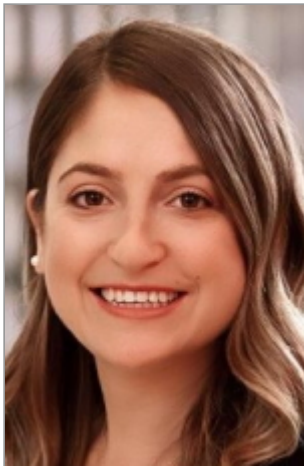


Wills, Trusts & Estates

Estate planning around U.S. citizenship: Step one, confirm status

By **Marly Peikes**

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(May 6, 2021, 2:08 PM EDT) -- In order to provide clients with a well-rounded estate plan, it is critical to know if your client or his or her intended beneficiaries are U.S. citizens. Citizenship is not always obvious to determine. It's possible for a person to be a U.S. citizen without knowing it.

It's important to consider the tax implications that go with U.S. citizenship or residency. The U.S. is unique because it levies tax based on citizenship even if a person is not resident in the U.S. Also, U.S. citizenship also confers various obligations, including income tax compliance and certain reporting requirements.

Under U.S. rules, there is an enumerated list of persons who can be U.S. citizens at birth and there are a number of factors to be considered based on different circumstances.

For example, under the *Immigration and Nationality Act* 301(g), in general, a person born outside the U.S. may acquire citizenship at birth if:

1. the person has at least one parent who is a U.S. citizen; and
2. the U.S. citizen parent meets certain residence or physical presence requirements in the U.S.

U.S. Citizenship and Immigration Services has helpful charts under the Appendices section outlining the different requirements for acquiring U.S. citizenship depending on the time period in question.

The various factors include, for example:

1. the date the child was born and the laws in force at the time;
2. the parents' citizenship at the time of the child's birth; and
3. whether the U.S. citizen parent(s) resided in the U.S. prior to the child's birth for the requisite period of time.

Whether the child's parents were married to one another at the time of birth also factors into the analysis.

In the example above, if the child was born in wedlock and on or after Nov. 14, 1986, the U.S. citizen parent had to have been physically present in the U.S. for at least five years, including at least two years after the age of 14.

U.S. citizens are subject to the U.S. transfer tax regime, including estate tax, gift tax and generation-skipping transfer tax.

Generally, on death, U.S. estate tax is calculated at graduated rates based on the gross value of certain assets owned by an individual at death. In the U.S., the current federal unified estate and gift

tax exemption amount is US\$11.7 million for 2021. The first \$11.7 million of assets of a U.S. person are sheltered from estate tax. The estate value over the exemption limit is subject to the top tax rate, which is 40 per cent for 2021. The current exemption amount is set to revert to its original US\$5 million amount indexed for inflation in 2026, although it may change soon under the Biden administration.

Assets that may not be obvious are included in the calculation of the value of a U.S. citizen's worldwide estate, including the proceeds of life insurance policies owned by the deceased, the total value of property held in a joint tenancy with right of survivorship (unless it can be established that the deceased did not contribute to the property) and certain trust interests.

There are various estate planning strategies that can be considered to minimize exposure to U.S. estate tax if your client or someone he or she wishes to benefit in his or her will is a U.S. citizen.

One example is a "bypass" trust, the value of which would be excluded from the U.S. beneficiary's estate for U.S. estate tax purposes. Under a bypass trust, the U.S. beneficiary's powers are restricted so that he or she does not have too much ownership and control. From a Canadian tax perspective, if this type of bypass trust is set up for the benefit of a U.S. surviving spouse, the trust can be drafted to also qualify as a Qualified Spousal Trust under the *Income Tax Act* (Canada) in order to take advantage of a deferral of capital gains tax until the death of the surviving spouse.

The rules are complex and the analysis is factual. U.S. legal advice should be obtained where there is a possibility that your client or any of his or her intended beneficiaries may be U.S. citizens in order to confirm their status.

It is important to determine whether your client or his or her intended beneficiaries are U.S. citizens (or residents) and consider whether any special planning needs to be undertaken to minimize U.S. estate tax exposure, and as well to make sure that they are compliant with U.S. income tax rules.

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