O'SULLIVAN
ESTATE LAWYERS

May 2024

Advisory

Cross-border Canada-U.S. estate administration highlights

In our Advisory "Estate Administration Basics", we discuss general issues which often arise in the administration of an estate in Ontario. We touched on, but did not explore in detail, additional issues which arise in an estate with cross-border connections to the United States (U.S.) and Ontario or any province or territory in Canada. This Advisory will discuss in further detail common issues that can arise when estates have connections on both sides of the border.

In this Advisory, we use the term "estate trustee", the term used for the legal representative of an estate under the Ontario *Rules of Civil Procedure.* The term executor (where the deceased died with a will) or administrator (where the deceased died without a will) are the traditional terms used for this role.

We will canvass issues arising in cross-border Canada-U.S. estate administration in two parts: Ontario estates (the deceased died or had the bulk of their assets in Ontario) which have some U.S. connection, and U.S. estates (the deceased died or had the bulk of their assets in a U.S. state) which have some Ontario connection. While this Advisory focuses on Ontario, many of the issues discussed are equally applicable to other Canadian provinces and territories. The differences in the tax regimes of the two countries, and the probate processes between each jurisdiction, makes each situation unique.

ONTARIO ESTATES WITH A U.S. CONNECTION

An Ontario estate with U.S. connections can face complications due to the presence of any of the following: the deceased was a U.S. citizen or green card holder, one or more beneficiaries are U.S. residents or citizens, or the deceased owned U.S.- situs assets. While planning may be available to alleviate some of the complexity, in many cases the issues must be dealt with in accordance with applicable laws, including income tax laws and rules governing compliance.

O'Sullivan Estate Lawyers LLP
TD Bank Tower, Toronto-Dominion Centre
66 Wellington St. W, Suite 3430, P.O. Box 68
Toronto, ON M5K 1E7

osullivanlaw.com
T 416-363-3336
F 416-363-9570

Ontario Estate if Deceased is a U.S. Person

A U.S. Person for the purposes of this Advisory is a U.S. citizen, including a dual citizen of the U.S. and another country, or a person who is domiciled in the U.S. Domicile includes the place where a person has a settled intention to make his or her permanent home. U.S. Persons are subject to U.S. estate, gift and generation-skipping tax. As a result, it is important to determine whether the deceased was a U.S. Person in order to ensure all U.S. tax compliance is carried out on a timely basis.

In addition to U.S. estate tax levied at the federal level, some U.S. states also levy estate or inheritance taxes on death. These states are: Connecticut, District of Columbia, Hawaii, Illinois, Iowa, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington.

It is possible to be a U.S. citizen without being aware of this status. For example, a person may be a U.S. citizen if he or she was born in Canada to a U.S. citizen parent, even if he or she never resided in the U.S. There are also other types of "accidental" U.S. citizens, including children born in the U.S. while their parents were visiting on vacation. A person may also be a U.S. Person if he or she moved to the U.S. to work and has a U.S. domicile because he or she intended to permanently reside in the U.S., or if he or she acquired a U.S. green card.

U.S. tax residents are subject to the U.S. income tax regime and must file an annual tax return. U.S. citizens must do so regardless of their country of residence. A discussion of U.S. gift and transfer taxes can be found in our advisory "Will and Estate Planning Consideration for Canadians with U.S. Connections".

U.S. estate tax is calculated at graduated rates based on the gross value of certain assets owned by an individual at death. Currently, the maximum rate of U.S. estate tax is 40%. For a U.S. Person, the tax is based on the value of his or her worldwide estate, subject to applicable exclusions, credits and deductions. U.S. estate tax may be payable on the death of an individual where the value of his or her worldwide estate exceeds the U.S. estate tax exclusion amount (currently $13.61 million USD in 2024, indexed for inflation, as a result of tax changes enacted in 2017, although it is important to remember that gifts during lifetime may reduce the available exemption on death, depending on the amount and to whom the gift is made).

Under U.S. tax rules, a person's worldwide estate includes certain assets that may not be considered part of his or her estate in Ontario, such as proceeds of life insurance policies owned by a deceased person on his or her own life, the total value of property held in joint

tenancy with right of survivorship (subject to certain exceptions and deductions), and property held in certain types of trusts.

