TAB 3A

Will Planning for Dual Citizens

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3A

12th *Annual* Estates and Trusts Summit
Day One - November 12, 2009

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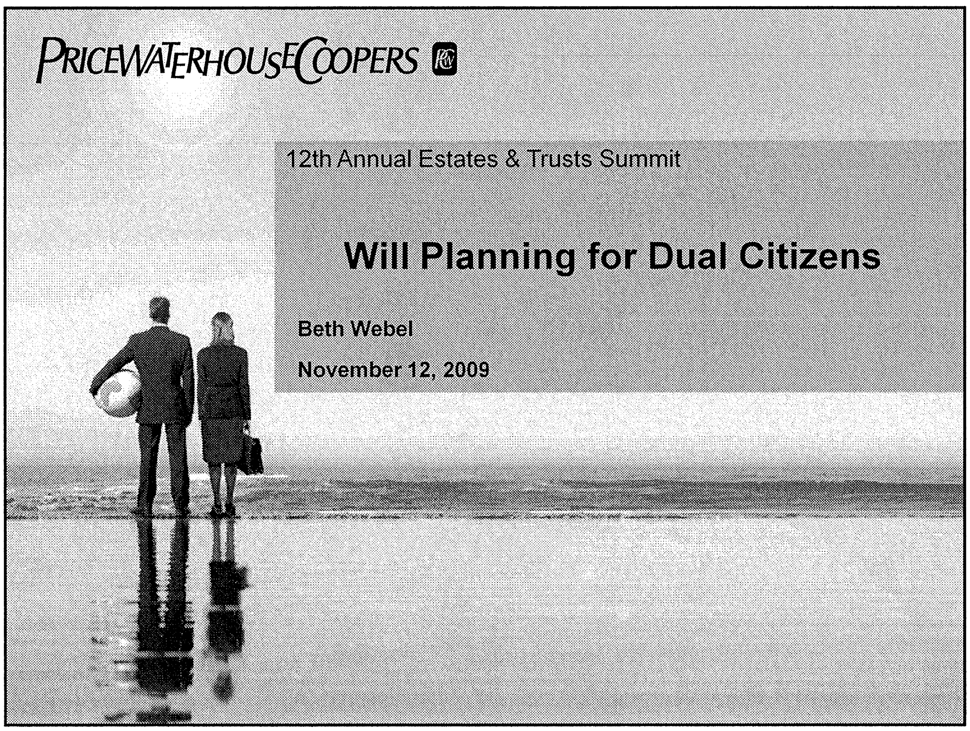
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12th Annual Estates & Trusts Summit
Will Planning for Dual Citizens
Beth Webel
November 12, 2009

US Estate Tax

Dual citizen of Canada/US

- Worldwide US estate taxation
- Same as US citizen
- Exemption $3.5 million for 2009
  - AFTER 2009???
- Rate 18% to 45% (at $1.5 million)
- Unlimited rollover to a **US citizen** spouse
  - Referred to as unlimited marital deduction

Treaty Relief for Canadian Spouse

Marital Credit

- Article XXIX-B, paragraph 3
  - Can double the exemption from $3.5 million to $7 million
- Requirements (see notes)
- Available if assets
  - Pass to spouse outright; or,
  - Pass to spouse trust that would otherwise qualify for marital deduction

Marital credit is provided under Article XXIX-B, paragraph 3, which requires:

1. The deceased was at the time of death a US citizen or a resident of Canada or US;
2. The spouse was at the time of the individual's death a resident of Canada or US; and,
3. The executor elects the benefits of the treaty and waives the right to the unlimited marital deduction.

Example 1: Dual Citizen, No Spouse

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Page 4
November 12, 2009

See appendices A and A-1

Example 2: Dual Citizen with Canadian Spouse

Example 2: Dual Citizen's Will

Option #1

- Assets pass to QDOT
- Estate tax on DS death is $nil
- Estate tax on death of spouse
  - $2,925,000 PLUS tax on growth of assets held in QDOT
  - Significant administrative burden associated with QDOT

- **MAY BE ONLY OPTION FOR VERY LARGE ESTATES**
  - **Caution when dual wills for private company shares**

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Page 6
November 12, 2009

General terms of QDOT:

- spouse entitled to all income

- no one other than spouse can take capital during lifetime of the spouse

Special provisions in US citizen's will include:

-at least one US citizen trustee (does not need to be a US domestic trust)

-If assets > $2 million must provide security (bond or letter of credit) or a US financial institution must be a trustee

If using dual wills (for example, private company shares), caution that the US financial institution trustee may require probate

Example 2: Dual Citizen's Will

Option #2

- Assets pass outright to spouse
- Estate tax on DS death of $1.47 million
- $8.53 million left for spouse
- No estate tax on death of spouse

Option #3

- Assets pass to spouse trust (qualifies for marital credit)
- Estate tax on DS death of $1.47 million
- $8.53 million left for spouse
- No estate tax on death of spouse

Example 3: Dual Citizen with Canadian Spouse

Example 3: Canadian Spouse's Will

Option #1

- Assets pass outright to DS
- Increase estate tax of DS by $2.25 million
  - Total tax of $5.2 million
- Eliminates Generation Skipping Tax planning

NO!!!

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Page 9
November 12, 2009

See appendices C and C-1

Example 3: Canadian Spouse's Will

Option #2

- Assets pass to spouse trust (designed to protect against estate tax)
- No increase in estate tax of DS
- GST planning available (can include grandchildren)

YES!!!

Example 4: Dual Citizen Spouses

Example 4: Dual Citizen Spouses

Option #1

- Assets pass outright to spouse
- No estate tax on DC1 death
- Estate tax on DC2 death of $2,925,000 PLUS 45% on asset growth

NO!!!

Example 4: Dual Citizen Spouses

Option #2

- $3.5 million to family trust
- Remaining $6.5 million to spouse or spouse trust
- No estate tax on DC1 death
- Estate tax on DC2 death of $1,350,000 PLUS 45% on asset growth

  - **SAVINGS OF $1,575,000**

    YES!!!

