LEGAL BUSINESS REPORT | ALPERT LAW FIRM
THE TAX LAW PROFESSIONALS
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ESTATE FREEZE TRANSACTIONS

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on estate planning techniques for small businesses and their shareholders. Alpert Law Firm is experienced in providing legal services to its clients relating to estate planning, including the preparation of wills, deeds of gift, trust documents and all documentation required in connection with estate freezes and other tax, corporate and estate planning matters.

A. INTRODUCTION

An "estate freeze" is designed for tax purposes to freeze the current value of capital assets, such as shares in a corporation, investments, or real estate (which is used to earn income from a business or an investment). It is particularly attractive to undertake an estate freeze as early as possible in order to obtain a lower valuation of the current fair market value (the "FMV") of capital assets.

This estate planning technique may result in substantial tax deferral by significantly reducing the transferor's liability for capital gains tax as a result of a deemed disposition of capital assets, which occurs upon death (except in situations where the capital assets are transferred to a spouse or a spousal trust on a tax-free rollover basis at the transferor's adjusted cost base (the "ACB")). In addition, by freezing the value of the transferor's assets that will be deemed to have been disposed of upon death, the technique will reduce the amount of estate administration tax payable by the transferor's estate.

Unlike life insurance premiums, which must be paid annually to ensure sufficient liquidity to pay capital gains tax arising on a deemed disposition upon death, the cost of implementing an estate freeze is generally a one-time expense. However, a fixed amount of life insurance may be used in conjunction with an estate freeze to off-set the amount of any capital gains tax liability regarding the frozen capital property. In such an arrangement, the amount of life insurance would be based on the excess of the freeze amount over the ACB of the frozen capital property.

For example, assume a family business is currently worth $500,000 and an estate freeze is implemented that transfers the future growth in value of the frozen assets to the owner's children. As discussed below, the owner will still maintain control over the family business. If the family business is worth $1,500,000 when the owner

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dies, then the payment of capital gains tax on the $1,000,000 gain is deferred as a result of the estate freeze. The rate of inclusion in income is one-half for capital gains. Based on the current top marginal rate of tax of approximately 50%, the capital gains tax deferral on the $1,000,000 gain as a result of the above-mentioned estate freeze would be approximately $250,000.

Under the *Income Tax Act* (the "Act") there are three ways an estate freeze can be effected: (i) a share rollover under subsection 85(1), (ii) a share reorganization under section 86, and (iii) a share conversion under section 51. The Act also prescribes the precedence among these provisions, in the event that more than one is applicable to a fact situation. Subsection 86(3) of the Act states that, if subsection 85(1) of the Act applies, subsections 86(1) and 86(2) do not apply. However, subsection 51(4) of the Act, states that each of subsections 85(1) and 85(2) and section 86 takes precedence over subsections 51(1) and 51(2) of the Act. Therefore, the order of precedence is: (i) subsections 85(1) and 85(2); (ii) subsections 86(1) and 86(2); and (iii) section 51.

B. SUBSECTION 85(1) ESTATE FREEZE

An estate freeze using a holding corporation may be used for the benefit of adult children. Either assets or shares of a corporation may be transferred on a tax-free basis to a holding corporation by filing a prescribed election form within the prescribed time, pursuant to the provisions of section 85 of the Act. This transfer does not trigger any capital gain or any recapture of depreciation. In exchange, the owner receives redeemable, retractable, demand special shares from the holding corporation that are worth the current FMV of the assets or shares that are frozen. A price adjustment clause is generally used in this type of transaction to retro-actively adjust the FMV of the redemption price of the special shares in the event that the Canada Revenue Agency (the "CRA") successfully determines that the FMV is greater or less than reported. The special shares received by the transferor control the holding corporation by virtue of having the majority of the votes at meetings of the shareholders.

C. SUBSECTION 85(1) AND SECTION 86 ESTATE FREEZES

Features common to estate freezes implemented under either subsection 85(1) or section 86 of the Act, include:

- Adult children of the owner may purchase common shares of the holding corporation for a nominal value. Alternatively, the owner may purchase

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common shares of the holding corporation and gift them to the adult children by way of deed of gift. The deed of gift to an adult child, who is married, may contain provisions excluding both the capital of the gift and any income generated from the gift in calculating net family assets of the adult child and his/her spouse.

