Estate Freeze 101

If the value of your corporation has appreciated over the years and it is expected to continue to grow, you may want to consider an estate freeze. This strategy allows an individual to set a fixed value on or "freeze" the value of their property and pass any future growth to the next generation.

What is an Estate Freeze?

- An estate freeze is an estate-planning strategy with the goal of locking in the current value (and therefore the tax liability), of a capital property while allowing the flexibility to attribute the value of future growth of that capital property to another person.

Assume, for example, that a business owner owns shares of her social media company valued at $5,000,000 and that the company has excellent growth prospects in the coming years. In simple terms, an estate freeze allows her to *exchange* her common shares for ***preferred shares*** with a fixed value of $5,000,000. Fixing the value of her shares allows her to more accurately calculate her future tax liability and develop any necessary strategies to reduce taxes when the shares are eventually disposed of. The other set of shares, ***common shares***, can be allocated to her children or be held in a Trust. These shares will continue to accumulate value as the company grows.

What are the benefits?

- An estate freeze fixes the value of the asset that is frozen, such as shares of a corporation, in the hands of the owner until the time of death, allowing the ”freezer” to anticipate the expected tax liability that will arise when the owner passes on.

- The new frozen assets (typically preferred shares) can be redeemed over time, allowing for an income stream as well as spreading out and reducing the tax liability over many years.

- A further benefit of an estate freeze is that it allows the accrual of the post-freeze growth in value in the hands of other persons, usually the owner’s family. This makes the estate freeze an effective way of transferring value to the future generation, by allowing the growth to be attributed to the next generation and also defer the tax. In some instances, if the lifetime capital gains exemption can be utilized, the receiving family member(s) may multiply and further increase the tax benefits across generations.

- Based on how the new structure is set up -- for example, by having new common shares issued and owned by a family trust -- there can be protection against creditors.

How do I do it?

An estate freeze can be implemented in many different ways depending on the individual’s current corporate structure and the assets subject to the freeze. For this reason, an estate freeze is a complex strategy that requires the involvement of a tax lawyer or an accountant competent in this area. It is often best to obtain a recommendation from a reliable source such as your financial advisor, accountant or a professional or industry group.

When do I do it?

There is no set date to trigger an estate freeze. However, the ideal date may depend on certain factors, such as the desired retirement date of the principal owner, or the readiness of the potential successors. The best time to implement an estate freeze can also depend on the value of the company. For example, when there is a market downturn, the value of the asset will have decreased, providing an excellent opportunity to lock in the value at a lower amount to allow the growth, or recovery, to be attributed to the successor(s). As long as the reduced value does not put the original owner at risk of not having enough assets, it can be a way to reduce taxes even further.

What are the pitfalls of an Estate Freeze?

- If not executed properly, this can create a taxable event. If the freeze value does not match the fair market value of the property, this may result in a shareholder benefit, which would require it to be reported as income,

- The Canada Revenue Agency (CRA) may dispute the valuation of the estate freeze asset,

- Failure to account for a new asset in your Will may result in that asset going to an unintended beneficiary.

Are there other considerations to take into account?

- An important consideration in undertaking this strategy is the cost of implementing the freeze. These costs can include valuation fees, tax planning fees, legal fees and fees associated with ongoing accounting and legal upkeep; i.e., if there is a new family trust created. As a result, the projected benefits of this strategy should outweigh the cost of implementation.

Consult with your tax and legal advisors to determine if an estate freeze is suitable for your circumstances.