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Estate Freezes: An Executive Summary

An estate freeze is a sophisticated tax planning technique designed to minimize the income taxes of an individual's estate due upon death. There are a variety of techniques available, all of which focus on locking in the value of an asset at a certain point in time while passing the future growth/profit onto the next generation. An estate freeze works best when an individual has assets that are expected to increase in value.

One of the most common estate freeze techniques is to transfer assets to an inter-vivos trust, whereby the individual can retain some control over the management of the assets. Selling or gifting an asset to adult children will also lock in today's value. Additionally, an individual might trigger an estate freeze by transferring his/her business assets to a holding company or through a corporate reorganization.

People considering estate freezes should ask themselves:

- Does my business/asset have good growth potential?
- Am I psychologically prepared to give up control of the business/asset and pass it on to the next generation?
- Will an estate freeze create a capital loss or gain thus resulting in immediate tax consequences?
- What are the legal and accounting costs to performing an estate freeze? Do the benefits exceed the costs?
- Will I be assured of a sufficient income/cash flow after the estate freeze?

Estate Freeze through a holding corporation:

Transferring the shares of an existing corporation to a new holding company, in exchange for preferred and common shares of the new company, can create an estate freeze.

Typically, the parent/owner would hold the voting preferred shares and the children would hold the common shares or growth shares of the company. All future growth in the company would then accrue to the common shares held by the children, which could be held in trust. The holder of the voting preferred shares would still control the company, while locking in their value of the asset.

Estate Freeze by reorganizing a corporation:

Another way to create an estate freeze is to reorganize the share structure of an existing company (commonly referred to as a section 86 freeze). In a section 86 freeze, the shares of one class are exchanged for the shares of another class. For example, the shares of a business could be reorganized into two new classes of shares: voting preferred shares and common shares. Similar to the example above, the parent/owner would hold enough preferred shares to maintain control of the company while passing on the future growth of the company to the next generation through the common shares.

Conclusion:

While an estate freeze may reduce the income tax due upon death, this should not be the only reason. There also needs to be a business reason for an estate freeze to make sense.

Performing an effective estate freeze is complex and requires professional financial, taxation, and legal advice.