



CESTNICK

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TAX MATTERS

# The many tax and planning benefits of an estate freeze

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I'll never pass up the offer of a good steak dinner. The other day, my neighbour Jack invited me over for a meal if I promised to give him some estate planning advice. He was wondering if he should he buy life insurance to cover the cost of taxes owing when he passes away.

But in Jack's case, an estate freeze seemed like the ideal strategy for him and his wife. Here's how it works.

## The situation

Jack and Janine are in their late 50s. They've had good success in business and can look after themselves financially for the rest of their lives. With good investment management, it's likely that their total net worth will continue to grow as they get older since they're not spending everything they earn today.

Sounds like everything is in order – right? Well, they have financial security. But they also have a problem: As their assets, which includes their business, continue to grow, so does the tax

liability that will be payable when the second of them dies. Another issue is that they're paying a lot of tax on the income they're earning today. Enter the estate freeze.

## The solution

What's an estate freeze? It's the idea of taking certain assets that you own and "freezing" them at today's value. As the assets grow in the future, that growth accrues to someone else – often the kids, or more commonly a family trust with the kids (and the parents) as beneficiaries.

Jack and Janine have decided to freeze the value of a portion of their growth assets – about \$7-million (\$2-million worth of equity investments, plus \$5-million of shares in their private company – an active business which they jointly own and started from nothing several years ago.)

The more you earn, the higher your retirement savings rate needs to be

How will this be done? Both Jack and Janine will transfer the assets to a new holding company. This transfer will take place under Section 85 of our tax law which will allow it to take place without being taxed at the time of the transfer.

In exchange for transferring the \$7-million of assets to the new holding company, Jack and Janine will take back preferred shares in the holding company that will be worth \$7-million but will be frozen in value. Then, common shares in the holding company – to which all the future growth will accrue – will be issued for a nominal amount to a new family trust they will set up. Their kids, future grandchildren, and Jack and Janine themselves will be beneficiaries of the trust.

But there's more. They want to take advantage of the lifetime capital gains exemption (LCGE) on their company shares (since the shares are qualified small business corporation shares), so they will elect to trigger a capital gain of \$2.5-million on those shares when they make the transfer. They're each entitled to an exemption of \$1.25-million (in 2025), which will shelter from tax the first \$2.5-million in capital gains (using both of their exemptions) on those shares. The adjusted cost base of the shares will then be bumped up to \$2.5-million, reducing taxes later when they sell the shares, transfer them, or pass away.

## The benefits

Here's what Jack and Janine will accomplish with the estate freeze:

- **Reducing taxes on death.** The future growth of the frozen assets will accrue to the common shares held by the family trust – not in Jack's or Janine's hands, so

they'll avoid the tax on the future growth. They plan for their heirs to pay the eventual tax as beneficiaries of the trust.

- **Utilizing the LCGE.** They'll use their LCGEs and will save about \$335,000 (in Ontario) each in taxes as a result. The LCGE is available on certain private company shares and qualified farm and fishing property.
- **Splitting income with family.** The new holding company will earn income on the assets and can distribute that income to the family trust to face tax in the trust and to then be reinvested with future "income on the income" taxed in the hands of their children and adult grandchildren.
- **Protecting assets.** The future growth of the holding company will be held in the trust and will be protected from creditors.
- **Reducing probate fees.** Since they have frozen the value of the \$7-million in their hands, the future growth will not be subject to probate fees when they pass away.
- **Maintaining control.** As trustees, and owners of voting preferred shares, they'll continue to control and have access to the \$7-million in the holding company.

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