

# Types of Ownership and Estate Tax

Excerpt from: South of 49 by Philip McKernan, Dan Sampson, and Mike Cunning

Without proper planning in place, a Canadian's estate may be required to pay US estate tax on the value of the US home. Rates start at 18% and rise quickly to 45% for the properties worth more than US\$1.5 million. The Canada-US Tax Treaty, however, provides some relief for Canadians.

## *How the Exemptions Work*

For US citizens, the first US\$3.5 million in assets is exempt from the US estate tax. The Treaty entitles Canadians to a percentage of that exemption, which is the proportion of values of the individual's US assets to worldwide assets. For example, if US property represents 20% of worldwide assets, the deceased will be entitled to an exemption of US\$700,000 (20% of 3.5 million).

The Treaty provides additional relief if the US property of the deceased passes to a Canadian spouse. In general, this provision will double the exemption (calculated above) if all of the assets pass to the surviving spouse.

The US annual exemption increased to US\$3.5 million in 2009. However, unless new legislation is enacted, in 2011 the exemption will decrease to its earlier level of US\$1 million and the 45% top rate reverts to 55%. Most practitioners believe the 2009 rates will be extended. While nothing is certain, it seems prudent to plan the assumption that the US estate tax will be around in some form beyond 2009.

## *Personal Ownership*

Personal ownership may be the simplest way to hold property if the US estate tax liability can be managed or eliminated. The best approach for married individuals may be to put ownership in the hands of the spouse with the lower net worth. However, one must consider the Canadian income tax attribution rules if the spouse doesn't have his or her own source of funds to complete the purchase. Under these rules, for Canadian tax purposes, the property could be considered to belong to the other spouse.

If the home is owned personally, individual's wills should be reviewed. It may be possible to eliminate US estate tax if the US property passes to a properly structured spousal trust on death.

## *Personal Ownership in Joint Tenancy*

Joint tenancy is a common form of ownership for Canadians. However, joint tenancy for a US property is generally not a recommended form of ownership for Canadian spouses. For US estate tax purposes, the entire value of the property is included in the US estate of the first spouse to die, unless the executor can prove that the surviving spouse contributed funds towards the purchase of the property. In addition, joint tenancy does not allow for any will planning to take place because the property will pass automatically to the surviving spouse. Owning the property as tenants-in-common may be an effective alternative because it would allow each spouse to undertake will planning to protect his or her half interest.

## *A Canadian Trust*

If the US estate tax cannot be dealt with through personal ownership and the provision of a will, consider establishing a Canadian discretionary family trust to hold the ownership of the property. The two key benefits are that:

- US estate tax may be voided on the death of both parties, and
- If the property is sold, any increase in the value will be subject to the same capital gains rates as if the property were owned personally.

Trust ownership generally appeals to Canadians when property values exceed US\$1 million and do not constitute a significant portion of the individual's net worth. This is because the individual must be willing to give up control over the property to his or her spouse and children. In addition, because of Canada's 21-year rule, the trust likely will distribute the property to the capital beneficiaries before its 21<sup>st</sup> anniversary and avoid a deemed realization of accrued gains. Therefore, the trust structure may not appeal to younger families.

### *Other options*

If personal or trust ownership doesn't fit the circumstances, other options should be considered, including:

- Ownership through a Canadian corporation
- Ownership through a Canadian partnership
- Donation of the property to a US-registered charity

In some cases, if the US estate tax exposure cannot be fully eliminated, it might be best to obtain additional life insurance that can adequately cover a tax bill. This could be the simplest solution for younger purchasers, who have access to low-cost insurance.

It is wise to consider all ownership options before entering into a purchase agreement. Many planning techniques cannot be used after the US property is purchased because of the US gift and income-tax consequences associated with the transfer of US real estate.