Principal Residence Rules

An Update

Presented by: Josh Harnett
December 7, 2016

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“One-Plus Rule”

Current Rule

- Individual taxpayers can designate one property as their principal residence (PR) for a taxation year
- Where PRs are sold and purchased in the same year, one property would not benefit from the Exemption for that year
- “One-Plus Rule” solves this problem – Exemption applies for one plus the number of years that a property is the taxpayer’s PR and taxpayer is resident in Canada

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"One-Plus Rule"

Current Rule

- Exemption generally only available where property is taxpayer's PR and taxpayer is resident in Canada
- "One-Plus Rule" technically allows non-residents to claim the exemption for one year

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“One-Plus Rule”

Proposed Change

- Formula for calculating the exemption is amended
- “One-Plus Rule” only applies where taxpayer resident in Canada in the year the taxpayer acquired the property
- Intended to prevent non-residents from claiming the Exemption

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Trusts

Current Rule

- Exemption can be claimed by “individuals” – includes natural persons and trusts
- Trusts have always been able to claim the Exemption subject to certain requirements
  - Must have a “specified beneficiary” – beneficiary that inhabits the property or has a spouse or minor child that inhabits the property
  - No corporations or partnerships as beneficiaries
  - No other property can be designated as PR of the “specified beneficiary” or their spouse or minor child

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Trusts

Proposed Change

- Beginning in 2017, only certain trusts will be able to claim the Exemption

1. "Life interest trusts" – alter ego trusts, joint partner trusts, spousal or common-law partner trusts and exclusive benefit trusts
2. Qualified disability trusts
3. Trusts for the benefit of a minor child of deceased parents

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Trusts

Proposed Change

- “specified beneficiary” must be resident in Canada for each year that the property is designated as the trust’s PR
- Where the trust acquired the property after October 3, 2016, trust must provide the beneficiary with the right to use and enjoy the property as a residence

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Trusts

Proposed Change

- "These criteria will improve fairness and integrity by better aligning trust eligibility for the principal residence exemption with situations where the property is held directly by an individual."
  - Department of Finance, Technical Backgrounder

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Trusts

Transitional Relief

- Exemption can still be claimed to the extent of FMV on December 31, 2016
- Where property sold after 2016, gain divided into two parts
  - Notional disposition at December 31, 2016 – Exemption
  - Disposition as if reacquired on January 1, 2017 – No Exemption
- Trusts holding properties after December 31, 2016 should obtain valuations

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Subsection 107(4.1)

Current Rule

- Prevents a tax-deferred rollout of property to a beneficiary if subsection 75(2) ever applied to the trust

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Subsection 107(4.1)

Proposed Change

- Will not apply where the property being distributed is a residential property that the trust owned at the end of 2016 and would otherwise have been the trust's PR if not for the new rules
- Intended to provide some relief – property can be rolled out to a beneficiary and then sold and Exemption claimed
  - Property will still have to be the beneficiary's PR for all years in question

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New Compliance Rules

Current Rule

- ITA has always required that individuals designate a property as their PR, report the gain and claim the Exemption
- Administratively, CRA has not required this
  - No reporting required for individuals if Exemption sheltered entire gain
  - Only trusts were required to comply

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Compliance Rules

Administrative Change

- All individuals must report gain from sale of PR, claim Exemption and provide certain information regarding the property and the sale
- If gain not reported, Exemption will be denied
- Applies to dispositions on or after **January 1, 2016**

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U.S. Estate Tax

Planning Considerations for Canadian Residents

Presented by: Lindsay Histrop
December 7, 2016

Estate Tax – Generally

- Canada: deemed disposition on death of capital property at FMV
- U.S.: estate tax is imposed on death on the value of worldwide estate
  - Applies to:
    - U.S. citizens
    - U.S. domiciliary
  - Non-resident aliens on the value of U.S.-situs property

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U.S. Estate Tax – Inclusions

- U.S. citizens subject to U.S. estate tax on worldwide assets
- Includes life insurance owned by deceased, property over which there is a power of appointment, retirement funds, personal articles, etc.
- Top rate of tax for 2016 is 40%
- Exemption for U.S. citizens allows $5.45 m. U.S. before U.S. estate tax payable plus a $5.45 m. U.S. marital credit for spousal transfers