Ontario Estates With U.S. Resident Beneficiaries

Estate Distributions

If one or more beneficiaries of an Ontario estate are resident in the U.S., most complications arise from tax matters. There may be filing requirements or the necessity to obtain a clearance certificate under section 116 of the *Income Tax Act* (Canada) each time a distribution is made to a beneficiary who is not a resident of Canada for income tax purposes. Section 116 applies to dispositions of "Taxable Canadian Property", which includes:

- Real property located in Canada;
- Assets used in a business in Canada;
- Shares in a private Canadian corporation where more than 50% of the value of the shares is derived from Canadian real property or certain Canadian resource property;
- An interest in a trust (which under the *Income Tax Act* includes an estate), where more than 50% of its fair market value was derived, directly or indirectly, from Canadian real property (or certain Canadian resource property) in the 60 months prior to the disposition.

For the purposes of an estate or trust, the disposition of an interest in the estate or trust happens whenever the estate or trust makes a distribution to a non-resident beneficiary. If it is a disposition of Taxable Canadian Property to a non-resident, a clearance certificate must be obtained prior to the disposition, or in certain circumstances, a filing regarding the disposition may be made instead within 10 days of the disposition date.

Withholding Tax

Non-residents of Canada are subject to withholding tax on payment of certain types of income earned in Canada, including rental income, dividends, royalties and income from an estate or trust. The payor of the income must withhold the tax and remit it to Canada Revenue Agency, although the payee may file a Canadian tax return for a partial or full refund of the tax paid (assuming such a refund is available to them). The usual withholding tax rate is 25%, however the Canada-U.S. Income Tax Treaty reduces the withholding tax rate on

some types of income, including to 15% on dividends and estate or trust income and 10% for royalties (although certain royalty payments are exempt from withholding tax).

In Kind Distributions

If the estate trustee wishes to distribute assets in kind to beneficiaries, this may create negative ongoing repercussions for U.S. tax residents regarding certain assets, such as shares in an Ontario private corporation. If shares are held by a U.S. Person in a foreign corporation, certain punitive tax rules may apply which may necessitate more complex post-mortem tax planning by the estate or the distribution of different types of assets to beneficiaries depending on their residency status.

If a separate trust is to be set up under the deceased's will with U.S. trustees and beneficiaries, it is important to consider special planning to avoid the trust being deemed to also be resident in Canada for tax purposes. Since the trust may also be considered to be resident in the U.S. for tax purposes, this would create tax complications and additional filing requirements.

In certain circumstances, U.S. inheritance tax may be payable by U.S. Persons on an inheritance from a non-U.S. Person who previously was a U.S. citizen, but who renounced his or her citizenship.

Ontario Estate With U.S. Situs Assets

Where a deceased person owned assets in the U.S., complications can arise due to tax considerations, practical difficulties in administering assets in another jurisdiction, and obtaining probate in the U.S. state in question, if necessary.

U.S. Estate Tax Considerations

For a non-U.S. Person, U.S. estate tax may be payable if he or she owns U.S. *situs* property on death. For Canadian residents, an exemption for U.S. estate tax is calculated either based on the value of his or her U.S. *situs* property as a proportion of his or her worldwide assets pursuant to the Canada-U.S. Income Tax Treaty multiplied by the exemption amount ($13.61 million in 2024) or there is a general exemption amount for assets valued at $60,000 USD or less.

There are also rules under the Treaty to avoid double-taxation of the same assets on death in both countries, although they are not always effective to eliminate double tax in all cases, which credit U.S. estate tax paid against Canadian capital gains tax, and *vice versa*.

U.S. *situs* property for federal estate tax purposes includes:

- Shares of U.S. publicly traded corporations and units of U.S. mutual funds and money market funds, even if held in Canadian registered plans or in certain other vehicles;
- Deposits in a brokerage account in the U.S.;
- U.S. retirement plans and annuities;
- Shares of a U.S. private company;
- Certain debts with a U.S. connection; and,
- U.S. real property and tangible personal property located in the U.S.

U.S. *situs* property generally does not include certain assets which appear to have a U.S. location or connection, such as:

- Canadian mutual funds invested in U.S. securities;
- Non-U.S.-issued securities listed in U.S. funds;
- U.S. bank deposits; and,
- U.S. Treasury Bills or Certificates of Deposit.