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Page 13
November 12, 2009

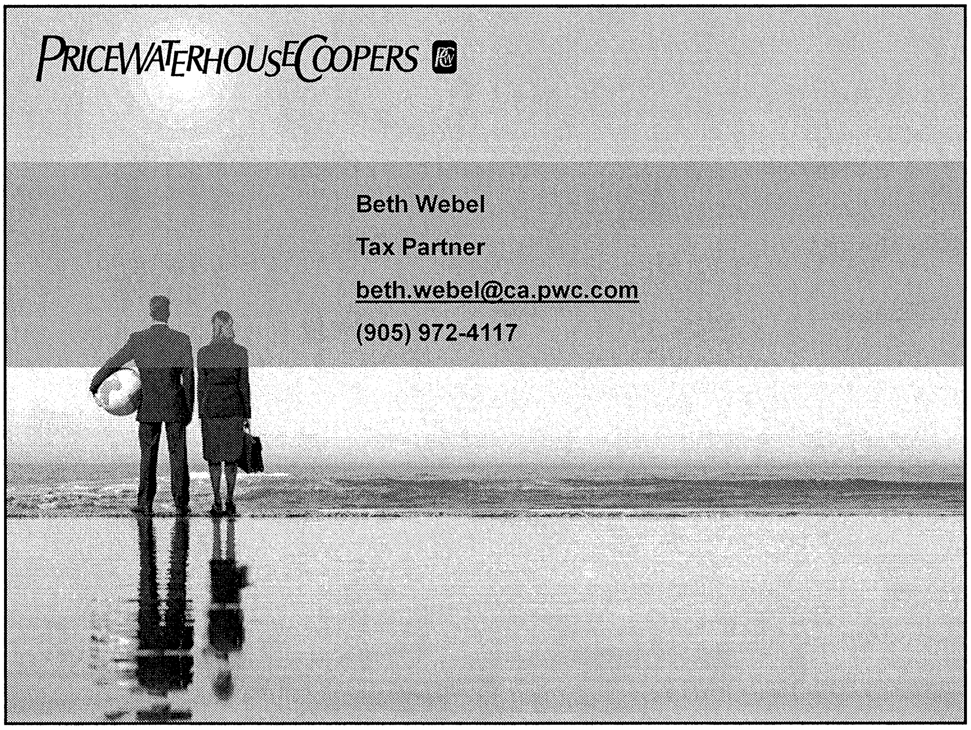
See appendices D and D-1

If necessary, family trust could be structured to qualify as a spousal trust for Canadian tax purposes. Spouse cannot be viewed as having a general power of appointment over the trust assets. For example;

-Spouse entitled to all income during lifetime and no one other than spouse can take capital during lifetime of spouse

-Spouse is a trustee; however, rights to participate in capital encroachment decisions are restricted to health, education, maintenance and support

-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Appendix A

U.S.Estate Tax Calculation

Year of Death	2009
FMV of U.S. Property in U.S. funds	10,000,000
Less deductions (see below)	-
Taxable Estate	10,000,000
Taxes on U.S. property	4,380,800
Unified credit (see calculation below)	(1,455,800)
Marital credit (see calculation below)	-
Other credits (refer to Data Input Sheet)	-
U.S. Estate tax (If negative number = $0 U.S estate tax payable)	2,925,000

Appendix A-1

2009 Unified Transfer Tax Rate Schedule

The unified rate schedule applying to estates of decendents dying and gifts made after 1983 appears below:

Tax on U.S. property calculation	Tax on transferred U.S. property calculation	Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in column A	Column D Rate of tax on excess over amount in column A Percent
10,000,000	10,000,000				
-	-	$ -	10,000	$ -	18%
-	-	10,000	20,000	1,800	20%
-	-	20,000	40,000	3,800	22%
-	-	40,000	60,000	8,200	24%
-	-	60,000	80,000	13,000	26%
-	-	80,000	100,000	18,200	28%
-	-	100,000	150,000	23,800	30%
-	-	150,000	250,000	38,800	32%
-	-	250,000	500,000	70,800	34%
-	-	500,000	750,000	155,800	37%
-	-	750,000	1,000,000	248,300	39%
-	-	1,000,000	1,250,000	345,800	41%
-	-	1,250,000	1,500,000	448,300	43%
4,380,800	4,380,800	1,500,000	999,999,999,999	555,800	45%
4,380,800	4,380,800	**Lifetime exemption amount:**	**3,500,000**		

* Under the U.S. legislation, the top rate is declining over the next several years and the the exemption amount is increasing. The estate tax and GST are repealed entirely for 2010. However, according the the U.S. legislation, the estate tax is repealed only for individuals dying in 2010. This is true because the entire U.S. tax bill is itself repealed on December 31, 2010, at which time all of the current rules would return (unless a later Congress and President do something about it).

The future top rates and exemption amounts are as follows:

Year	Top Rate %	Exemption $US	Credit Amount
2001	55	675,000	-
2002	50	1,000,000	-
2003	49	1,000,000	-
2004	48	1,500,000	-
2005	47	1,500,000	-
2006	46	2,000,000	-
2007	45	2,000,000	-
2008	45	2,000,000	-
2009	45	3,500,000	1,455,800
2010	N/A repealed	N/A repealed	-
2011	55	1,000,000	-
			1,455,800

APPENDIX B

U.S.Estate Tax Calculation

Year of Death	2009
FMV of U.S. Property in U.S. funds	10,000,000
Less deductions (see below)	-
Taxable Estate	10,000,000
Taxes on U.S. property	4,380,800
Unified credit (see calculation below)	(1,455,800)
Marital credit (see calculation below)	(1,455,800)
Other credits (refer to Data Input Sheet)	-
U.S. Estate tax (If negative number = $0 U.S estate tax payable)	1,469,200

Unified Credit Calculation

Credit equals the greater of A and B:

A	Minimum credit for non U.S. residents or citizens	13,000		13,000
B	Credit for U.S. residents x proportion of U.S. property to total property			
	FMV of U.S. property (U.S.$)	10,000,000		
	FMV of total assets	10,000,000		
	Portion of U.S. investments to total assets	100.00%	100.00%	
	Credit for U.S. residents		1,455,800	
	Credit for non U.S. residents or citizens		1,455,800	**1,455,800**

Canadian Marital Credit Calculation (Pursuant to Article XXIX B, paragraph 4, of the Canada-U.S. Income Tax Convention)

Credit equals the lesser of A and B:

A	Unified Credit above		1,455,800	
B	Amount by which 1 exceeds 2			
1	Taxes on Total U.S. property	4,380,800		
	Property not transferred to spouse	-		
	Less deductions (see below)	-		
		-		
2	Taxes on property not transferred to spouse	-		
			4,380,800	
	Marital Credit			**1,455,800**

