

## **CDA-US Tax Planning: Tax Traps in Canada - U.S. Personal Tax Planning**

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*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.*

*[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 following.]*

### **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.*

*[Please note this is a continuation of the article released January 10, 2006.]*

#### **4. Canadian Estate Freeze in Favour of U.S. Children**

A further complication for U.S. citizens, or residents who are beneficiaries of Canadian trusts, is the U.S. throwback rule which would tax prior accumulations in a Canadian trust formed for the benefit of children resident in the U.S. This poses a problem for Canadian non-U.S. citizen parents who wish to freeze their Canadian businesses in favour of a Canadian trust for their children.

#### **5. U.S. Resident is Beneficiary of Canadian Trust Which is to be Wound-Up**

Canada permits a trust resident in Canada to distribute its capital on a tax-deferred basis to a Canadian resident beneficiary. If the beneficiary does not reside in Canada, the trust is deemed to dispose of its assets at fair market value and to pay any tax thereon. This problem frequently arises as a Canadian personal trust is subject to a deemed realization every 21 years. Most trusts with appreciated assets opt to dissolve prior to the 21st anniversary. A possible solution for a U.S. beneficiary is to transfer the trust interest to a Nova Scotia Unlimited Liability Company ("NSULC") prior to the trust dissolution. This transfer may be accomplished on a tax-deferred basis for both Canadian and U.S. tax purposes. The trust may then distribute its assets on a tax deferred-basis to the NSULC, which would be regarded as a Canadian corporation, although ignored for U.S. tax purposes.

#### **6. Use of a Holding Company**

A Canadian adviser may recommend that investments be transferred or held in a holding company. If the client is a U.S. citizen resident in Canada, this may expose the person to U.S. subpart F rules, or, if there are other Canadian shareholders, to the U.S. passive foreign investment company ("PFIC") rules. The problem may be avoided by using the aforementioned NSULC.

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