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FAMILY FEUD: Resolving Estate Disputes



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A mother wants her son to assume control of the family business to the exclusion of her other children, while at the same time, she wishes to provide an equivalent value of her other assets to them; a husband, on his deathbed, tries to strike the appropriate balance

between providing appropriately in his Will in favour of his wife while fulfilling his parental obligations to his adult children from a previous marriage still dependent on his financial support; three children, their spouses, and families struggle over sharing in the occupation of the family cottage that was owned by their parents and left to the three of them.

The examples are infinite, and yet, all have one thing in common: they all involve interpersonal family relationships, some of which existed from birth while others came into existence later in life. They will inevitably result in these individuals coming into conflict with one another. Conflict is a normal consequence of relationships by virtue of the intense emotional elements involved. But why do conflicts often become disputes?

Disputes within families are unfortunately common. They arise equally within close families and within families where relationships are already strained; disputes are evident in wealthy families as well as

within those with modest financial resources; and disputes also surface within families where the relationships span various periods of time.

The Will often evokes a tremendous emotional response since it symbolically represents much more than simply a distribution of assets. Individuals who are considering their estate plans rarely, if ever, think about much more than the financial consequences of that plan. It is, after all, considered to be a form of "financial" planning. The same may be said about their professional advisors who rarely consider some of the non-financial issues that can arise following the death of a loved one. It is critical, however, to consider the emotional response of family members.

The increasing variety of family relationships emphasizes the need to address the non-financial issues involved in estate planning. How do you treat a stepchild who has been raised as a natural child? Is an adopted child treated any differently? How might each of them react to decisions about them in

the Will? The “easy” route for testators is to follow that of equal distribution of assets. What is equal or equivalent, however, may not be considered fair or equitable.

Predictors of Potential Disputes

There may be opportunities to identify potential disputes during the estate planning process and to attempt to minimize future disputes or, at least, reduce the number of issues that may subsequently be in dispute.

Examples of potential problem situations include:

- unequal division of assets among children;
- continued operation of a business where only one child has been actively involved;
- disposition of the family cottage;
- non-disclosure of information to family; and
- naming the eldest child as executor of the estate simply because he/she is the eldest.

What is the Underlying Dispute?

Based upon my experience as an estates litigation lawyer, I firmly believe the legal action in most estate disputes only serves as the vehicle through which an offended individual is able to publicly verbalize his or her emotions.

Often, the longer the dispute goes on, the greater the divide between the origin of the dispute and what is cited as the cause. Over time, the individuals become adamant and are only guided by what is perceived as advice from so-called friends and others and which serves only to solidify the surface-level legal dispute.

Sheer greed and feelings of entitlement are not the only reasons people choose to pursue litigation. Often, psychological issues regarding the relationship between the disputant and the deceased form the basis for pursuing a legal challenge. In some cases, the surviving family member is trying to deal with feelings of jealousy over ways in which a parent treated a sibling. Starting a lawsuit against the sibling is the only way the claimant feels those emotions can be released and articulated.

In other cases, the claimant may truly believe that Mom or Dad could never have intended the result supported by another family member, whether this is true or not. In these situations, the motivation may be feelings of perceived moral injustice and inequity. A lawsuit is seen as the only way to balance the scales of morality.

Mediation v. the Judicial Process

Resolving a dispute between family members by facilitating dialogue between them, particularly through use of mediation, has been somewhat foreign until recently.

Few conceive an estate dispute as being rooted in relationship issues. Conventional “wisdom” is that one fights over assets through the judicial process, however, alternatives to the judicial process are becoming known. In particular, mediation is a useful method to resolving disputes, especially in cases involving relationship issues. In addition to all of the other “advertised” benefits of mediation, such as it being less costly, less time-consuming, and achieving greater party satisfaction, etc., it is particularly beneficial in situations where ongoing relationships are intended to be maintained.

Estate disputes are similar to matrimonial disputes in that they both possess the common element of deteriorated relationships. We think of divorce as commonplace since statistically, a large proportion of the population has encountered marital discord resulting in separation. Recall, as well, that a marital relationship is one in which two individuals enter voluntarily. When comparing the similarities between marital relationships and blood relatives, is it therefore so surprising that there are a multitude of estate disputes?

Mediation appears to be a more beneficial way in attempting to resolve these disputes compared with the judicial process. Simply because mediation might not completely heal emotional wounds is not a sufficient reason to abandon the process altogether. It may actually serve a valuable purpose in decoding the true underlying cause of the dispute, which is a prerequisite in attempting to resolve it. If one truly believes, in general, that a settlement is preferable to



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a judicial judgment (a view that is often subscribed to by members of the legal profession), movement towards the settlement of an estate dispute requires, at a minimum, identification of the obstacle that caused the dispute.

