The Use of Estate Freezes by Family-Owned Businesses

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PRÉCIS

On prétend que le plus grand obstacle à la réussite continue d'une entreprise familiale est sa succession — le passage de l'entreprise d'une génération à la suivante. Le gel successoral peut faciliter le processus en déterminant la valeur de la participation du parent dans l'entreprise à une date donnée, les enfants bénéficiant alors de la plus-value future. L'article documente le nombre de gels successoraux dans les entreprises familiales au Canada et explore les raisons qui l'expliquent. Deux outils d'enquête ont été utilisés : un sondage auprès de propriétaires d'entreprise familiale et un autre auprès de fiscalistes.

Un nombre relativement peu élevé des entreprises familiales sondées (15,8 % des entreprises dont le propriétaire avait des enfants) ont procédé à un gel. L'avantage net découlant du report — la valeur du report découlant d'un gel successoral moins la valeur actualisée des honoraires professionnels — pour chaque entreprise familiale est déterminé. Il y a certes un avantage financier pour la plupart des entreprises soumises au sondage qui ont procédé à un gel successoral; selon des hypothèses raisonnables, plus de 90 % des entreprises auraient bénéficié d'un avantage de report net positif. Pour qu'un gel successoral ait une valeur de report, le père ou la mère doit avoir l'intention de laisser l'entreprise à ses enfants. Fait étonnant, ceci ne vaut pas pour une majorité d'entreprises familiales au Canada. Soit que les parents ne sont pas certains de vouloir léguer l'entreprise aux enfants, soit qu'ils ont décidé de ne pas le faire. Par ailleurs, les entreprises familiales peuvent procéder à un gel successoral, mais à une date ultérieure à celle qui permettrait de maximiser la valeur de report nette. Il semble que ces deux facteurs combinés expliquent pourquoi un nombre relativement restreint d'entreprises ont procédé à un gel, même si elles semblent avoir un avantage financier à le faire.

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ABSTRACT

It has been argued that the greatest risk to the continued success of a family-owned business is succession—the passing of the business from one generation to the next. Estate freezes can facilitate succession by fixing the value of the parent's interest in the business at a particular date, with future growth accumulating to the benefit of the children. This article documents the frequency of estate freezes among family businesses in Canada and explores the reasons for the level of use. Two investigative instruments are used: a survey of family business owners and a survey of tax professionals.

Relatively few of the family businesses surveyed (15.8 percent of businesses whose owners have children) have performed a freeze. The net deferral benefit—the deferral value of an estate freeze less the present value of professional fees—for each family business is determined. There is a financial incentive for almost all of the sampled firms to have performed an estate freeze: on reasonable assumptions, over 90 percent of firms would have had a positive net deferral advantage. For an estate freeze to have deferral value, the parent must intend to pass the business on to his or her children. Surprisingly, this does not hold for a majority of family businesses in Canada. Parents are either uncertain whether they will pass the business on to their children or have decided against doing so. Alternatively, family businesses may be performing estate freezes, but at a later time than that which would maximize the net deferral value. Together, these two factors appear to explain why relatively few businesses have frozen, even when there is an apparent financial incentive to do so.

KEYWORDS: ESTATE FREEZES ■ ESTATE PLANNING ■ FAMILY ■ BUSINESS

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INTRODUCTION

In Canada and throughout the world, the continued success of family businesses is of great importance because they are the prevalent business form and because they are thought to have certain competitive advantages. An estimated 80 to 90 percent of the world's businesses are family firms.[1] Recent estimates of the proportion of Canadian businesses that are family-owned vary from 75 percent[2] to 80 percent[3] to 90 percent.[4] Family businesses account for over one-half of Canada's gross domestic product and employment.[5]

It can be argued that family businesses have particular attributes that make them more valuable to the nation—that they often enjoy a competitive advantage over other business organizations. This advantage stems from a high level of trust, perseverance, and commitment to success.[6] Family businesses are said to be focused on building customer loyalty; they play an active role in the community, and they present a culture of shared values.[7] Owners of family businesses think in a longer term, with higher standards.[8] Family businesses may also be nimbler, more customer-oriented, and more focused on quality—attributes that make them well-suited for global competition.[9] Porter[10] argues that family businesses offer a competitive advantage to a nation through the owners' sustained commitment to the firm and its industry and its greater flexibility. However, a growing literature suggests that family-owned firms may be at a competitive disadvantage. Family business ties may result in less accountability for poor performance,[11] managerial and owner opportunism,[12] and contracts that fail to reflect economic rationality.[13]

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1 See John L. Ward, *Keeping the Family Business Healthy: How To Plan for Continuing Growth, Profitability and Family Leadership* (San Francisco: Jossey-Bass, 1987).

