

Freeze (or Re-Freeze): Come Out of the COVID-19 Crisis With Your Hands Up (in a Victory Pose!)

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By Ryan Morris

With the exception of a few businesses (e.g., hand sanitizer and toilet paper manufacturers), the COVID-19 crisis has had a material detrimental impact on the current value of a business. A potential silver lining to the suddenly depressed valuations is that it presents a **wonderful but time-sensitive opportunity** to consider, and, if appropriate, carry out an estate freeze (or a “re-freeze” if an estate freeze was previously carried out).

An estate freeze generally converts a shareholder's interest in their business into preferred shares with a value equal to the value of the business at the time of conversion, with future growth accruing to newly issued common shares that are often issued for nominal consideration to a family trust or individual family members (including the owner-manager if he/she wants to participate in some of the future growth of the business).

At a high-level, the benefits of an estate freeze may include:

1. A deferral of capital gains that would otherwise be realized on death. On death, a Canadian resident is generally deemed to have disposed of his/her capital property (including shares) at fair market value. By freezing the value of the current shares, any growth in the new common shares would not be taxed on the death of the current shareholder; rather it can potentially be deferred until the death of a descendant, even a present or future grandchild (assuming the shares are not disposed of at some earlier time).
2. Multiplication of the lifetime capital gains exemption (currently, \$883,384 per person) on a future disposition of qualified shares. An estate freeze is often structured to contemplate more shareholders (all within the family of the owner-manager) selling shares on a disposition, each potentially utilizing their lifetime capital gains exemption.
3. Dividend sprinkling to lower-income family members (subject to the “TOSI” or “tax on split income” rules, among other things). Dividend sprinkling aims to lower a family's aggregate income tax liability by having the corporation pay dividends to family members who are in a lower tax bracket.
4. Tax efficient creditor-proofing and capital gains exemption purification. A holding corporation is sometimes incorporated into a freeze/reorganization to allow for inter-corporate dividends to be paid from the operating company to the holding corporation (often on a tax-free basis).

Doing an estate freeze now during the COVID-19 crisis can be very beneficial since valuations will likely be materially lower than they were before the crisis. Provided there is an expectation of value-recovery, the recovered value (and any growth thereafter) can accrue to the new common shares, positioning the parties to more fully benefit from an estate freeze (specifically any capital gains exemption multiplication and/or capital gains deferral planning).

Where an estate freeze was previously undertaken, a “re-freeze” can be considered – particularly where the redemption value of the preferred shares is set at an amount that is materially higher than the present value of the corporation. To effect a re-freeze, the

preferred shareholder will generally purchase the common shares for a nominal amount so that the preferred shareholder owns all shares of the corporation. Following this, the preferred shareholder will exchange the original preferred shares and common shares for a new class of preferred shares with the updated lower redemption value. The existing or a new family trust or individual family members (including the owner-manager if he/she wants to participate in some of the growth) can then subscribe for new common shares for nominal consideration.

If you would like to consider an estate freeze or re-freeze, please contact your WeirFoulds lawyer or the [author](#) to discuss.

The information and comments herein are for the general information and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, please contact any of our lawyers for further guidance.

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