Appendix B-1

2009 Unified Transfer Tax Rate Schedule

The unified rate schedule applying to estates of decendents dying and gifts made after 1983 appears below:

Tax on U.S. property calculation	Tax on transferred U.S. property calculation	Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in column A	Column D Rate of tax on excess over amount in column A Percent
10,000,000	-				
-	-	$ -	10,000	$ -	18%
-	-	10,000	20,000	1,800	20%
-	-	20,000	40,000	3,800	22%
-	-	40,000	60,000	8,200	24%
-	-	60,000	80,000	13,000	26%
-	-	80,000	100,000	18,200	28%
-	-	100,000	150,000	23,800	30%
-	-	150,000	250,000	38,800	32%
-	-	250,000	500,000	70,800	34%
-	-	500,000	750,000	155,800	37%
-	-	750,000	1,000,000	248,300	39%
-	-	1,000,000	1,250,000	345,800	41%
-	-	1,250,000	1,500,000	448,300	43%
4,380,800	-	1,500,000	999,999,999,999	555,800	45%
4,380,800	-	**Lifetime exemption amount:**	**3,500,000**		

* Under the U.S. legislation, the top rate is declining over the next several years and the the exemption amount is increasing. The estate tax and GST are repealed entirely for 2010. However, according the the U.S. legislation, the estate tax is repealed only for individuals dying in 2010. This is true because the entire U.S. tax bill is itself repealed on December 31, 2010, at which time all of the current rules would return (unless a later Congress and President do something about it).

The future top rates and exemption amounts are as follows:

Year	Top Rate %	Exemption $US	Credit Amount
2001	55	675,000	-
2002	50	1,000,000	-
2003	49	1,000,000	-
2004	48	1,500,000	-
2005	47	1,500,000	-
2006	46	2,000,000	-
2007	45	2,000,000	-
2008	45	2,000,000	-
2009	45	3,500,000	1,455,800
2010	N/A repealed	N/A repealed	-
2011	55	1,000,000	-
			1,455,800

Appendix C

U.S.Estate Tax Calculation

Year of Death	2009
FMV of U.S. Property in U.S. funds	15,000,000
Less deductions (see below)	-
Taxable Estate	15,000,000
Taxes on U.S. property	6,630,800
Unified credit (see calculation below)	(1,455,800)
Marital credit (see calculation below)	-
Other credits (refer to Data Input Sheet)	-
U.S. Estate tax (If negative number = $0 U.S estate tax payable)	5,175,000

APPENDIX C-1

2009 Unified Transfer Tax Rate Schedule

The unified rate schedule applying to estates of decendents dying and gifts made after 1983 appears below:

Tax on U.S. property calculation	Tax on transferred U.S. property calculation	Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in column A	Column D Rate of tax on excess over amount in column A Percent
15,000,000	15,000,000				
-	-	$ -	10,000	$ -	18%
-	-	10,000	20,000	1,800	20%
-	-	20,000	40,000	3,800	22%
-	-	40,000	60,000	8,200	24%
-	-	60,000	80,000	13,000	26%
-	-	80,000	100,000	18,200	28%
-	-	100,000	150,000	23,800	30%
-	-	150,000	250,000	38,800	32%
-	-	250,000	500,000	70,800	34%
-	-	500,000	750,000	155,800	37%
-	-	750,000	1,000,000	248,300	39%
-	-	1,000,000	1,250,000	345,800	41%
-	-	1,250,000	1,500,000	448,300	43%
6,630,800	6,630,800	1,500,000	999,999,999,999	555,800	45%
6,630,800	6,630,800	**Lifetime exemption amount:**	**3,500,000**		

* Under the U.S. legislation, the top rate is declining over the next several years and the the exemption amount is increasing. The estate tax and GST are repealed entirely for 2010. However, according the the U.S. legislation, the estate tax is repealed only for individuals dying in 2010. This is true because the entire U.S. tax bill is itself repealed on December 31, 2010, at which time all of the current rules would return (unless a later Congress and President do something about it).

The future top rates and exemption amounts are as follows:

Year	Top Rate %	Exemption $US	Credit Amount
2001	55	675,000	-
2002	50	1,000,000	-
2003	49	1,000,000	-
2004	48	1,500,000	-
2005	47	1,500,000	-
2006	46	2,000,000	-
2007	45	2,000,000	-
2008	45	2,000,000	-
2009	45	3,500,000	1,455,800
2010	N/A repealed	N/A repealed	-
2011	55	1,000,000	-
			1,455,800

APPENDIX D

U.S.Estate Tax Calculation

Year of Death	2009
FMV of U.S. Property in U.S. funds	6,500,000
Less deductions (see below)	-
Taxable Estate	6,500,000
Taxes on U.S. property	2,805,800
Unified credit (see calculation below)	(1,455,800)
Marital credit (see calculation below)	-
Other credits (refer to Data Input Sheet)	-
U.S. Estate tax (If negative number = $0 U.S estate tax payable)	1,350,000

Unified Credit Calculation

Credit equals the greater of A and B:

A	Minimum credit for non U.S. residents or citizens	13,000		13,000
B	Credit for U.S. residents x proportion of U.S. property to total property			
	FMV of U.S. property (U.S.$)	6,500,000		
	FMV of total assets	6,500,000		
	Portion of U.S. investments to total assets	100.00%	100.00%	
	Credit for U.S. residents		1,455,800	
	Credit for non U.S. residents or citizens		1,455,800	**1,455,800**

Canadian Marital Credit Calculation (Pursuant to Article XXIX B, paragraph 4, of the Canada-U.S. Income Tax Convention)

Credit equals the lesser of A and B:

A	Unified Credit above		1,455,800	
B	Amount by which 1 exceeds 2			
	1 Taxes on Total U.S. property	2,805,800		
	Property not transferred to spouse	6,500,000		
	Less deductions (see below)	-		
		6,500,000		
	2 Taxes on property not transferred to spouse	2,805,800		
			0	
	Marital Credit			-

Deductions

Itemized Deductions			For Marital Credit
1.	Funeral Expenses	0	
2.	Income tax liability at death	0	
3.	Legal Expenses for Estate Administration	0	
4.	Claims against the Estate	0	
5.	Unpaid mortgages or other liens	0	
6.	Uncompensated Losses	0	
		0	
		100.00%	100.00%
	Allowable Itemized Deductions	0	-

Other Deductions		
Charitable Deduction	0	
Marital Deduction	0	
	0	
Total Deductions	0	-