- Dividends may be paid on the common shares to the adult children without any attribution of dividend income or any deemed receipt of interest income back to the transferor, thus permitting a fluctuating dividend to be payable on the special shares received by the transferor on the freeze.

- The value of the special shares does not increase from the date of the estate freeze, while all the future growth of the holding corporation passes to the adult children by virtue of their ownership of the common shares. This transaction may considerably reduce the transferor's liability for capital gains tax at death. The common shares of the holding corporation have a nominal value at the time of acquisition and there may be significant capital appreciation in the value of these shares in the future.

- Estate freezes for the benefit of minor children or grandchildren are also possible. However, the impact of tax on split income and income attribution rules must be considered regarding taxable dividends received by the minor children or grandchildren.

D. <u>SECTION 86 ESTATE FREEZE</u>

Alternatively, an estate freeze may be implemented using the provisions under section 86 of the Act. Section 86 of the Act allows a tax-free rollover in the situation where, under a reorganization of the capital structure of a corporation, a taxpayer disposes of all the shares of any particular class of the capital stock of the corporation (the "old shares") in consideration for which the taxpayer receives from the corporation other shares of the capital stock of the corporation (the "new shares").

The section 86 rollover does not apply to: (i) the disposition of securities other than shares, such as bonds or other debt securities; (ii) the disposition of shares that do not constitute capital property of the shareholder; and (iii) dispositions by a shareholder of less than all of the shares of a particular class of the corporation's capital stock.

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The section 86 rollover occurs by operation of law under the Act and therefore, no election form needs to be filed with the CRA.

This type of rollover may be implemented by Articles of Amendment under the *Ontario Business Corporations Act* or the *Canada Business Corporations Act*. The rollover generally involves the re-classification of the common shares of a corporation into special shares by filing Articles of Amendment for the corporation and the transfer of common shares of the corporation on a tax-free basis in exchange for redeemable, retractable, demand special shares from the corporation that are worth the current FMV of the shares of the corporation. A price adjustment clause is generally used in this type of transaction to retro-actively adjust the FMV of the redemption price of the special shares in the event that the CRA successfully determines that the FMV is greater or less than reported. The special shares received by the transferor would control the corporation by virtue of having the majority of the votes at meetings of the shareholders.

In addition, a section 86 rollover is available where shares of a certain class are sold by the taxpayer to the corporation in exchange for shares of another class from the treasury. However, the share transfer agreement must reflect the intention of the parties to have section 86 of the Act apply to the transaction. Otherwise, the transaction will be deemed to take place under section 69 of the Act at FMV and it will not receive rollover treatment.

There are certain restrictions which may limit the effectiveness of the section 86 rollover. Namely, the effect of a section 86 rollover will be reduced in cases where the value of the new shares and the property other than the shares is less than the value of the old shares, and it is reasonable to consider the difference as being a gift to a person related to the taxpayer. In this instance, subsection 86(2) of the Act provides a formula, which determines the amount of the proceeds of disposition of the old shares and the ACB of the new shares received on the reorganization. The automatic application of this formula in the aforementioned circumstances may result in the triggering of a capital gain on the disposition of the old shares.

E. SECTION 51 ESTATE FREEZE

Alternatively, an estate freeze of the shares of a corporation may be implemented using the provisions of section 51 of the Act. Section 51 of the Act permits a tax-free rollover where the taxpayer exchanges convertible securities for shares of the same corporation. As an alternative to a share-for-share exchange rollover pursuant to section 86 of the Act, a corporation may reorganize its share capital by using section 51

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of the Act to defer the realization of capital gains. This provision allows for a deferral of capital gains on a share-for-share exchange. As a result, the ACB of the exchanged shares will be the same as the ACB of the shares that were converted.

