ATB WEALTH

TAX CONSIDERATIONS FOR SNOWBIRDS

2023 Reference Guide

Canadian residents often spend significant amounts of time in the US, whether for vacations, shopping, as a second home during retirement, or for a variety of other reasons. Many Canadians own real estate in the US or an interest in real estate. While most snowbirds understand that this border-hopping lifestyle can have tax considerations, there can be many misconceptions about how US tax applies to Canadian tax residents.

In this guide, we will discuss three common US tax topics for Canadian residents to be aware of: US tax residency; some tax considerations for Canadians owning US real estate; and the US estate tax regime. While these are common US tax considerations for Canadians, they are not comprehensive, and there may be other US tax topics worth discussing with your tax advisor.

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US TAX RESIDENCY FOR CANADIANS

In most tax systems, taxpayers owe tax on their worldwide income to the country in which they are a resident. The US is unique in that it levies tax against its citizens, regardless of where they normally reside, but it will also tax non-citizens that are considered to be tax residents of the US.

Canadians who travel to the US frequently or for extended periods of time should ensure they are aware of these tax residency rules. It is possible to inadvertently become a US tax resident. If this happens, it can result in cumbersome US filing obligations, penalties for non-compliance, and even the requirement to pay tax in the US on your worldwide income. While this guide describes these rules at a high level, it is vital to seek tax advice from a qualified cross-border specialist to understand how they apply to your situation.

Becoming a US tax resident: days in the US

Many snowbirds are familiar with the idea that they need to count the number of days spent in the US each year. There can be several misconceptions about how to count these days, why they matter, and what to expect if you spend too much time in the US in any particular year.

The main purpose of counting your days spent in the US each year is to determine whether the US will treat you as a US tax resident. These tests for residency are for tax purposes only, and they are different from tests used for immigration purposes. If you meet one of the tests to be a US tax resident, it may still be possible to rely on our tax treaty to avoid paying US income tax, but it will usually result in some filing requirements, at a minimum.

The day-count test for US residency

There are two day-count tests for becoming a US tax resident. The first is relatively simple. If a Canadian resident spends 183 days or more in the US in any calendar year, they will generally be treated as a US tax resident for that year and be required to make some US tax filings or, in some cases, pay US income tax. When counting the number of days, it usually includes days where you spent only a short amount of time in the US, like crossing the border for a brief shopping trip.

This 183-day test is not the only test, however. If you were in the US for 31 days or more in the current calendar year—but not as many as 183 days—a different test may apply.

This test, known as the "substantial presence" test, looks not only at the number of days spent in the US in the current calendar year, but also a portion of the days in the previous two years.

The substantial presence test adds the following three numbers:

- The number of days spent in the US in the current year; plus
- One-third of the number of days spent in the US in the previous year; plus
- One-sixth of the number of days spent in the US two years prior.

If the total number of days calculates out to 183 days or more, you will normally have a US tax filing obligation.

This can catch some snowbirds off-guard. Under these rules, it is entirely possible to become a US tax resident while spending less than 183 days in the US in any given year. Unless you have relief from an exception, this can result in some unexpected tax burdens.

As a general rule of thumb, if a Canadian spends around 120 days in the US each year, they will usually be in danger of falling offside this "substantial presence" test.[1] Even if you spend less than 120 days in the US in any given year, however, you will need to run the calculations to determine whether the substantial presence test is met.

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[1]For a taxpayer spending 120 days in the US each year, the calculation works out to (120 days) + (120 days * 1/3) + (120 days * 1/6) = 180 days, just three days shy of the substantial presence threshold.

EXAMPLE: THE SUBSTANTIAL PRESENCE TEST

Consider the case of Sophie and Jean Tremblay. The Tremblays bought a property in Palm Desert, California. In 2022, the Tremblays spent a total of 135 days in Palm Desert and travelled to other parts of the US. In 2021, they had spent 123 days in the US, and in 2020 they spent only 96 days.