Conclusion

Estate disputes are unique as they usually involve individuals who are involuntarily bound together by a family unit, creating a relationship between them. The family relationship, especially the “expanded family” relationship, brings a myriad of emotional issues.

Because of this, disputes often reflect pre-existing feelings and events. Death serves as the catalyst; yet, the nature of the dispute expressed in the formal legal proceedings will generally not reflect the true, often undisclosed, root of the problem. The legal process serves only as the vehicle through which the grievance can be expressed.

The judicial system is not the most effective way in which to deal with estate disputes since they generally involve unresolved interpersonal conflicts. Although a judge’s arbitrary decision may determine the legal issue that has been raised, it will not address the underlying cause of the dispute. Mediation offers a preferable alternative method to negotiate a resolution in a way that will ultimately prove to be more satisfying to the parties.

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Howard's practice focuses on estate litigation and mediation of estates disputes with extensive practice experience in all aspects of estate planning and administration.

In addition to a busy estate litigation and mediation practice, Howard provides estate planning services, including the preparation of wills and powers of attorney, for middle and high net-worth individuals.



Court Notes

In a bitter, hard-fought contest between the deceased husband's third wife and two children of the deceased's first marriage, the wife claimed the husband intended that, on his death, she receive one-third of the proceeds of sale of their condominium. The husband also intended that the two children each receive one-third of the proceeds of sale.

The deceased was very sophisticated in business matters. He arranged for a corporation to take title to the condominium and was the sole director of the corporation. His wife and two children were each one-third shareholders. The husband advanced all of the funds for the purchase of the condominium and treated the advance as a loan from him to the corporation.

There was little doubt the husband intended his wife and children each to receive one-third of the proceeds of sale of the condominium. The wife was able to adduce corroborating evidence, while the two children could adduce no evidence to the contrary, however, the husband omitted to provide in his Will for the disposition of the proceeds of sale.

The two children submitted that the corporation was obligated to repay the loan to their father's Estate, of which they, but not the wife, were the residuary beneficiaries. As directors of the corporation after their father's death, the children caused the corporation to repay the loan. As a result, the wife was left with much less than one-third of the proceeds of sale, while the children were left with much more.

The wife applied to the Commercial Court for a declaration that the two children, who were in control of the corporation after their father's death, had dealt oppressively with the wife within the meaning of the *Ontario Business Corporations Act*. The two children submitted that, as directors of the corporation, they had an obligation to ensure that the corporation

repaid the loan – even though repayment ultimately benefited them and worked to the wife's disadvantage.

The Court upheld the submissions of the two children that:

1. Since the deceased treated the advance of funds to purchase the condominium as a loan from him, that loan could not just disappear. For the husband to achieve what he intended, the loan would have to be forgiven in some way.
2. The husband did not forgive the loan while he was still alive since, on the wife's own evidence, the husband wished to have control over the condominium while he was alive.
3. The result: any forgiveness of the loan would have to take effect after the husband's death. The forgiveness would be testamentary in nature and would have to comply with the formal requirements of a will. But the husband did not forgive the loan in his Will.
4. Since the loan was not forgiven, the two children did not oppress the wife by causing the corporation to repay the loan to the Estate.

The Court held, in effect, that, although the scope of the oppression remedy is wide, it is not so wide that it can be used to circumvent the existing law of testamentary disposition. The husband's intention was ultimately frustrated by the very mechanism which he had set up. He was a victim of his own sophisticated planning.

Arnie Herschorn and **Stephen C. Nadler** of Minden Gross acted for the two children.



Implementing Estate Freezes

What is an Estate Freeze?

An estate freeze refers to the transfer of the future growth in value of a business, investments, or other assets into the hands of subsequent generations (the “Children”). The current owners (the “Parents”) are effectively divested of this future growth. An estate freeze typically limits the value of the Parents' estate to the value at the date the freeze is implemented (the freeze typically retains the current value of the asset, although often in a different form). Accordingly, capital gains and other tax exposure on the future growth that would otherwise arise when the assets pass from Parents to Children are avoided.

Why is an Estate Freeze Implemented?

A freeze is implemented to maximize the value of the estate that will ultimately pass to the beneficiaries. Avoiding capital gains and other tax means the beneficiaries will receive more (and the CRA less). Generally, an individual is considered to dispose of his or her capital property upon death at fair market value. Reducing the value of one's property, which will be subject to these “deemed disposition” rules, serves to maximize the value of the assets received by the beneficiaries. As such, an estate freeze is implemented when the assets of the freeze are expected to appreciate. If the assets are expected to depreciate, it is usually preferable not to freeze.

