Leith Wheeler
INVESTMENT COUNSEL LTD.
Well Into the Future

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Planning Matters

So I Married An American...

The good news is that it is definitely better than marrying an axe murderer, but there may be "issues." Cross-border couples – Canadian families that have one spouse who is an American citizen – raise particular planning challenges for tax and estate planning. The United States applies its full taxation and compliance regime to all of its citizens, even when they do not reside in the U.S. This means that U.S. citizens who reside in Canada are subject to taxation by both countries – Canada because of residency and U.S. on account of citizenship.

U.S. Estate Tax Exposure Also Affects Planning for the Canadian Spouse

U.S. estate tax is a tax on wealth that applies to the estate of U.S. citizens and long-term residents and its conception of an estate is much broader than the typical Canadian probate estate. For example a U.S. estate *includes* life insurance proceeds and assets in registered retirement accounts and many trusts established by or for the benefit of the deceased. Typical cross-border couples expect the survivor to continue to benefit from some or all of the wealth of the first to die, but to achieve this ordinary objective without increased exposure to U.S. estate tax takes planning for both spouses. Holding property in joint title, or simply providing that the surviving spouse receives everything can increase estate tax exposure if the Canadian spouse dies first. The Canadian spouse needs a Will that provides, if the Canadian spouse is the first to die, a specially-structured trust for the benefit of the surviving U.S. spouse that will allow limited use of the deceased Canadian spouse's assets, but not include those assets in the estate of the U.S. spouse on his or her later death. In addition, to maximize tax planning alternatives and flexibility should the U.S. spouse die first, the U.S. spouse should have a Will that will minimize U.S. estate tax by maximizing exemptions and exclusions, whether they flow from the U.S. tax code or the Canada/U.S. tax convention.

U.S. Gift Tax Complicates Planning for Cross-Border Couples

Gifts from the U.S. Spouse to the Canadian Spouse have an Annual $135,000 Exclusion

The U.S. has a complete exemption from its gift tax for gifts to U.S. citizen spouses, which is equivalent to the Canadian spousal rollover, but a different rule applies to gifts to a spouse who is not American. If there was no U.S. gift tax, U.S. persons could avoid paying estate tax by gifting all of their assets before they die, but this "leakage" is prevented because the gift tax is imposed on the gift, essentially collecting the estate tax in advance. Recognizing that transfers between spouses are a necessary aspect of many marriages, the U.S. allows that the first US$135,000 of gifts in each calendar year to be excluded from U.S. gift tax, just as gifts up to US$13,000 to any person other than a non-U.S. spouse are also excluded from U.S. gift tax. Often an ideal use of the annual exclusion is to transfer to the Canadian spouse portions of the ownership of the Canadian principal residence, until the U.S. spouse owns an amount small enough that its portion of any gain does not exceed the US$250,000 principal residence exclusion recognized for U.S. capital gains tax.

Gift Tax May Also Limit the Application of a Spousal Trust

A typical Canadian estate plan may include a spousal trust for all assets of the first to die, in order to allow the surviving spouse to continue to have some use of the assets of the first to die, but also providing the benefit of the assets being within a trust, including the deferral of gain recognition until the death of the survivor. For a trust to qualify as a spousal trust under Canadian law, no person other than the spouse can receive any of the income or capital of the trust during that spouse's life. For many Canadian families if most of the family assets are to be within the trust it could raise the question: what if one of the children "needs" a large gift (*e.g.*, to help the child to buy a home). The usual Canadian solution to this question is that the trustee could encroach capital from the trust to the surviving spouse, and then the surviving spouse could make a personal gift to the child. Unfortunately, if the surviving spouse is a U.S. citizen, this gift would be subject to U.S. gift tax. As a result, cross-border families may be faced with a dilemma: obtain the benefits of spousal trust treatment *or* maintain the flexibility to provide capital to other family members. In the appropriate situation the solution may be to split the estate assets between a spousal trust (for assets that would otherwise be subject to recognition of capital gains), and a family trust in which the children are also beneficiaries (for assets that will not be subject to capital gains on the death of the first spouse).

Are Your Children U.S. Citizens Too?

U.S. citizenship applies to Canadians born in the U.S. (excluding children of diplomats), and to children born with at least one U.S. parent (including dual nationals), if that parent grew up in the U.S. On the other hand, children of a U.S. parent who never resided in the U.S. or came to Canada when that parent was a young child are not U.S. citizens. The gap between Americans who left the U.S. as a young child and those who left as adults is complicated because of many changes to the requirements under the law that apply to different ages and for different periods. There are favourable rules that limit the application of the tax on expatriation for U.S. citizens who are citizens of another country since birth.

Summary

Issues relating to cross-border couples or individuals who hold dual citizenship in the U.S. and Canada are complex and constantly changing. The foregoing article is not legal advice, which must consider your specific circumstances. As with other estate planning issues, we recommend you seek expert advice to ensure your Estate is structured effectively to meet your unique needs.

Contributing Writer:
Will Todd, LL.B
Lawyer
Davis LLP

Phone 604.643.6483
Email wtodd@davis.ca

DAVIS LLP LEGAL ADVISORS SINCE 1892

Editor:
Karey Irwin, CFP
Portfolio Manager

Leith Wheeler
INVESTMENT COUNSEL LTD.
Well Into the Future

1500—400 Burrard Street
Vancouver, BC V6C 3A6

Phone 604.683.3391
Toll-Free 1.888.292.1122

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