In each year, the Tremblays spent fewer than 183 days in the US. They even spent fewer than the 120 days mentioned in the rule-of-thumb, above, in 2020. At first glance, they may seem safe from being treated as US tax residents. However, the substantial presence test gives us a different result. Under this test, the Tremblays spent:

2022		2021		2020		
135 days	+	41 days (1/3 of 123 days)	+	16 days (1/6 of 96 days)	=	**192 days**

Combined, this adds up to 192 days. Since this exceeds 183 days, and since they spent 31 or more days in the US in 2022, they likely have US filing obligations for 2022.

Filing requirements and retaining Canadian tax residency

If you exceed the 183-day test or the substantial presence test above, you may be required to make US tax filings. However, this does not necessarily mean you will owe US income taxes. There are two important exceptions for Canadians: the “closer connection” test and the treaty exemption.

The closer connection form

For taxpayers who have spent fewer than 183 days in the US in the current calendar year, it may be possible to avoid being treated as a US tax resident if you have a “closer connection” to another country like Canada. This requires you to file a Closer Connection Exception Statement (Form 8840) by your US filing due date (generally April 15 or June 15).

The closer connection test is not simple. Depending on your personal circumstances, it may be difficult to prove that your connection is closer to Canada than to the US. Some factors that can help to establish which country is closer for you are as follows:

- Having a permanent home available for your use in that country;
- Proof that your family lives in that country;
- Social, cultural or religious connections to the country, such as membership in local clubs or religious institutions;
- Holding a driver's license for that country; and
- The place you have declared as your residence on official forms like tax returns or IRS compliance forms.

This is not a complete list. There are rarely black-and-white answers to which country you are most closely connected. Cross-border tax advice can be very valuable when filing US tax forms like these.

If you are able to establish that you have a closer connection to a country other than the US, you may be able to avoid paying US tax on your worldwide income and some other US filing obligations. You may still owe US tax on any US-source income, like any other Canadian resident.

Relying on a tax treaty

If you spend more than 183 days in the US in a single year (rather than through the three-year calculation), you will normally be considered a US tax resident and be required to file a US income tax return. The closer connection exception is not usually available in this case. However, you may be able to file Form 8833 (Treaty-Based Return Position Disclosure) along with your US tax return to assert a treaty exemption.

When a taxpayer is a resident of both Canada and the US, there are a series of tie-breaker rules in the US-Canada tax treaty to decide which country should tax your worldwide income. These tie-breaker rules can be complicated, and, like any other US tax filing, you should seek advice from a cross-border tax advisor when filing this form.

Generally, the tie-breaker rules say that if you are a resident in two countries, but have a home available for your use in only one of those countries, you will be a resident of only that country. If you have a home (whether owned or leased) available in both countries, you will be a resident of only the country where your "personal and economic ties" are closest. As with the closer connection tests above, this is rarely black and white, and involves a detailed review of your ties to each country.

Even if you are successful in claiming a treaty benefit and avoid filing a US tax return as a US resident, this is not the end of your US obligations, unfortunately. Unlike the closer connection form above, a successful treaty exemption does not exempt you from the need to file other non-resident forms, like the Report of Foreign Bank and Financial Accounts (FBAR). These forms can be cumbersome, and there are steep consequences for failing to file on a timely basis.

Consequences for failing to file

If you have become a US tax resident, there can be significant costs for failing to file your forms in a timely manner. This can be a concern for taxpayers who have not been tracking their days in the US, since they may not even be aware they have a filing obligation.

The failure to file a US income tax return when required can come with a penalty of up to 5% of the taxes you owe per month (or part of a month) that the return is late, to a maximum of 25%. Alternatively, the failure to pay your US income taxes on time can result in penalties of 0.5% per month for the amount of unpaid taxes, up to a maximum of 25%. These penalties can also accrue interest.