U.S. Estate Tax – Rates

2017 Federal Estate and Gift Tax Rates			
Column A	Column B	Column C	Column D
Taxable amount over:	Taxable amount not over:	Tax on amount in column A	Rate of tax on excess over amount in column A
--	$10,000	--	18%
$10,000	20,000	$1,800	20%
20,000	40,000	3,800	22%
40,000	60,000	8,200	24%
60,000	80,000	13,000	26%
80,000	100,000	18,200	28%
100,000	150,000	23,800	30%
150,000	250,000	38,800	32%
250,000	500,000	70,800	34%
500,000	750,000	155,800	37%
750,000	1,000,000	248,300	39%
1,000,000	--	345,800	40%

Annual Gift Tax Exclusion	$14,000
Annual Gift Tax Exclusion to a Non-US Citizen Spouse	$149,000
Estate Tax / Lifetime Gift / GST Exemption	$5,490,000

U.S. Estate Tax – Deductions/Credits

- For 2016 $5.45 m. U.S. exemption per person indexed for inflation ($5.49 m. U.S. for 2017)
- U.S. Gift tax imposed on inter vivos gifts
- Lifetime gift tax exemption unified credit of $ 5.45 m. U.S. per person indexed for inflation (U.S. citizens only; reduces U.S. estate tax exemption)
- Annual Gift tax exemption of $14,000 U.S. for U.S. and non-U.S. citizens

U.S. Estate Tax – Exemptions

- $147,000 U.S. (increasing to $149,000 in 2017) exemption for gifts by U.S. citizen to a non-citizen spouse
- No gift tax on transfers between 2 U.S. citizen spouses
- Annual gift tax exempt gifts are in addition to the lifetime gift tax exemption of $5.45 m. U.S. and do not reduce the lifetime exemption or the U.S. estate tax exemption

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U.S. Estate Tax – Non-resident Aliens

- Non U.S. citizens resident outside the U.S. subject to U.S. estate tax on U.S.-situs assets
- Includes real property in the U.S., stock of U.S. corporations, personal articles in the U.S., etc.
- Certain allowable deductions for debts, funeral, medical and charitable donations
- Typically an issue only for those Canadian residents having a worldwide estate greater than the U.S. estate tax exemption threshold

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U.S. Estate Tax – Non-resident Aliens

Treaty

- U.S.-Canada Tax Treaty ("Treaty") provides some relief to Canadian residents
- Generally, no U.S. estate tax if value of worldwide estate less than $5.45 m. U.S.
- In addition, the marital credit under the Treaty for assets left to a spouse or spousal trust is the lesser of the prorated unified credit and the amount of estate tax assessed – essentially doubles the unified credit available under Treaty to $10.9 m. U.S.

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U.S. Estate Tax – Non-resident Aliens

Treaty

- U.S. Estate tax may be applicable if the U.S. situs assets are valued at more than $60,000 U.S. and worldwide assets valued at more than 5.45 m. U.S.
- If a Canadian citizen/resident's worldwide estate is worth less than $1.2 million, U.S. estate tax applies only to U.S. situs real property and to personal property that's part of a business in the United States

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U.S. Estate Tax – Non-resident Aliens

Treaty

- Modified tax credit relief for U.S. estate tax paid by Canadian residents may be available in respect of those assets also subject to Canadian tax on capital gains in the same year
- No relief for double taxation in respect of U.S. gift tax and tax on capital gains arising in respect of the same property

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Treaty Relief Example

- If William dies leaving Florida condo worth $2 m. U.S. to children, with a worldwide estate of $10 m. U.S.:
- Gross U.S. estate tax owed: $745,000
- Unified credit under Treaty is = greater of
  - $13,000 and
  - $2,125,000 x value of the U.S. assets ($2 m.) /worldwide assets ($10 m.) = $425,160
- Net U.S. estate tax owing after Treaty relief applied is $320,640