If the value of a non-U.S. Person's U.S. *situs* property at death is greater than $60,000 USD, his or her estate trustee may be required to file a U.S. estate tax return. Furthermore, U.S. estate tax may be payable where the value of his or her worldwide estate for U.S. estate tax purposes exceeds the U.S. estate tax exemption amount (as noted above, $13.61 million USD in 2024).

Ontario estate trustees should not make the mistake of thinking that there will be no cross-border tax consequences if no reporting is done. "How will the tax authorities in the other jurisdiction ever find out?" is a common question. The current global agenda for governments includes aggressive measures to ensure greater transparency and information exchange to stop leakage of tax revenues due to non-reporting across borders. For example, between Canada and the U.S., under the *Foreign Account Tax Compliance Act* (FATCA) and our intergovernmental agreement with the U.S., Canadian tax authorities are now providing information on the Canadian accounts of U.S. persons to U.S. tax authorities. Further, failure to accurately report taxable income or gains or file required tax returns can result in personal

liability for an estate trustee, including substantial penalties, particularly if deliberate tax evasion is involved.

Further, even if U.S. estate tax is not payable by the estate, in order to transfer certain U.S. *situs* property after death it may be necessary for the estate trustee to obtain U.S. estate tax clearance (for example, for the sale of Florida real estate). In addition, to obtain tax credits which may partially offset double taxation of Canadian income tax and U.S. estate tax on death allowable under the Canada-U.S. Tax Treaty as described above, the estate trustee may need to file a U.S. estate tax return. It should be noted that U.S. estate tax returns are typically due nine months from date of death, which may be considerably earlier than when the Canadian terminal tax return is due, although it may be possible to obtain an extension for the filing deadline if applied for before the nine-month period expires.

U.S. State Probate Requirements

In order to be able to deal with U.S. *situs* property, the estate trustee may need to obtain a probate certificate from the local court in the state where the property is located. In Ontario, the necessity for a probate certificate will depend upon whether any asset holder (e.g. a financial institution) requires it to allow the estate trustee to access, liquidate and distribute the asset in question. This may be the situation in the state in which the U.S. *situs* property is located, or the state in question may require probate for all estates over a certain value where the deceased held property located in the state. In either case, the estate trustee will need to complete the local probate requirements to be able to administer the assets of the deceased in that jurisdiction.

Unfortunately, the local probate rules can create complications for an Ontario-resident estate trustee. Some U.S. states allow a non-resident estate trustee to obtain a probate certificate and some do not, and some allow it only if there are multiple estate trustees and at least one of them is resident in the state. For example, in Florida, only estate trustees who are close family members are allowed to act as estate trustees if they are non-residents of Florida. Professionals or trust companies not resident in or licenced in Florida cannot act.

There may be a requirement to file a bond for non-resident estate trustees, which may create problems if the estate trustee does not qualify for a bond in that jurisdiction (for example, they do not own any assets there). If the estate trustee does not qualify under the rules to apply for probate, or cannot obtain a bond, he or she or the beneficiaries may need to appoint a resident to act in the U.S. state in question and administer the U.S. assets, adding to the expense of the estate administration.

The process in many U.S. states is time-consuming and requires the assistance of local counsel. For example, in many U.S. states, including Florida and Arizona, the court exercises a supervisory function, reviewing the estate trustee's administration of the estate. The estate trustee may require the court's approval for certain actions, and a "closing" of the estate process, which may involve the filing of an accounting to be reviewed by a local judge. General court supervision of the estate administration does not exist in Ontario, where typically the court will only be involved in an estate matter after a probate certificate is issued if a dispute arises. Also, local rules may provide certain rights in or to the assets located in that jurisdiction to a spouse or dependent which differ from Ontario law, complicating the estate administration regarding the U.S. *situs* property.

