

# Mitigating clients' exposure to U.S. federal estate tax

**The death of any individual—whether a U.S. resident or not—can give rise to U.S. federal estate taxes<sup>1</sup> if the individual owns property in the United States at the time of death. Investment in Canada-domiciled Vanguard ETFs™ may help mitigate U.S. federal estate taxes and related filing obligations for clients while giving exposure to U.S. stocks to Canadian residents who are not U.S. citizens.**

1 This article discusses U.S. federal estate taxation only. U.S. state estate tax may also apply in certain circumstances, depending on whether the U.S. situs property is physically located within a specific state (e.g., real property). States' rules regarding situs, exemptions, and property subject to estate taxation vary and are outside the scope of this article. Similarly, Canadian federal and provincial taxes may apply, and are outside the scope of this article.

## What triggers U.S. federal estate tax?

Generally, estates of non-U.S. resident, non-U.S. citizens who have died may be subject to U.S. federal estate taxation if the individual had assets located in, or tied to, the United States valued at more than USD 60,000 at the date of death. These assets are often referred to as U.S. situs assets.

U.S. federal tax law provides offsets, such as deductions and tax credits, against estate tax that may be due to eligible estates. In addition, there is a double taxation treaty (the "Treaty") between the U.S. and Canada. The Treaty is designed to reduce or eliminate double estate taxation, which can occur when an individual dies while deemed to be resident or domiciled in one country but owns property in the other.

The Treaty also sets forth special rules that help determine the residency of the decedent—someone who has died—and the tax "situs" of his or her property. Under the Treaty, certain property is exempt from inclusion in a decedent's gross estate. Also under the Treaty, Canadian resident estates may be able to reduce any U.S. federal estate tax by applying certain tax credits if eligible.

## What are "U.S. situs assets"?

U.S. situs assets include all property and securities in which the estate of the person who died has an interest and which is located in or connected to the United States. Examples include (but are not limited to):

- U.S. real estate
- Tangible personal property located in the United States
- Stock in or bonds of U.S. corporations (private or public, even if held in a Canadian brokerage account)
- Municipal bonds
- Interests in U.S. mutual funds or ETFs
- Interests in certain trusts (for example, a Canadian registered plan, such as an RRSP) if assets held by the trust have U.S. situs (such as investments in U.S. mutual funds)
- Assets of a trade or business conducted within the United States
- U.S. retirement plans

## How is U.S. federal estate tax calculated?

While the calculation is quite complex, at a high level, non-U.S. estates would start with the total value of U.S. situs assets at the time of the person's death and subtract the pro-rata share<sup>2</sup> of certain debts, expenses, and other deductions<sup>3</sup> as permitted to arrive at the "taxable estate." U.S. federal estate tax would then be calculated on this figure and reduced by any applicable tax credits (such as the unified credit and foreign tax credits under the Treaty).<sup>4</sup>

Figure 1 shows how to determine whether the estate of a deceased Canadian resident may be subject to U.S. federal estate tax. For non-U.S. estates, the unified credit effectively exempts USD 60,000 of U.S. situs assets from U.S. federal estate tax. Under the Treaty, for 2023, Canadian residents may also be eligible for a credit of up to USD 5,113,800 effectively exempting from U.S. federal estate tax an estate with worldwide value up to USD 12.92 million.<sup>5</sup>

Figure 2 provides a simplified, hypothetical example of how the tax calculation might work for someone who died and left an estate worth USD 20 million.

