

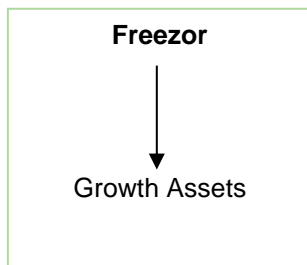
Structuring an Estate Freeze

Estate Freeze strategies

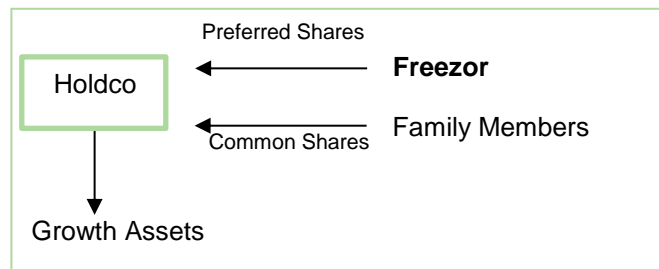
1. Holdco Freeze

This type of freeze involves the transfer of growth assets by the freezor (i.e., the current owner of the growth assets who wishes to transfer the future growth of those assets to the next generation) to a new corporation on a tax deferred basis in exchange for preferred shares of the new company with a fixed value equal to the fair market value (FMV) of the growth assets at the time of the exchange.

Prior to Freeze



Post-Freeze



How it works:

- A new company (Holdco) is incorporated.
- Growth assets belonging to the freezor are transferred to Holdco.
- In exchange, the freezor must take back shares of Holdco but can also take additional non-share consideration. Usually, the freezor will take back preferred shares that have a fixed value equal to the FMV of the growth assets at the time of the freeze. This ensures that the capital gains tax liability on the death of the freezor will not increase. The freezor will in many cases also take back a special class of low-value voting shares which carry more votes than the new common shares, in order to retain control over the Holdco. Family members (usually the children of the freezor) subscribe for new common shares of Holdco. New common shares are growth shares with nominal initial value but which carry rights to all future appreciation.

2. Internal Freeze / Reorganization of Capital

This is a simpler way to freeze the value of an asset with no holding company required, and no election form needs to be filed. The transaction involves filing articles of amendment to provide for the creation of a new class of preferred shares and the conversion of the shares to be frozen into shares of this new class.

How it works:

- The corporation files articles of amendment to create the new class of preferred shares. These new preferred shares will typically be retractable and redeemable for an amount equal to the fair market value of the common shares immediately prior to the exchange.
- All the common shares held by the freezor (the “freeze shares”) must be exchanged for the new preferred shares.
- Family members (usually the children of the freezor) subscribe for new common shares (these are the growth shares).

The freezor will not trigger an immediate capital gains liability on the share exchange if the steps are carried out properly.

3. Family Trust Estate Freeze

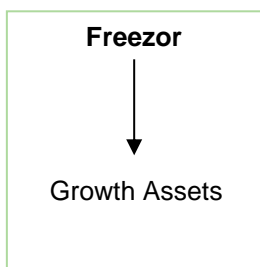
Instead of issuing common shares directly to the intended beneficiaries in a Holdco freeze or an internal freeze, the freezor may wish to use a discretionary inter-vivos family trust (meaning that the trust is created during the lifetime of the freezor) to hold legal title to the common shares. Depending on the terms of the trust, a family trust can be structured to meet the objectives of the freezor (such as planning for dependents with disabilities, blended family situations, marital breakdowns etc.) while still providing flexibility for future planning. The beneficiaries of the trust are usually the children/grandchildren and other family members of the freezor.

After the freeze, the trustees will control the trust assets. The trustees may be provided broad powers to determine when and how income or capital is to be distributed to the beneficiaries. For example, this would allow flexibility in who gets allocated dividends from a Holdco. Having a discretionary trust can also help alleviate concerns about the dissipation of family wealth on a child’s marital breakdown or as a consequence of the potential claims of creditors.

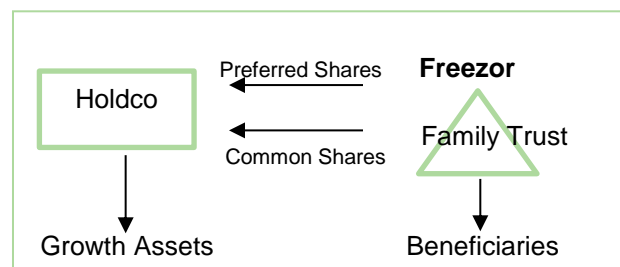
While the family trust is a useful tool in the context of an estate freeze, one must be aware of the limitations that can arise. For example, the 21-year deemed disposition rule associated with trusts, as well as other technical roadblocks, including personal and corporate attribution rules can arise. These issues involve extended discussion and professional advice should always be sought when a family trust estate freeze is contemplated.

Illustration of a Holdco Family Trust Freeze

Prior to Freeze



Post-Freeze



Important considerations in implementing an Estate Freeze:

Valuation of the Freeze Shares

Consider the use of an independent valuator to help establish the company’s fair market value. This is important because the valuation of a closely-held corporation can be very complicated. Valuation

reports prepared by the freezer's usual accounting advisors tend to be more vulnerable to a challenge by the Canada Revenue Agency (CRA).

It is also prudent to include a price adjustment clause. The way this works is that, in case CRA refuses to accept the valuation relied on by the parties, the parties may subsequently adjust the price to any revised determination.

Timing of the Freeze

It is important not to freeze the value of the assets prematurely in light of potentially increased life expectancy. Given the effects of inflation, if the freezers do not accurately predict the funding requirements to maintain their lifestyles, they may later find themselves in the unenviable situation of being required to adjust to a lifestyle less affluent than that which they enjoyed prior to the estate freeze.

Family Law Legislation

Family law legislation varies from province to province and it is important to consider the potential impact upon the company shares should a beneficiary experience a relationship breakdown. Professional legal advice should be sought in this regard before proceeding with an estate freeze.

An estate freeze can be a critical component of the business owner's business succession plan. As estate freezes are complicated transactions, professional advice should be obtained.



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