Appendix D-1

2009 Unified Transfer Tax Rate Schedule

The unified rate schedule applying to estates of decendents dying and gifts made after 1983 appears below:

Tax on U.S. property calculation	Tax on transferred U.S. property calculation	Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in column A	Column D Rate of tax on excess over amount in column A Percent
6,500,000	6,500,000				
-	-	$ -	10,000	$ -	18%
-	-	10,000	20,000	1,800	20%
-	-	20,000	40,000	3,800	22%
-	-	40,000	60,000	8,200	24%
-	-	60,000	80,000	13,000	26%
-	-	80,000	100,000	18,200	28%
-	-	100,000	150,000	23,800	30%
-	-	150,000	250,000	38,800	32%
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-	-	1,000,000	1,250,000	345,800	41%
-	-	1,250,000	1,500,000	448,300	43%
2,805,800	2,805,800	1,500,000	999,999,999,999	555,800	45%
2,805,800	2,805,800	**Lifetime exemption amount:**	**3,500,000**		

* Under the U.S. legislation, the top rate is declining over the next several years and the the exemption amount is increasing.
The estate tax and GST are repealed entirely for 2010. However, according the the U.S. legislation, the estate tax is repealed only for individuals dying in 2010. This is true because the entire U.S. tax bill is itself repealed on December 31, 2010, at which time all of the current rules would return (unless a later Congress and President do something about it).

The future top rates and exemption amounts are as follows:

Year	Top Rate %	Exemption $US	Credit Amount
2001	55	675,000	-
2002	50	1,000,000	-
2003	49	1,000,000	-
2004	48	1,500,000	-
2005	47	1,500,000	-
2006	46	2,000,000	-
2007	45	2,000,000	-
2008	45	2,000,000	-
2009	45	3,500,000	1,455,800
2010	N/A repealed	N/A repealed	-
2011	55	1,000,000	-
			1,455,800

TAB 3B

Us Beneficiaries of Non-Us Trusts – Benefit or Detriment?

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3B

US BENEFICIARIES OF NON-US TRUSTS – BENEFIT OR DETRIMENT?

BY: Jim Yager, KPMG LLP[i]

United States citizens and residents (US persons) should be thrilled to be a beneficiary of a foreign trust. However, they should be cognizant of the US tax law which has been enacted with the intent to eliminate abusive offshore trust structures. Additionally, in certain situations beneficiaries can be subject to tax on deemed income even if the trust does not distribute the income. Consequently, US beneficiaries and their tax advisors should be aware of these complex rules and take appropriate steps to mitigate the potentially adverse tax consequences. Failing to plan appropriately can turn the lucrative beneficiary status to a detrimental nightmare.

Grantor or Non-grantor Trust

If any of the beneficiaries of a foreign trust[ii] are US persons, the US income tax consequences to such beneficiaries depend on whether the trust is a grantor trust or a non-grantor trust.

If the grantor[iii] of a portion of the trust is a US person, that portion of the trust will be considered a grantor trust pursuant to section 679 if any beneficiary is also a US person. Under these circumstances, the US grantors will be liable for the US income tax attributable to that portion of trust assets.

If the grantor of a portion of the trust is not a US person, that portion of the trust will be a grantor trust only if:

- The grantor has the power to revest to himself title to that portion of the trust property without the approval or consent of any other person or with the consent of a related or subordinate party who is subservient to the grantor, or

- The only amount distributable from such portion during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor.[iv]

The grantor trust rules were modified on August 20, 1996. Prior to that date, it was easier for a non-US person to be considered the grantor of a grantor trust. The new law allows trusts existing on August 20, 1996 to maintain their grantor trust status under "grandfathering" provisions if the trust was treated as owned by the grantor under IRC sections 677 or 676.[v] IRC section 676 provides that the grantor is treated as the owner of any portion of a trust, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party or both. IRC section 677 provides that the grantor is treated as the owner of any portion of a trust, whose income can be distributed to the grantor (or may be held or accumulated for future distribution to the grantor), without the approval or consent of any adverse party, or in the discretion of the grantor or a nonadverse party. An adverse party is any person having a substantial beneficial interest in the trust, which would be adversely affected by the exercise or nonexercise of the power, which he possesses respecting the trust. A nonadverse party is a person who is not an adverse party. [vi]

The US beneficiary of a foreign grantor trust is not subject to US income tax on either income of the trust or distributions from the trust, since the foreign grantor is deemed the owner of such income. A foreign grantor trust can present a significant tax advantage to a US beneficiary. However, once the foreign grantor dies, it is likely that the trust will become a non-grantor trust.

If the foreign trust is not a grantor trust, the trust will likely be considered a foreign non-grantor complex trust if the trust can accumulate income.[vii] The balance of this paper will review the US tax implications to US beneficiaries of a foreign non-grantor complex trust.

US Taxation of Trust Distributions

On receiving distributions from non-grantor trusts, US beneficiaries (residents and citizens) are generally subject to US tax based on the distributable net income (DNI) of the trust. In the case of a foreign trust, DNI is generally the taxable income of the trust under US rules, including capital gains.[viii] Distributions of accumulated trust income are subject to tax computed under the "throwback" rules. These rules subject a US beneficiary to income tax plus an interest charge for the period during which US income tax on the income has been protected (offshore) from US taxation. Distributions in excess of DNI and accumulated trust income are treated as distributions of capital and are not subject to US income tax.

Special throwback rules apply to certain distributions from a foreign trust to a US beneficiary.[ix] The rules are designed to prevent the accumulation of trust income by a trust over a period of years with a distribution to a beneficiary only in low-income years.[x] The rules also prevent a distribution from being treated as a non-taxable distribution of "trust corpus" in situations where the foreign trust has accumulated income in prior years.

The rules have the effect of carrying back to the preceding years any distributions in excess of DNI (ordinary income) for the distribution year and taxing them in the beneficiaries' hand in the same manner as if the income had been distributed in the year it was actually earned (and accumulated) by the trust. This additional income is taxed to the beneficiary in the year that the beneficiary receives the accumulation distribution, but the beneficiary's tax liability is computed on Form 4970 (Tax on Accumulation Distribution of Trusts).

