

MONROE COUNTY BAR CENTER FOR EDUCATION

Thursday, 13-March-2014

12:15 - 2.00 p.m.

The Rubin Center for Education, 1 W Main street, 5th Floor Rochester, NY

CROSS BORDER ISSUES IN TRUSTS & ESTATE MATTERS

Speakers:

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CROSS-BORDER ESTATE PLANNING OVERVIEW

Overview of Cross Border Problems for Non-U.S. Resident with U.S. Connections

- U.S. Gift and Estate Taxes
 - On transfer of worldwide assets of U.S. citizens or domiciliaries
 - On transfer of U.S. situs assets (vacation homes, real property interests, stocks, options, business interests, etc.) of noncitizens/nondomiciliaries

- Expansive Reach of U.S. income tax regimes on U.S. income tax residents or citizens
 - Worldwide income (may be different than Canadian)
 - Beneficial interests in non-U.S. estates and trusts
 - Anti-deferral regime for non-U.S. companies (resulting in deemed, or phantom, income)

Residency for U.S. Transfer Tax Purposes

- Residency based on domicile (intent to remain permanently)
 - “Green Card” visa holders; others
- If a resident, then:
 - U.S. gift and estate taxes imposed on worldwide assets
 - May have problems with U.S. marital deduction if spouse is non-U.S. citizen

Residency for U.S. Transfer Taxes Purposes... contd....

- If not a U.S. resident (and not a citizen), then:
 - Only certain assets (“U.S. situs”) subject to gift or estate tax
 - Different definition of U.S. situs assets for gift than estate tax
 - Same marital deduction problems if spouse is not a U.S. citizen

Which of These Are U.S. Situs Assets for Gift, Estate or Generation-Skipping Tax Purposes

- U.S. real estate
- U.S. stocks (no matter where traded)
- U.S. money market funds
- IRAs; profit sharing or pension plans of U.S. companies
- Debts of U.S. Person
- Deferred compensation from a U.S. company
- U.S. Stock options
- Units of a foreign mutual fund organized as a trust which fund invests in U.S. equities
- Interests in a U.S. LP or LLC
- Interests in foreign LP that holds US situs assets
- Tangible personal property in the U.S. (including Cash)

U.S. Transfer Tax—Marital Deduction

- If otherwise taxable gift is made to a non-citizen spouse (outright only), the first \$145,000 (2014) of the gift is excluded (this is an annual exclusion, similar to the \$14,000 exclusion for gifts to all other persons)
- An estate tax deduction for property passing at death to a non-citizen spouse is only eligible for a deduction if it passes to a Qualified Domestic Trust (“QDOT”, aka “QDT”). This only results in a deferral of the tax that otherwise would be payable on the first death

Bi-lateral Tax Treaty Basics

- 15 Death Tax Treaties [including Income Tax Treaty with Canada]
- Not all cover gift and generation-skipping taxes
- Look to domestic laws first
 - Factors may be citizenship; domicile or residence of decedent; domicile or residence of recipient; location and type of assets
 - Analyze type of taxation (such as based on gain component, on amount received (like an inheritance tax), or an amount transferred (like an estate tax))
- Then examine treaties to see if any relief available in either taxing jurisdiction
- Determine requirements to make election

Summary of U.S./Canada Tax Treaty

- Charitable deduction in full for NRA estate but only for American charities (Canadian charities were eliminated under 5th Protocol)
- Prorated unified credit for NRA estate
 - [U.S. situs assets/worldwide estate] x U.S. unified credit
- Marital credit = additional [prorated] unified credit (effectively shelters \$10.5M estate of US citizen married to non-citizen)
- Canadian capital gains and accrued income taxes creditable as foreign death tax (and vice versa)

Bi-Lateral Tax Treaty Basics... Contd...

Some Surprising Examples

- French resident who inherits from U.S. citizen's estate: no inheritance tax in France!
- U.S. citizen, Canadian resident decedent married to NRA Canadian may exempt (fully shelter) \$10.5M from estate tax!

Illustrations of Canada/U.S. Treaty Pro-Rated Credit

- U.S. condo worth \$2M and worldwide estate of \$10 million
- Credit + Tax Calculation [2013]
 - Tentative tax = \$745,800;
 - Credit:
2M
_____ x \$2,045,800 = \$409,160
10M
 - Net Tax = \$336,640
- Same facts, but survived by spouse, and Will leaves U.S. assets [plus residue?] in Testamentary Spousal Trust
- Marital credit = another \$409,160
- So No U.S. Estate Tax!