A section 51 rollover is available even if the terms and conditions of the exchanged shares do not provide a right of exchange or conversion. Subsection 51(1) of the Act may be used in cases where it is desirable to create two or more classes of convertible shares for the purpose of declaring different types of dividends on each class of convertible shares.

One of the requirements under section 86 is that all of the shares of a particular class of a corporation that are owned by the taxpayer must be exchanged for the new shares of the corporation. However, in order to obtain the deferral tax benefits of a section 51 share-for-share exchange, this is not necessary and the taxpayer is permitted to exchange a portion of his shares of a particular class of the corporation for the new shares of the corporation.

Another difference between conducting an estate freeze under section 51 compared to under section 86 of the Act, is that section 51 deems the exchange to be a transfer of property, not a disposition of property, for the purposes of corporate attribution rules. Therefore, under section 51, the taxpayer is not required to report a disposition.

One of the main disadvantages of conducting an estate freeze under section 51 of the Act is that non-share consideration may not be received on the conversion.

In the event that the transaction results in an indirect gift to a related person, whereby the value of the received shares is less than the value of the convertible property, subsection 51(2) of the Act will apply and override subsection 51(1) of the Act. As a result the taxpayer may be forced to recognize a capital gain on the conversion and to adjust the ACB of the exchanged shares accordingly.

Subsection 51(3) of the Act contains a provision whereby a paid-up capital deficiency on the exchanged shares will flow through to the shares received by the taxpayer as a result of the share exchange. This provision ensures that the share exchange will not result in any increase in the paid-up capital of the exchanged shares to which section 84 of the Act could apply. If section 84 of the Act did apply, the taxpayer would be deemed to have received a dividend.

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Subsection 51(4) provides that a section 51 share-for-share exchange will only apply to transactions where the provisions of subsection 85(1), subsection 85(2) or section 86 do not apply. Therefore, care must be taken when documenting the transaction to specify that the taxpayer intends that the share-for-share exchange is governed by section 51 of the Act.

F. TRANSFER OF REMAINDER INTEREST FREEZE

Subject to the provisions of section 43.1 of the Act, a partial estate freeze may be used by a parent to transfer the remainder interest in real property to children while retaining the life interest for the benefit of the parent. Since the parent retains the life interest in the assets there is no change in beneficial ownership of the life interest and no resulting disposition of the life interest for capital gains purposes.

However, subject to the provisions of section 43.1 of the Act, the remainder interest in the property is deemed to be disposed of by the parent at FMV pursuant to section 69 of the Act giving rise to a capital gain, one-half of which is required to be included in the parent’s income subject to tax in the year that the asset transfer occurs.

Usually an actuary is retained to apportion the FMV of the transferred asset between the life interest and the remainder interest. The younger the age of the parent at the date of the transfer, the greater the portion of the FMV of the assets that is attributed to the life interest and the lower the capital gain resulting from the disposition of the remainder interest to the children.

This type of freeze is especially attractive when the FMV of the frozen asset does not greatly exceed the ACB. When the transferor dies the remainder interest passes to the children without any disposition for capital gains purposes.

Pursuant to section 43.1 of the Act, a parent who disposes of a remainder interest in land while retaining a life interest in the land is deemed to have disposed of and subsequently reacquired, the life interest at its FMV at the time of the transfer. Therefore, the entire accrued gain in the land will be taxable at that time. Any gain in the value of the land after the division of the land into a life interest and a remainder interest is deferred, since a rollover is available under subsection 43.1(2) of the Act on the death of the life interest owner. The parent is deemed to have disposed of the life interest upon death at its ACB which would usually be equal to its FMV at the time of the division of interests and that amount is required to be added to the ACB of the land in the event that the surviving holder of the remainder interest and the deceased did not

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deal at arm's length. In the event that the value of the land has decreased since the division of interests, the surviving non-arm's length owner's ACB must be reduced by an equivalent amount.

Section 43.1 of the Act does not apply to Crown or charitable donations. Consequently, remainder interests in land can be donated to the Crown or a registered charity without triggering a disposition of the life interest. Section 43.1 of the Act does not apply to a transfer by a parent of a remainder interest in a qualified farm property to a child.