The beneficiary may claim a foreign tax credit for Canadian or other foreign income taxes previously paid by the trust.[xi] Because the Canadian income tax rates currently imposed on the income of a trust are comparable to and often higher than the US income tax rates imposed on individuals, one would expect that the accumulations distributions rules would not produce material amounts of additional tax. However, when a capital gain is accumulated in a foreign trust, it is reclassified as ordinary income in the later year in which it is received by the beneficiary. Because the capital gain loses its status and is treated instead as ordinary income, US income tax applies not at the preferred capital gains tax rate but at the higher ordinary income tax rates.[xii] The additional tax is payable with an interest charge for the deemed deferral period.[xiii]

If a trust has one or more US beneficiaries, the trustees must take care with regard to ongoing trust administration to avoid the additional US income taxes potentially imposed under the US "throwback" rules. Careful administration of the trust is advisable to avoid the accumulation of income in the trust that would be subject to adverse US tax treatment to the US beneficiary in a subsequent year. For example, a corporate reorganization of the shares of a closely held company owned by the trust may be non-taxable in Canada but taxable for US tax purposes. The trust would then recognize DNI, which – if not distributed currently – would become accumulated income in the trust. A distribution from the trust in a subsequent year could result in taxable ordinary income to US beneficiaries. There would be no foreign tax credits since no Canadian taxes were paid. The interest charge would also apply.

US Tax and Information Filing Requirements

The trustees must also be aware of the US beneficiary's information reporting requirement to disclose data related to the interest in the "foreign trust" and provide the beneficiary with sufficient information to make these filings.

For any year(s) in which a US beneficiary receives a distribution from the trust, the beneficiary is required to report such information on Form 3520. Significant penalties – generally equal to 35% or more of the gross value of the trust distributions – may be imposed on the beneficiary if the required form is not filed.[xiv]

A US beneficiary is also required to complete Form 4970 (Tax on Accumulation Distribution of Trusts) for each tax year in which an accumulation distribution is received as an attachment to form 3520. Schedule J of Form 1041 (Accumulation Distribution for Certain Complex Trusts) is used to determine the amount, the year, and the character of the additional distribution taxable to beneficiaries under the throwback rules. Non-deductible interest and penalties apply to an understatement of tax and/or a failure to file a complete return.

US Estate Tax Consequences

Depending on the terms of the trust, all or a portion of the trust's assets may be includible in the estates of the beneficiaries for US estate tax purposes. Two common situations, which would cause the trust assets to be includible in the beneficiary's taxable estate are as follows:

- Sometimes the beneficiaries of the trust are named as one of the trustees. A beneficiary's authority to participate in the determination of the timing and amounts of trust distributions constitutes a "power of appointment" (a power that is exercisable in favour of the decedent, his estate, his creditors, or the creditors of his estate). If the power is considered to be a "general power of appointment," then the entire trust capital (or the portion to which the power relates) is treated as part of the beneficiary's estate for tax purposes.[xv] In order to avoid inclusion of the trust assets in the beneficiary's taxable estate, it is advisable for this power to be limited to an "ascertainable standard" relating to the power holder's health, education, support, or maintenance. Another option would be to exclude the beneficiary from any decisions involving distributions to himself. [xvi]

- Sometimes the beneficiaries of the trust are given the power to designate the individuals who will inherit a portion of the trust's assets. Such a power is typically exercised by including related provisions in the beneficiary's Will. The portion of the trust over which the beneficiary holds a general power of appointment is includible in the beneficiary's taxable estate, even if the beneficiary does not exercise the power. If such treatment is inconsistent with the family's estate and generation-skipping transfer tax planning intentions, then such power should not be granted to the beneficiary.

Attribution of Ownership

Although the beneficiaries of the trust do not directly own any shares of companies owned by the trust, the US tax rules may cause them to be considered owners of the shares and subject them to reporting requirements and potential taxation arising from a deemed dividend.

The attribution of ownership rules for controlled foreign corporations ("CFCs"), and passive foreign investment companies ("PFICs") attribute shares owned by a trust to the beneficiaries as follows:

CFC rules: A CFC is generally a foreign corporation if more than 50% of the total combined voting power or the total value of the stock is owned by US shareholders on any day during the taxable year.[xvii] A US shareholder is a US person (including a US citizen or resident) who owns 10% or more of the total combined voting power of all classes of stock entitled to vote.[xviii] A person is considered to own stock that is owned indirectly through other entities and stock that is owned by attribution. Stock owned directly or indirectly by or for a foreign trust is considered to be owned proportionately by its beneficiaries.[xix] A person's proportionate interest is determined on the basis of all the facts and circumstances.[xx]

The CFC rules are quite complicated and will not be reviewed in detail in this paper. However, if a CFC receives certain "tainted income" such as subpart F income (including investment income), the US shareholders must recognize a deemed dividend, even if not distributed. Furthermore, US beneficiaries of a trust could be taxed on the deemed dividend if the beneficiary is considered an indirect owner of the CFC.

PFIC rules: A PFIC is a foreign corporation that meets one of two tests: 1) 75% or more of the foreign corporation's gross income is passive, or 2) more than 50% of the assets of the foreign corporation produces passive income.[xxi] If a foreign corporation owns 25% or more of another company, the tests are applied on a "look-through" basis, where the foreign corporation is deemed to own its pro rata share of the assets and income of the subsidiary.[xxii] If a corporation meets both PFIC rules and it is also a CFC, a US shareholder of the corporation is exempt from the PFIC provisions. However, if the company was a PFIC before it was a CFC or before 1998, the PFIC provisions may still apply.[xxiii]

If a US person receives an "excess distribution" from a PFIC or disposes of the shares of a PFIC, he or she would be subject to the harsh PFIC taxing regime unless he or she previously made a "qualified electing fund" (QEF) election.

Generally, if a US individual realizes a gain from the sale of a PFIC or receives an excess distribution from a PFIC, he or she is required to allocate the income to each day over the entire holding period.[xxiv] For each year that the company was a PFIC (other than the current year), the allocated income would be subject to tax at the highest individual tax rate for that year.[xxv] An interest charge (at the IRS underpayment rate) would also be assessed from the due date of the tax return for that prior PFIC year, until the due date of the tax return for the current year.[xxvi] Any income allocated to the current year or to pre-PFIC years would be included as ordinary income in the current year.[xxvii] An excess distribution is a distribution from the PFIC to the extent it exceeds 125% of the average of the distributions of the prior three years.[xxviii]

In the year that a company either become PFICs or is acquired by a US person, the US person could elect QEF status by filing Form 8621 with his tax return and checking the appropriate box. It is important that the US person make the election in the first PFIC year to avoid potentially more onerous elections in future years. Shareholders of a QEF must include in income their pro rata share of the ordinary earnings and net capital gains of the company.[xxix] The PFIC must comply with various reporting requirements or the QEF election will not be allowed.[xxx] The QEF election may protect the shareholder from the harsh tax consequences arising from the taxation of a disposition of PFIC shares or an excess distribution.

