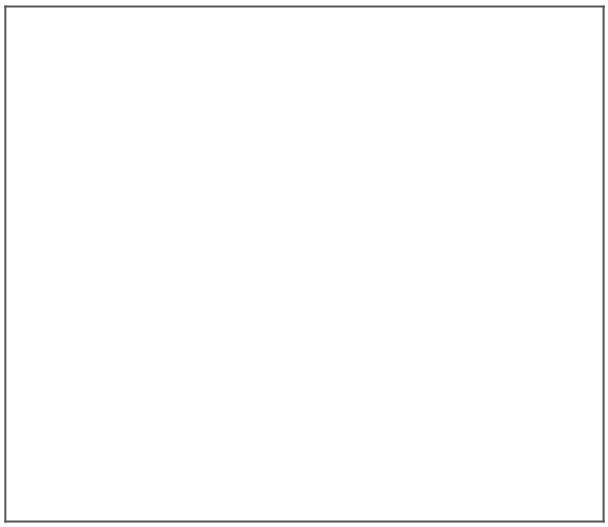
The ‘Estate Freeze’ And Risks In Gifting Shares

published 06/01/2011

Parents often want to restructure their family corporation through an estate freeze, to minimize the impact of corporate taxes in the event of death and for creditor proofing. If this is not done properly, the gifted shares will not be excluded from a child’s family property accounting in the event of a failed marriage or common-law relationship.



In general, an estate freeze puts a limit on the growth in the value of the parent’s shares, and transfers expected future growth to the next generation (i.e. their children). This strategy can provide the existing shareholder(s) (typically the parents) with income tax savings and estate planning flexibility. In some circumstances, to accomplish the estate-freeze, a nominal value of issued common shares in the corporation owned by a parent are gifted to a son or daughter, and then the balance of the shares are exchanged for fixed-value preference shares, owned by the parent(s), having a redemption value equal to the fair market value of those shares at the time of the estate freeze.

The 2010 Ontario Superior Court of Justice decision in *McNamee v. McNamee* is a very important decision because it may restrict the ability of parents to gift all or part of a family corporation so as to exclude the gift under a family property accounting. It has been appealed, but as of yet the Ontario Court of Appeal has not rendered a decision.

The *McNamee* case is relevant in Manitoba because property division, pursuant to *The Family Property Act,* does not apply to any asset acquired by a spouse or common-law partner by way of gift or trust benefit from a third person, unless it can be shown that the gift or benefit was conferred with the intention of benefiting both spouses or common-law partners. Shares “gifted” to a son or daughter as part of an estate freeze would typically be excluded from his/her property accounting. However, documentation that appears to evidence an intention by a parent to make a gift of shares may on careful examination by a court be found not to meet the legal definition of a gift.

In *McNamee*, the husband's father, on the advice of his accountant and corporate lawyer, executed a corporate restructuring and estate freeze. The husband and his brother received common shares, which had no value at that time, and the father took back preferred shares which had a value equal to the business as of the date of the estate freeze. However, there were two unusual aspects to the McNamee estate freeze. The father's preference shares were voting shares, so that he could maintain absolute control, and the quantum of the dividend that he could pay himself was not limited.

Approximately four years later, after the son separated from his wife, it was determined that the husband had little knowledge about the corporate restructuring that had taken place, even though he had signed some documents. He did not know about the Declaration of Gift until after the separation.

After the separation the wife took the position that her husband's shares, which were by then worth more than $400,000.00, were not a gift from his father, but transferred pursuant to a contract that he would continue to work and receive potential growth in the company and provide benefits to the father. She argued that the necessary elements of a gift from father to son were not present, and therefore the value of the husband's shares should be included in the family property accounting.

Like Manitoba's legislation, the Ontario Family Law Act does not contain a definition of a gift, and therefore the judge did an extensive review of what was required for a valid gift. He concluded that the essential elements of a gift are:

- Capacity of the donor;
- Intention on the part of the donor to transfer the property without consideration, without expectation of remuneration;
- The intention of the donor must be without conditions, from detached and disinterested generosity, out of affection, respect, charity or like impulses and not from the constraining force of any moral or legal duty or from the incentive of anticipated benefits of an economic nature;
- The donor divests himself of all power and control over the property and gives such control to the donee;
- Intention on the part of the donee to accept the property as a gift; and
- Delivery by the donor to the donee completed.

After a careful review of the evidence, and even in the face of a declaration of gift, the judge found that the shares had not been gifted to the son, and therefore the value of the shares at the date of separation was included in the family property accounting.

The outcome of the McNamee case could have serious implications for those who have received shares as a result of an estate freeze. While this case had some unique aspects, it will open the door to family law lawyers examining all of the circumstances that gave rise to the gift. It may be that whenever there is an estate freeze to children who remain involved with the company, the receipt of shares is not a true gift, but a payment for past and future

services. We look forward to the Ontario Court of Appeal's decision.
