

Estate Planning Update 2018

U.S. Expatriation and Other Cross-Border Planning Tools

Overview

U.S. Estate and Gift Tax Update
Dynasty Trust Planning
Principal Residence Exemption
Expatriation

The U.S. “*Tax Cuts and Jobs Act*”

- Actual Name: *An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018*” (Public Law 115-97)
- We will primarily discuss the following and the impact, both positive and negative, on planning
 - **Increased the estate and gift tax exemption (temporarily)**
 - **Moved to a territorial tax system for corporations**

U.S. Estate and Gift Tax Update

- For U.S. citizens and residents, imposed on worldwide taxable estate
- U.S. Estate Tax Exemption now \$11,180,000 **per person**
- Top rate of estate tax is 40%
- U.S. spouses still have the benefit of portability if a U.S. estate tax return is timely filed – spouses may together leave \$22,360,000 to beneficiaries with zero estate tax
- Scheduled to return to the \$5M adjusted for inflation (but with Chained CPI-U) in 2026

U.S. Estate and Gift Tax Update, continued

- Still linked to the U.S. Gift Tax Exemption (and Generation-Skipping Transfer Tax Exemption)
- Annual Gift Tax Exclusion = \$15,000 (or \$152,000 to a non-U.S. citizen spouse)
- Don't forget State Estate / Inheritance Taxes – applicable in many states and varied in application

Example – U.S. Citizen Deceased

Deceased dual U.S. and Canadian citizen and Canadian resident owned the following assets:

	<u>U.S. \$</u>
Insurance Proceeds	2,000,000
RRSP	1,000,000
House	4,000,000
Canadian Investments	1,500,000
U.S. Investments	2,000,000
U.S. Condominium	<u>2,000,000</u>
Total	\$12,500,000

Example – U.S. Citizen Deceased, continued

U.S. Estate Tax Calculation:

Gross Estate Tax	\$4,945,800
Less Applicable Credit	<u>(\$4,417,800)</u>
Net Estate Tax	\$528,000

Credit for Canadian capital gains tax paid

Surviving Spouse a U.S. Citizen?

Unlimited Marital Deduction

Olden Days - Traditional Planning – Shelter Trusts

Portability

**Surviving Spouse Canadian Only? Treaty Marital Credit –
Extra \$4,417,800 – no tax!**

U.S. Estate and Gift Tax Update

- The Kicker: assets in the estate tax base are still entitled to a free step-up in basis (ACB)
- Beneficiaries inheriting assets never have pay capital gains tax on the assets they inherit, nor does the deceased
- Donald Trump's presidential campaign included capital gains realization, but ...

U.S. Estate Tax application to Canadians

- For non-citizen non-residents, imposed on “U.S. taxable estate”, includes:
 - Real property located in the United States;
 - Shares in a U.S. corporation;
 - Trusts with retained interests; and
 - Tangible personal property located in the United States
- Treaty Credit for Canadians is linked to the Applicable Credit, so non-U.S. Canadians have a larger exemption now too

U.S. Estate Tax application to Canadians, continued

Ex. Deceased Canadian citizen and Canadian resident owned the following assets with an exemption of \$11.18M:

	U.S. \$
Insurance Proceeds	2,000,000
RRSP	1,000,000
House	6,000,000
Canadian Investments	2,500,000
U.S. Investments	2,000,000
U.S. Condominium	1,000,000
Total	\$14,500,000

Estate entitled to Credit of \$914, 028, as follows:

$$\frac{\$3,000,000}{\$14,500,000} \times \$4,417,800 = \$914, 028$$

U.S. Estate Tax Calculation:

U.S. Taxable Estate	\$3,000,000
Tentative U.S. Estate Tax	\$1,145,800
Less: Applicable Credit	(\$914, 028)
Equals: Net Tax	\$231,772

- Credit for Canadian capital gains tax paid (accelerate if necessary)
- Surviving Spouse a U.S. Citizen? Unlimited Marital Deduction
- Surviving Spouse Canadian Only? Marital Credit – Extra \$914, 028 – no tax!
- Have to file a U.S. estate tax return to claim the credits, which involves disclosing worldwide assets and support for valuation. Also, tax paid to the IRS *not* CRA.

Trust Planning for U.S. Beneficiaries

- *Inter Vivos* Trust Planning for the U.S. Settlor
 - U.S. Gift Tax Exemption is \$11,180,000
 - “Clawback” is unlikely
 - Gift of the funds *and* income tax attributed to the U.S. donor, so further reduction of estate without a further gift tax liability

Trust Planning for U.S. Beneficiaries

- *Inter Vivos* Trust Planning for the U.S. Settlor
 - On Settlor’s death, consideration of the “throwback rules” if not U.S. domestic trust
 - Consider domestication if U.S. resident beneficiaries
 - Local U.S. State counsel may be advisable

Trust Planning for U.S. Beneficiaries

- *Inter Vivos* Trust Planning for the Canadian Settlor with U.S. Resident Beneficiaries
 - Provided the trust is not funded with U.S. situs assets, unlimited opportunity
 - TOSI rules do not apply
 - Grantor trust or “throwback rules”
 - If structured properly, only tax owing is a 15% Canadian withholding tax rate
 - Local U.S. State counsel advisable

Trust Planning for U.S. Beneficiaries

- Testamentary Trust Planning
 - For the U.S. decedent, funded with remaining “generation-skipping transfer” tax exemption, currently \$11,180,000
 - For the Canadian “NRA” decedent, consideration of U.S. situs assets but otherwise no limit
 - Immediate consideration of the “throwback” rules and potential domestication
 - Local U.S. State counsel advisable if U.S. resident trust
 - Cost base considerations – is U.S. estate tax planning necessary?