Strategies for U.S. Situs Property

- Hold property as tenants in common rather than joint-tenants
- If both spouses are non U.S. citizens, have the spouse with the smaller worldwide estate own the U.S.-situs property and/or reduce the size of the owner's worldwide estate by divesting assets by way of spousal gifts, alter ego/joint partner trusts
- Utilize a trust to purchase U.S. situs property
- Have the U.S. citizen spouse hold the U.S. property

Strategies for Holding U.S. Property

- Gift the U.S. situs property to a spousal trust under the will so it does not form part of the survivor's U.S. taxable estate
- Qualified Domestic Trust ("QDOT") – if the value exceeds the Treaty exemption, a QDOT may defer U.S. estate tax until death of second spouse (who is non-U.S. citizen) – only a deferral of tax
- QDOT requirements include that there be one U.S. resident trustee, and that it be governed by the law of a U.S. state

U.S. Estate Tax – Case Study

- Kate's Assets: (assume all figures are U.S. dollars)
  - $3 m. Toronto home
  - $1 m. cottage
  - $2 m. securities and cash – joint name with William
  - $1 m. RRSP
  - $10 m. term life insurance policy payable to William

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U.S. Estate Tax – Case Study

- William's Assets:
  - $6 m. shares in family business
  - $2 m. earmarked to acquire Florida home
  - $2 m. securities in joint name with Kate
  - $1 m. RRSP
  - $5 m. corporate owned life insurance policy payable to his company

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U.S. Estate Tax – No Planning

- If William dies first, leaving all his assets to Kate, she will inherit an additional $10 m.
- When Kate subsequently dies, her U.S. taxable estate will be approximately $ 26 m. U.S. (including her life insurance policy) assuming no change in asset values
- U.S. estate tax exemption shelters $5.45 m. U.S.
- U.S. estate tax is $10,345,800, less the tax credit of $2,125,000 leaving $8,220,000 payable

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U.S. Estate Tax – No Planning

- If Kate dies first, leaving all her assets to William:
- In calculating Kate's U.S. taxable estate, jointly held property will be considered 100% owned by Kate for U.S. estate tax purposes(rebuttable presumption)
- Proceeds of life insurance owned by Kate and payable to William forms part of her estate for U.S. tax purposes
- Kate's U.S. taxable estate could be considered to be $17 m U.S.

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U.S. Estate Tax – No Planning

- Unified tax credit and marital exemption should shelter 10.9 m. from tax;
- U.S. estate tax of about $2,490,000 on the excess will be payable by Kate’s estate
- Capital gain realized on the principal residence is not exempt from tax in the U.S.
- Some federal double tax relief under the Treaty but the relevant province or territory may not provide any relief from double tax

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U.S. Estate Tax – Better Planning

- Kate should take steps to reduce her taxable U.S. estate value
- Re-conveys to William, all joint assets that he put in her name
- Gift the Toronto house to William, utilizing part of her lifetime U.S. gift tax exemption unified credit
- Consider making annual gifts to the children within the exemption limits ($14,000 annually)

U.S. Estate Tax – Better Planning

- Kate should hold her life insurance in an irrevocable life insurance trust (“ILIT”)
- She may be able to assign the existing policy to an ILIT, but if she dies within 3 years, the policy will generally form part of her U.S. taxable estate
- Kate should consider establishing a QDOT in her will with discretion for estate trustee to transfer assets directly to William (up to the marital credit limits) with the balance to a QDOT (U.S. unlimited marital deduction)

U.S. Estate Tax – Better Planning

- William's will should provide a qualifying spousal trust for Kate, including the ascertainable standard "HELM" language
- if Kate acquires the Florida property, (rather than acquiring it through a trust) she should establish a Canadian resident spousal trust in her will for the Florida property to exclude it from William's U.S. situs assets if Kate predeceases William
- Both spouses should consider leaving assets for their children and their issue to U.S. grantor trusts

U.S. Estate Tax – Conclusion

- Highly complex combined set of rules governing U.S. estate tax and gift tax for Canadian residents
- Steps to avoid 1.5% estate administration tax or creditors claims may increase exposure to U.S. estate tax
- Combined advice of U.S. qualified specialists and Canadian specialists is essential where one (or both) spouse is a U.S. citizen, or where intended beneficiaries reside in the U.S., or are U.S. citizens or green card holders

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Canadians with Connections to the U.S.A.