How is an Estate Freeze Implemented?

In its most basic form, an estate freeze is simply the transfer of appreciating assets to a subsequent generation. It can be as simple as transferring

ownership of an asset (by sale or gift) to a child or grandchild. Although this transfer will shift capital gains tax liability from one generation to the other, such simple transfers may involve immediate tax exposure because of the deemed disposition rules. Also, in a straightforward transfer, Parents may not maintain any control over the assets.

For these reasons, the most common form of estate freeze involves the transfer of assets to a corporation with a freeze configuration or the reorganization of an existing corporation, typically combined with a family trust. The corporate vehicle usually permits the implementation of the estate freeze on a tax-deferred basis. Furthermore, corporate equity structures allow economic and legal rights in respect of the underlying property to be specifically defined and carved out. The trust affords additional degrees of control and protection against mismanagement by the beneficiaries and may enable the trustees to actually determine the beneficiaries themselves.

When Should a Freeze be Implemented?

Before proceeding to implement a freeze, a practitioner should review the pros and cons with the client. Do not presume a freeze will always be advantageous.

Traditionally, several non-tax factors have been put forward. First, it is important to ensure that the effects of inflation do not leave Parents without sufficient assets to meet their personal needs.

The psychological (and legal) effects of income splitting and estate freezing should be considered carefully, as the outcome may place substantial

assets in the hands of Children. These effects should be looked at from the point of view of both the Parents and the Children. (There may be more control available through the use of a family trust; but, it is normally advisable to distribute growth shares before the 21st anniversary of the trust. After this, it might be possible to obtain a significant degree of protection if a shareholders' agreement can be implemented.)

Family law and creditor protection considerations should be addressed.

If the assets to be frozen are likely to be sold after the death of the Parents, an estate freeze might not be the answer, since the Children will have to pay tax on the sale of the assets anyway.

Simply, a freeze is for a long-term hold only. For example, if there is a mandatory sale of shares on death resultant from a buy-sell, consideration should be given to the effective utilization of corporate-owned life insurance to reduce death tax exposure instead of a freeze.

Often, assets which are looked on by Parents as long-term holds may not be once the Parents pass away. A vacation property might not be as desirable to the Children as it was to the Parents. Children may have a very different view of marketable securities perceived by Parents as long-term family assets.

In recent years, a more fundamental issue has arisen in terms of preservation of family wealth: The presumption valid in previous generations - that

Children will be motivated to carry on a family business - may no longer be well-founded. In many cases, the work ethic taken for granted by previous generations may be different for the Children. Far from wishing to take over the family business, or pursue a lucrative, but demanding, career, Children's financial prospects may be based on the affluence of their Parents. Assets treasured by Parents may be used to finance the lifestyle of a succeeding generation. A family business - with all its pressures and responsibilities - may be put up for sale. It may not be the situation parents envisioned for their kids - but it's a growing fact of life.

For some, the assumption of a continual build-up of family wealth may no longer be valid. If not, an estate freeze takes on a new rationale.

If the prospects of succeeding generations are tied to that of Parents, the drain on wealth resulting from death tax can be even more crippling. An estate freeze can preserve the asset base, pending a more gradual liquidation as assets are sold off to finance lifestyles. In addition, if the financial prospects of Children are limited, it may be possible to reduce the tax impact from a gradual liquidation as a result of low marginal tax rates.

Very generally, to the extent that future growth of a corporation would generate refundable tax (or capital dividend) balances, e.g., where investment-type assets are involved, it may not be necessary to undertake a freeze. Although the shares of the corporation would continue to grow in value and thus increase the tax exposure from a deemed disposition

Firm News

Minden Gross is pleased to announce that **Monica E. Bianchini** has joined the Commercial Real Estate Group.

The **Commercial Leasing Group** will be participating in the upcoming 2005 ICSC Canadian Convention at the Metro Toronto Convention Centre on September 14-15, 2005.



at death, it may be possible to undertake post-mortem procedures to mitigate this. Note, however, that there are a number of issues in respect of post-mortem reorganizations, especially when a complete liquidation of the corporation is not desirable.