G. ALTERING AN ESTATE FREEZE

Estate freezes are not irreversible. There are various ways you can alter an estate freeze, including: (i) an estate melt, (ii) an estate thaw, and (iii) an estate re-freeze. Before altering an estate freeze, you should contact a qualified legal professional to ensure that you choose the best method for the situation and to avoid triggering any unintended tax consequences, like a deemed dividend.

1. Estate Melt

A "melt" allows the freezor to access some of the appreciation of the corporation, not necessarily through growth shares, so that some of the future value of the corporation will accrue to the freezor while the legal structure of the estate freeze remains intact. There are several ways to conduct an estate melt, including: (i) increasing the salary or bonus paid to the freezor; (ii) increasing the dividends declared in favour of the freezor; (iii) increasing management fees paid to the freezor; (iv) increasing the interest rates paid on any notes the freezor took back as part of the initial estate freeze; and/or (v) redeeming the freezor's preferred shares in the corporation, provided that they are redeemable at the option of the freezor.

2. Estate Thaw

A "thaw" goes one step further than an estate melt and alters the legal structure of an estate freeze. Consequently, the estate freeze is retroactively unwound with the result that the freezor returns to the same situation he was in before the freeze was implemented. The primary methods of achieving an estate thaw are as follows: (i) the freezor re-acquires the growth shares and (ii) the freeze shares are converted into growth shares.

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3. Estate Re-Freeze

Individuals who participated in an estate freeze during prosperous times may find that a recessionary period has eroded the value of the demand special shares received under the estate freeze. If so, the individual may consider undertaking a re-freeze of the estate at the lower FMV of the capital assets. This would allow a further reduction of the freezor's tax liability on death, including a reduction in estate administration tax.

In order to avoid conferring a benefit on other shareholders, the re-freeze could be structured so that the freezor is the sole shareholder at the time of the re-freeze. This could be accomplished if the other shareholders gift their shares to the freezor or if the corporation purchases their shares for cancellation for nominal consideration. Then, the freezor may exchange all of his shares for new, demand special shares, redeemable at the current FMV of the corporation, and acquire new common shares for nominal consideration. The freezor may later elect to gift the new common shares to the previous shareholders but there must be no contractual commitment at the time of the re-freeze between the previous shareholders and the freezor requiring him to do so.

Provided that the decrease in value of the preferred shares in this type of transaction is not the result of stripping corporate assets, the CRA has commented that it will not ordinarily consider a benefit to have been conferred on the common shareholders or the preferred shareholder.

The CRA has also commented that a benefit would generally not be considered to have been conferred in the event that prior to a re-freeze transaction, the common shares of the freeze corporation are sold at FMV to either the holder of the preferred shares or the freeze corporation, thereby resulting in only one shareholder, and new common shares are then issued to the former common shareholders. As a result, this will avoid any potential problem under the general anti-avoidance rule pursuant to the Act.

Caution must be exercised in structuring estate re-freezes, since the above-mentioned CRA comments are not binding on the CRA.

H. TAX ON SPLIT INCOME

Tax on split income, also known as "kiddie tax", is intended to limit income-splitting techniques that seek to shift certain types of income from a higher-income

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individual to a lower-income minor. The highest federal marginal tax rate (currently 29%) applies to split income.

Under section 120.4 of the Act, tax applies to the following types of split income:

(a) taxable dividends and other shareholder benefits on unlisted shares of Canadian and foreign corporations whether received directly or through a trust or partnership;

(b) income from a partnership or trust where the income is derived from the business of providing goods or services to a business carried on by a relative of the child or in which the relative participates (there may possibly be an exception where a trust provides services directly to customers of the business rather than merely providing services to the business itself); and

(c) capital gains where the gain is attributable to a disposition of shares, other than shares listed on a designated stock exchange or shares of a mutual fund corporation, to a person with whom the minor does not deal at arm's length.

