

For Your Information ... CDA-US Tax Planning: *Tax Traps in Canada - U.S. Personal Tax Planning*

Special thanks to CCH Canadian Limited, for allowing Concentra Trust to reprint the article "CDA-US Tax Planning: Tax Traps in Canada – U.S. Personal Tax Planning", written by Jack Bernstein of Aird & Berlis LLP, published in the June 2005 issue of CCH Canadian Limited's financialWORKS®, © 2005, CCH Canadian Limited. This article may not be reprinted without the prior written permission of CCH Canadian Limited.

Tax Traps in Canada — U.S. Personal Tax Planning

This excerpt from an article written by Jack Bernstein of Aird & Berlis LLP discusses various Canada-US cross-border situations with adverse tax implications

Introduction

Over the years, I have encountered many situations where Canadian or U.S. tax advisers, not knowledgeable in cross-border taxation, have provided advice harmful to their clients. This article sets out numerous examples of such problems.

1. Canadian Citizen/Resident Married to U.S. Citizen/Canadian Resident

For asset-protection reasons, assets are accumulated in the name of the U.S. citizen. In addition, the will of the non-U.S. citizen provides for an outright bequest to the U.S. citizen with a gift over to children. Both spouses have personal life insurance. The foregoing planning may be common for Canadian citizens and residents but can increase the exposure to U.S. estate tax. The assets accumulated in the name of the U.S. citizen, the bequest to the U.S. citizen, and the life insurance may all be unnecessarily exposed to U.S. estate tax on the death of the U.S. citizen. The assets should be accumulated in the name of the non-U.S. citizen, the will should only provide the U.S. citizen with a life interest, and the life insurance should be held in a trust.

2. Canadian Resident Purchases U.S. Insurance Policy

Assume that a Canadian citizen and resident purchases a U.S. whole life insurance policy from a U.S. agent while vacationing in Florida. Canada will only allow the tax-free accumulation of income in a Canadian exempt insurance policy. Canada will require a Canadian resident to annually report the growth of a foreign insurance policy under the foreign investment entity rules using the mark-to-market approach.

3. Traditional Canadian Estate Freeze

In Canada, it is acceptable to accomplish an estate freeze by reorganizing a Canadian company so as to exchange common shares for redeemable preference shares. The preference shares would be redeemable at the shareholders option and may yield a non-cumulative dividend. The share exchange is not taxable in Canada. The company may then issue new common shares for nominal consideration to children or to a trust for children.

If the parent participating in the estate freeze is a U.S. citizen, substantial U.S. gift tax may arise under the traditional Canadian estate freeze. With the assistance of U.S. counsel, we have developed other techniques to avoid this problem. The customized structure provides the parent with shares yielding a cumulative dividend at a reasonable rate, and requires a payment by the children for the common shares equal to at least 10% of the value of the business.

The advice of an independent lawyer and/or accountant specializing in U.S. taxation issues should be sought when dealing with any legal matter relating to the above.

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