U.S. ESTATES WITH AN ONTARIO OR CANADIAN CONNECTION

U.S. Estate with an Ontario Resident Beneficiary

Due primarily to the differences between the two tax regimes, in particular taxation on death, there are fewer complications arising for U.S. estates with Ontario connections if there is an outright distribution with no continuing trusts. Typically, an Ontario-resident beneficiary would create no significant complications for a U.S. estate, since the U.S. levies no additional tax on inheritances which are capital distributions payable to non-U.S. Persons and Canada treats such inheritances as gifts, which are not taxable in Canada in the hands of a beneficiary when received. It should be noted that distributions from a U.S. revocable trust are different and special issues can arise given the different rules for taxation of trusts, which are beyond the scope of this Advisory.

U.S. Estate of a Deceased Canadian Citizen

An estate trustee dealing with the estate of a U.S. resident or citizen who was also a Canadian citizen, would encounter no additional complications due to the deceased's Canadian citizenship, other than it possibly being necessary to inform various federal and Ontario government authorities, such as Service Canada, Service Ontario, and the Canada Revenue Agency, of the individual's death. Canada does not tax based on citizenship or levy an estate tax on its citizens' estates. Instead, Canada taxes based on actual or deemed tax residence in Canada or on income which is earned in Canada, as well as capital gains tax on certain property located in Canada (referred to as "Taxable Canadian Property", discussed above) when assets are disposed of or deemed to be disposed of (including on death, subject to exemptions and credits, etc.). The estate of a non-resident Canadian citizen is typically not required to file Canadian income tax returns unless the deceased owned Taxable Canadian Property at death or earned income in Canada in the year of death.

If the deceased did own assets in Ontario at death, complications can arise on both sides of the border, particularly for U.S.-resident estate trustees (who typically will be appointed in a U.S. estate) or for certain types of assets, which typically arise either from the probate process or applicable tax rules.

Ontario Probate Requirements

In many, if not most, cases, an Ontario asset-holder (such as a financial institution) will require that an Ontario probate certificate be obtained by the U.S.-resident estate trustee in order for him or her to be able to deal with Ontario assets. This will be so regardless of whether he or she has already obtained a probate certificate in the U.S. state where the deceased lived or had the majority of their assets. Also, if the deceased owned land in Ontario, in most cases a probate certificate will be required under the Ontario Land Titles rules in order for the executor to be able to deal with the property, although certain exemptions do exist.

The Ontario rules provide that a non-resident of Ontario who applies for an Ontario probate certificate and who is not resident in another Canadian province or territory or a Commonwealth jurisdiction, which would include a U.S.-resident estate trustee, must post a bond in the amount of twice the value of the Ontario assets before the certificate will be issued by the Ontario Court (although if the probate certificate sought is a resealed or ancillary grant, the bond must only be for the value of the Ontario assets which will be under the estate trustee's administration). The bond must be provided by an insurance company licensed in Ontario or by one or more personal sureties of the estate trustee, or both. This requirement can be waived or the necessary value of the bond reduced by the court in certain circumstances. It may be difficult or even impossible to obtain a bond if the estate trustee has no substantial assets required for the issuance of the bond and no one who will act as a personal surety.

If the deceased died without a will (intestate), a U.S.-resident estate trustee cannot obtain an Ontario certificate to administer the estate assets in Ontario (either original letters of administration or an ancillary grant) as the Ontario rules restrict who may apply for such a certificate to Ontario residents for original certificates and residents of Canada or Commonwealth jurisdictions for secondary certificates (resealed certificates). A U.S.-resident estate trustee needs to find an Ontario-resident individual or a trust company in Ontario to administer the Ontario estate assets.

U.S. financial institutions and trust companies, if they are not licensed to carry on the business of a trust company in Ontario, may not be able to act as an estate trustee to administer Ontario assets, even though appointed under the deceased's will. However, in at

least one Ontario case, the court allowed a U.S. trust company to apply for and receive an Ontario probate certificate where it was necessary to administer Ontario real property owned by the deceased on the basis that the trust company was not attempting to carry on business or hold itself out as an Ontario trust company, but the appointed trustee needed to administer a non-resident's estate where the deceased happened to own land in Ontario.

If no probate certificate has been obtained in a U.S. jurisdiction, an Ontario probate application will be considered the original application. The estate trustee must pay Ontario probate fees (Estate Administration Tax) on the value of all the deceased's worldwide property, other than certain exempt assets such as property held jointly with another person and passing to that person by right of survivorship, assets with beneficiary designations, and real property located outside Ontario. At the current rate of approximately 1.5%, this can create a serious and unexpected financial cost for the estate, which may otherwise not require an Ontario probate certificate to be administered, but the total value of which will nonetheless be subject to Ontario probate fees.