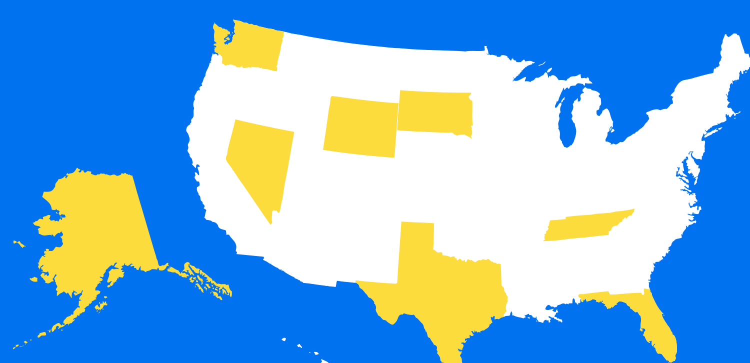
The failure to file other forms can be similarly punitive. An accidental failure to file an FBAR, for example, can carry a penalty of US$10,000 or more, depending on the year. Wilful violations can be significantly more costly. If you are unaware of your need to file, these penalties can quickly grow out of control.

State tax filing requirements

There may also be state tax filing requirements if you reside or are domiciled in a state. Not all states have income tax. Florida, Alaska, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming are states that do not have a personal income tax or individual state tax filing requirements. States that have a personal income tax generally require a person to file as a full-year resident if that person is domiciled in that state. Each state has its own rules as to when an individual is domiciled. In many states, an individual is domiciled if the individual spends more than 183 days a year and “maintains a permanent place of abode” in the state. Note that even if you are claiming treaty benefits to avoid filing a US federal individual income tax return, you may still need to file a state individual income tax return if you are domiciled in a state, because states generally do not follow the US-Canada tax treaty. You should discuss your potential state filing requirements with your tax advisor as the rules regarding state tax residence and domicile are often complex.

STATES THAT DO NOT HAVE PERSONAL INCOME TAX

- Alaska
- Florida
- Nevada
- South Dakota
- Tennessee
- Texas
- Washington
- Wyoming



Consequences in Canada

Becoming a US tax resident may also have consequences in Canada. If you lose your Canadian tax residency, you may be treated as if you have emigrated from Canada, for tax purposes.

When a Canadian resident departs the country, there can be a variety of tax implications not discussed in full detail here. One significant event is that an emigrating taxpayer is generally treated as if they have sold most[2] of their capital property immediately before leaving the country, such as non-registered investments or shares of a private company. The capital gains or accrued income on those properties would be taxable upon emigration.

Once you have ceased to be a Canadian tax resident, you will continue to owe tax on your Canadian-source income. Dividends from Canadian companies, rental income on Canadian real estate, and distributions from an RRSP, among other things, would normally be subject to withholding taxes, at rates of up to 25%.

In some cases, this might be a preferable result, since US tax rates in many states can be lower than Canadian tax rates. In other cases, it can create a substantial tax bill, possibly without an easy way to fund that bill. In either case, emigration from Canada for tax purposes is a decision that should be made conscientiously, after discussion with your tax advisor, rather than accidentally by spending too much time in the US.

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[2]Some notable exclusions from this rule are assets in a registered account like an RRSP and personally owned real estate located in Canada.

OWNING REAL ESTATE IN THE US

US real estate is an especially common investment for Canadian residents with cross-border exposure. Most countries will tax real estate located within their borders, even if the owner is a non-resident. Canadian residents who own US real estate should expect to have tax considerations in both the US and Canada.

This portion of the guide is written specifically for Canadian residents who are not US citizens, US permanent residents, or tax residents of the US (discussed above). US persons will also have exposure to tax on US real estate, but the tests, thresholds, and planning strategies may differ.

Rental income from real estate

Many Canadians who own real estate in the US will earn rental income from that property. In some cases, this is the primary purpose of the property. In others, owners may have a simple vacation property that is rented out when not in use. When a Canadian earns rental income in the US, they should expect to have some US tax and filing obligations in addition to their Canadian obligations.

Tax obligations in the US for rental income from US real estate

The US tax system is designed to ensure foreign owners of real estate pay their tax bill in the US first. As a default rule, if a Canadian holds real estate in the US and leases it to a tenant, the tenant is required to withhold up to 30% of the gross rent. You may be exempted from this rule if the property is used as a home and leased out for fewer than 15 days in the year. Any amount withheld by the tenant is forwarded to the IRS on behalf of the Canadian owner, and the tenant is expected to file Form 1042-S to report this income.

