S. citizen spouse or any other individual be included in the estate of the first to die for U.S. estate tax purposes unless it can be demonstrated that the surviving joint tenant(s) contributed to the purchase of the assets. If you maintain appropriate records to support the contributions made, only your proportionate share of the assets based on your contributions will be included in your estate.

Ownership of U.S. property through JTWROS is not generally recommended for Canadians. To illustrate, let's assume that a married Canadian couple each contribute 50% to the purchase of a property in Arizona. Half the fair market value of the property will be subject to U.S. estate tax on the first spouse's death. The deceased spouse's interest in the property will automatically be transferred to the surviving spouse at the time of the first death. This does not provide flexibility to implement other U.S. estate tax planning strategies such as a testamentary spousal trust or a QDOT(discussed earlier in the article). Furthermore, when the surviving spouse dies, the full value of the property will be included in determining the U.S. estate tax for the surviving spouse.

Although there is a credit that may reduce the U.S. estate tax of the surviving spouse if he or she dies within 10 years, this credit is significantly reduced on a sliding scale after 2 years. The result is that the U.S. property may be subject to U.S. estate tax twice in the same generation.

If you hold U.S. property as JTWROS, you may wish to consider severing the property, based on each tenant's contributions, and hold your interest as tenants in common.

Hold U.S. situs property through a tenancy in common

It may be more beneficial to own property as tenants in common rather than JTWROS for U.S. estate tax purposes. Two or more individuals can own property as tenants in common without the right of survivorship. Each tenant may own an equal or unequal share in the property and on the death of one tenant, only that deceased tenant's share in the property may be subject to U.S. estate tax, not the full value of the property. On the death of one of the tenants, that person's interest does not automatically pass to the other tenants in common. Instead, the deceased person's share passes through his or her Will. This can provide more flexibility to implement other U.S. estate tax planning strategies that use testamentary trusts (e.g. QDOT).

Holding assets as tenants in common may also pose certain ownership issues, especially where this form of ownership is used to own property with children. For example, a tenant in common can sell his or her share to someone else, mortgage his or her interest, use it as collateral, or give it to someone else as a gift without requiring the consent of the other tenants.

Hold U.S. situs assets in a Canadian corporation

Shares you hold in a bona fide Canadian corporation (e.g. holding company incorporated in Canada) are generally not subject to U.S. estate tax. It may therefore be possible to hold certain U.S. assets in a Canadian corporation (e.g. shares of U.S corporations but not vacation properties located in the US) to insulate you from U.S. estate taxes.

Consider the cost associated with this strategy. Using a corporation involves additional tax filings and financial reporting costs, as well as possible corporate capital tax liabilities. Furthermore, this strategy may result in a larger current tax liability than a strategy where the assets are held personally due to the integration of the Canadian holding company's tax situation and the shareholder's personal tax situation.

Before using a Canadian corporation to hold U.S. situs assets, ensure that the strategy is reviewed by a professional tax advisor who can evaluate the risks from both a Canadian and U.S. perspective to determine whether using a Canadian corporation will achieve the desired objectives.

Transfer U.S.-based retirement plans to an RRSP

If you spent time working in the U.S., you may have accumulated funds in a U.S.-based retirement plan such as a 401(k), a traditional Individual Retirement Account (IRA) or another U.S. retirement plan. For U.S. estate tax purposes, all assets held in a U.S.-based retirement plan are considered U.S. situs assets regardless of how these funds are invested. However, with a registered retirement savings plan (RRSP) only the particular assets inside the RRSP that are U.S. situs would be exposed to U.S. estate tax, not the entire RRSP. Therefore, you may be able to reduce or eliminate your exposure to U.S. estate tax by transferring your U.S.-based retirement plan to an RRSP in Canada. Ask your RBC advisor for the article that discusses the transfer of a U.S. based retirement plan to an RRSP, for more information on this strategy.

Canadians with assets over US$ 1 million should consider ways to minimize their exposure in the face of U.S. estate tax uncertainty in 2013 and beyond.

Make charitable donations

When U.S. situs property, on which U.S. estate tax would otherwise be payable, is given or bequeathed to a U.S. charitable organization, the bequest reduces the amount of U.S. situs property on which U.S. estate taxes are calculated. The U.S. charitable organization must be operated exclusively for religious, charitable, scientific, literary or educational purposes and your Will must contain specific provisions for the donation of the U.S. situs property.

Does my estate need to file a U.S. estate tax return after I die?

U.S. estate tax return filing requirements

There is no requirement to file the U.S. estate tax return for Canadians (IRS Form 706-NA) if the value of your U.S. situs assets is US $60,000 or less. However, if you exceed this threshold, your executor or personal representative must file a U.S. estate tax return even if the value of your worldwide estate is less than US $5.12 million and U.S. estate tax is not payable.

The U.S. estate tax return must be filed with the Internal Revenue Service (IRS) within nine months of the date of death unless a time extension is granted. Any U.S. estate tax payable must also be paid within this time period. Note that a time extension to file the U.S. estate tax return does not extend the due date for payment of your U.S. estate tax liability. The U.S. Internal Revenue Code imposes severe sanctions if your executor or personal representative knowingly avoids filing the necessary return. The estate could be subject to significant penalties and the executor or personal representative could face imprisonment. There are also substantial penalties for understating the value of assets.

What changes are on the horizon for U.S. estate tax after 2012 and how do they affect my estate planning?

Planning beyond 2012

What happens if the U.S. estate tax rate reverts to a maximum 55% in 2013 and the exemption amount decreases to US $1 million?

