

CLIENT ALERT

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IS NOW THE RIGHT TIME FOR AN ESTATE FREEZE?

by Jennifer C. Leve and Carly J. Walter

IS AN ESTATE FREEZE THE RIGHT TAX MOVE?

In the midst of COVID-19 and the surrounding economic uncertainty, Canadians have found themselves significantly impacted. Business owners have seen their enterprises grind to a halt, while investors have watched their portfolios bottom out. With much out of our control, it may still be possible to regain control by taking advantage of the current conditions with tax-saving measures to provide some financial security and future certainty.

WHAT IS AN ESTATE FREEZE AND WHY MIGHT YOU BENEFIT FROM ONE NOW?

An Estate Freeze is a mechanism by which the value of an individual's assets, including an active business, can be "frozen" at a particular moment in time. To see why an Estate Freeze may benefit you now, it's important to understand the tax implication on death for an individual holding private company shares and/or investments directly.

Capital gains are imposed on death by way of a "deemed disposition" on private company shares and investments to the extent of the "gain" which is equivalent to the market value of the asset over the amount of its cost. In a typical example, a security purchased for \$100 and worth \$1000 on the date of death will give rise to a \$900 capital gain of which 50% (\$450) is included in income and subject to tax. In the case of private company shares, most of which were likely subscribed for by the initial shareholder at a nominal value (for example, \$10 on incorporation), the value of the capital gain on death can be quite substantial if no tax planning is undertaken prior to death and the business has appreciated significantly. The result of this can be a large capital gain on death and a large tax burden to the beneficiaries of the estate.

Before undertaking an Estate Freeze, the taxpayer may have to perform an additional step to move his or her assets into a corporation. Once a shareholder of a private company, the individual may perform the Estate Freeze. With a properly administered Estate Freeze, the taxpayer's shares are essentially converted from participating common shares into "frozen" preferred shares, which are equivalent to the value of the common shares they exchanged but which do not participate in future growth of the assets or business. Generally, new shareholders, such as the next generation or a family trust, become the new common shareholders and can participate in future growth as the assets and business appreciate in value. As the business and/or assets increase in value over the years, that increase is attributed to the participating common shares, while the taxpayer's frozen preferred shares can never increase in value.

When undertaken properly, significant tax and family objectives may be achieved. Along with "freezing" the maximum capital gain tax liability to today's value at the time of death, a correctly made gift of shares to a child during a child's marriage should fall outside of the ambit of that child's "net family property" meaning it should not have to be shared with that child's spouse in the event of a breakdown of the marriage.

An additional benefit is that every individual is entitled to what is referred to as the "Lifetime Capital Gains Exemption," which can currently shelter up to \$883,000 of capital gains on the sale of certain types of active business corporation shares. If available, a taxpayer can freeze their shares and, if new shareholders are introduced as part of the estate freeze, can multiply the number of capital gains exemptions that can be available on the sale of the shares down the road, potentially resulting in significant savings in the future.

IS NOW THE RIGHT TIME TO UNDERTAKE AN ESTATE FREEZE?

If you believe the value of your assets and/or business have hit a low point, it may be the right strategy to capture this lower value (and minimize your future tax burden) in new frozen preferred shares which would not increase in value as the markets, and your business, recover down the road.

If, in the past, you have already performed an Estate Freeze and already own frozen preferred shares, you may still take advantage of the reduced value of your underlying business and assets and lower your future tax bill by completing a "thaw" of those frozen preferred shares and "re-freezing" at today's lower value.

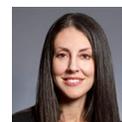
HOW DOES A FAMILY TRUST FIT IN TO AN ESTATE FREEZE?

A family trust can be implemented at the same time as the Estate Freeze to hold the participating common shares and can provide you with additional flexibility and tax planning opportunities, as well as allow you to maintain control of your business and assets. A properly formed family trust can assist not only with tax planning, but with family and even creditor protection objectives.

HOW WE CAN HELP

We remain committed to paying attention to the changing circumstances and taking advantage of planning opportunities. Contact a Dickinson Wright LLP team member to discuss your current financial situation and see what is the best option for you.

ABOUT THE AUTHORS



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Please Note: These materials do not constitute legal or medical advice. Government initiatives, announcements, and regulations in response to the COVID-19 situation continue to evolve and change frequently.

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