

NetWorth



Estate Freeze/Re-Freeze Strategy for Family Businesses

A potential strategy used by owners of family businesses to transfer wealth or implement a succession plan to manage the tax liabilities on a transfer or death is to “freeze” the value of their shareholdings during lifetime.

An “estate freeze” allows a business owner to fix their share value to the current value of the business, thereby locking in current capital gains that have accrued to date on their shares of the business, with all future growth in the business accruing to the eventual owners (typically children or grandchildren). This allows for a reduced tax liability on the death of the founder(s), by deferring the taxation of any future growth to the next generation(s).

A depressed value of a business resulting from the current economic slowdown provides an opportune time to consider a freeze, since the accrued capital gains may be lower, thereby allowing the ability to transfer greater future growth to the next generation(s), assuming that the value of the business will recover and continue to increase over time. In the right circumstances, an estate freeze can also provide further benefits, including potential income-splitting with family members, and multiplication of the enhanced capital gains exemption to shelter growth realized on the eventual sale of the family business, or upon death.



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If an estate freeze was previously undertaken, it is possible that the value of the family business may have now declined to an amount below its value at the time of implementation. If so, the “frozen” preferred shares received when the earlier estate freeze was implemented may now exceed the current aggregate value of the business. In these circumstances, it may be possible to undertake a “re-freeze” of the business now, to take advantage of a lower valuation resulting from the current economic conditions.

For more information, please ask your BMO financial professional to receive a copy of our publication, *Transferring Your Business to the Next Generation*.

As with any tax strategy, please consult with your external tax (and legal) advisors to determine all potential implications and/or possible planning in your specific scenario.

Three Reasons to Review Your Choice of Executor During a Pandemic

Life events typically trigger a re-evaluation of who we choose to take on the responsibility of executor of our estate. The COVID-19 global pandemic is no exception and serves to highlight three of the top considerations in evaluating your choice of executor. While we’re naturally inclined toward choosing a spouse or an adult child, the decision should be made with the head and not the heart.

1. Location

International, interprovincial and even local travel restrictions have significantly hampered the ability of Canadians to move quickly and easily. It has always been important to consider someone who lives in your province as your executor.

It can be difficult for a non-local executor to understand the legal and tax issues in your jurisdiction, and appointing an executor who lives out of the province increases the logistical complexity of the estate administration. Appointing one who lives outside of the country creates even more administrative and tax challenges.

2. Objectivity and expertise

Prolonged periods of self-isolation and “sheltering in place” have reminded many of the delicacy of family dynamics. This is particularly true in the context of transferring wealth from one generation to another, and especially so in blended families. Review your choice of executor to ensure that she/he has the necessary skills to navigate these dynamics diplomatically while remaining impartial and efficient in the administration of your estate.

Your executor needs to be knowledgeable about financial matters, taxes and legal topics and know when to engage appropriate professionals to assist. If you have experienced a significant change in your assets, have become a business owner, or have reinvented your business as a consequence of the pandemic, ensure that your executor has the necessary financial acumen to deal with the assets of your current estate. Depending on its complexity, you may want someone with relevant corporate experience.

3. Availability and flexibility

The current global pandemic has made many acutely aware of the demands on their time, as they juggle the competing obligations of home, work and in many cases home-schooling or eldercare. Conducting all of these activities out of the same confined premises can heighten that awareness.

It may be a good time to consider whether your chosen executor has the time and flexibility to add the administration of your estate into the mix, should the need arise. Further, in times of stress, some are not able to manage their own finances – will they be able to handle yours as well? While others may have the necessary skills, will they have the time and the flexibility in their schedule?

Depending on your answers to these questions, a corporate executor may be your best choice.



Financially Assisting Family Members During This Time

Many people are financially assisting family members who have been negatively impacted by the COVID-19 pandemic. These three tips will assist you in ensuring that you are in control of the long-term consequences of your generosity:



1. **Financially assisting elderly parents or adult children** - Be sure to inform yourself as to whether you may have a legal obligation to continue this assistance under the law of your province, including after your death should your parent(s) or adult child survive you. If so, have you provided for this in your Will?
2. **Helping out the kids and/or grandkids** - Do you intend this assistance to be a gift or a loan? If it is a loan, do you intend for it to be forgiven at the time of your death? Whether a gift or a loan that is to be forgiven, should this support be taken into account when equalizing your estate with other beneficiaries after your death?

