ESTATES & TRUSTS
LEGALNEWS

US ESTATE TAX UPDATE : CROSS BORDER PLANNING

by Kathleen A. Strachan

U.S. Transfer Taxes

U.S. transfer taxes consist of three tax regimes: estate tax, gift tax and generation skipping transfer tax. For the purposes of this newsletter we will focus on the U.S. estate tax. The application of the transfer taxes to an individual depends if the individual is a U.S. citizen and/or resident (collectively, a U.S. person) or a non-resident of the United States who is not a U.S. citizen (a non-resident alien).

Residency for U.S. transfer tax purposes is not determined in the same way as residency for U.S. income tax purposes. For U.S. transfer tax purposes, a resident is a person who is domiciled in the United States. A person acquires domicile in the United States by:

- being physically present in the United States, however briefly; and
- forming the intent to reside in the United States permanently.

For U.S. transfer taxes, a non-resident alien is an individual who is not domiciled in the U.S. Non-resident alien status includes Canadians who do not hold U.S. citizenship and do not live in the U.S. but also includes individuals who are not U.S. citizens who may be considered U.S. residents for U.S. income tax purposes but who are not domiciled in the U.S. Canadians who are domiciled in the U.S. will be subject to U.S. transfer taxes such as estate tax on the value of their worldwide assets owned at the time of their death. Those who are not domiciled in the United States will be subject to U.S. estate tax only on the value of their U.S. situs property at the time of their death.

Domicile

Both physical presence and intent to remain in the United States are required for domicile to be implied for U.S. transfer tax purposes. Physical presence without the intention of remaining indefinitely does not constitute domicile on its own. Therefore, Canadian individuals who live and own assets in the United States will not be domiciled in the United States for transfer tax purposes unless they intend to remain there permanently. However, even if they retain certain ties to Canada, if their behaviour indicates intent to remain permanently in the United States, they will be regarded as domiciled there for estate tax purposes.

For example, an individual with continued ties to Canada who is in the United States on a non-immigrant visa that can be renewed annually can develop the subjective intent to remain in the United States permanently and therefore establish domicile. Because intent is subjective, domicile is not always easy to determine, and is based on the facts of each case.

May 2012 • Volume 1, Number 1

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Recent Changes to U.S. Transfer Tax Regimes

On December 17, 2010, the U.S. signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 which reinstated estate and generation skipping taxes for 2010 through 2012, effective for individuals dying and transfers made after December 31, 2009. The estate tax was temporarily repealed in 2010. However, for the estates of individuals who died in 2010, the estate's executor may elect to treat the estates as if the new legislation had not been enacted; namely the estate would not be subject to estate tax and the modified carryover basis rules would be applicable. For gifts made in 2010, the gift tax exemption was $1 million and the tax rate was 35%. In 2011 and 2012, the gift tax has been reunified with the estate tax which effectively merges the two exemptions into one $5 million exemption amount that may be utilized for either lifetime gifts or bequests. Any use of the $5,000,000 exclusion amount towards a gift will reduce the exclusion amount available at death for estate tax. The estate tax rate remains at 35% until the end of 2012.

The U.S. imposes an estate tax on the fair market value of the decedent's estate at death. For U.S. persons, the tax is levied on the decedent's worldwide estate. A U.S. person includes a U.S. citizen living in Canada — including dual citizens of Canada and the U.S. For non-resident aliens, U.S. estate tax is levied only on assets with U.S. situs such as shares of a U.S. corporation, real estate situated in the U.S., etcetera.

U.S. Estate Tax for U.S. Persons

For U.S. persons, the gross estate of the decedent includes all property, real or personal, tangible or intangible, wherever situated, in other words, all worldwide assets are included. In addition to the assets owned directly by the decedent, this broadly worded statement includes assets that one might mistakenly exclude from the decedent's gross estate, for example, property held in joint tenancy. For estate tax calculation purposes, the decedent's gross estate includes property with which the decedent was a joint tenant, except to the extent that the surviving joint tenant(s) can show contribution to the acquisition of the property. The contribution made by the surviving joint tenants cannot have been by way of gift from the decedent. If the property was held in joint tenancy with right of survivorship by the decedent and his/her surviving U.S. citizen spouse and they were the only joint tenants, only half of the value of the jointly owned interest will be included in the gross estate of the decedent regardless of which spouse provided the original consideration.

Life insurance would be another inclusion. If the decedent's gross estate includes proceeds of insurance on the life of the decedent and the proceeds are payable to the estate or the decedent had any incidents of ownership in the policies, this amount must be included in the calculation of the decedent's gross estate for estate tax purposes.

Future Outlook of U.S. Estate Tax

The U.S. has not passed legislation that extends the 2011 federal estate tax rate and exemption level beyond December 31, 2012. As a result, the federal estate tax rate of 35% and exclusion amount of $5,000,000 is valid only until December 31, 2012. If new legislation is not passed by the end of 2012, the following federal estate tax rate and exclusion amount will be reinstated in 2013:

- an exclusion amount of only $1,000,000 (indexed for inflation); and
- a maximum tax rate of 55% (60% on the portion of the estate between US$10,000,000 and US$17,184,000).

Due to the uncertainty of the exclusion amounts for U.S. transfer taxes after 2012, planning to secure access to the $5,000,000 exclusion amount is prudent. For example, where there is a U.S. person spouse married to a Canadian non-resident alien spouse, the U.S. person spouse could gift $5,000,000 to the Canadian spouse and use the exclusion amount against gift taxes. The Canadian non-resident alien spouse's will would need to be revised to ensure that if he or she predeceases the U.S. person spouse, the $5,000,000 originally gifted is not bequeathed back to him or her. Alternatively, a U.S. person can use the exclusion amount by gifting $5,000,000 worth of property into a trust for the benefit of his or her non-resident alien family members, such as minor children. Planning should be undertaken to ensure the U.S. person does not have a general power of appointment; otherwise, the amount will be included in his or her gross estate.