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TAX MATTERS

Cross-border couples need special tax planning

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My niece, Tori, was married last weekend. I gave her the same advice that I was given when I got married: “Never go to bed angry at your spouse,” I shared. “Your aunt Carolyn and I have never gone to bed mad. Although, one year, we were wide awake for three months straight.” Now, Tori married Silas – a Swiss citizen. No problem there. She’s in for great chocolate, private banking and reliable watches.

But what if she had married an American? The fact is, there can be special tax and estate challenges in these cases. Here’s a primer on key planning issues for cross-border couples where one is a U.S. person (a U.S. citizen, long-term resident or green card holder).

ESTATE TAX

The United States levies an estate tax on the worldwide estate of U.S. citizens (and long-term residents of the U.S.). This estate tax applies broadly, to more assets, than what the Canada Revenue Agency will tax when you pass away. For example, the U.S. estate tax can apply to life insurance proceeds paid out when the U.S. person dies, or to assets in trusts established by or for the benefit of the deceased. This is in addition to the other assets owned by the U.S. person at the time of death.

Most couples aim to pass their assets from the deceased to the surviving spouse on a tax-free basis so that the survivor can continue to enjoy those assets during their lifetime. But this will take careful planning if one spouse is a U.S. person. Holding assets in joint names, or simply leaving everything to your surviving spouse might cause greater U.S. estate tax problems if the Canadian spouse dies first.

If you’re the Canadian spouse, it might make sense for your will to provide that, if you die first, a properly structured trust is set up for the benefit of your U.S. spouse. This trust should allow your U.S. spouse appropriate use of your assets and should allow your spouse to use up his or her U.S. estate tax exemption later when they die, but should ensure that no unnecessary estate taxes are paid.

What if the U.S. spouse dies first? The planning should allow for use of the U.S. estate tax exemption and other credits or deductions (there's a marital credit that can help to reduce the estate tax burden if assets are left to the Canadian spouse). To the extent there's going to be an estate tax bill even after the exemptions and credits, consult a tax pro for other ideas available to reduce this exposure.

Finally, the estate tax exemption in 2019 is a healthy US$11.4-million, but this exemption was bumped up by U.S. President Donald Trump's Tax Cuts and Jobs Act in 2017, and the increase is due to be repealed after 2025, reducing the exemption to its old value of half this amount. The estate tax is a controversial matter, with many politicians south of the border calling for a significant increase to the tax. So, the wise person will plan for the worst and hope for the best.

GIFT TAX

The United States applies a gift tax if a U.S. person gives assets to someone else. There's an unlimited exemption available for any gifts made to a U.S. spouse, but not so if the spouse receiving the gift is a Canadian and not a U.S. person. In this case, the U.S. will allow the first US$155,000 (in 2019) in each calendar year to be given to the non-U.S. spouse without the gift tax. One silver lining is that making gifts within this limit will reduce the estate of the U.S. spouse and could thereby reduce the estate tax owing by that U.S. spouse on death. A U.S. spouse can also give up to US$15,000 (in 2019) annually to any person other than the non-U.S. spouse (to each child, for example).

In Canada, it's common planning to leave assets to a "spousal trust" for a spouse upon death (to provide asset protection, for example). Any assets left to a spousal trust will transfer without Canadian capital gains taxes upon death. If the surviving spouse, however, is a U.S. person, any withdrawals from the spousal trust that are subsequently gifted to someone else (to the kids, for example), could be subject to U.S. gift taxes. It may be better to split the estate assets between a spousal trust (for assets that would otherwise face capital gains taxes on your death) and a regular family trust (for non-appreciated assets) from which gifts to the kids can be made.

Finally, if one spouse is a U.S. citizen and grew up in the United States, it could be that your kids will be U.S. citizens, too. They may need special planning later in life as well.

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