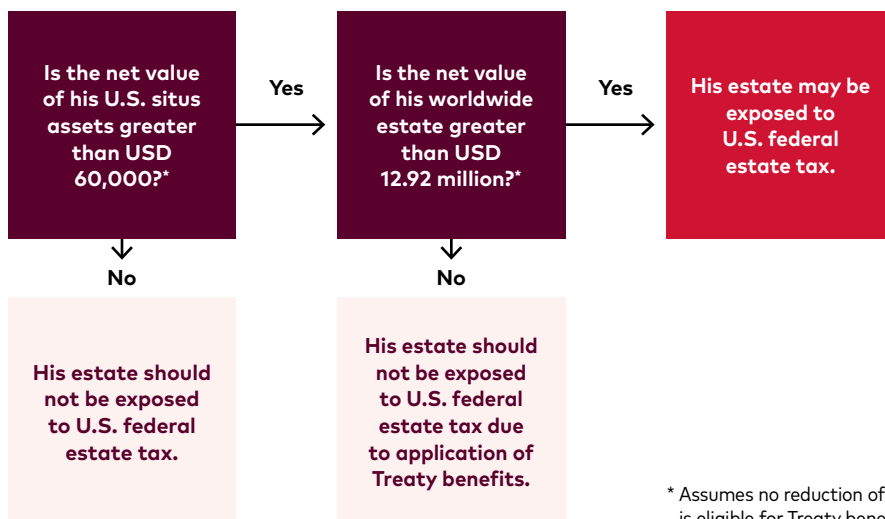
The Treaty also provides for "small estate relief" for certain estates of Canadian residents who are non-U.S. citizens. If the value of the decedent's

worldwide gross estate at the time of death does not exceed USD 1.2 million, then the estate's total U.S. situs assets are generally exempt from U.S. federal estate tax.<sup>6</sup>

Another provision under the Treaty provides for a potential credit<sup>7</sup> of U.S. federal estate tax (and other U.S. taxes that may be triggered by someone's death, such as state inheritance tax) paid against Canada's "gains at death" tax on the deemed realization of capital gains at death. This credit is limited to offsetting the gains at death tax on income or gains arising out of the U.S. or from property situated in the U.S.

- 2 Pro-rata share is the proportion of total expenses that the decedent's U.S. gross estate bears to a decedent's worldwide gross estate.
- 3 A discussion of the availability of the marital deduction on assets left to a spouse is outside the scope of this brief. Additional factors affecting a taxable estate include gift tax paid on lifetime gifts and generation-skipping transfer tax, both of which are also outside the scope of this brief.
- 4 In order to obtain the benefits of the credits referred to in this brief, documentation and filing of tax forms may be required.
- 5 U.S. tax law changes enacted on December 22, 2017 temporarily increased the estate tax exemption from USD 5 million to USD 10 million (subject to an inflation adjustment). These figures are the inflation adjusted amounts for 2023. Unless new legislation is enacted, the estate tax exemption will revert to USD 5 million (as adjusted for inflation) and the unified credit will be reduced accordingly beginning on January 1, 2026.
- 6 U.S. situs property of a small estate of a non-U.S. citizen residing in Canada may be subject to U.S. estate tax even if the estate is eligible for small estate relief if certain circumstances apply; small estate relief does not apply to U.S. real property, including interests in U.S. partnerships or corporations holding real property in the United States.
- 7 This double taxation credit relief may not be available in all Canadian provinces.

**Figure 1. My client is a Canadian resident, non-U.S. citizen. Could his estate be subject to U.S. federal estate tax?**



\* Assumes no reduction of the unified credit for lifetime gifts and that estate is eligible for Treaty benefits.

## Figure 2. Calculating U.S. federal estate tax: a simplified illustration.

Jane is a Canadian resident who is not a U.S. citizen. At her death in 2023, she had U.S. situs assets worth USD 2 million and a worldwide estate worth USD 20 million. Deductible expenses and debts totaled USD 1,000,000. She was not married and made no lifetime gifts.

2,000,000	U.S situs asset value
-100,000	Pro-rata share of deductible expenses and debts (1,000,000 * 2,000,000/20,000,000)
1,900,000	Taxable U.S. estate
705,800	Gross estate tax (345,800 + (40% x 900,000))
-511,380	Unified credit The greater of 13,000 or (2,000,000/20,000,000 * 5,113,800)
194,420	Unified credit

Note: This hypothetical situation is for illustrative purposes only.

