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FINANCIALPLANNING

How Canadians with U.S. assets can reduce their stateside taxes

Nexus

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Canadians are usually surprised to learn that 50 per cent of their retirement savings will go to the tax department on the death of both spouses.

Joining the list of the "heavily taxed" after the death of both spouses are people with company assets, accumulated capital gains from investments, real estate and business equity.

Life insurance can often be used to reduce those taxes to zero. It is certainly the most cost-effective solution to that tax problem. That's here in Canada.

A similar tax fate awaits those who have significant assets or business interests outside of the country, specifically in the United States. That is, unless they take advantage of the ideas laid out in this article.

Fortunately, Canadians with an attachment, or "nexus," to the U.S. have unique advantages available to them.

Nexus: A connecting thread

In common speech, "nexus" refers to "connections." In this context, however, "nexus" is a legal term that applies to citizens from countries outside the United States who have family (i.e., children) living in the U.S., or who spend time there, or have money, businesses or property investments in the United States.

Who is covered by this rule

This is important for you to know if you have any of the attachments described above and a worldwide estate of more than US$5.43 million per person or almost $11 million per couple (the current threshold).

A Canadian resident is entitled to a prorated portion of the estate tax exemption for a U.S. citizen based on the ratio of his or her "U.S. situs property" (i.e., assets located in the U.S.) to his or her worldwide property.

Now that the price of an average detached home can easily exceed C$1 million, many readers with retirement savings, some real estate and an investment portfolio have unknowingly passed that threshold.

Your estate may be subject to a 40 per cent estate tax from the American government—and there may be state and other estate taxes on top of that.

A nexus + life insurance = tax savings

With a nexus, you can now buy a life insurance policy in the U.S. market without being subject to American income or estate taxes.

A wide range of your assets may be subject to U.S. estate tax, including the following: a vacation home; shares of U.S. publicly traded corporations; units of American mutual funds; deposits in U.S. brokerage accounts; an ownership interest in a business carried on in the United States, such as shares of an American private company; other real property and personal property located in the U.S.

Some key benefits of having an insurance policy

As with the Canadian tax

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situation, having life insurance can help cover taxes and potentially other costs. In some cases, it can even ensure that a family and business will remain intact.

A colleague in the U.S. shared this recent example of a family business. The company, now in its third generation, is located in a Midwestern town, where it employs about 10 per cent of the workforce. The business is worth roughly US$1 billion. Without proper estate planning, the family would be subject to at least $400 million in estate taxes when the current owner dies.

The surviving family members would be forced to sell the company to pay that hefty tax bill, throwing many family members and a large chunk of the town's population out of work.

The tax advantage of U.S. nexus-related insurance

One of the big benefits of buying U.S. nexus-related insurance is that compared to American citizens and residents, a foreign national who is considered a non-resident alien (someone who does not meet certain residency requirements) can own a life insurance policy on his or her life outright without it being subject to U.S. income or estate taxes.

The insurance policy selected should be an "exempt policy" for Canadian tax purposes. Careful planning will ensure the policy is tax-exempt both in the U.S. and Canada.

'Citizens of the world': An expanding demographic

We consider those who take advantage of this kind of insurance "citizens of the world." A growing number of people with significant assets move around the world with homes in a few countries and report large amounts of income. In these cases, life insurance is frequently used to replace the income lost from the death of a substantial wage earner.

Other advantages of U.S. nexus-related insurance

This type of insurance also provides foreign nationals with the ability to put together a post-retirement income plan in addition to the security of the death-benefit protection.

There are several reasons why a Canadian would want to buy life insurance that's "made in the U.S.A.," aside from current and anticipated currency fluctuations and the perceived value of the Canadian and U.S. dollars.

To start, people with significant assets in the United States and who would be subject to American estate tax would probably want to pay for that tax from a U.S.-dollar-denominated policy rather than a policy denominated in Canadian dollars.

In addition, with a much larger population and many more life insurance companies, American insurers can offer greater insurance packages and capacity—far more than what's available here in the Canadian market, which is dominated by a small and shrinking number of insurance companies.

For example, a person under 60 years of age can get from US$300 million to $350 million of well-priced insurance in the U.S. Here in Canada, more than C$100 million would be difficult. Those who do have nexus can get the larger amounts of insurance available stateside, and with so many players in the competitive American market, can likely do so at a better price.

No U.S. nexus? There's an alternative

Those who need more insurance than Canada can offer, but who do not have nexus to the U.S., can go through Bermuda to get an offshore product that is available. It provides up to US$200 million in life insurance, is also denominated in U.S. dollars, and is backed by highly rated insurance companies and regulated by AAA-rated countries outside the United States.

This offshore insurance can be crucial to those with businesses in countries where governments and their currencies may not be very stable, have stringent inheritance laws, high taxes, or restrictions on how people can distribute their estate.

Going offshore is a good option if you need a source of liquidity for your portfolio, or diversification because you have a large portion of your wealth concentrated in a single, non-liquid asset such as a business or real estate.

A key advantage: Ensuring assets stay within the family

The nexus-related insurance can be most advantageous for clients with multi-generational wealth who are concerned that their property, business or wealth will not be passed on from generation to generation.

Take a farming family, for example. They're land rich, but don't have much in the way of liquid assets. However, their massive 5,000-acre farm in the U.S. is worth US$10 million. The owners may be anxious that the farm might not continue on to the next generation because of tax issues. They may want to take advantage of this nexus-insurance to help defray the cost of those taxes.

Nexus-related insurance and business succession

As well, foreign national business owners with a properly structured buy-sell plan can use the proceeds of a life insurance policy to fund the purchase and sale requirements outlined in their agreement, key to ensuring smooth business succession.

Seek professional advice

It's important to note that the death benefit of a life insurance policy is included in the net estate for a person who is exposed to U.S. estate tax. The inclusion in the net estate can be avoided if the policy is owned by a properly structured trust.

Most people think that buying a home is a pretty simple transaction. But if it's done outside your country, out of your comfort zone, it can become complicated, especially when it comes to foreign taxes.

Just as you would have a lawyer with cross-border savvy look over this real estate transaction, the same should be done when it comes to nexus-related insurance—or any life insurance. The need for an integrated solution with the right professionals will ensure the job gets done correctly.

Having significant assets often comes with much responsibility for you, your family, your business and generations to come. It's a responsibility I have found that most people must take very seriously. ❐

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