Key Cross-Border Tax Planning Principles

- Co-ordinate taxpayer and taxable event
- Take full use of exceptions, exemptions and Treaty benefits
- Plan ahead
- Utilize Dynasty Trusts for U.S. Children's Inheritances from Canadian Parents

Inheritance Trust Design Implementation

- Create a Lifetime irrevocable trust by using an outside “Settlor”, with U.S. child (or third party) as Trustee
- During lifetime trust may only be nominally funded if lifetime gifts are problematic in donors’ tax home.
- Canadian parents’ Wills would provide that inheritance “pours over” into trust. If beneficiary is living in the U.S. then, the trust would be located there and the U.S. foreign trust rules would be avoided.
- The trust could be moved almost anywhere in the world, from time to time, for any reason, whether or not beneficiary is living in the U.S.

**U.S. INCOME TAX ANTI-DEFERRAL RULES
(FOR U.S. PERSONS WHO OWN SHARES OF A
CANADIAN COMPANY OR ARE BENEFICIARIES
OF A CANADIAN TRUST)**

Issues for U.S. Grantors and Beneficiaries of Foreign Trusts

Complex reporting requirements for U.S. Grantor or beneficiary (whether FNGT or FGT)

- 35% penalty to beneficiary for failure to comply with reporting obligation (Form 3520)
- All distributions deemed to be accumulation distributions unless proven otherwise
- Retirement and savings plans (RRSPs, RESPs, RDSPs, TFSAs) in Canada
- 5% penalty to grantor for failure to comply with reporting obligation (Form 3520-A)



Issues for U.S. Beneficiaries of Foreign Trusts

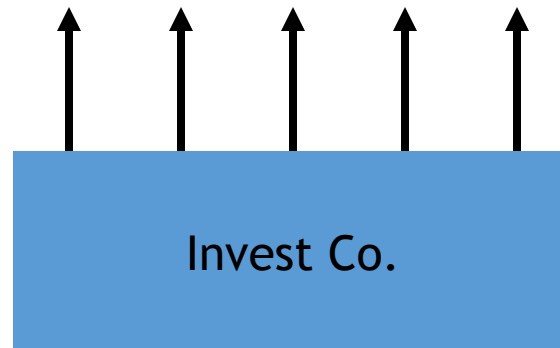
- Distributions from foreign non-grantor trust (“FNGT”) of prior year income are subject to accumulation distribution rules: taxed at ordinary income rates (up to 35%), plus interest is imposed to reflect deferral
 - What was capital gains in year earned is taxed as ordinary income when distributed in a later year
 - Interest charge may become punitive

Common Canadian Structures

Exposing U.S. Taxpayers to Anti-Deferral Rules

Foreign HoldCo for Investments

Non-U.S. and U.S. Shareholders [Family]



Corporate Anti-Deferral Rules

Passive Foreign Investment Company (PFIC)

- 75% or more passive income or 50% or more passive assets
- No minimum U.S. shareholder ownership required
- Attribution through foreign estate or trust
- Taxed when excess dividend distributions or stock disposed (including non-recognition transactions), at highest U.S. rate (35%), plus interest compounded over holding period
- Forms 8621, 8938



■ QEF Election

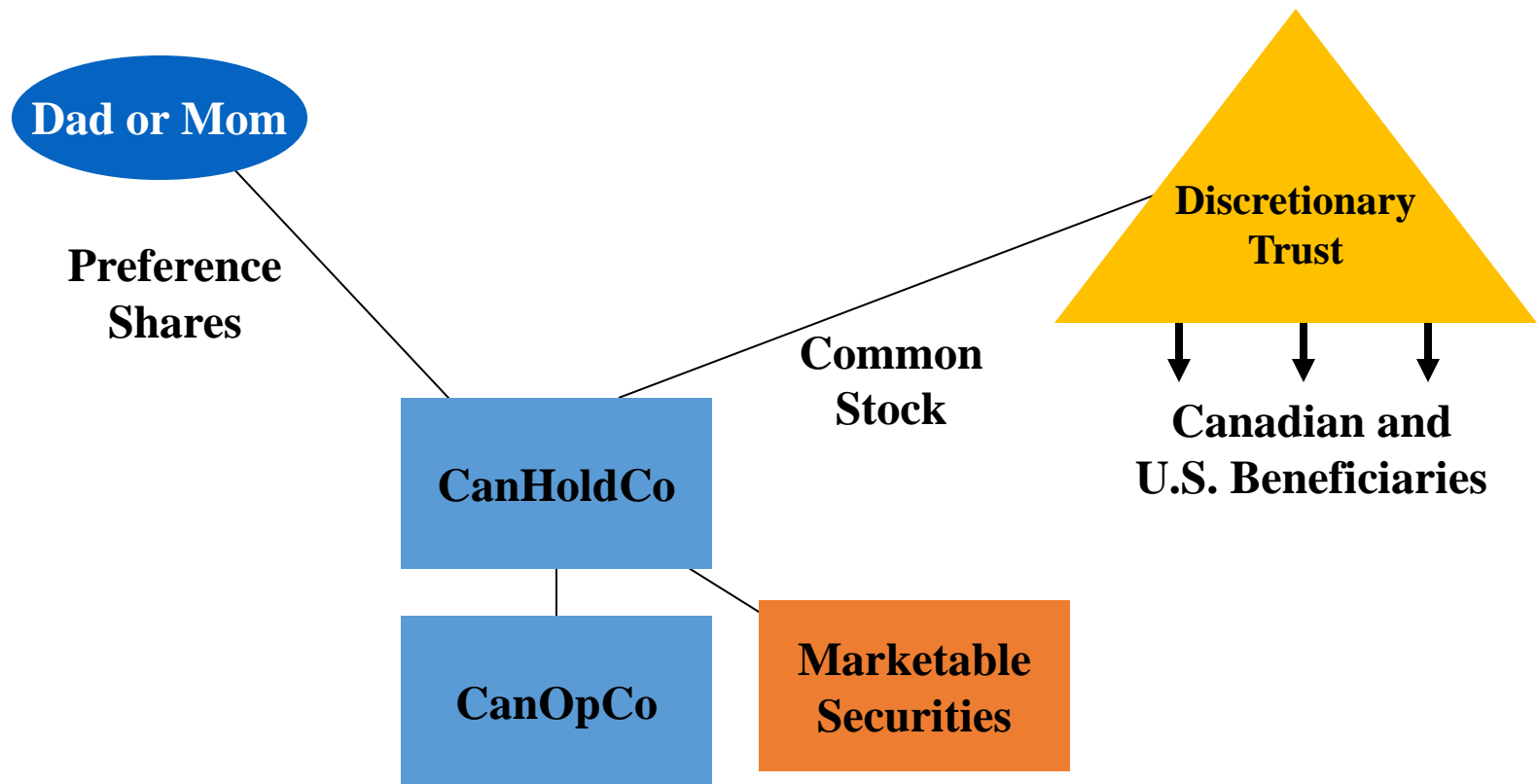
- A U.S. investor can avoid excess distribution regime by making an election known as QEF election.
- QEF election must be made by due date for filing the U.S. investor's tax return for the first year to which the election applies (Form 8621).
- QEF election to be in effect for all years the corporation was a PFIC.
- Investor may have the option of filing a retroactive QEF election.