If a capital gain is subject to tax on split income under subsection 120.4(4) of the Act (example (c) above): (i) the capital gain will be deemed to be a taxable dividend of twice the amount of the capital gain; (ii) the deemed taxable dividend will be taxed at the highest marginal tax rate and will therefore not benefit from capital gains inclusion rates or qualify for the lifetime capital gains exemption; (iii) the taxable dividend will not be an eligible dividend; and (iv) the corporation will be considered not to have paid a dividend for the purposes of the Act. This applies to capital gains realized on or after March 22, 2011. However, note that tax on split income will not apply in the context of an arm's length sale or in the context of a private corporation going public.

With respect to capital gains realized in the context of an estate freeze, tax on split income could apply where a trust held common shares for the benefit of a minor and these shares were sold to a non-arm's length party. However, it is possible to avoid application of the tax in these circumstances, by retaining the gain in the trust because then the gain would retain its characteristic as a capital gain and would be taxed at the top marginal capital gain rate which would still be lower than the effective tax rate on a non-eligible dividend.

The 2014 Federal Budget changed the definition of "split income" to include income that is, directly or indirectly, paid or allocated to a minor from a trust or partnership if: (i) the income is derived from a source that is a business or from the

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rental of property; and (ii) a person related to the minor (a) is actively engaged on a regular basis in the activities of the trust or partnership of earning income from a business or the rental of property, or (b) in the case of a partnership, has an interest in the partnership, whether held directly or through another partnership. This measure will apply to the 2014 and subsequent taxation years.

I. RELEVANT CASE LAW

1. *Bugera et al. v Canada,* 2003 DTC 5282

In this Federal Court of Canada decision, the taxpayers made an application to the Federal Court for judicial review of a decision by the Minister refusing to permit the late filing of a subsection 85(1) election. The parents and their five children were the owners of a pub, which they operated though a corporation. In 1992, the corporation underwent an estate freeze, in which the parents transferred their common shares to the corporation in exchange for preferred shares and issued common shares to their children. In 1994, the children undertook an estate thaw to crystallize accrued capital gains, in which they gave up their common shares for preferred shares and the parents acquired common shares.

All of the taxpayers received legal advice that section 85 elections had to be filed within a specified time period for both the estate freeze and thaw transactions. The taxpayers relied on their family tax advisor to file the elections, but the elections were not filed. Several years later the family sold its shares in the corporation to an arm's length party. After the sale, the taxpayers were advised by their new accountant that the section 85 elections had not been filed.

Soon after discovering this error, the taxpayers made a formal request to the Minister for a positive exercise of his discretion to permit late filing of the section 85 elections. As an act of good faith, along with the formal request, the taxpayers paid $455,000 to the CRA for estimated penalties, interest, and income taxes. However, this payment was not accompanied with instructions that it was to be designated for the estimated penalties, interest and income tax resulting from the error, so the CRA applied it against the taxpayer's regular income tax instalment payment obligations.

The Minister declined to permit the late filing of the elections stating that: (i) the filing errors were not inadvertent, but were the result of negligence or carelessness and (ii) the late filing amounted to retroactive tax planning. In the 1994-1997 taxation years, many of the family members invested in speculative limited partnership tax shelters that

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affected their cumulative net investment loss balances and thus, their taxable capital gains. The Minister found that if those investments had not been made, these family members would not have needed to file section 85 elections, and as a result the requests for late filing constituted retroactive tax planning.

In the circumstances, the Federal Court declined to overturn the decision of the Minister and dismissed the taxpayers' application for judicial review. The Federal Court held that the Minister's decision was not patently unreasonable given the facts, which included sophisticated tax planning.

2. *Krauss v Canada,* 2010 FCA 284

In this decision of the Tax Court of Canada, a partnership was formed between the taxpayer, her son ("L"), a corporation wholly-owned by the taxpayer, and a family trust. The purpose of the partnership was to execute an estate freeze where certain real estate assets would be transferred to the partnership such that the future growth in value of these assets would accrue to the beneficiaries of the trust: (i) L's wife and (ii) L's two minor children. The taxpayer and L each transferred 50% of their interest in certain properties to the partnership pursuant to the provisions of subsection 97(2) of the Act. In exchange, the taxpayer and L each received 1,252,000 preferred, redeemable Class A units of the partnership. The properties that were transferred to the partnership were treated as capital property under the Act. The taxpayer's corporation and L also transferred an interest in a co-tenancy to the partnership and each was issued redeemable Class B units of the partnership. The trust received 100 Class C common units of the partnership for cash consideration of $100.

