

## EFFECTING AN ESTATE FREEZE

By Stuart Bollefer and Henry Chong, Aird & Berlis LLP

### Masters Series

This is one of a series of articles prepared for CIBC Private Wealth Management™. The series is written by professionals in such fields as taxation, trusts, and estates.

One of the things that should be considered as part of your estate planning is whether a “freeze” can be effected for any of your property. In the appropriate circumstances, an estate freeze can provide both tax and non-tax benefits during your lifetime and upon your death.

An estate freeze generally involves reorganizing the ownership of your property so that the value of your interest is fixed (or “frozen”) at its level on the date the reorganization is completed. Any future increase in the value of the property is transferred to your family members, typically your children, either directly or through a trust for their benefit.

Here’s an example. Suppose that you own a property that is worth \$1,000,000. You transfer the property to a corporation (“Holdco”) in exchange for preferred shares of Holdco. The value of these shares is fixed at the time of purchase to reflect the fair market value of the property. (Note that if the property has increased in value since the time you purchased it, the transfer may trigger a taxable capital gain.) The value of these shares will not change over time. As a result, your interest in the property is “frozen” at the value of the preferred shares.

Holdco then issues new common shares, which your children acquire for a nominal amount. These shares will fluctuate in

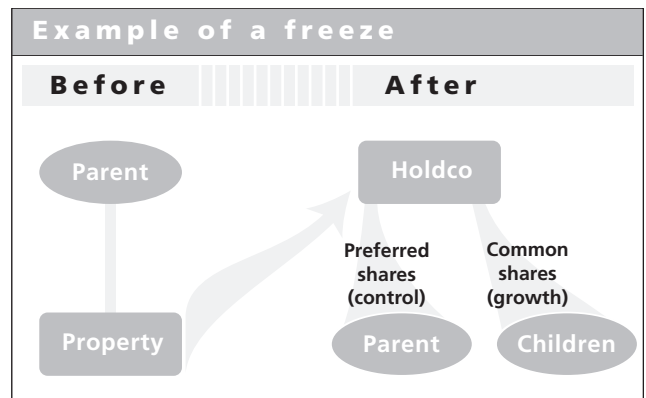
value, reflecting the value of the underlying property. In other words, the future growth of the property will accrue only to the common shares.

Where the property to be frozen consists of shares of an existing corporation, there’s no need to incorporate a second company. You can simply exchange common shares for preferred shares of the existing corporation. The company can then issue new common shares for the children at a nominal value.

Suppose that, five years after the freeze is completed, the property is worth \$1,500,000. As a result of the freeze, your interest is still just \$1,000,000 (its value on the date the freeze was completed). The \$500,000 growth in the value of the property has been transferred to your children and will not be realized until they sell or transfer their shares.

### What are the benefits of a freeze?

The transfer of future capital gains is the main benefit of an estate freeze. There are other potential benefits as well.



**Capital gains tax reduction.** If the property is disposed of during your lifetime, you will pay tax on only the capital gain realized on the frozen interest. The capital gain realized on the growth interest will be taxed in the hands of your family members, resulting in a deferral and a potential overall tax savings if they are in lower tax brackets. If the property consists of shares of a qualified small business corporation, each of your family members may also be able to use the \$500,000 capital gain exemption.

**Reduced taxes at death.** If the property is not sold during your lifetime, the taxes on your death will be limited to the value of your frozen interest in the property. This will minimize both income taxes and probate fees. (Probate fees are not applicable in Quebec.)

**Income-splitting.** In the appropriate circumstances, the freeze can reduce the overall tax on the income generated by the frozen property during your lifetime. For example, the income can be paid to family members over the age of 18 who are in lower tax brackets. (The so-called “kiddie tax” has generally eliminated the ability to split income with

family members under the age of 18.)

**Protection from creditors.** Because the growth interest in the property is owned by your children, it may not be subject to claims by your creditors.

### Why not transfer property directly?

You could, of course, transfer future capital gains by selling or giving the property directly to your children. But that would mean giving up all your rights to the property. You could not benefit from any income it might generate, or play a role in its management. With an estate freeze, you can retain these rights.

Typically, the preferred shares of the holding company will come with voting rights, effectively giving you voting control of the holding company. You can manage it and distribute income (via dividends) as you see fit.

### When is it appropriate?

Property that has potential for significant growth in value, which will be subject to tax, is ideal for a freeze. For instance, shares of a private company that carries on an active business are often frozen. Marketable securities and rental property can also be considered for a freeze, as can shares of a holding company that owns such assets.

In some cases, it may be possible to freeze the property on a tax-deferred basis. In all cases, a tax review should be undertaken to determine the tax implications both at the time the freeze is implemented and on the income that is earned from the property during your lifetime. For example, freezing real estate may result in land transfer taxes.

### Does it make sense for you?

An estate freeze can be an important part of an estate plan, providing benefits both during your lifetime and upon your death. You should consult a tax advisor to review your particular circumstances to determine whether a freeze will be beneficial in your circumstances and the appropriate structure to implement such a freeze.

*This article is intended to provide general information only and should not be construed as specific advice suitable for individuals. Since a consideration of individual circumstances and current events is critical, anyone wishing to act on information in this article should consult a tax professional. This article reviews Canadian federal tax laws only, unless otherwise stated. Provincial tax laws may also apply and may differ.*

### Avoiding the attribution rules

The attribution rules generally come into effect if you give or transfer property to a non-arm’s-length individual, such as your spouse or minor children. The rules apply whether the property is transferred directly, or indirectly through a trust or corporation, as in an estate freeze. Under the attribution rules, any interest and dividend income generated by the transferred property will be treated for tax purposes as if you had earned it. In certain estate freeze situations involving corporations, this may require an annual income inclusion to the “freezor,” even if no income is earned on the property transferred to the corporation. In the case of a spouse, any capital gains will also be subject to attribution.

However, if your spouse or children use their own capital to acquire the property, the attribution rules do not apply. Similarly, you can lend money to your spouse or children so they can acquire the growth shares; attribution will not apply as long as the loan bears interest at least at the government’s prescribed minimum rate and the interest is actually paid within 30 days of the year-end.

Where the common shares are owned by a trust for the benefit of minor children, one or more arm’s-length trustees, such as a trust company, should be named, so that you do not have sole control of the trust. Otherwise, certain attribution rules may apply.

<sup>TM</sup>Trade-mark of CIBC.

CIBC Private Wealth Management consists of services provided by CIBC and its subsidiaries.