

COVID-19 Provides Rare Opportunity for an Estate Freeze

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COVID-19 has resulted in significant decreases to the value of many assets, including marketable securities, private businesses and real estate. This provides an opportunity to implement an estate freeze at low values, which allows for future savings in income tax.

The Canadian income tax system results in capital gains tax being payable upon death on the value of assets, subject to deferral if assets are transferred to a spouse. An important aspect of estate and tax planning is to take steps to minimize and defer the income tax otherwise payable upon death. An estate freeze is a key tool for this planning. The general concept of an estate freeze is permitted by our tax rules and generally accepted by CRA, subject to proper implementation.

An estate freeze involves freezing the value of an asset owned by a parent and allowing future increases in value of the asset to be passed to future generations. This allows the amount of income tax payable upon death of the parent to be frozen at the current value. For example, if the parent owns an asset with a current value of \$3,000,000, and upon the parent's death in 25 years the asset has a value of \$7,000,000, the estate freeze will limit the tax being paid upon a value of \$3,000,000 instead of the future value of \$7,000,000.

An estate freeze is generally implemented using a private corporation. The parent would receive shares with a fixed value of \$3,000,000. The parent can also receive a separate class of voting shares so the parent can retain control of the corporation, even if the frozen shares are all redeemed. The frozen shares can be redeemed gradually during the parent's lifetime, which can totally eliminate the capital gains tax that would otherwise be payable upon the parent's death.

The new growth shares can be either issued directly to other family members, but most commonly are issued to a discretionary family trust. This allows the parent to defer having to make decisions as to how the growth shares are ultimately allocated among other family members. If the parent wants to retain possible access to the future increase in value, the parent can be included as a discretionary beneficiary. The use of a discretionary trust allows the parent to retain maximum control and flexibility.

If an estate freeze has been previously implemented and the value of the corporation is now less than the previously frozen value, it is possible to do a refreeze at the lower current value. This allows to further reduce the income tax otherwise payable upon the parent's death.

It is necessary that the transactions relating to the estate freeze be carefully implemented to avoid a number of potential traps that could result in adverse income tax consequences.

Please do not hesitate to contact any of the GR team members with any questions relating to estate freezes.

(This blog is provided for educational purposes only, and does not necessarily reflect the views of Gardiner Roberts LLP).

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