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How Trump's tax plans could benefit high net worth dual citizens and Canadians living in U.S.

By Jamie Golombek

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While some Canadians may still be in shock that Donald Trump will soon become the next president of the United States, others have been wondering what, if any, impact Trump's presidency and proposed tax plan would have on their wallets. The quick answer is: not much. And if you're a wealthy Canadian or a dual Canadian-U.S. citizen, you may even come out ahead.

Of the many aspects of Trump's tax plan, two may affect certain individuals more than any other: the promised repeal of the U.S. estate tax and the cancellation of the Affordable Care Act, known as "Obamacare."

Elimination of U.S. estate tax

The U.S., unlike Canada, has an estate tax that applies to the fair market value of an American's assets upon death. The U.S. estate tax was originally enacted in 1916 and was scheduled to be repealed altogether in 2010 as part of George W. Bush's broader tax reform package, but a sunset clause in that legislation meant that the estate tax was effectively only eliminated for one year - 2010 - and was resurrected as of Jan. 1, 2011. There is an exemption equal to US$5.45 million indexed annually to inflation.

Contrast this with Canada, where we don't have an estate tax on death based on the fair market value of your assets, but rather we tax only the unrealized appreciation of assets (other than your principal residence) upon death. We also tax the fair market value of your RRSP or RRIF on death.

High-net-worth U.S. citizens living in Canada, including dual citizens, and non-U.S. citizens who own "U.S.-situs property" at the time of death may still be caught by the U.S. estate tax. The most common examples of U.S. situs property are U.S. real estate or U.S. shares.

Canadians who are not U.S. citizens are allowed prorated access to the US$5.45 million exemption under the Canada-U.S. tax treaty, based on the fraction of the value of their U.S. situs property divided by the value of their worldwide estate. From a practical point of view, this means that if your worldwide estate is under US$5.45 million when you die, you will get a full exemption from U.S. estate tax.

High-net-worth Canadians who die owning U.S. situs property and have an estate larger than US$5.45 million currently have exposure to U.S. estate tax and have been using a variety of tax planning strategies. Some result in a change to the ownership structure of their U.S. assets, perhaps by using a discretionary trust to own U.S. real estate or a Canadian investment holding corporation to hold U.S. securities. If Trump follows through on his promise to repeal the U.S. estate tax, then this planning would no longer be necessary.

The potential elimination of the U.S. estate tax would also benefit wealthy Canadian families with children living in the U.S. by making their estate planning much simpler. Under the current rules, if you leave your assets to someone who is a U.S. person, such as a son or daughter who moved to the U.S., then U.S. estate taxes could impact the value of the assets that your beneficiaries (and future generations) are able to retain.

While your own Canadian estate may not be subject to any U.S. taxes upon death, your U.S. daughter's worldwide estate could be subject to the U.S. estate tax when she dies as a U.S. person. Today, rather than leaving your assets directly to U.S. beneficiaries, it may be preferable to create what's become known as a "dynasty trust," which is a trust arrangement designed mainly to prevent U.S. estate tax erosion of family wealth. Assets held in a dynasty trust are not owned by the trust beneficiaries and, therefore, are not subject to estate tax upon the death of the U.S. beneficiaries.

The repeal of the estate tax would make this planning no longer necessary.

Obamacare tax

The second Trump tax proposal that may be beneficial to high-income U.S. citizens living in Canada (including dual citizens) is his proposed repeal of Obamacare. Officially known as the Patient Protection and Affordable Care Act, Obamacare included a new tax, which began in 2013, and applied to high-income U.S. tax filers making over US$200,000 annually. Called the "net investment income tax" (NIIT), it imposes a 3.8 per cent surtax on net investment income, including interest, dividends and capital gains.

Under U.S. law, citizens are required to file an income tax return reporting worldwide income no matter where they reside, which is why U.S. citizens living in Canada are required to file U.S. tax returns each year. In the majority of cases, however, U.S. citizens don't end up owing U.S. federal tax due to offsetting foreign tax credits.

The problem for dual income tax filers since 2013 has been that foreign tax credits are not available in relation to the 3.8 per cent Obamacare NIIT. This means that high-income, dual-filers, have been paying an extra 3.8 per cent on their investment income. In high tax rate provinces like Ontario, this means an effective marginal tax rate on investment income of over 57 per cent for U.S. citizens living in Ontario.

The proposed repeal of Obamacare would eliminate the NIIT, resulting in a 3.8 per cent tax savings for these high income, U.S. tax filers.

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References

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