This withholding tax system can be relatively straightforward for non-Americans, but it can also be an expensive method of paying your taxes. The withholding tax applies to gross rental income, rather than net rental income, so the tax may be higher than expected. When paying tax on gross rental income, the calculation would ignore deductions for things like property tax, insurance, and depreciation, which can all have a significant impact on your total tax bill.

Foreign owners of US real estate also have the option to pay tax on net rental income, rather than withholding tax on gross rental income. To receive this treatment, you must file a non-resident tax return in the US by the filing deadline and elect to have the income taxed as net rental income. This can enable access to various deductions, such as mortgage interest, property management fees, insurance, and depreciation.

Note that once you have elected to pay tax on net rental income—rather than falling into the default withholding tax system—the election cannot be revoked without the consent of the IRS. Furthermore, the election will typically apply to all US real estate you own. That is, it is not usually possible to pay tax on some properties through withholding tax on gross income and on other properties through income tax on net income. It is important to receive tax advice from a US tax specialist before making such an election.

In some cases, you may realize a rental loss when using this net income calculation method. The US has restrictions on your ability to claim a loss from passive activity like leasing real estate. In general, you may claim these losses, but only against income from passive activity. Unused losses can be carried forward indefinitely, and are typically available to claim once the underlying property has been sold.

In the event you choose to file a tax return and pay tax on a net rental basis, you may also wish to provide a certificate to your tenant, confirming your tax election. Otherwise, the tenant may still withhold tax from your rental payments. While you may be able to receive those funds back as a refund after filing your tax return, the money will be inaccessible while it is held by the IRS. Note that you may also have non-resident state income tax filing requirements if you collect rental income on real property situated in a state.

Tax implications in Canada for rental income from US real estate

Tax in the US is only one side of the coin. As noted earlier in this guide, Canada will generally tax Canadian residents on their worldwide income, regardless of where it is earned. This rule applies equally to rental income earned on real estate in the US. As a result, Canadians who earn rental income in the US will generally be expected to report that income in Canada.

Though the income must be reported, you are typically allowed a tax credit in Canada for the tax you paid in the US. This credit is equal to the lesser of (1) the Canadian tax you would have otherwise owed on that income; and (2) the total amount of US taxes paid. In other words, if your US tax is higher than your Canadian tax, you will generally not owe significant taxes in Canada, though the income must still be reported. If your US tax is lower than your Canadian tax on that income, you would normally only pay that excess amount to the Canada Revenue Agency (CRA).

Canada and the US have different systems for how to determine your net rental income. In some cases, this can create a mismatch across the border. For example, Canada limits your depreciation expense each year to a "capital cost allowance." This amount is optional to claim, and cannot be used to create a loss. In the US, on the other hand, depreciation is usually a mandatory deduction for real estate. This can result in different amounts of taxable rental income on each side of the border. Furthermore, Canada will expect you to report your tax results in Canadian dollars, which can give rise to an exchange rate gain or loss.

Canadians with certain types of foreign properties costing CAD$100,000 or more (in the aggregate) are also required to disclose these properties on a Foreign Income Verification Statement (Form T1135) with the CRA each year. Foreign real estate held for rental purposes will often need to be disclosed on this form. The failure to file this form can carry substantial penalties of CAD$25 per day (up to CAD$2,500) or 5% of the cost of that foreign property.

Tax on the sale of US real estate

There can also be significant tax considerations at the time of selling US real estate. These considerations may apply in both the US and in Canada.

US withholding tax on gross sale proceeds

When a Canadian resident sells US real estate, the purchaser is generally required to withhold some of the sale price. The purchaser has an obligation to pay 15% of the total purchase price to the IRS on your behalf, as a prepayment of your taxes. Since the tax applies to the full purchase price—rather than just your gain on the property—this withholding tax is often higher than the capital gains and other taxes you actually owe on the sale.

There are several exceptions to this. The withholding tax does not apply to sales of real estate priced at US$300,000 or less, provided that the purchaser (or their family) intends to reside in the property for the next two years and for at least 50% of the time the property is actually inhabited. For homes priced between US$300,000 and US$1,000,000, the withholding tax is reduced to 10%, provided that the purchaser intends to use the property as a residence.