Principal Residence Exemption

- No change (slight marginal rate level changes)
- \$250,000 per taxpayer exemption (\$500,000 for a U.S. taxpayer couple)
- Top capital gains tax rate still 20% + 3.8% surtax
- Gifting – now is a good time with the \$11,180,000 exemption
- Probate < U.S. capital gains tax
- Gifting can be a concern with second spouses, in certain cases where there are outstanding liabilities attached to the residence, and requires payment of deferred property taxes
- If the U.S. taxpayer owns the home until death, no capital gains tax (but hard to plan for)
- Where gifting can be accomplished, this is not a reason to expatriate

Expatriation

- Section 877A applies to:
 - Expatriates who:
 - Income Tax Liability – have an average annual net U.S. income tax liability over 5 years of \$165,000 (in 2018 – adjusted for inflation)
 - Net Worth Test – have a net worth of \$2,000,000 or more
 - Federal Tax Obligations – fail to certify under penalty of perjury that they have met their U.S. federal tax obligations for preceding 5 years

Expatriation – Exemptions

- Exemptions for Citizens:
 - Dual Citizens
 - Citizen of the U.S. and another country from birth who continues to be a taxed citizen of other country. Has been a resident of the U.S. for no more than 10 taxable years during the 15 taxable years before expatriation
 - Minors
 - Expatriation occurs before age 18 ½ and individual has been resident of U.S. for less than 10 taxable years total

Effect of Expatriation Legislation on Green Card Holders

- Green Card Holders
- Same rules apply to individuals relinquishing green card status
- Green card held in 8 taxable years in the 15 taxable years prior to relinquishment
- No exemptions

Expatriation – Income Tax Consequences

- Deemed disposition of most assets, and a tax on the gain above \$600,000 (adjusted for inflation to \$713,000 in 2018)
- Deferred Compensation Items
 - Eligible → subject to withholding on payments to the expatriate
 - Non-Eligible → present value of accrued benefit treated as received before expatriation
- Interests in Non-Grantor Trusts
 - Trustee to withhold 30% of distributions
- Specified Tax Deferred Accounts
 - Treated as received before expatriation
- No foreign tax credits

Expatriation – Gift and Estate Tax Consequences

- Gifts and Bequests
 - Gifts and Bequests received by a U.S. person from an expatriate are subject to highest rate U.S. gift and estate tax unless the expatriate files and pays the transfer tax himself or herself
 - Highest U.S. estate and gift tax rates are 40%
 - Form 8854 – file to certify 5 year tax compliance

Expatriation – Why Now?

- A “Territorial Tax System” taxes income earned by a corporation in the country it is earned. Prior to the tax reform, corporations were taxed on their worldwide income
- Resulted in the “One-Time Repatriation Tax” – only for 2017 so expatriation cannot reverse this
- GILTI Tax – for tax years 2018 and forward
- Changes to the definition of “U.S. Shareholder”

GILTI

- Global Intangible Low-Taxed Income
- Taxed at the highest rate
- Nothing to do with Intangibles – why is it called that? So they can call taxpayers GILTI
- GILTI is similar to subpart F income
 - Income deemed repatriated in year earned
 - Anti deferral regime
- GILTI is the amount by which a US shareholder's net CFC tested income for the tax year exceeds the US shareholder's net deemed tangible income return for the tax year
- Broadened categories of taxpayers to whom the CFC rules apply (no longer need >10% votes to be a "U.S. Shareholder" – now >10% value)

Controlled Foreign Corporations – Changes to the Definition of “U.S. Shareholder”

- Another international tax change is the broadening of the definition of “U.S. Shareholder”
- Result: more non-U.S. corporations are “Controlled Foreign Corporations” or CFC
- CFC are subject to current tax on Subpart F Income (broadly, passive or deemed passive income)

Controlled Foreign Corporations – Changes to the Definition of “U.S. Shareholder”, continued

- A non-U.S. corporation is a CFC if “U.S. Shareholders” hold more than 50% of the votes or value of the particular corporation
- Prior to tax reform, a person was a “U.S. Shareholder” if the person was a U.S. citizen or resident (including an entity) and held 10% of the votes of the particular corporation
- Post-tax reform, a person is a “U.S. Shareholder” if the person was a U.S. citizen or resident (including an entity) and held 10% of the votes or value of the particular corporation
- Includes direct, indirect, or constructive ownership

Controlled Foreign Corporations – Changes to the Definition of “U.S. Shareholder”, continued

- Problem: Canadian family trusts often give rise to indirect ownership
 - Medco with the Canadian physician holding all votes could now be a CFC if the spouse and/or children indirectly hold sufficient votes and value
- Grantor Trust: taxed as owned by a person who made a gratuitous transfer to the trust.
 - Narrow circumstances in which a non-U.S. person can be taxed as the owner
 - Where Grantor Trust status applies, no U.S. tax to the beneficiary during the lifetime of the “grantor” and no attribution of the trust’s assets (CFC and PFIC status can be avoided)
 - Where Non-Grantor Trust status applies, the beneficiaries are treated as having a proportionate interest in the trust. Different rules for different purposes; no clear guidance

Expatriation – Current Opportunities

- U.S. Gift Tax Exemption is \$11,180,000 + annual spousal exclusion of \$152,000 + unlimited \$15,000 annual exclusions
- Most individuals willing to irrevocably gift assets away can now do so to get below the \$2,000,000 threshold
- Risk - “step transaction doctrine”
- Still need to certify 5 years tax compliance and fall below income tax liability threshold

Questions?

Thank you!

Cheyenne J.H. Reese

604.631.1251

creese@legacylawyers.com

Christine M. Muckle

604.631.1250

cmuckle@legacylawyers.com