
INFORMATION BULLETIN

Estate Freezes

An estate freeze is a method used to transfer the future growth of a corporation from its current owners to new owners, usually the next generation of family members. While the concept is quite simple, there are some fairly significant legal and income tax issues that must be met, and these make estate freezes fairly costly to carry out.

To accomplish an estate freeze, the owner(s) of a Canadian corporation directs the company to issue preferred shares to them in exchange for the common shares that they already own. These preferred shares are valued at the current fair market value of the company, and this value is established by attaching specific redemption rights to the shares in which the

redemption value is fixed. Because all of the value of the company is attached to the preferred shares, the common shares are valueless, and as such, can be issued to other individuals at no cost. Also, because the value of the preferred shares is fixed, any future increase in value of the company directly affects the value of the common shares. In this way, future growth in value has been transferred to the new shareholders.

The advantages of an estate freeze to the existing owners are that income taxes, either at the time of redemption of the shares, or on death, are pre-determined, allowing the owners to manage those taxes by arranging suitable financing or life insurance. In

addition, the current owners can transfer their equity to new owners with no immediate tax costs.

The disadvantages are the legal and accounting costs, the possibilities that the value of the company will deteriorate instead of grow, and that funds may not be available to pay out the redemption value of the preferred shares.

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An estate freeze is one of the methods used for business succession purposes - in other words to allow a current business owner to sell his or her business without immediate tax implications. It assumes of course, that there are suitable individuals available to take over the business. If succession is the primary goal, then the business

operations must be organized well enough to assure that the business will continue uninterrupted if the current owners retire or significantly cut back their contributions to the business.

In summary, estate freezes are a useful tool to assist in transferring future growth or actual business operations to others, without incurring immediate income taxes.

For further information on this subject, please contact Harvey & Lister Inc. at one of the above communication numbers, or e-mail to info@harveylister.com.