For PFIC purposes, stock owned directly or indirectly by a trust is considered to be owned proportionately by its beneficiaries.[xxxi] Therefore, if a foreign trust owns shares in a PFIC, the US beneficiaries may face adverse tax consequences.

Generally, the two taxing regimes have similar, but not identical, attribution rules, but they provide little or no guidance on how to attribute stock ownership to beneficiaries of a fully discretionary trust. In PLR 9024076, the IRS was faced with determining the actuarial interest of beneficiaries of a discretionary trust for purposes of the personal holding company rules. The IRS considered the facts and circumstances to determine a beneficiary's actuarial interest. The IRS considered the pattern of distributions to determine what portion of current income had been distributed to beneficiaries. Then, with reference to mortality tables based on the age of each beneficiary, it determined an actuarial interest for each beneficiary. The IRS in TAM 200733024 used a "facts and circumstances" test to determine which beneficiaries indirectly owned the PFIC stock. The facts and circumstances test in that instance seemed to incorporate the actuarial interest concept, though not necessarily directly. Presumably if a trust has a pattern of distributions, the IRS could use a similar methodology to determine proportionate interest for purposes of the CFC and PFIC rules. Without a pattern of distributions and without some other appropriate method to determine actuarial interest, it is impossible to determine an actuarial interest. So, in the absence of such patterns or IRS guidance, a discretionary beneficiary could conservatively report his portion of the trust based on the number of beneficiaries, or potentially claim that he or she has no actuarial interest in a discretionary trust.

If shares of companies owned by the trust are attributed to the beneficiaries, the beneficiaries must determine whether they are shareholders of a CFC or PFIC based on the ownership attribution rules. Although the beneficiaries may be treated as owning shares of a CFC or PFIC, whether they would actually be required to include amounts in gross income under these provisions must additionally be determined under each anti-deferral regime.[xxxii] The reporting and income recognition requirements must be met to avoid penalties.

If any of the companies owned by the trust are PFICs, the US beneficiaries should consider electing QEF status in the initial year of the trust to protect themselves from the onerous PFIC rules.[xxxiii]

CONCLUSION[xxxiv]

Many Canadian trusts have US beneficiaries. The focus of planning for US beneficiaries is to avoid an accumulation distribution from the trust, avoid deemed dividends from companies and avoid adverse penalties. This involves close, ongoing attention to the trust's affairs to ensure there are no tax surprises. With appropriate attention, the US person can enjoy beneficiary status rather than suffer detrimental US tax liabilities.

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[ii] IRC section 7701(a)(31) defines a foreign trust as a trust that is not a US trust as defined in IRC section 7701(a)(30). A US trust is a trust where a court within the US is able to exercise primary supervision over the administration of the trust, and one or more US persons have the authority to control all substantial decisions of the trust.

[iii] Reg. section 1.671-2(e) defines a grantor to include any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer of property to the trust. A gratuitous transfer is any transfer other than a transfer for fair market value.

[iv] IRC section 672(f)(2)

[v] Regulations section 1.672(f)-3(b)(3) provides the following:

> "Grandfather rule for certain section 677 trusts in existence on September 19, 1995. Subject to the rules of paragraph (d) of this section (relating to separate accounting for gratuitous transfers to the trust after September 19, 1995), the general rule of §1.672(f)-1 does not apply to any portion of a trust that was treated as owned by the grantor under section 677 (other than section 677(a)(3)) on September 19, 1995, as long as the trust would continue to be so treated thereafter. However, the preceding sentence does not apply to any portion of the trust attributable to gratuitous transfers to the trust after September 19, 1995." Similarly, regulation section 1.672(f)-3(a)(3) provides a grandfather rule for certain section 676 trusts.

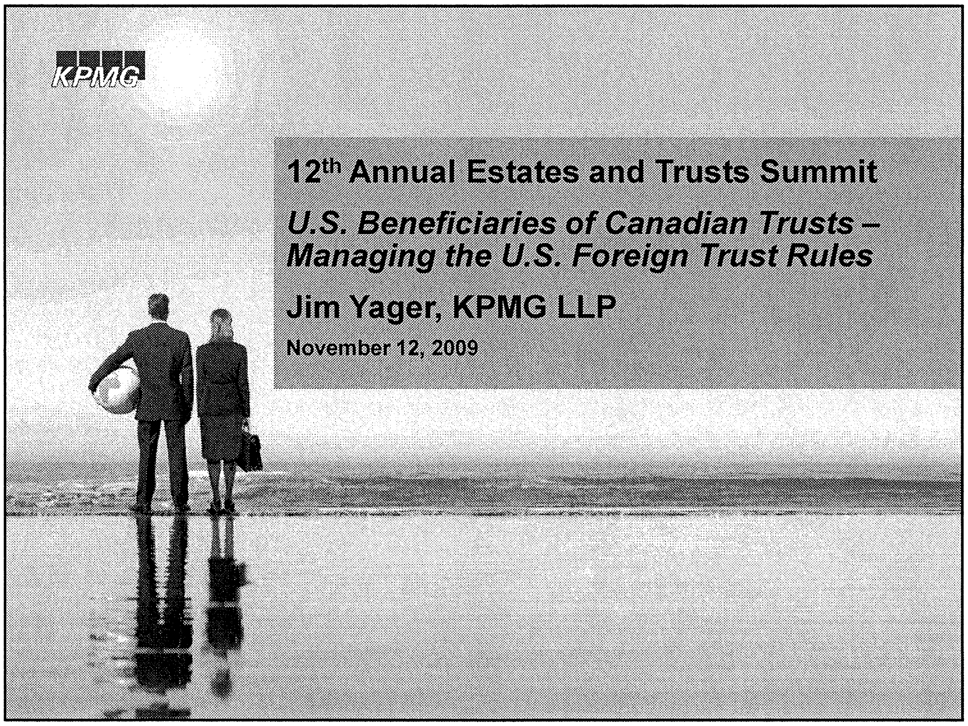
[vi] IRC section 672(a) & (b)

[vii] Reg. section 1.661(a)-1.