In the 1994 taxation year, the partnership earned $343,431, which was allocated in accordance with the partnership agreement as follows: (i) the taxpayer and L each received $108,355 as a return on their Class A units and (ii) the trust received the remainder, $126,721. Upon reassessment, the Minister added 50% of the amount allocated to the trust to the taxpayer's income. The taxpayer appealed to the Tax Court of Canada. The Minister argued: (i) subsections 103(1) and 103(1.1) of the Act prohibit the use of a partnership to conduct an estate freeze and (ii) the partnership income was allocated unreasonably and should have been reallocated pursuant to subsection 103(1) of the Act, or alternatively subsections 103(1.1) or 74.1(2) of the Act.

The Tax Court of Canada dismissed the taxpayer's appeal. In *obiter*, the Tax Court remarked that, if structured properly, it was likely possible for a valid estate freeze to be implemented using a transfer to a partnership instead of a corporation. However, in this case, the Tax Court held that the deviation from a regular estate freeze was too

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substantial for the transaction to be deemed a valid estate freeze. The Tax Court held that in order for a reallocation to be made under subsection 103(1.1) of the Act:
(i) members of the partnership must not be dealing at arm's length; (ii) such members must have agreed to a given allocation of income or loss; and (iii) the allocation to any member must have been unreasonable in the circumstances, including the investors' relative capital contributions and performance obligations and the risk and return associated with the investment. The Tax Court held that the consequence of falling under subsection 103(1.1) of the Act is that an unreasonable allocation of income or loss to a member of a partnership, will be deemed to be the amount that is reasonable in the circumstances. The Tax Court also cited *Fillion v The Queen* (2004 DTC 2667), which held that "reasonableness" for the purposes of subsection 103(1.1) of the Act requires at a minimum that the allocation reflects reality.

In this case, the Tax Court found that the trust had not provided any substantial capital or any services to the partnership. The Tax Court concluded that the trust's $100 contribution was too trivial to account for. As a result, the allocation to the trust of $126,721, which represented a risk-free return of 126,721%, was unreasonable, did not reflect reality, and was delusive to the point of absurdity. Consequently, pursuant to subsection 103(1.1) of the Act, one-half of the partnership income from the capital property, allocated to the trust, was attributed to the taxpayer (presumably the other half of this amount would be attributed to L but this was not at issue nor addressed in the appeal).

The taxpayer appealed the decision to the Federal Court of Appeal. The Federal Court of Appeal dismissed the taxpayer's appeal on the basis that there was no error of law or palpable and overriding error of fact in the Tax Court's decision.

3. *McNamee v McNamee*, 2011 ONCA 533

In this Ontario Court of Appeal case, the husband and his wife were married for 18.5 years and their marriage was one conducted as an equal partnership, with the parties sharing their incomes and expenses and holding assets and liabilities in their joint names. On August 5, 2007, the parties separated. At issue was whether the husband's 500 common shares in his father's concrete trucking company had been received by way of gift. If the shares were received by way of gift, they would be exempt from inclusion in the couple's net family property.

The husband was the son of the founder of McNamee Concrete Ltd. (the "Corporation"), John McNamee ("John"). The Corporation was established in 1977. In

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1988, John invited his two sons to join him by working for the Corporation. After which time the Corporation grew dramatically and successfully.

In 2003, John implemented a corporate estate freeze in order to protect the business from creditors and to reduce the tax that would be payable upon his death. The shares of the Corporation were rolled into a holding company ("Holdco") and the value of the business was fixed at $2,000,000 for the purposes of the estate freeze, the value of which was held by John. Future growth in value would be reflected in common shares of Holdco to be issued to John's two sons. To give effect to the freeze, John transferred his only two common shares in the Corporation to the newly created Holdco in exchange for 20,000 voting, preferred shares valued at $2,000,000. He then subscribed for 1,000 common shares for $1 and transferred 500 of those common shares to each of his two sons.