Toolbox Seminar

Presented by: Lorne Saltman
December 7, 2016

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2. Estate Freeze of Canadian Business with U.S. Beneficiary
3. Canadian Family Trust for Mobile Art Collection

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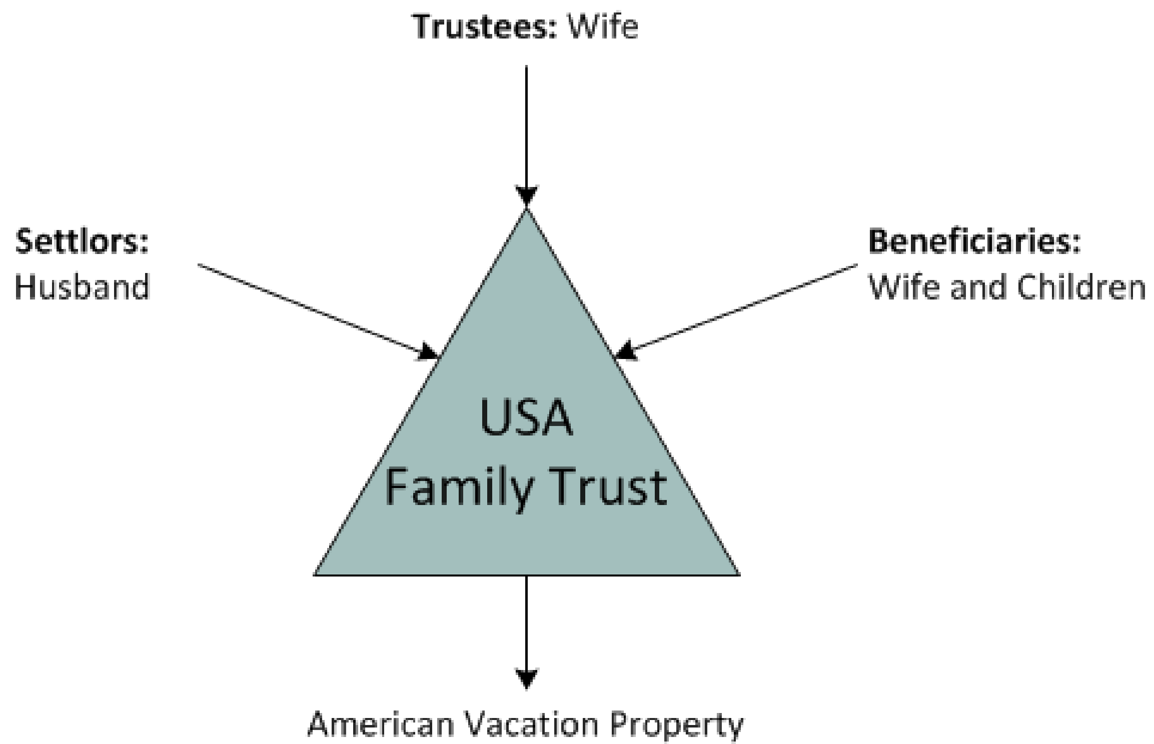
U.S.A. Family Trust



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The issues to consider include the following:

- U.S. Estate tax at an escalating rate up to 40% of the gross value of U.S. *situs* property, such as a U.S. vacation home
- U.S. Gift tax on a similar scale
- U.S. tax on sale of the property
- Canadian income tax on the capital gain either deemed to be realized on death or from actual sale of the property
- Avoiding double taxation

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Available Arrangements to Hold U.S. Vacation Property

- Individual ownership
- Holding company in Canada
- Holding company in U.S.
- Non-recourse mortgage
- Life Insurance
- Canadian family trust

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Use of Canadian Family Trust

- Structure
  - Spouse with resources contributes purchase price of property to trust as settlor
  - Other spouse is trustee
  - Beneficiaries include other spouse and issue (but not settlor spouse)

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Use of Canadian Family Trust

…cont'd

- Implications
  - Insulation from U.S. Estate tax and Gift tax
  - Avoidance of U.S. probate on death
  - Integration of trust with wills and estate planning
  - On sale, capital gain taxed in the U.S. to trust or individual beneficiaries at long-term capital gains rate, currently 20%
  - On sale, must recognize U.S. capital gain to trust or beneficiary in Canada , subject to maximum tax at 26.5%, with a foreign tax credit for the 20% tax paid to the U.S.