If your true tax burden on the sale will be less than the withholding tax, you may be able to file Form 8288-B with the IRS to request a certificate reducing or eliminating the withholding tax. This certificate can be provided to the purchaser to release them from some or all of their withholding obligations. Please note that it can take several months for the IRS to issue this certificate, so you should request it well in advance of the sale, if desired.

Please also note that some states may impose additional withholding requirements on the sale of certain real property. For example, proceeds from the sale of California real estate by a California non-resident may be subject to 3.33% withholding tax.

WITHHOLDING TAX RATES

0%	Less than $300,000*
10%	$300,000 to $1,000,000*
15%	More than $1,000,000

*Provided that the purchaser (or their family) intends to reside in the property for the next two years and for at least 50% of the time the property is actually inhabited.

US tax on gains and recaptured depreciation

The purchaser forwards withholding tax to the IRS on your behalf, but you are also required to report the sale of US real estate to the IRS by filing a tax return. On this return, you will calculate any taxes payable to the US from the sale of the property. This can include several different types of tax, including, among other things, capital gains, recaptured depreciation, and any unrecaptured 1250 gain.[3]

The capital gains tax rate will depend on how long you held the property. For real estate owned for less than 12 months, your capital gains will be taxed as regular income in the US, at graduated rates between 10% and 37%. Long-term real estate held for more than 12 months will be taxed at long-term capital gains rates, instead. In the US, long-term capital gains are currently taxed at 15% or 20%, depending on your income for the year.

> If the property was used for non-personal reasons, there are two other common taxes upon the sale of US real estate: "recaptured depreciation" and "unrecaptured 1250 gain." These taxes relate to your historical depreciation claims. Unlike in Canada, it is typically mandatory to claim depreciation on rental properties in the US. This generally would have reduced your US tax on that rental income in prior years. Upon sale, those historical depreciation claims may be re-included in your income, to the extent that the sale price exceeds the depreciated cost of the property. Depending on the details, this amount may be taxable as "recaptured depreciation," taxed at regular income tax rates between 10% and 37%, or as an "unrecaptured section 1250 gain," taxed at a rate of up to 25%.

These tax rates are subject to change. Various levels of the US government regularly propose tax changes, so it is always prudent to confirm the status of US tax laws with your tax advisor.

Canadian taxes on gains and recaptured depreciation

In addition to the tax results in the US, a Canadian who sells US real estate will also have tax and filing obligations in Canada. As noted, a Canadian resident must pay tax on their worldwide income, even if that income is reported in another country. This amount will be taxed according to Canadian tax rules.

Only half of capital gains are taxable in Canada in 2023. For Albertans, the top tax rate on capital gains can be up to 24% of the total gain.

[3] A detailed discussion of the "unrecaptured 1250 gain" is beyond the scope of this guide.

Canada also taxes recaptured depreciation, to the extent the seller has claimed capital cost allowance in prior years and sells the property for a price that exceeds the depreciated cost of the property. This recaptured depreciation is generally taxed at regular income rates and does not apply to real estate used principally for non-income earning purposes.

Fortunately, the CRA allows taxpayers to claim a foreign tax credit to avoid most of the double taxation that would otherwise occur. As above, the calculation of your income for US purposes and for Canadian purposes may be slightly different, so the amount of income reported to each country may differ. Furthermore, as above, the CRA will expect your Canadian tax return to be calculated in Canadian dollars, which can sometimes result in a foreign exchange gain or loss at the time of selling your US real estate.

Sale of a principal residence

One well-known tax benefit available to Canadians is the Principal Residence Exemption (PRE). Each Canadian-resident family is entitled to claim one property as their principal residence each year. The capital gain on a property that you designate as your "principal residence" for every year in which you owned it will not be taxable in Canada at the time of sale, due to this PRE.

It is technically possible to claim the PRE on US real estate, as well, provided that you or your family regularly inhabit the property. However, this may not create the tax results you would expect. Even if the capital gain on the property is not taxable in Canada, the US will still expect to receive its share of tax. This still may be advantageous to some Canadians in particular circumstances, but it is important to speak with a qualified tax advisor before claiming a US property as your principal residence. Since only one property may be designated as your principal residence each year, it may be more tax-efficient to save the PRE for a different property, depending on your circumstances.

