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US TAX REFORM AND ESTATE TAX

Britta McKenna
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Attorneys

Britta McKenna

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On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (TCJA or US tax reform). After 2017, the TCJA significantly amends the US estate tax regime, affecting both US persons and Canadians (Canadian citizens and residents who are not US citizens) with US-situs assets.

For US persons, the TCJA increases each of the US estate tax exemption, the US lifetime gift tax exemption, and the US generation-skipping transfer tax exemption to US$10 million per person, indexed for inflation to $11.18 million for 2018. Significantly, however, the increased exemptions apply only from the beginning of 2018 to the end of 2025, when each reverts to the pre-TCJA level of US$5 million per person (indexed for inflation). The step-up in basis for assets includible in a decedent's US gross estate remains (whether or not estate tax is actually due); the maximum rate for estate, gift, and generation-skipping transfer tax remains at 40 percent of the taxable asset's FMV.

The TCJA made no changes to the US annual gift tax exclusion, which increased in 2018 to $15,000 per donee and to $152,000 for gifts to a spouse who is a non-US citizen.

For a Canadian with US-situs assets, the TCJA effectively doubles the prorated US estate tax exemption under the Canada-US treaty's 1995 protocol until the end of 2025. Under the protocol, a Canadian citizen and resident is entitled to a prorated US estate tax credit, which is calculated by multiplying the estate tax credit for a US person ($4,417,800 on an $11.18 million exemption) by the proportion that the decedent's US-situs assets' value is of his or her worldwide assets' value. The TCJA also effectively doubles the marital credit under the protocol, making it equal to the prorated credit available to a Canadian citizen who dies owning US-situs assets that he or she leaves to a surviving spouse in a qualifying manner. There is no prorated exemption for a Canadian from the US gift tax.

The TCJA provides an opportunity for many US individuals and Canadians with US-situs assets to simplify their estate planning. Some couples previously needed a trust to fully utilize US exemptions, but they can now dispose of assets outright to the survivor at the first death. However, the temporary nature of the exemptions in

the TCJA can make it difficult to plan long term: after the eight-year TCJA term, the exemptions return to pre-TCJA levels. A US person can take advantage of the increased lifetime gift tax exemption and generation-skipping transfer tax exemption before 2026, but consideration must be given to the manner in which the estate tax is calculated at death. Taxable gifts made during life are added back to the gross estate, and a credit is given for gift taxes paid or a gift tax exemption used during life. This calculation can undercut the effectiveness of gifting when the lifetime gift tax exemption is higher than the estate tax exemption at death. The TCJA indicates that regulations will address this concern, but none have yet been issued. But there is no relief for Canadians from the US gift tax other than the annual gift tax exclusions, and thus this issue does not affect Canadians with US-situs assets.

The estate tax provisions of the TCJA could still be modified before 2026 by Democrats if they regain control of Congress and the White House, or by either party at the sunset of the eight-year period. In the interim, advisers may take advantage of current gifting opportunities for US persons and of the ability to simplify estate plans, but the safest course of action for long-term estate-tax planning is to continue to plan at pre-TCJA levels.