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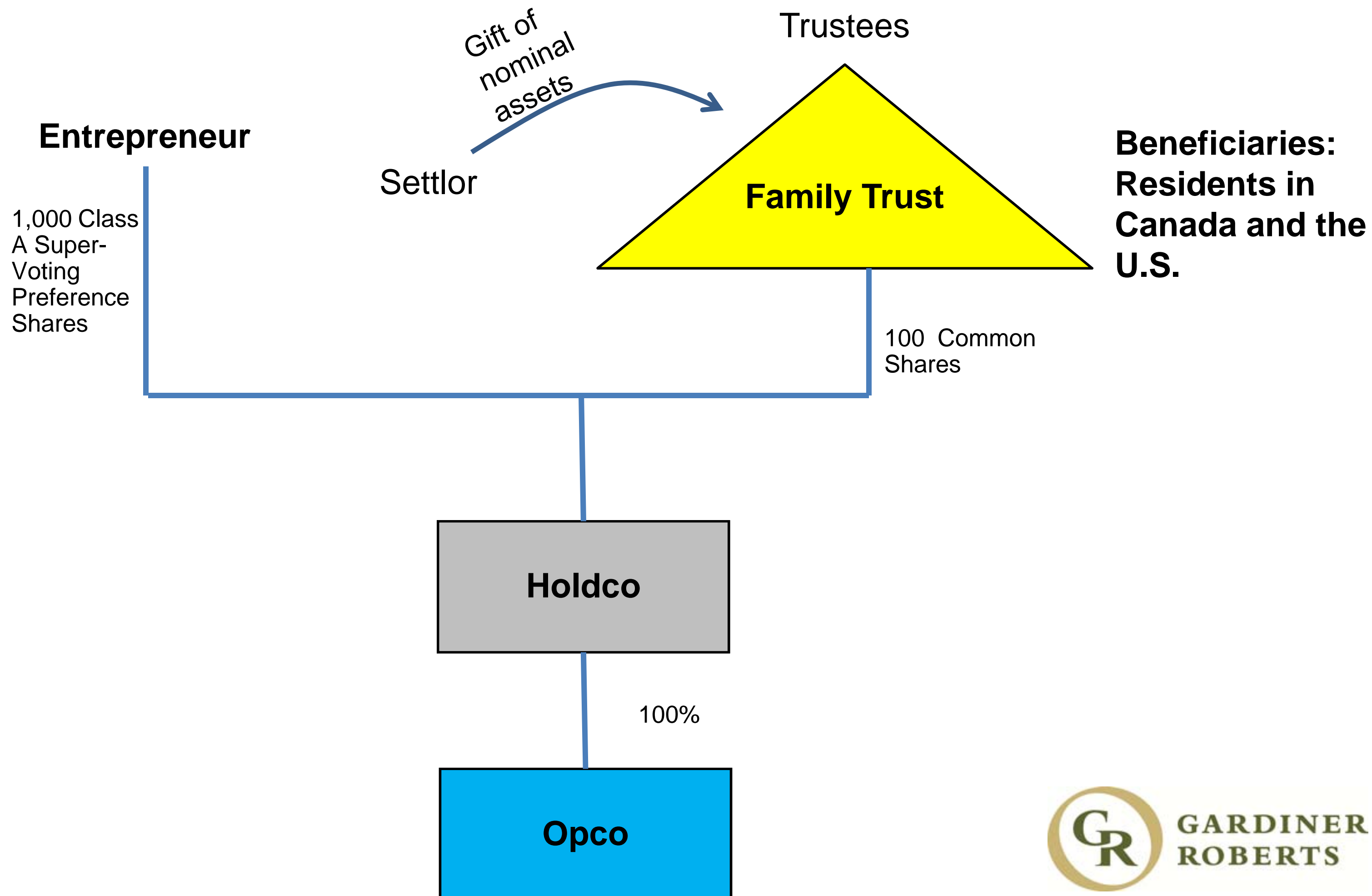
Estate Freeze Ownership Structure