Although the common shares in the Holdco were held by his sons, John wanted to retain control of the Corporation and he was adamant that no one would get the shares he had transferred to his sons without his approval. John retained full control by ensuring that his preferred shares: (i) were voting shares and (ii) entitled him to take unlimited dividends from the company at any time, thus enabling him, should he wish, to denude the company of any equity or retained earnings in the future. He also executed a Declaration of Gift at the time the common shares were issued to his sons which stated: (i) neither the shares, nor any increase in their value or income from them, were to form part of the net family property of each son in the event of marital breakdown and (ii) the shares were to remain each son's separate property, free from the control of his spouse. The evidence suggested that neither of John's sons was aware of these conditions.

The trial judge held that the transfer of shares to the husband, one of John's sons, was not a gift based on the following four factors: (i) the transfer was not a gratuitous transfer but a transfer for consideration; (ii) John did not intend to gift the shares; (ii) John did not divest himself of all power or control over the shares; and (iv) the husband did not accept the gift. The husband appealed this decision to the Ontario Court of Appeal.

The Ontario Court of Appeal allowed the appeal concluding that the transfer was by way of gift. The Ontario Court of Appeal began its analysis by stating the essential ingredients of a legally valid gift: (i) an intention to make a gift on the part of the donor, without consideration or expectation of remuneration; (ii) an acceptance of the gift by the donee, and (iii) a sufficient act of delivery or transfer of the property to complete the transaction.

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The Court of Appeal held that the trial judge erred in concluding that sufficient consideration for the transfer of shares existed in the form of the sons' continued employment with the Corporation. The Court of Appeal held that there was no bargaining and, therefore, there could be no consideration in law. The Court of Appeal also commented that it was helpful to remember that the issue was not whether the donor received some benefit from the estate freeze; the issue was whether the donee provided any consideration to the donor for the transfer of shares.

In analyzing the second requirement of a gift, the Court of Appeal held that the trial judge erred by conflating intention with underlying motivation or purpose. The Court of Appeal stressed that they are not the same concepts; the fact that John's primary purpose or motivation in transferring the shares was to underpin the estate freeze was of no consequence and did not mean he did not intend to gift the shares in order to give effect to that purpose. The Court of Appeal held that John's intention of making a gift of the shares was evidenced by the language in the Declaration of Gift and that evidence was reinforced by the fact that John did not sell the shares to his sons because they had no money.

Finally, the Court of Appeal also held that the husband had accepted the gift of the shares. The Court held that the husband understood the essential nature of the transaction to be that he had received shares in the company without paying for them and he willingly accepted title to those shares; his lack of knowledge of the terms and conditions attached to the gift was of no consequence. There was no evidence that the husband would not have accepted the gift had he known about the strings attached.

The Court of Appeal then went on to consider the issue raised by the wife that she had a beneficial interest in the shares or her husband held them on constructive trust for her due to his being unjustly enriched by her contribution to their marriage. Although this was a live issue at trial, the trial judge did not make sufficient findings of fact in respect of it because he had found that the shares were not a gift and as such were part of the couple's net family property. The Court of Appeal commented that the trial judge should have determined claims of ownership, including beneficial ownership, of all assets prior to dealing with net equalization payment exclusions under the *Family Law Act*. The Court of Appeal ordered a new trial to determine whether the shares were subject to a constructive trust or a beneficial interest of the wife, since there were insufficient facts in the record for it to render a decision on the matter.

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4. *Triad Gestco Ltd. v The Queen*, 2011 TCC 259

This decision of the Tax Court of Canada held that the general anti-avoidance rule (the "GAAR") applied on the facts of the case to a series of transactions that the taxpayer alleged was undertaken to effect a reverse estate freeze. However, the Tax Court held that they were in fact undertaken to circumvent the stop-loss provisions and allow Triad Gestco Ltd. ("Triad") to create an artificial capital loss to offset its capital gain. The decision of the Tax Court was affirmed by the Federal Court of Appeal (2012 FCA 258).

