

U.S. Estate Tax ON U.S. STOCK OWNERSHIP

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The United States imposes estate tax on individuals who are neither U.S. citizens nor U.S. residents if they own *situs property*; that is property considered situated in U.S. at the time of death.

The two most common U.S. assets considered *situs property* to a non-resident are U.S. real estate and shares of stock issued by a U.S. corporation. Canadian resident estates with worldwide assets valued at less than \$1,200,000 are only subject to U.S. estate tax on real property owned in the U.S.



The calculation of U.S. estate tax is very complicated and beyond the scope of this article. However, for the purpose of illustration, a Canadian holding \$1,000,000 in U.S. stocks and a \$500,000 U.S. condominium could be subject to U.S. estate tax of approximately \$244,000 if their U.S. assets were approximately 40% of their total worldwide assets (ie: total estate net worth of all worldwide assets is approximately \$3,750,000).

In our last newsletter, we touched on the ownership of U.S. real estate. In this issue we wish to discuss U.S. stock ownership. Many Canadians have significant holdings of U.S. equities and other securities in their portfolios. Many of these securities are considered U.S. *situs property* for purposes of U.S. estate tax.

On more than one occasion a client has asserted “why worry about U.S. estate tax, how will the IRS ever know I hold U.S. *situs property*?” From a practical perspective, the disposition of U.S. securities after the death of the owner is not likely to come to the attention of the IRS. However, the same cannot be said for U.S. real estate. In any event, the obligation to pay U.S. estate tax remains.

The simplest way to avoid U.S. estate tax on U.S. stocks is to hold the investments through a Canadian holding company or a Canadian trust. Thus, when the taxpayer dies, he or she cannot be deemed to hold U.S. *situs property*. Rather the U.S. *situs property* is owned by the Canadian company or trust and thus not subject to U.S. estate tax. Where the taxpayer does not have a holding company in place, most experts suggest that a holding company be incorporated or a trust used once the portfolio reaches \$500,000-\$700,000. Before transferring U.S. stocks to a holding company or trust please speak to Cunningham LLP.

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ALBERTA AND THE USE OF ALBERTA TRUSTS – The Next Tax Haven?

Investing in offshore tax havens subjects Canadians to a myriad of rules and disclosures. However, one doesn't need to look outside the borders of our country to find an opportunity to shift income to a lower-tax jurisdiction. Here in Canada, the province of Alberta has a significantly lower personal income tax rate than Ontario. For Ontario taxpayers in the highest marginal personal income tax bracket, the tax rate on ordinary income (e.g. employment income and interest income) and dividends is more than 7% lower in Alberta. This presents a tax planning opportunity if an Ontario taxpayer can shift income and have it taxed in Alberta.

Short of selling the house and being a resident of Alberta on December 31st, a taxpayer can take advantage of the lower tax rate in Alberta by establishing an Alberta trust. For example, if

an Ontario resident taxpayer earns \$100,000 in interest income annually, the taxpayer will end up paying approximately \$46,000 in personal income taxes. If that income is earned through an Alberta trust, the total taxes paid would be approximately \$39,000 – a savings of \$7,000.

An Alberta trust can also subscribe for shares of a corporation and earn dividends at a lower rate. For example, ABC Inc. is a private Canadian company which pays annual dividends of \$500,000. If the dividends are received by an individual shareholder, the taxes on those dividends would be approximately \$123,000 (assuming the dividends are paid out of income that has been subject to the general corporate tax rate). However, if the dividend was received by an Alberta trust, the total taxes would be approximately \$87,000 – a savings of \$36,000.

Similarly, if an investment company ABC Inc. has paid income tax in Canada on its investment income but has not paid out dividends to its shareholder(s), it creates a large "refundable dividend tax on hand" balance. Transferring

the shares of the investment company to an Alberta trust may result in a recovery of corporate tax at 33% when a dividend is paid, but only a payment of tax at 25% at the shareholder level - a difference of 8% (a 2% difference would result if the dividends were received by an Ontario taxpayer) (note: the transfer of shares to the trust may result in a capital gain for the shareholder, see below).

Before a taxpayer establishes an Alberta trust, they must consider a few matters. First, the trustees of an Alberta

trust must reside in Alberta. Generally, if the taxpayer does not know any Albertan residents they can choose an Alberta law firm or financial institution to act as trustee. Second, if property with an accrued gain is transferred to the Alberta trust, the transfer will likely cause a gain to be realized for tax purposes.

If an individual is older than 65 years of age though and is comfortable with only the taxpayer and his or her spouse having entitlement to the income and capital from the trust during their lifetime, any realized gain on the transfer of property to the trust can be avoided by way of a tax-free rollover. Third, the taxpayer must consider the costs of establishing and maintaining an Alberta trust. Most independent trustees charge a fee. Finally, each province has a General Anti-Avoidance Rule (GAAR) which they can invoke. There is little guidance on what type of inter-provincial tax planning is considered offensive such that a province would apply its GAAR.

An Alberta trust is also a great way to avoid probate fees on certain assets since a trust's assets are not subject to probate and can assist in reducing or eliminating the "clawback" of Old Age Security payments. In certain circumstances an Alberta trust can provide a great estate and tax planning opportunity. Please contact the tax department at Cunningham LLP for more information.