## How can Vanguard help?

An interest in a Canadian investment product, even one which invests in the stocks or bonds of U.S. corporations, is considered to be an interest in a Canadian situs entity as the investment product (such as an ETF) is generally opaque. For example, a Vanguard Investments Canada ETF with an investment mandate based on U.S. stock indexes allows investment in the U.S. stock market without triggering U.S. federal estate tax because the investor is deemed to be investing in a Canadian situs asset— the ETF— rather than looking through to the location of the assets in the underlying portfolio of the ETF.

Additional matters an investor may want to consider with their legal, financial or tax advisor include:

- Use of a Canadian entity (for example, a corporation or partnership) to hold U.S. investment properties
- Estate and gift planning, especially if you own property in multiple countries or travel frequently
- Reducing the value of U.S. situs assets or worldwide estate, taking into consideration any income-tax consequences that may result, such as using any capital losses to offset resulting capital gains

# Important information

**Commissions, management fees, and expenses all may be associated with investment funds. Investment objectives, risks, fees, expenses, and other important information are contained in the prospectus; please read it before investing. Investment funds are not guaranteed, their values change frequently, and past performance may not be repeated. Vanguard funds are managed by Vanguard Investments Canada Inc. and are available across Canada through registered dealers.**

This material is for informational purposes only. This material is not intended to be relied upon as research, investment, or tax advice and is not an implied or express recommendation, offer or solicitation to buy or sell any security or to adopt any particular investment or portfolio strategy. Any views and opinions expressed do not take into account the particular investment objectives, needs, restrictions and circumstances of a specific investor and, thus, should not be used as the basis of any specific investment recommendation. Investors should consult a financial and/or tax advisor for financial and/or tax information applicable to their specific situation.

All investment funds, including those that seek to track an index are subject to risk, including the possible loss of principal. Diversification does not ensure a profit or protect against a loss in a declining market. While the Vanguard ETFs are designed to be as diversified as the original indices they seek to track and can provide greater diversification than an individual investor may achieve independently, any given ETF may not be a diversified investment.

All monetary figures are expressed in Canadian dollars unless otherwise noted.

The information contained in this material may be subject to change without notice and may not represent the views and/or opinions of Vanguard Investments Canada Inc.

Certain statements contained in this material may be considered "forward-looking information" which may be material, involve risks, uncertainties or other assumptions and there is no guarantee that actual results will not differ significantly from those expressed in or implied by these statements. Factors include, but are not limited to, general global financial market conditions, interest and foreign exchange rates, economic and political factors, competition, legal or regulatory changes and catastrophic events. Any predictions, projections, estimates or forecasts should be construed as general investment or market information and no representation is being made that any investor will, or is likely to, achieve returns similar to those mentioned herein.

While the information contained in this material has been compiled from proprietary and non-proprietary sources believed to be reliable, no representation or warranty, express or implied, is made by The Vanguard Group, Inc., its subsidiaries or affiliates, or any other person (collectively, "The Vanguard Group") as to its accuracy, completeness, timeliness or reliability. The Vanguard Group takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this material.

This material is not a recommendation, offer or solicitation to buy or sell any security, including any security of any investment fund or any other financial instrument. The information contained in this material is not investment advice and is not tailored to the needs or circumstances of any investor, nor does the information constitute business, financial, tax, legal, regulatory, accounting or any other advice.

The information contained in this material may not be specific to the context of the Canadian capital markets and may contain data and analysis specific to non-Canadian markets and products.

The information contained in this material is for informational purposes only and should not be used as the basis of any investment recommendation. Investors should consult a financial, tax and/or other professional advisor for information applicable to their specific situation.

In this material, references to "Vanguard" are provided for convenience only and may refer to, where applicable, only The Vanguard Group, Inc., and/or may include its subsidiaries or affiliates, including Vanguard Investments Canada Inc.

© 2023 The Vanguard Group, Inc. All rights reserved.

The Vanguard logo, featuring the word "Vanguard" in a bold, red, serif font.

© 2023 Vanguard Investments Canada Inc.  
All rights reserved.

ETABC 072023