Initially, the sole shareholder of Triad was Peter Cohen ("Cohen"). He then undertook an estate freeze, whereby the growth shares of Triad were settled upon the Peter Cohen Family Trust ("Family Trust") and Cohen received preferred shares in Triad. In the year following the estate freeze, Triad sold a property giving rise to a capital gain of $7,799,545. During the same taxation year, the series of transactions comprising the alleged estate refreeze were undertaken.

To effect the alleged estate refreeze, a new corporation, Rcongold Systems Inc. ("Rcongold") was established as a wholly-owned subsidiary of Triad. Triad subscribed for 8,000 voting, common shares of Rcongold for total consideration of $8,000,000. Rcongold issued a dividend to Triad on its common shares in the form of preferred shares with a FMV of $8,000,000.

Triad then sold its common shares of Rcongold to the Peter Cohen Trust ("PCT"), which had been settled by an individual who dealt at arm's length with Cohen, Triad, and Rcongold but was settled for the sole benefit of Cohen. The common shares of Rcongold were sold to the PCT for $65, creating a capital loss for Triad of $7,999,935. Although the transactions had the effect of Cohen receiving the benefit of any growth in Rcongold through its common shares that were now held by the PCT, the capital loss created was sufficient to offset Triad's capital gain of $7,799,545 from the sale of a property in the same taxation year.

The Court applied the GAAR analysis and held that all three requirements of the GAAR were satisfied by the series of transactions. First, a tax benefit was achieved by Triad offsetting a capital gain against the capital loss and thereby reducing its tax that would otherwise have been payable to nil.

Second, the series of transactions constituted an avoidance transaction because they were undertaken for the purpose of avoiding tax that would otherwise have been payable. The Court rejected the argument that the transactions were undertaken to

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effect an estate refreeze so that any future growth in Rcongold would accrue to Cohen, and not his children, because there was no reason to have used the chosen method for effecting the alleged estate refreeze other than to create an artificial capital loss. The Court remarked that if the *bona fide* purpose had been to achieve an estate refreeze, it could have been accomplished using the rollover provisions in section 51, 85, or 86 of the Act.

Third, the Court held that the series of transactions were a misuse and abuse of the Act. The Court found that the series of transactions allowed Triad to achieve a tax advantage that would otherwise have been prevented by the stop-loss provision under subparagraph 40(2)(g)(i) of the Act. By its structuring of the series of transactions, Triad was able to create an artificial capital loss the kind of which the Act sought to prevent and that circumvention of the stop-loss provision amounted to a misuse and abuse of the Act.

5. *S. Cunard & Co. Ltd. v Canada*, 2012 FC 683

In this Federal Court case, the taxpayer appealed the Minister's decision to deny the taxpayer's request for a late filing of a subsection 85(1) election.

The taxpayer had entered into a purchase and sale agreement with another company (the "purchaser"). The taxpayer sold a 20% interest in Irving Oil, LLC in exchange for 100,000 preferred shares of the purchaser. The agreement provided that the transaction would be completed on a rollover basis under subsection 85(1) of the Act, and that the parties would jointly file the required election in the time and manner prescribed. The transaction was completed on June 7, 2004 but the required election form was not filed. On June 11, 2004, the directors of the purchaser passed a resolution to voluntarily dissolve the corporation. On July 8, 2009, the taxpayer filled the subsection 85(1) election and requested the Minister allow it to do so beyond the prescribed time. The Minister refused to allow the late filing.

In upholding the Minister's decision to refuse the late filing, the Federal Court emphasized that subsection 85(1) of the Act requires that both the transferee and the transferor make the election and that the form used to make such an election requires both parties' signatures. The Court further noted that: (i) a New Brunswick corporation that has voluntarily been dissolved cannot be revived and (ii) unless the corporation is subsequently revived, a person cannot bind a corporation after its dissolution. Therefore, the purchaser was no longer capable of making a subsection 85(1) election and as a result the taxpayer could not make the late filing.

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