The US has a similar tax benefit. The US principal residence exemption allows a seller to avoid tax on the first US$250,000 of capital gains upon the sale of a principal residence. However, for a property to be considered a principal residence for US purposes, it must be used as your main home for at least two of the five years leading up to the date of sale. It is often difficult for a Canadian resident to meet this test, since their main home is typically located in Canada. Even if the test is met, the sale of US real estate will still result in tax implications in Canada, unless the property is also claimed as a principal residence in Canada.

It is not impossible to take advantage of the Canadian or American principal residence exemptions on the sale of US real estate, but the benefits may be lower than expected in many cases. This should be discussed with a qualified tax advisor prior to sale.

THE US ESTATE TAX

Canadian residents who own certain types of US property may be surprised to discover that the US can tax the value of those properties at the time of death, in some cases. The US estate tax can even apply to Canadians who never step foot within the US. It is important to understand how the US estate tax system applies to Canadians, to ensure your estate meets its tax and filing obligations across the border.

This portion of the guide is written specifically for Canadian residents who are not US citizens, US permanent residents, or tax residents of the US (discussed above). US persons will also have exposure to the US estate tax, but the tests, thresholds, and planning strategies may differ.

When does the US estate tax system apply to me?

The US estate tax can be quite complicated, but there are several rules of thumb that can help to simplify it. As a starting point, for non-US persons, the US estate tax will only apply if they own "US-situs property" with a value of US$60,000 or more at the time of their death.

A property is "US-situs property" when it is physically located in the US with some degree of permanence, like a vacation property or a vehicle stored in the US. Intangible assets that have a connection to the US can also be US-situs property. For example, shares of US corporations will typically be considered US-situs property, even if they are held in an account at a Canadian financial institution or within an RRSP.

Some properties may appear to have a connection to the US, but are surprisingly not considered US-situs property. Generally, units of a Canadian mutual fund will not be considered US-situs property, even if that mutual fund owns a significant amount of US investments. Similarly, investments held within a Canadian holding company are generally not considered to be US-situs property for your estate.

You should consult with your tax advisor to confirm which of your assets will count as US-situs property.

If the value of your US-situs properties exceeds US$60,000 at the time of your death, your estate will likely be required to file a US estate tax return within nine months of your death. However, as we will discuss below, this does not necessarily mean your estate will owe taxes in the US.

How much is the estate tax?

Basic tax rate for estate tax

If the estate tax applies to you, the tax rate will depend on the value of the US-situs property in your estate (less some deductions not discussed here). Unlike most taxes in Canada, the US estate tax is a tax on the value of your property—not just its growth. The tax rates are graduated, beginning at 18% on the first US$10,000 of estate value and reaching 40% for any estate value above US$1,000,000.

The applicable credit amount (formerly the "unified credit")

Despite these high rates and relatively low thresholds for falling into the US estate tax system, most Canadians do not end up paying US estate taxes. Under the Canada-US tax treaty, Canadian residents have access to a large tax credit to offset their US estate tax liability. This credit—known as the "applicable credit"—often means that Canadians avoid the tax entirely (though they generally must still file a US estate tax return).

The applicable credit can be applied against your estate tax bill to reduce your US tax liability directly. The credit changes each year, and is indexed to inflation. In 2023, the applicable credit is equal to:

- US$13,000; or
- US$5,113,800, prorated depending on what percentage of your estate's value is attributable to US-situs property.

The actual credit available in your situation depends on how much of your estate's value is from US-situs property, compared to your worldwide estate value. For example, if 20% of your estate's value is from US-situs property, your applicable credit would be 20% of US$5,113,800, or US$1,022,760.

As a general rule of thumb, this credit means that the US estate tax will not generally apply to Canadian residents unless they have a worldwide estate value of US$12,920,000 or more. This credit alone can minimize the US estate tax for many Canadians.