Where a probate certificate for a deceased who died with a will is first obtained from a U.S. jurisdiction, the Ontario probate process will be an ancillary process, and Ontario probate fees will only be payable on the value of the deceased's assets located in Ontario. This may still create some double-taxation if the U.S. original probate state also levies probate fees on the value of the deceased's property, including some or all of the Ontario assets. Other complications, causing additional time and expense, may arise if the U.S. jurisdiction's original probate documentation does not coordinate well with the Ontario rules. Sometimes even different terminology between the U.S. jurisdiction and Ontario can create confusion.

Further, the U.S. probate process may be complicated by the fact of the necessity to complete the Ontario probate process. For example, in some U.S. states, the necessary U.S. court documentation required by the Ontario probate rules will not be issued after the U.S. probate has been closed. This will mean that the U.S. probate will have to remain open, possibly requiring additional court filings, until it is certain no further documentation is required for the Ontario estate administration.

Canadian Income Tax Issues

For non-residents, Canada levies income tax on income arising in Canada (subject to certain exemptions) and capital gains tax on Taxable Canadian Property (discussed above) when such property is sold or otherwise disposed of, subject to certain exemptions. When a person dies, they are deemed to have disposed of their property for Canadian income tax purposes. Their estate trustee will be responsible for filing a terminal tax return for the income tax year up to the deceased's date of death, as well as possibly additional tax returns

if the estate has income or capital gains after the deceased's date of death. This is so even if U.S. tax returns are filed and U.S. tax paid on the same income or gains. Many U.S. resident property holders or estate trustees are not aware of these rules, and the fact that certain exemptions may not apply to non-residents. Penalties and interest on unpaid tax may also be payable if timely tax filings and payments are not completed.

While the Canada-U.S. Tax Treaty is designed to eliminate double-taxation of assets by both countries, in some cases it will not be of assistance in eliminating double-taxation for an estate. Also, where the U.S. Person's worldwide estate is less than the exemption limit for U.S. estate tax, no U.S. estate tax will be payable, but Canadian capital gains tax will nevertheless be payable on Taxable Canadian Property, with no corresponding U.S. tax to offset it.

Further, some Canadian assets will create additional U.S. tax filing requirements and mismatch of taxation, for example shares of a Canadian private corporation or an interest in a Canadian-resident trust. While the deceased would already have been subject to these requirements during his or her lifetime, the estate trustees may find them more onerous as they come on top of other obligations of the estate administration and/or due to their unfamiliarity with such matters.

Other Issues

Aside from the practical difficulties of geography, where an estate trustee is outside of Canada and assets are located in Canada, it is becoming increasingly difficult with the sharp increase in financial institution compliance designed to prevent income tax evasion and money laundering for a non-resident estate trustee to open an estate bank account or liquidate financial assets in Canada. Canadian financial institutions have implemented extensive and often onerous procedures and requirements which can be burdensome to meet, and which increase the time and costs of the estate administration. These requirements are applied even where an Ontario probate certificate has been obtained.

Further, where a U.S.-resident estate trustee wishes to retain the deceased's investments for a more extended time, this may prove difficult or even impossible due to U.S. securities rules which restrict Canadian financial institutions providing investment advice to U.S. residents from owning or controlling certain types of Canadian investments.

CONCLUSION

As Canadians and Americans increasingly have connections on both sides of the border, acquire assets in the other country and relocate across the border, their estates become more complicated. This Advisory is designed to explain some of the more common issues

which can arise when there are cross-border assets, estate trustees and beneficiaries or where the deceased was subject to tax rules on both sides of the border due to residence, nationality or domicile. As with many estate situations, expert legal and tax advice will be necessary to successfully navigate these complex matters.

The comments offered in this Client Advisory are meant to be general in nature, are limited to Ontario law and are not intended to provide legal advice on any individual situation. In particular, they are not intended to provide US legal or tax advice. Before taking any action involving your individual situation, you should seek legal advice to ensure it is appropriate to your personal circumstances.

1400-8981-6587, v. 2