- If a loan, ensure that you document it as such and indicate who is the borrower. Is his/her spouse or partner a borrower as well?
 - If a gift, ensure that you document it as such and indicate to whom it is a gift. Is it a gift to his/her spouse or partner as well?
 - If the gift or the outstanding amount of the loan is to be taken into account at the time of your death, consider updating your Will to include an equalization mechanism to rebalance the equal shares with the other beneficiaries. This can be done by a Codicil.
3. **Have these times shown some beneficiaries to be more financially vulnerable than you thought?** If so, then creditor-proofing their inheritance through a testamentary trust in your Will may make more sense than an outright gift.

Assisting family members during your lifetime is an important part of any estate planning conversation. More information on beginning this conversation is available through your BMO financial professional.

Building Your Legacy with a Private Foundation

Would you like to take a more strategic approach to your giving? Do you want to have a sustained impact on your community or in an area that interests you? Would you like to pass on philanthropic values to your children and grandchildren, or involve other family members in your giving? There are many ways to give meaning and structure to your philanthropy, and a private foundation is one such way.

What is a private foundation?

A private foundation is a philanthropic vehicle that can provide greater flexibility for charitable giving by you and your family. It is constituted and operated exclusively for charitable giving purposes. A private foundation may be created by trust or incorporation. It fulfills its charitable purposes through the disbursement of its assets to other qualified donees; typically other registered charities. Registered charities that are designated as private foundations are charitable foundations in which:

- The majority of the directors or trustees do not deal at arm's length with each other or with the foundation's principal contributor(s); or
- A contributor to the foundation controls the foundation.

Advantages of the private foundation

A private foundation provides flexibility for donors wishing to take a more strategic and long-term approach to their giving. A private foundation can be controlled by the donor and the donor's family, as these individuals are permitted to be trustees or directors of the foundation. As such, they remain in a position of influence or control many aspects of the foundation's operations, including decisions on:

- Investment management of the donated assets;
- Distribution of income earned by the foundation; and
- Grants made by the foundation.

The donor's creation of the foundation means that the foundation can be named for the donor or the donor's family. It is an opportunity to create a philanthropic legacy that survives the founder's death or can exist for a defined period of time.

Factors to consider whether a private foundation is right for you

If you are considering a private foundation there are some key issues to be considered when determining if this vehicle is the right option for you:

- You would like to have an organization that reflects your interests;
- You wish to be more personally engaged with the process of giving, and direct where funds are allocated;
- You would like to engage your family through a vehicle that connects the different generations around a cause or project in your community, or has meaning to your family; and
- You are interested in taking a more hands on approach with grant-seekers.

How to start a foundation

To be a registered charitable foundation, the entity must apply for, and be granted registered charity status by the Canada Revenue Agency ("CRA"). This involves crafting the constituting documents of the foundation and other governance documents, such as by-laws, and then making an application to the Charities Directorate Division of the CRA. Many individuals interested in creating a private foundation will retain a lawyer experienced in charity law to draft the legal documents and file the application with CRA for charitable status.

Funding and operating a private foundation

In many cases, funding comes from an individual or family unit, or even by businesses related to the founder of the foundation. In order for a contribution to qualify as a gift for tax receipting purposes, it must be a transfer of property by the donor for which no consideration is expected.

The operations of a private foundation are generally managed by directors or trustees that do not deal with each other at arm's length.

While the investment of the assets of the foundation can be managed by the trustees and directors, in many cases these powers are delegated to an investment management firm. Since 3.5% of the investable assets must be disbursed each year to registered charities, a professional investment manager can be retained to ensure that the goal of growing the capital is achieved and only the annual revenue is disbursed to donees. It is important to pay attention to the 3.5% disbursement quota as this is a requirement by Federal law in order to maintain the charitable status of a private foundation.

Tax treatment of gifts made to a private foundation

Gifts of cash and gifts of property to a private foundation are eligible to be tax receipted for the property's fair market value at the time the gift is made.

A donor can claim a donation tax credit in the case of an individual, or a donation tax deduction in the case of a corporation, to reduce personal or corporate tax liabilities, subject to annual net income limitation. A special donation incentive will apply when publicly-traded marketable securities that are listed on a stock exchange are donated to a private foundation.

Many private foundations are created to coincide with a significant event in the founder's life, such as the sale of a business. The sale of a business can result in a tax liability as well as significant cash proceeds, so the establishment of a private foundation at this time can provide some tax relief to the business owner. For more information, you can consult the Canada Revenue Agency website which includes some key information on the tax treatment of gifts made to a private foundation.

Often creating and giving shape to one's charitable giving through a private foundation can be rewarding, as well as a learning experience for those who are new to the concept. Planning in advance can make the philanthropic journey even more fulfilling, and is therefore recommended that you speak with a BMO Philanthropic Advisor about whether a private foundation is the right choice for you and your family.