Corporate Anti-Deferral Rules

- Controlled Foreign Corporation (CFC)
 - More than 50% by vote or value owned by U.S. shareholders with at least 10% voting power
 - Attribution through foreign estate or trust (and other chains of ownership)
 - “Subpart F” income (generally, passive income) taxed currently to U.S. owners (10%+) as a dividend (creating “phantom” income)
 - Rental or royalty income may be passive or active
 - Forms 5471, 8938

Common Canadian Structures Exposing U.S. Taxpayers to Anti- Deferral Rules

Typical Canadian Freeze



PFIC/CFC Attribution to U.S. Beneficiaries

- If FGT, attribution solely to grantor
- If FNGT, attribution to U.S. beneficiaries
 - Facts and circumstances:
 - History of distributions if discretionary
 - If no distribution history,?
 - Possibility of phantom income where no cash ever received!
 - Protective QEF
- Not synchronized with FNGT accumulation rules

Cross-border Issues Pertaining to U.S. Persons' Ownership of Canadian Real Property

American Tax Issues (Multi-Generational Use)

- Coordinate Canadian and American Income tax events
- Coordinate American and Canadian Taxpayers
- Meet rental income exceptions
- Avoid US shareholder benefit treatment
- Simplify income tax compliance (?)
- Minimize/Avoid U.S. Estate Tax
 - On senior generation's (Purchasers') death
 - On later generations' deaths

Canadian Tax Issues Facing U.S. Owners of Canadian Real Property

- Taxable Canadian Property
 - Rental Income
 - Capital gains
 - (But no dividend treatment)
- Income tax issues during life
 - Income events
 - Gifts or other transfers
- Income tax issues upon death of owner of interest
- Real property taxes
- Land transfer taxes

List of US Entity Ownership Possibilities

- Individual
 - Joint WROS
 - Tenancy in common (joint use agreement?)
- Trust (U.S.; Canadian not an option)
- U.S. S Corporation
- U.S. C Corporation
- U.S. Limited Partnership
- U.S. LLC

Why not Canadian entities?

1. Canadian Resident Trust

- U.S. issues
- Canadian Tax
 - Gains Taxed in Trust or Part XII.2 tax of 36%
 - 15% withholding tax on distributions

2. Canadian Corporation

- U.S. issues
- Canadian Tax
 - Gains taxed at Canadian rates
 - Withholding tax on dividends (capital and taxable)
 - Deemed disposition of shares at death
 - No bump in cost base of real property without planning
 - Shareholder benefit withholding tax issues

DISCLAIMER

Note to Readers

- This Presentation is not intended to be legal advice
- Reading the materials does not create an attorney-client relationship
- The outcome of each case stands on its own merits
- Pursuant to I.R.S. regulations, any conclusions or comments contained herein is not intended or written to be used, and cannot be used by the reader, for the purpose of avoiding tax penalties