Having said this, build-ups of refundable tax and capital dividend balances in a frozen corporate system will be available to redeem freeze shares on a tax-effective basis, including when the build-up occurs after the freeze. Thus, in a standard corporate freeze (e.g., of a business or real estate) it is desirable to inject assets that facilitate the build up of investment profits and therefore future refundable tax balances. While, in a sense, such refundable tax balances “should belong” to the holders of the growth shares, dividend refunds will be generated as freeze shares are redeemed, mostly tax-paying such redemptions, which would otherwise be exposed to capital gains tax upon death. Of course, one subset of this effect occurs with corporate-owned life insurance, which generates capital dividend accounts and can reduce taxes through post-mortem redemptions, subject to certain stop-loss rules. In addition, if the business has been successful, it will tend to generate cash which would presumably be used for investment purposes and increase refundable tax and (possibly) capital dividend accounts.

Income Splitting

In the corporate context, the primary advantage of income-splitting is the ability to divert dividends to low-bracket shareholders. Practitioners should review the advantages of such distributions, and whether there are alternatives to achieve this effect. For example, it may be possible to pay low-bracket family members a salary if the amount is not unreasonably large in relation to the business-related services performed.

If funds are not required for personal and living expenses, the advantages of paying dividends to

low-bracket family members may be limited. For example, for a corporation which earns active business income of more than \$300,000 per year, the normal salary and bonus mechanism may enable funds to be distributed for expenses. If so, the primary advantage may be the ability to reduce the corporation's net assets and thus keep the value of the corporation at a relatively low amount; but, the ultimate tax benefits of this objective will be deferred. However, increasing disparities between top personal and corporate rates have caused owner-managers and their advisors to reconsider bonusing down to the small business limit (in Ontario, the disparity is greater than 10% counting EHT). This, of course restores the desirability of income splitting by means of dividends.

The advantages of income splitting in respect of an estate freeze were restricted by the introduction of the so-called “kiddie tax.”¹ While the advantages of “dividend splitting” with minors are restricted, such restrictions do not apply to adult children. As mentioned earlier, the possibility of limited financial prospects of many adult children may make this area more important.

This article consists of excerpts from the introductory chapter of Implementing Estate Freezes, by David Louis. The second edition of this publication will be available shortly from CCH Canadian Limited.

¹ Applicable to individuals who have not reached the age of 18 in the year. Another significant barrier to dividend splitting is the so-called ‘corporate attribution rules’, which cease at the age of 18.

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David Louis is the Chair and senior member of Minden Gross’ Tax Group. Both a lawyer and C.A., David has over 25 years of experience in income tax matters, including personal, corporate, international, and estate planning, focusing largely on entrepreneurs.

Professional Notes

Timothy R. Dunn presented "Understanding the Plight of the Landlord on the Insolvency of a Tenant," and he and **Stephen Posen** were part of a panel on landlord and tenant issues at the Insolvency and Restructuring Forum presented by the Canadian Association of Insolvency and Restructuring Professionals (CAIRP) on May 12, 2005.

Timothy R. Dunn and **Glenn O. Lewis** discussed traditional rights and remedies available to commercial landlords when faced with indebtedness owing by a tenant in "Landlord as Creditor: What Remedies are Available?" at the Ontario Bar Association's "Six-Minute Debtor-Creditor Lawyer" in May 2005. The article is also available at www.mindengross.com.

David Louis' *Estate Freeze Implementation* is due out this fall and published by CCH Canadian.

Alan D. Litwack presented "IN-HOUSE COUNSEL: Conflict Between Management and Boards of Directors" at the Canadian Corporate Counsel Association's National Spring Conference held April 17-19, 2005.

Stephen J. Messinger was on the advisory board and also a panelist at the annual Georgetown University Law Center Advanced Commercial Leasing Institute held on March 30-April 1, 2005.

Stephen will be a seminar leader and will present "Doing Business in Canada" and "Ten Things That Every Tenant Must Have In Its Shopping Center Lease" at the National Retail Tenant Association's Annual Conference on September 18-20, 2005. On October 16-18, 2005, Stephen will lead a seminar titled "Fixing or Floating CAM Charges - Which is Better?" at the ICSC Fall Convention in San Diego.

Daniel Sandler advised the State of Louisiana's Department of Economic Development (LED) on two House bills that were introduced to promote venture capital investment in the state. On June 10, 2005, Daniel gave a presentation at Industry Canada on "The Role of Government in Tech-Led Development." Both the Industry Canada presentation and the work for the LED stem from Daniel's continued research in the area of government incentives for venture capital formation. His book, *Venture Capital and Tax Incentives: A Comparative Study of Canada and the United States*, is based on this research and was published by the Canadian Tax Foundation in July 2004.

David T. Ullmann appeared on ROBTv's *The Business News with Howard Green* to discuss Stelco's restructuring plan outline released on July 5, 2005.