

Thaw transactions

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As a follow-up to our November 24, 2008 blog entry regarding tax planning during uncertain times, another tool that should be considered is the so-called estate “thaw” or “refreeze.” As discussed in the November 24, 2008 entry, a freeze is a powerful succession planning tool. It could possibly be made even more potent by refreezing in these uncertain times.

Those business owners, who have planned ahead and opted for an estate freeze when their shares were at a relatively high market value, may benefit tremendously from the perhaps current lower values of their businesses. Where a taxpayer's preferred freeze shares have declined in value since being issued during the estate freeze, a refreeze will further reduce deemed capital gains on the death of the taxpayer.

While a refreeze transaction can potentially take on many forms, a simple method of refreezing is by converting the existing preferred freeze shares into a new class of preferred shares having a redemption value equal to the current fair market value (“FMV”) which would be lower than original stated value of the old preferred shares. For example, if the FMV of the original preferred freeze shares was \$100 at the time of the freeze and their current FMV is \$50, the taxpayer may exchange the preferred shares into a new class of preferred shares with a FMV of \$50, thus eliminating \$50 of capital gains on a deemed disposition upon death. Quite a bit of savings! There has been some concern that a refreeze transaction could result in a benefit being conferred on the common shareholders. CRA has addressed this issue in a string of technical interpretations. The CRA's current position is that if the decline in value is not due to the stripping of corporate assets, there will not be a benefit conferred on the common shareholders.

Considering that many estate freezes are carried out when the business is thriving and the FMV of the business is often high, a refreeze transaction should seriously be considered in these uncertain times when FMVs are perhaps lower.