EXAMPLE: APPLYING THE US ESTATE TAX

Returning to our case of Sophie and Jean Tremblay, there may be good reason to expect the Tremblays have exposure to the US estate tax system. Imagine if Jean Tremblay were to pass away while still holding his property in Palm Desert, California. At that date, Jean Tremblay owned the following assets:

Property	Value ($US)
Vacation property in Palm Desert	$500,000
Residence in Calgary, AB	$800,000
Investments within his RRSP:	
• Canadian mutual funds and shares of Canadian corporations	$1,500,000
• Shares of US corporations	$500,000
Investments in a non-registered account:	
• Canadian mutual funds and shares of Canadian corporations	$750,000
• Shares of US corporations	$200,000
Personal items, jewelry, artwork, vehicles and other items physically located in Canada	$250,000
Total estate value ($US):	**$4,500,000**
Value of US-situs properties ($US):	**$1,200,000**

EXAMPLE: APPLYING THE US ESTATE TAX (CONTINUED)

Before applying the applicable credit amount, Jean's estate would have a US estate tax liability on the value of his US-situs properties. Using 2023 tax rates, the first US$1,000,000 of estate value would result in taxes of US$345,800. The value above that US$1,000,000 would be taxable at 40%. Jean's initial US estate tax bill would therefore be US$345,800 + 40% x (US$1,200,000 - US$1,000,000) = US$425,800.

Fortunately, our tax treaty rescues his estate from this bill. Against this US$425,800 of tax liability, Jean's estate would be entitled to the applicable credit of up to:

$$\$5{,}113{,}800 \times \frac{\$1{,}200{,}000}{\$4{,}500{,}000} = \mathbf{\$1{,}363{,}680}$$

Since this credit is higher than Jean's total US estate tax liability, his estate would not typically owe any estate tax. However, his executor would still be expected to file a US estate tax return within nine months of his death.

What if Jean's worldwide estate value had been US$15,000,000, instead? In this case, the credit would not fully offset his US estate tax liability. The credit amount would be only:

$$\$5{,}113{,}800 \times \frac{\$1{,}200{,}000}{\$15{,}000{,}000} = \mathbf{\$409{,}104}$$

In this case, Jean's estate would still owe tax in the US for the difference, or around US$17,000, unless it took advantage of another credit or deduction.

What is my worldwide estate value?

As shown above, a Canadian resident will not normally owe US estate taxes unless they meet two thresholds. First, the value of their US-situs property must be US$60,000 or more. Second, the value of their worldwide estate must be US$12,920,000 or more.

The value of your worldwide estate will be calculated using US tax rules, not Canadian rules. This can sometimes have unexpected results. For example, US tax rules would normally require you to include the value of a life insurance death benefit, even if that benefit is paid to somebody other than your estate.

An especially common pitfall in determining your worldwide estate value involves jointly-owned assets. When two Canadian residents own a US-situs property jointly (and not as tenants-in-common), the full value of that property is included in the estate of the deceased. Furthermore, if the other joint owner continues to own the property at the date of his or her death, its full value will be included in their estate, as well, potentially being subject to US estate taxes twice. In the event you are considering the purchase of US property, you should consult a cross-border tax advisor to ensure it is held in a tax-efficient manner.

The marital credit

For Canadians with particularly large estates, the applicable credit may be insufficient to fully offset your estate's tax liability. In these cases, the marital credit may provide some further relief. This credit is generally available when a Canadian resident passes away to the extent they leave their US-situs assets to their Canadian-resident spouse.

The amount of the marital credit is equal to the lesser of:

- The applicable credit amount (as calculated above, pro-rated); and
- The amount of US estate tax that would have been payable on the US-situs assets left to the surviving spouse.

As a general rule of thumb, this allows Canadian residents to effectively double their available US estate tax credit for that first spouse's death, from a worldwide estate value of US$12,920,000 to US$25,840,000. However, the estate tax concern may return once that second spouse has passed away, to the extent they continue to own US-situs assets.

The future of the US estate tax

Most Canadian residents do not end up paying US estate taxes upon the death of the first spouse, due to the generous applicable credit and marital credits currently available under the Canada-US tax treaty. However, the US$12,920,000 threshold for worldwide estate value may be temporary. Until 2018, the US estate tax applied to Canadians with a worldwide estate value of US$5,490,000 or more—a bit less than half as much as the current exemption. This change was time-limited, and the threshold will revert back to the lower number in 2026, unless the US Congress votes to extend the changes to the US estate tax system. The estate tax is a common topic of debate in the US, and it is impossible to predict whether Congress will extend this higher exemption amount in the future.