Always consider this possibility in your U.S. estate tax planning. Although many politicians would like to see the estate tax repealed or remain at its current level, President Obama has proposed that the U.S. estate tax revert to level similar to 2009. He has proposed an estate tax exemption of US $ 3.5 million and a maximum tax rate of 45%. There is great uncertainty as to whether these proposals will be implemented. Canadians with assets over US$ 1 million should consider ways to minimize their exposure in the face of U.S. estate tax uncertainty in 2013 and beyond.

If you own U.S. situs assets or plan to purchase U.S. real estate, talk to your professional tax advisor about your exposure to U.S. estate tax and strategies that may help you reduce your potential liability.

Appendix A

U.S. estate tax exclusion, unified credit and top marginal rates

Year	Exclusion Amount	Unified Credit	Max / top tax rate
2001	$675,000	$220,550	55%
2002	$1 million	$345,800	50%
2003	$1 million	$345,800	49%
2004	$1.5 million	$555,800	48%
2005	$1.5 million	$555,800	47%
2006	$2 million	$ 780,800	46%
2007	$2 million	$ 780,800	45%
2008	$2 million	$ 780,800	45%
2009	$3.5 million	$1,455,800	45%
2010	$5 million or NIL with special election	$1,730,800 or n/a	35% or NIL
2011	$5 million	$1,730,800	35%
2012	$5.12 million	$1,772,800	35%
2013 *	$1 million *	$345,800 *	55% *

* Assumes no further legislation is enacted.

Appendix B

Graduated U.S. estate tax rates 2012

Column A: Taxable Amount Over	Column B: Taxable Amount Not Over	Column C: Tax on Amount in Column A		Column D: Rate of Tax on Excess Over Amount in Column A
$0	$10,000	$0	Plus	18%
$10,000	$20,000	$1,800	Plus	20%
$20,000	$40,000	$3,800	Plus	22%
$40,000	$60,000	$8,200	Plus	24%
$60,000	$80,000	$13,000	Plus	26%
$80,000	$100,000	$18,200	Plus	28%
$100,000	$150,000	$23,800	Plus	30%
$150,000	$250,000	$38,800	Plus	32%
$250,000	$500,000	$70,800	Plus	34%
$500,000	$750,000	$155,800	Plus	35%
$750,000	$1,000,000	$243,300	Plus	35%
$1,000,000	1,250,000	$330,800	Plus	35%
$1,250,000	$1,500,000	$418,300	Plus	35%
$1,500,000	$2,000,000	$505,800	Plus	35%
$2,000,000	$2,500,000	$680,800	Plus	35%
$2,500,000	$5,120,000	$855,800	Plus	35%
$5,120,000	–	$1,772,800	Plus	35%

Appendix C

Sample U.S. estate tax calculation for Canadians

Mrs. C, a Canadian resident has U.S. situs assets valued at US $2,000,000 and a worldwide estate valued at US $12,500,000. Will Mrs. C have exposure to U.S. estate tax if she dies in 2012?

STEP 1: Compare the value of the U.S. situs assets and the worldwide estate to the U.S. estate tax thresholds
Since the value of Mrs. C's U.S. situs assets is greater than US $60,000 and the value of her worldwide estate is greater than US $5.12 million, U.S. estate tax exposure exists. A calculation is required to quantify it.

STEP 2: Using Appendix B, look up the U.S. estate tax value on US $2,000,000 of U.S. situs assets
The tentative U.S. estate tax on US $2,000,000 of U.S. situs assets is US $680,800. Mrs. C can deduct liabilities (which may need to be prorated) relating to her U.S. situs assets but let's assume there are none.

STEP 3: Determine the prorated U.S. estate tax unified credit that can be deducted
The non-refundable unified credit for 2012 is US $1,772,800. For Canadians like Mrs. C, the amount of the unified credit that can be deducted is a prorated amount based on the proportion of the fair market value of U.S. situs assets to the worldwide estate.

Ratio of U.S. situs assets to wsorldwide estate:
US $2,000,000 ÷ US $12,500,000 = 16%

Prorated U.S. estate tax unified credit:
US $1,772,800 x 16% = US $283,648

STEP 4: Subtract the prorated unified credit in step 3 from the U.S. estate tax from step 2
Net U.S. estate tax payable before applying the marital credit deduction (if applicable):

US $680,800 – US $283,648 = US $397,152.

If Mrs. C was not married, US $397,152 would be her U.S. estate tax liability if she died in 2012.

STEP 5: If you are married to a non-U.S. citizen Canadian or a U.S. resident of the opposite sex (i.e. same-sex spouses are not considered married and common-law partners may not be considered spouses) and leave your assets to your spouse, you can

deduct an additional non-refundable marital credit

The marital credit is equal to US $283,648 which is the lesser of:

a) the prorated unified credit calculated in step 3 (i.e. US $283,648); and,

b) U.S. estate tax otherwise payable on U.S situs assets not transferred to a spouse (i.e. US $397,152)

STEP 6: Subtract the marital credit in step 5 from the U.S. estate tax payable from step 4

Net U.S. estate tax after deducting the marital credit:

US $397,152 – US $283,648 = US $113,504

Mrs. C's U.S. estate tax using the unified credit and marital credit is US $113,504.

Canadians may offset their Canadian tax liability attributable to U.S. situs assets with a foreign tax credit on their Canadian final tax return for the U.S. estate tax paid. Note: This calculation is an estimate for Canadians holding U.S. situs property. This calculation does not apply to U.S. citizens, greencard holders or U.S. residents domiciled in the U.S.

› Please contact us for more information.