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Original version: As a matter of law

# As a matter of law

**Timely commentary from Dianna Flannery on current life insurance, legal and estate planning issues.**

PREVIOUS COLUMNS

## An estate freeze may not allow family law act planning

Implementing an estate freeze is a common tax planning strategy that can pass on future growth in a corporation to the next generation. An estate freeze involves taking the value of a corporation, either some or all of it, and fixing the value at a certain date by exchanging the common shares representing that value for fixed value preference shares. Thereafter, the growth in the company accrues to the newly issued common shares. The capital gains taxation from this point accrues to the common shares and the holder of the preference shares can redeem the preference shares over time, presumably when it is most advantageous to do so from a tax perspective.

Under the Ontario Family Law Act, “net family property” (NFP) includes all property except property that can be “excluded” under the Act. Property that is acquired by “gift” or inheritance from a third person after the date of marriage is considered “excluded” property.

When common shares are received by a son as part of a corporate restructure and estate freeze, can the shares also be excluded from the net family property calculation under the Ontario Family Law Act because they are a “gift”? This was the issue before the Ontario Superior Court in McNamee v. McNamee 2010 ONSC 674.

Connie McNamee and Clayton McNamee married in 1989. They had two children. In every aspect their relationship was an equal partnership. All investments, bank and savings accounts and property were held jointly.

Clayton and his brother Trevor had worked at their father’s concrete business for over 15 years. Clayton’s father, John, on the advice of his accountant and lawyer, implemented an estate freeze using a holdco structure and not a trust. The corporate transaction included a Declaration of Gift signed by the father. The intention was that the shares transferred to Clayton and his brother Trevor, plus any accrued interest or value, would be excluded from net family property under the Family Law Act upon separation from a spouse. John was adamant about addressing this issue after going through his own divorce. John also insisted, however, on maintaining as much control as possible by having voting rights attached to his preference shares, which is not uncommon. He also insisted that the quantum of dividends paid to him be done without limit, which was unusual. He was quite clear that he did not want to lose out on future growth of the company.

Clayton at the time thought he had become a one-third owner of the business and communicated as such to his wife. He believed the shares were an acknowledgement by his father for the many years of hard work he had done to help grow the business. However, it was only after Clayton and Connie separated four years after the estate freeze was affected that it was disclosed to them for the very first time that the shares were “gifted” and were not to be shared equally.

The judge found the couple to be amicable in their split and wondered why a trial was required to settle their property issues; the judge concluded that it was because of the actions of third parties without any notice to either Clayton or Connie. At the end of the day, that may in fact have very much played into the decision rendered by the court.

The court considered what constitutes a gift and looked at the definition to make a determination. From various legal and other sources, the court indicated that to establish a gift for Family Law Act purposes, the essential elements include:

1) Capacity of the donor
2) Intention on the part of the donor to transfer the property without consideration, without expectation and remuneration
3) The intention of the gift must be inspired by affection, respect, charity like purposes – not for sophisticated tax-planning purposes
4) A divesture of all power and control over the property by the donor
5) An intention on the part of the donee to accept the property as a gift, and
6) Delivery by the donor to the donee be complete

The court concluded the onus was on the husband to prove that the transfer of shares to him satisfied each of these elements. With the exception of point one and to a certain extent point six, the court found that Clayton did not succeed on any of the other elements. In particular, the court cited that John had not given up control of the company and that the structure was done for tax-planning purposes and creditor protection and certainly not as a “gift” as intended by the exclusion provisions of the Ontario Family Law Act. Further, Clayton never believed that the transferred shares were a gift. The court therefore concluded that the value of the shares as at the date of separation were to be included in the husband’s NFP.

From a family law perspective where cases are very much fact driven, the conclusions the court came to as to what constitutes a “gift” for family law purposes may make sense. However, from a tax and estate planning perspective, the case raises many concerns about implementing an estate freeze while also planning for family law issues. Clients may have difficulty having it both ways even where they appear to take all the right steps.

**These columns are current as of the time of writing, but are not updated for subsequent changes in legislation unless specifically noted.**



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