Estate Freeze Ownership Structure

…cont'd

- Family trust uses nominal capital to subscribe for newly-issued common shares of Holdco from its treasury
- On a future disposition of the shares of Holdco (that carry along the shares of Opco), either on an actual sale or deemed disposition, Entrepreneur realizes proceeds equal to the value fixed at the time of the estate freeze

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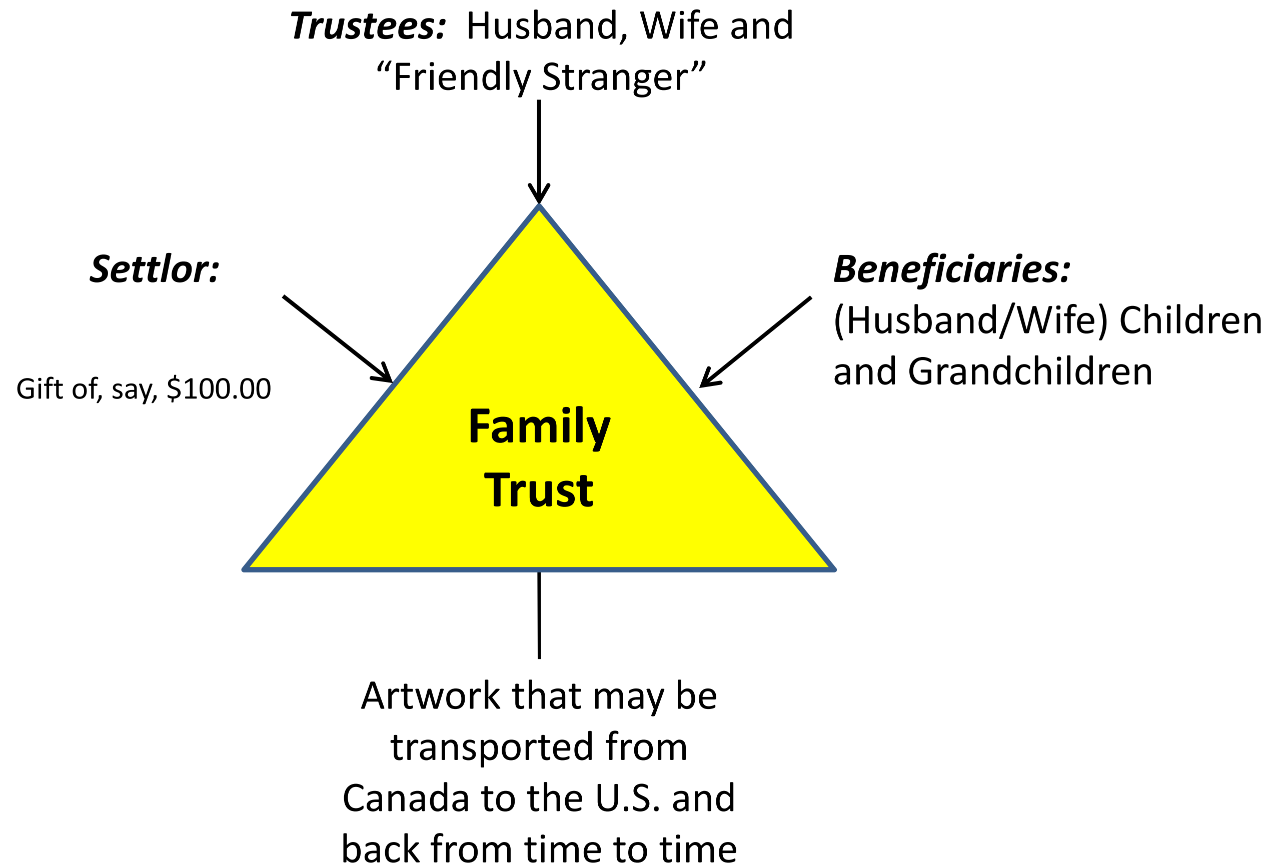
Estate Freeze Ownership Structure