US estate tax planning strategies

Most Canadians will not be terribly concerned by the US estate tax, given the generous exemptions in our treaty. For Canadians who do have some exposure, there are often some planning options available to reduce the risk. However, it is very important to receive advice from a US tax advisor before attempting to plan for this tax.

Since the US estate tax applies only at the time of death, it may seem—at first glance—that one obvious strategy would be to gift your US-situs property to the next generation during life. Unfortunately, the US also has a gift tax regime that can apply to Canadians[4] who make gifts of tangible or real property located in the US (but generally not intangibles like US stocks). If a Canadian resident makes gifts of these types of US-situs property of more than US$17,000[5] to any particular recipient in a single year, the donor will need to file a US gift tax return and pay any applicable taxes. The gift tax rates are functionally the same as the estate tax rates, but there is generally no foreign tax credit available in Canada to offset US gift taxes.

There can be other tax consequences to gifting, as well. In Canada, gifted property will be treated as if it had been sold for its fair market value, triggering tax on any gains on that property up to the date of transfer. Furthermore, the US estate tax system includes an anti-avoidance rule that will deem some types of gifts in the three years leading up to the date of your death to still be a part of your estate, possibly defeating the original goal of your planning.

Though it still has value in some circumstances, the gifting of US-situs property is often a fairly limited-use strategy. Instead, many strategies to plan for the US estate tax will instead focus on how to structure your ownership of US-situs property. Canadians will often make decisions about whether to hold US-situs property in special structures, including a Canadian-resident trust, one or more partnerships, or a Canadian holding company. Each structure has its own broad tax and non-tax considerations. This planning will often be quite complex, so we recommend that you discuss it in detail with a qualified US tax advisor.

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[4]The gift tax rules are substantially different for US citizens, permanent residents, and tax residents of the US, or for persons with an American spouse. A full discussion of the gift tax rules is beyond the scope of this guide.

[5]This amount is higher for gifts given to a non-US citizen spouse, at up to US$175,000 per year. US gift tax does not generally apply to gifts given to a US citizen spouse.

Canadian taxes upon death and double-tax risks

The US estate tax can be a significant consideration for Canadians with particularly large estates. This tax only tells part of the story, however. This tax can apply in addition to Canadian taxes.

When a Canadian-resident taxpayer passes away, they are generally considered to have sold all of their capital property immediately before death. As a result of this deemed sale, Canadian residents are taxed on any accrued and untaxed capital growth. Investments, real estate, and other growth assets may be taxable in Canada at that time. An exception exists for assets transferred to a surviving spouse.

This tax in Canada is in addition to the US estate tax. However, there is typically some relief available under the Canada-US tax treaty to reduce the amount of double-taxation. Generally, Canadians who owe US estate tax will have the right to claim a foreign tax credit in Canada. This credit will reduce the amount of federal taxes payable in Canada on any US-situs assets. As a result of this foreign tax credit mechanism, Canadians will generally pay only the higher of the two taxes, rather than both.

The foreign tax credit method only applies to federal taxes. While some provinces (including Alberta) do allow a similar credit, others do not. Ontario and British Columbia do not provide credits for the US estate tax to reduce the provincial tax burden of the deceased. This means that the US estate tax system will sometimes result in some level of double taxation in Canada for Canadian taxpayers with exposure to both the US estate tax and provincial taxes in British Columbia or Ontario.

NEXT STEPS

It can be surprisingly easy to stumble into exposure to the US tax system. This is especially true for Canadians, many of whom have strong reasons to spend time in the US each year or to acquire US properties. In the event you spend significant amounts of time in the US in any given year; hold US properties for personal, commercial, or investment reasons; or are considering doing so in the future, it is important to ensure you speak with a cross-border tax advisor to understand your US obligations and avoid unexpected penalties. Your ATB advisor can help to connect you with the right specialists.