[viii] IRC sec. 643(a)(3)(C)

[ix] IRC section 667

[x] This "throwback" concept was adopted in the US in 1954. The throwback rules were repealed for domestic accumulations trusts by the Small Business Job Protection Act of 1996, however, the rules remain applicable to distributions from foreign trusts.
[xi] IRC section 667(d).
[xii] IRC section 643(a),(b),(c).
[xiii] IRC section 668.
[xiv] IRC section 6677(a).
[xv] IRC section 2041(b)(1)(C)(ii).
[xvi] IRC section 2041(b)(1)(A).
[xvii] IRC section 957(a).
[xviii] IRC section 951(b) .
[xix] Reg. section 1.958-1(b).
[xx] Reg. section 1.958-1(c)(2).
[xxi] IRC section 1297(a).
[xxii] IRC section 1297(c).
[xxiii] IRC section 1297(e). This section became effective for tax years beginning after December 31, 1997. For prior years, a foreign corporation could have been both a CFC and a PFIC. Under such circumstances the US shareholder would have been considered the shareholder of a PFIC, unless a QEF election was timely made.
[xxiv] IRC section 1291(a)(1)
[xxv] IRC section 1291(c)
[xxvi] IRC section 1291(c)(3)
[xxvii] IRC section 1291(a).
[xxviii] IRC section 1291(b).
[xxix] IRC section 1293.
[xxx] IRC section 1295.
[xxxi] IRC section 1298(a)(3).
[xxxii] For instance, under the Subpart F provisions, a foreign corporation may be a CFC because US shareholders are considered to constructively own its stock, although the Subpart F provisions only require inclusion of income if the US shareholder owns stock directly or indirectly. See IRC section 951(a)(1); 951(b).
[xxxiii] Similar to the CFC provisions, the PFIC provisions do not tax constructive owners of PFIC stock.
[xxxiv] The information contained herein is general in nature and based on authorities subject to change. Applicability to specific situations is to be determined through consultation with your tax advisor.



US Beneficiary – Benefit or detriment?

- **Benefits –**
  - Wealth transfer
  - Possible tax savings and deferrals
  - Insulation from estate tax
- **Detriments**
  - Increased taxation
  - Penalties
  - Complex compliance
  - Estate tax exposure

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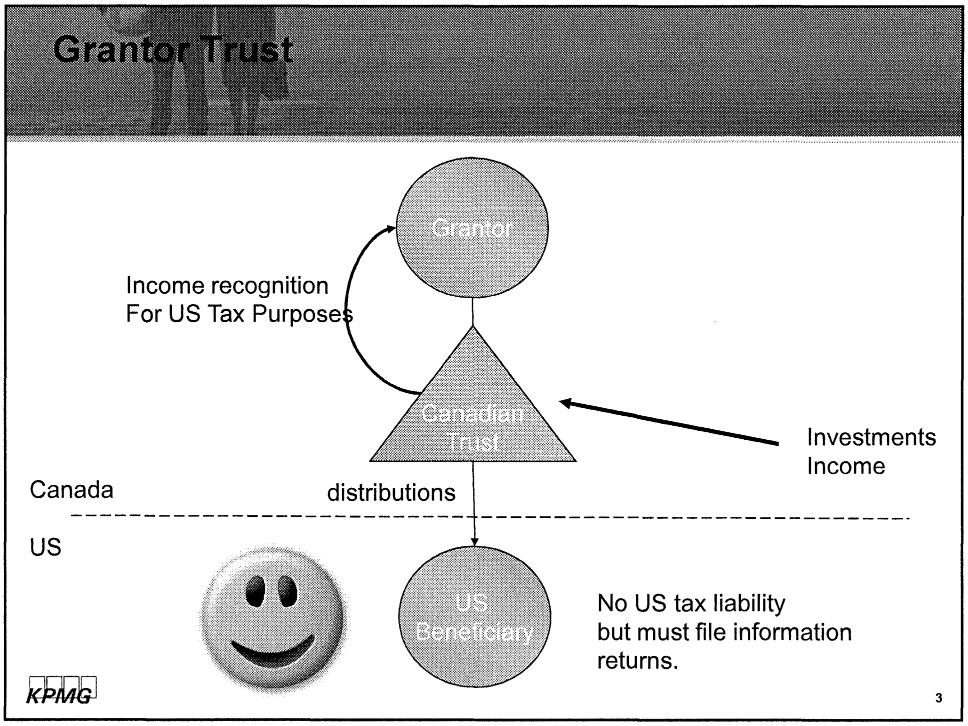
Grantor Trust
Grantor
Income recognition
For US Tax Purposes
Canadian Trust
Investments
Income
Canada
distributions
US
US Beneficiary
No US tax liability
but must file information
returns.
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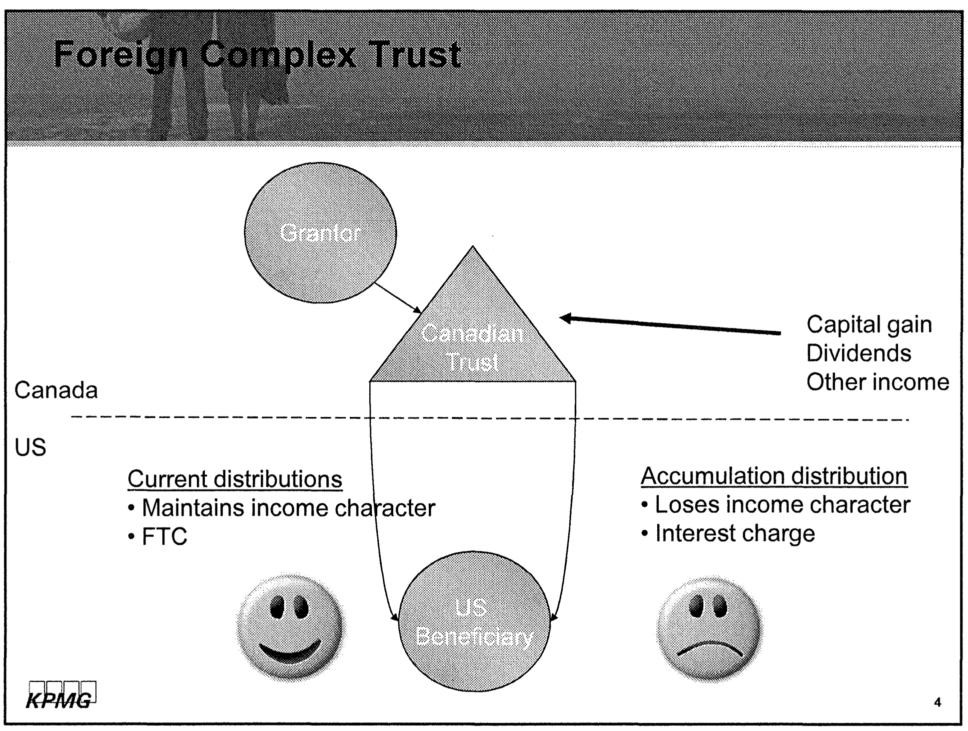
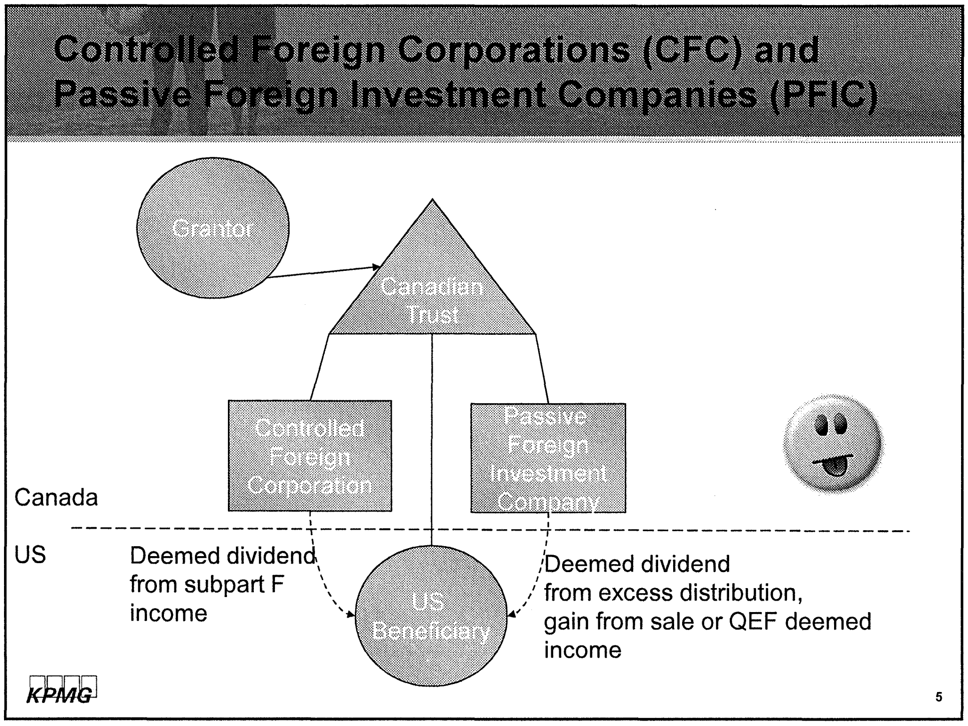
3


