

# Canadians – Manage your US estate tax exposure



Canadian residents who own certain US assets should be aware that you may be subject to US estate tax upon death. These taxes, which can be significant, may arise if you own property that is considered to be situated in the United States and meets other criteria. As a result, if you determine that you may have a US estate tax exposure, you may want to consider potential tax planning strategies to manage these costs.

In addition, because US estate tax rates and exclusions are subject to legislative changes, and the rates and exclusion amounts change annually, it's a good idea to periodically review your exposure to US estate tax to ensure you make any needed adjustments and pass on more of your estate to the ones who matter most.

This slip-sheet provides an overview of US estate tax and highlights important considerations to keep in mind when revisiting your estate plan. Note that the calculation of US estate tax is based on US estate tax rules, which may differ from Canadian principles. Additionally, this article may not apply to US citizens or situations in which one spouse is a US citizen and does not address potential state tax issues.

## What assets are subject to US Estate Tax?

Generally, US estate tax applies at graduated rates on the fair market value of a deceased's "taxable estate." To calculate the value of this estate, individuals must consider certain assets located or deemed to be located in the United States (or "US situs assets"), less certain allowable deductions. These assets may include:

- US real estate
- Tangible property located in the US (e.g., cars, boats, furniture, artwork)
- Shares of public and private US corporations, regardless of where the shares are held or traded
- Bonds and other debt issued by US corporations and governments (except for certain bonds)
- US retirement plans and annuities (e.g., IRAs and 401(K) plans)

However, some assets are not considered US situs assets for US estate tax purposes, such as:

- Shares and units in Canadian mutual funds and exchanged traded funds (ETFs) that invest in US securities
- Personal US bank accounts (as long as these are not connected to a US business)

- American depository receipts (ADRs) where the underlying shares are of non-US corporations
- US\$ pay bonds from a Canadian issuer
- Shares of Canadian corporations<sup>1</sup>

Note that the situs of a Canadian or US partnership interest is uncertain.

## Make deductions from asset value

In calculating your taxable estate, there may be certain debt and expenses that you can deduct from the gross value of your US situs assets. Some of these examples, which may have to be pro-rated based on the ratio of US situs assets to worldwide assets, include:

- Funeral and administrative expenses
- Amounts transferred to a "qualified domestic trust"
- A non-recourse mortgage on US real estate
- The deceased's liabilities at the time of death (e.g., Canadian income taxes)
- State death tax
- Charitable donations

<sup>1</sup> US securities are subject to US estate tax regardless of whether they are held in a Canadian registered account such as an RRSP, RRIF, TFSA, RESP or RDSP. US securities are also subject to US estate tax if they are held in an Alter-ego Trust or Joint Partner Trust.

## Claim credits to reduce your tax bill

There may also be certain credits available under the Canada-US Tax Treaty to reduce the resulting tax liability in the year of death, including a unified credit, a marital credit and a Canadian credit for US estate taxes.

### Unified Credit

For 2023, Canadians may be eligible for a unified credit of up to **US\$5.11 million** that can be applied against a tentative US estate tax liability. This credit effectively shelters **US\$12.92 million** of a taxable estate. The unified credit must be pro-rated based on the ratio of US situs assets to worldwide assets as follows:

$$\text{US Situs Assets} \times \text{Unified Credit} = \text{Prorated Unified Credit Worldwide Assets}^{**}$$

\*\* The denominator is based on US estate tax principles and includes amounts such as the value of life insurance proceeds and a principal residence.

### Marital Credit

In addition, a "marital credit" is also available that can almost double the unified credit if US property is transferred to a spouse upon death. The marital credit is limited to the lesser of:

- The pro-rated unified credit, or
- Tax otherwise payable on qualified property transferred to a spouse

Where individuals who are married and transfer all US property to a spouse upon death, then no estate tax should be payable, as long as the value of the deceased's taxable estate is US\$23.98 million or less.

Note that where assets are jointly held, the first joint tenant to die is deemed to own 100% of the property, unless the executor can show that the surviving joint tenant paid for their share with their own money. This rule applies to property held as joint tenants with right of survivorship but does not apply to property held as tenants in common.

### Canadian Credit for US Estate Taxes

You may be able to apply a credit for US estate taxes paid against your Canadian federal income tax on US source income in the year of death. This credit includes gains on the shares of US corporations.

## 2023 US estate tax exclusion thresholds

US estate tax is calculated at graduated rates (see the Appendix) on the fair market value of an individual's "taxable estate" as follows:

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### US Situs Assets: US\$60,000

If the value of your US situs assets is **US\$60,000 or less** upon death, you are not liable for US estate tax, regardless of the value of your worldwide assets.

If the value of your US situs assets is **greater than US\$60,000** upon death, your estate must file a US estate tax return, even if no tax is payable.

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### Worldwide Assets: US\$12.92 million

If the value of your worldwide assets is **US\$12.92 million or less** when you die, you are not liable for US estate tax, regardless of the value of your US situs assets. You still must file a US estate tax return to claim Canada-US treaty benefits if the value of your US situs assets is **greater than US\$60,000**.

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### US Situs Assets & Worldwide Assets

If the value of your US situs assets is **greater than US\$60,000** and the value of your worldwide assets is **greater than US\$12.92 million**, you may have a US estate tax liability when you die. You must file a US estate tax return to claim Canada-US treaty benefits of the Treaty and calculate your tax liability.

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**Note:** The estate tax exclusion (and unified credit) will return to pre-2018 levels beginning January 1, 2026. The exclusion amount will be reduced to US\$5.49 million (from US\$12.92 million) (adjusted for inflation).

The US estate tax return (Form 706-NA), along with any estate tax payable, must be filed nine months after the date of death (although a six-month extension to file the return is available). The deadline to pay estate tax can also be extended, but interest accrues while the amount remains unpaid.

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<sup>2</sup> Note that the basis of property held at death is adjusted to fair market value for US income tax purposes even if no estate tax is payable.

## Managing US estate tax exposure

If you have determined that you may have exposure to US estate tax, there are strategies available that may help you potentially reduce, defer, eliminate, or fund this exposure. In particular, you may want to consider implementing changes to:

- Keep your worldwide assets under US\$12.92 million (2023 amount)
- Split your worldwide assets with your spouse to maximize the unified credit amount under the Canada-US Tax Treaty
- Use a Canadian corporation to acquire US assets
- Use a specially structured Canadian trust to acquire US assets
- Use a Canadian limited partnership that elects to be treated as a corporation for US tax purposes
- Amend life insurance policies

- Dispose of US assets prior to death
- Gift US assets prior to death
- Donate US assets to a US charity on death
- Use a Qualified Domestic Trust (QDOT)
- Create a trust for your spouse on death.

## Contact your adviser

If you believe your estate has a US estate tax exposure, your KPMG tax adviser can help you understand the latest changes to the rules and determine whether you are eligible for deductions and credits that could help reduce your liability. In addition, your KPMG tax adviser can assist with reviewing tax planning strategies that can ensure that your estate plan is suitable to your needs for the years to come.

## Contact us

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