Transferring Capital Losses TO A SPOUSE

What happens when one spouse has capital gains and the other spouse has capital losses? The Income Tax Act prevents taxpayers from triggering a loss by selling a property to a person with whom they do not deal at arm's length, such as a spouse, through the concept of a "superficial loss". A superficial loss is a capital loss realized on a disposition where in the 30 day period before and 30 day period after the sale, an affiliated person acquired the same or similar property, and the same or similar property was still owned by the affiliated person 30 days later. An affiliated person includes one's spouse. If a taxpayer disposes of a property and incurs a superficial loss, the loss is denied and added to the cost of the substituted property.

However, where there is a will there is a way (or at least a way around it) and proper tax planning can utilize the superficial loss rules that will allow spouses to offset gains and losses realized by each other. For example, say a taxpayer purchased a share of a publicly traded company for

\$100 and the current market value is \$30. If the taxpayer sold this share to his or her spouse for \$30 (electing to sell the share at its current market value, rather than its cost), and the spouse holds on to this share for a minimum of 30 days, the cost base of the share received gets bumped up to \$100 for tax purposes. The recipient spouse could then sell the share for its current market value, \$30, and realize a \$70 capital loss. This loss could then be used to offset any capital gains he or she may have. Remember, the only caveat to this type of tax planning is that the share must be held by the acquiring spouse for at least 30 days. This type of tax planning can only be used in connection with one's spouse, since the superficial loss rules do not apply on dispositions to children, parents or other family members.

The Income Tax Act provisions relating to capital and superficial losses are very technical and you should contact Cunningham LLP before undertaking a loss transfer transaction.

ELECTRONIC FUNDS Transfers and Fraud

Electronic Funds Transfers ("EFTs") are widely accepted as a method for organizations to transfer funds on a timely basis to suppliers, employees and other organizations. However, EFTs can pose an internal control weakness for many organizations. Employees can circumvent the built-in internal controls, if any, and defraud the organization of significant amounts of cash at one time or over a period of time. EFTs typically allow employees to withdraw organizational funds by way of an Online Banking Agreement ("OBA") in which an employee may transfer funds between bank accounts, download detailed transaction information into accounting software and monitor the daily cash position. Although EFTs are designed to allow the organization to operate effectively and efficiently, it also poses significant risks to an organization and, as such, a strong system of internal controls should be considered by management in order to prevent and detect fraudulent activities.

Internal controls are not just about fraud prevention. A strong system of internal controls could also assist in detecting errors. For example, an EFT can be initiated and paid to the wrong supplier or for the wrong amount. This type of error would typically be identified in a normal cheque run internal control by way of a review of invoices, purchase orders and other supporting documentation. However, an EFT typically only has one person initiating the transfer and therefore an error can go unnoticed.

The ability for employees to circumvent a basic system of internal controls often occurs in extraordinary cases in which business decisions are made without consideration of internal controls. For example, a supplier requires payment prior to shipment. In this case, the EFT is initiated by an employee without any of the approvals or processes as indicated in the OBA. The bank accepts the transfer because the employee may have a strong relationship with the banking representative.

For its own protection, any organization using EFTs should implement some controls. These could include: dual approval, a review of invoices, a review of all transfers made, limited access for EFT initiation, a review by upper management of bank reconciliations, segregation of duties, rotation of workers, control over the addition of new vendors, management approval of invoices, monthly preparation and review of reconciliations, and an OBA that outlines the individuals that can initiate and approve EFTs.

The size of the organization will clearly dictate the extent of internal controls and several of the internal control measures noted above may or may not be practical for smaller organizations. However, several of the basic internal controls noted in this article should be adhered to regularly in order to minimize the risk of fraudulent activity at your organization.

Please contact Cunningham LLP should you wish to conduct a review of your EFT controls.

CLIENT Profile

Inland North America is a full service freight transportation brokerage firm specializing in project management. From managing the transport of overweight containers to moving time-sensitive merchandise, Inland offers innovative freight transportation solutions throughout North America. They coordinate every aspect of the movement of cargo from point of origin to point of destination.

Inland understands the complexity and unpredictability of the logistics industry, which is why they place so much emphasis on reliability, safety and service. Inland enjoys strategic partnerships with an extensive network of independent truckers, trucking companies, rail and barge operators all of whom have proven records of safety and reliability. These carriers are not only experienced but also adept at handling diverse types of cargo. Moreover, they employ the latest GPS technology, which provides Inland customers consistent, reliable service.

Given the dynamic nature of the freight transportation industry, Inland prides itself on providing dependable customer service. Inland remains diligent in its constant communication with their carriers and therefore can provide their customers with up to the minute status reports on the location of their freight.

Updates are available via telephone or email. In addition, Inland has a team of drivers on call for last minute moves.

In response to increasing market demands, Inland has recently opened an office in Canada and expanded their services to include consulting, warehousing, consolidation and exporting, in addition to its normal service offerings of expedited, specialty carrier, truck load, intermodal, re-ferated, and heavy haul. Among Inland's service points located across the U.S. and Canada, the largest are situated in Port Newark, Savannah, Laredo, Toronto, New Orleans, Chicago and Miami. These service points, when matched with Inland's others across the U.S. and Canada, position Inland truly as a total freight solution

Cunningham LLP assisted, the U.S. based company, Inland in all respects recently in setting up their Canadian permanent establishment, including providing advise for the most tax efficient ownership structure for them in Canada and explaining the various income taxes and commodity taxes that they must consider now operating in Canada.



INLAND
North America



THIS MONTH'S Smile



“When I was a boy of 14, my father was so ignorant I could hardly stand to have the old man around. But when I got to be 21, I was astonished at how much the old man had learned in 7 years.”.

— Mark Twain

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