…cont'd

- The Family Trust will realize a capital gain on the sale of its common shares equal to the growth in value from the time of the freeze until the time of disposition
- Possible to multiply the $824,176 lifetime capital gains exemption on sale of qualifying small business corporation shares

Discretionary Family Trust



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Charitable Gifting

A Summary

Presented by: Pamela Liang
December 7, 2016

Methods of Gifting

- Inter vivos
- Testamentary
  - Will
  - Designation of life insurance proceeds, RRSPs, RRIFs and TFSAs
- Trusts

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Testamentary Gifts

For Graduated Rate Estates (GREs):

- For deaths occurring after January 1, 2016:
  - Flexibility in availability of donation tax credits for donations to qualified donees:
    - The estate in the taxation year in which the donation is made;
    - The estate in an earlier taxation year;
    - The estate in any of the 5 years following the year in which the donation was made;
    - The deceased in the year of death; or
    - The deceased in the year prior to the year of death

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Testamentary Gifts cont'd

Graduate Rate Estates:

- Draft Legislation – January 2016
  - Extension of 36 month period to 60 months after the death of the individual
- Donations made within 60 months are permitted to be allocated in:
  - The estate in the taxation year in which the donation is made;
  - The estate in any of the 5 years following the year in which the donation was made;
  - The deceased in the year of death; or
  - The deceased in the year prior to the year of death

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Life Interest Trust Gift

- If donation made on or before 90 days after the end of the calendar year in which the life interest beneficiary dies:
  - Donation may be carried back to the taxation year of the trust that resulted from the life interest beneficiary's death
  - If Kate is the beneficiary of a spousal trust and she passes away on June 12, 2017 and the spousal trust makes a donation to the American university before March 31, 2018, the trust can apply the donation to the year in which the death occurred.

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Charitable Giving
Planning Considerations for Canadian Residents

Presented by: James Parks
December 7, 2016

Charitable Giving

- Recipient must be "qualified donee" or eligible under U.S. treaty;
- Qualified donees include registered Canadian charities, RCAAAs, municipalities, federal and provincial crown, U.N. agencies, some foreign universities, some foreign organizations recognized by federal government;
- Gifts can be made during lifetime or on death by will or, subject to appropriate drafting, by trustees of a trust or can be made by a corporation or partnership;

Charitable Giving

- Individuals get credits – corporations get deductions;
- General rule limits relief up to 75% income for the year;
- For year of death and previous year up to 100% of income can be sheltered;
- Election mechanism for gifts made by will;
- Coordination of rules for gifts made by will with filing for year of death and previous years and for filing T3 return for year of donation, previous years and subsequent years;

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Charitable Giving

- U.S. treaty provides tax relief for donations to "recognized" U.S. organizations, subject to 75% rule based on U.S.-source income;
- Must be (a) a resident of U.S., (b) generally exempt from U.S. tax, (c) eligible for registration, if it were Canadian (i.e. "charitable");
- CRA publication T4016 lists exempt organizations;

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Charitable Giving

- Special treaty rule provides relief for donations to U.S. college or university, without regard to 75% limit, provided donor or "family member" is or was enrolled (no need to graduate);
- Meaning of "family member";
- In some cases, U.S. university may be both qualified donee and eligible under treaty, either as recognized foreign organization or because donor or family member enrolled. Where U.S.-source income, is needed, synchronize Canadian tax relief with U.S. tax relief for donations;

Charitable Giving

- CRA does not recognize U.S. organizations that are eligible recipients under treaty as "qualified donees";
- Canadian charities not able to "donate" to those U.S. organizations, despite the fact that other donors get relief, subject to 75% rule (except for eligible U.S. colleges and universities);
- Five year carry forward may be useful if large donations cannot be utilized in year of death or previous year;

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Charitable Giving

- Provincial tax not necessarily consistent with federal tax;
- U.S treaty does not necessarily affect provincial tax – recent Quebec decision.

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