Foreign Complex Trust
Grantor
Canadian Trust
Capital gain
Dividends
Other income
Canada
US
Current distributions
• Maintains income character
• FTC
Accumulation distribution
• Loses income character
• Interest charge
US Beneficiary
KPMG
4


Controlled Foreign Corporations (CFC) and Passive Foreign Investment Companies (PFIC)
Grantor
Canadian Trust
Controlled Foreign Corporation
Passive Foreign Investment Company
Canada
US
Deemed dividend from subpart F income
US Beneficiary
Deemed dividend from excess distribution, gain from sale or QEF deemed income
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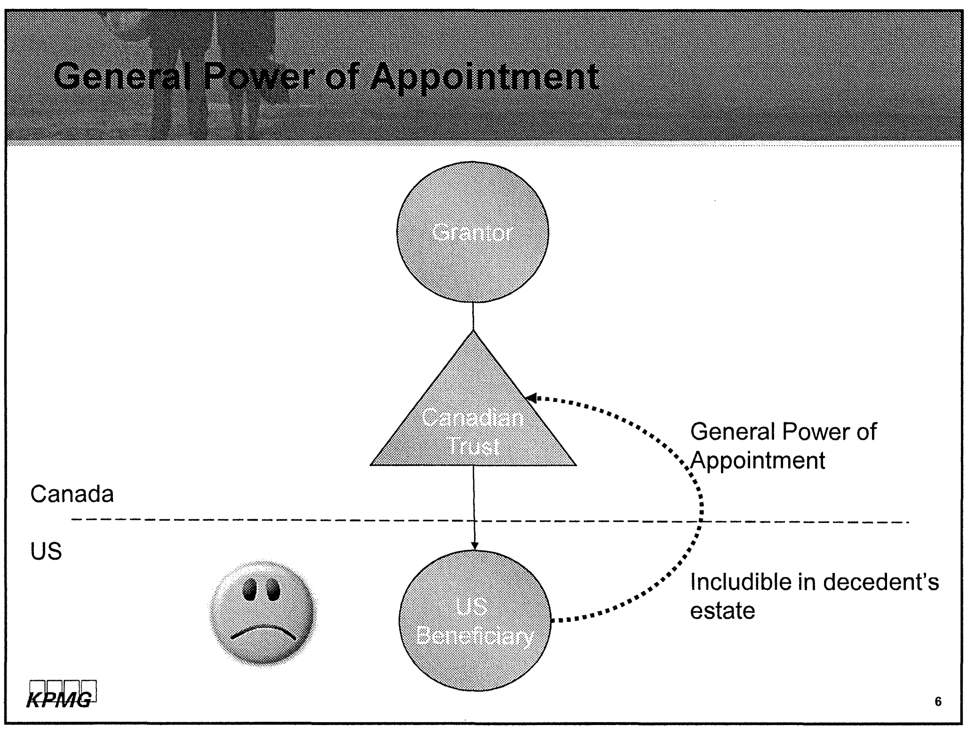
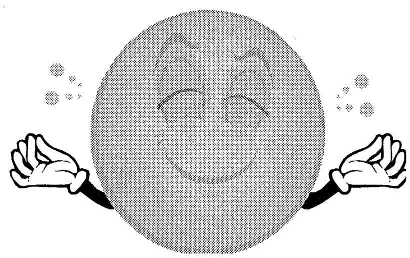
5


General Power of Appointment
Grantor
Canadian Trust
General Power of Appointment
Canada
US
Includible in decedent's estate
US Beneficiary
KPMG
6

Advanced Planning Can Keep US Person a Happy Beneficiary



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7

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8