2 Tammi S. Feltham, Glenn Feltham, and James J. Barnett, "Are Canadian Family Businesses Ready for Succession?" (2001) vol. 2, no. 4 *Isuma: Canadian Journal of Policy Research* 116-22.

3 Eleni T. Stavrou and Paul Michael Swiercz, "Securing the Future of the Family Enterprise: A Model of Offspring Intentions To Join the Business" (1998) vol. 23, no. 2 *Entrepreneurship Theory and Practice* 19-39.

4 Grant Thornton, "Succession Planning for Family-Owned Businesses—Making the Tough Calls," *Catalyst*, September 1993.

5 Supra note 2.

6 W. Gibb Dyer Jr. and Wendy Handler, "Entrepreneurship and Family Business: Exploring the Connection" (1994) vol. 19, no. 1 *Entrepreneurship Theory and Practice* 71-84.

7 Bonnie J. Montgomery and Anne M. Sinclair, "All in the Family" (2000) vol. 46, no. 2 *Business and Economic Review* 3-7.

8 Jim Klaes, "Credibility for the Family Business" (available online at http://www.fambiz.com/).

9 Enresto J. Poza, "Business Continuity Is the Prize of Succession (Part I)" (available online at http://www.fambiz.com/).

10 Michael E. Porter, *The Competitive Advantage of Nations* (New York: Free Press, 1990).

11 Luis R. Gomez-Mejia, Manuel Nuñez-Nickel, and Isabel Gutierrez, "The Role of Family Ties in Agency Contracts" (2001) vol. 44, no. 1 *Academy of Management Journal* 81-95.

12 William S. Schulze, Michael H. Lubatkin, Richard N. Dino, and Ann K. Buchholtz, "Agency Relationships in Family Firms: Theory and Evidence" (2001) vol. 12, no. 2 *Organization Science* 99-116.

13 See W. Gibb Dyer Jr., "Integrating Professional Management into a Family Owned Business" (1988) vol. 1, no. 3 *Family Business Review* 221-35; W. Gibb Dyer Jr., "Potential Contributions

Many observers have argued that the greatest risk to the family business is succession—the passing of the business from one generation to the next.[14] In fact, relatively few family businesses survive to the second generation.[15]

> One could consider irrational and paradoxical the common belief that while family businesses are considered important economic and social pillars throughout the world, not many survive beyond the first generation.[16]

One important factor in a family business's continuation is the tax liability that arises on the transfer of the business from the parent to the children. Therefore, effective tax and estate planning are essential.[17]

An estate freeze can facilitate the passing of a family business from one generation to the next by fixing the value of the parent's interest in the business at a particular date, with future growth accumulating to the benefit of the children.[18] This article documents the frequency of estate freezes among Canadian family businesses and explores alternative explanations for the level of use. A "family business" is defined as a business that is under family control and family management. Share ownership

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of Organizational Behavior to the Study of Family Owned Businesses" (1994) vol. 7, no. 2 *Family Business Review* 109-34; Rosabeth Moss Kanter, "Work and Family in the United States: A Critical Review and Agenda for Research and Policy" (1989) vol. 2, no. 1 *Family Business Review* 77-114; and Kenneth Kaye, "Penetrating the Cycle of Sustained Conflict" (1991) vol. 4, no. 1 *Family Business Review* 21-44.

14 See, for example, Mark K. Fiegener, Bonnie M. Brown, Russ Alan Prince, and Karen Maru File, "Passing on Strategic Vision: Favored Modes of Successor Preparation by CEOs of Family and Nonfamily Firms" (1996) vol. 34, no. 3 *Journal of Small Business Management* 15-26; Anthony L. Curatola, "Family Business Values and Estate Planning" (2000) vol. 82, no. 4 *Strategic Finance* 17-18; and Bonnie M. Brown, "Developing Leadership in Family Businesses" (available online at http://www.fambiz.com/).

15 Estimates across countries tend to find that only 30 to 40 percent of family businesses survive to the second generation (see Manfred Kets de Vries, "The Dynamics of Family Controlled Firms: The Good and the Bad News" (1993) vol. 21, no. 3 *Organizational Dynamics* 57-71; Stavrou and Swiercz, supra note 3; and Laura Koss-Feder and Valerie Marchant, "Business, Too Close to Home," *Time*, July 17, 2000, B25-29).

16 Eleni T. Stavrou, "Intergenerational Transitions in Family Businesses: Exploring the Effects of Demographic Factors" (1999) vol. 37, no. 3 *Journal of Small Business Management* 43-61, at 43.

17 Dyer and Handler, supra note 6.

18 More specifically, to perform an estate freeze, the parent transfers his or her common shares of an operating company in exchange for fixed-value preference shares (frozen shares) of the operating company or of a holding company, thus freezing his or her interest in the value (net assets) of that company. The fixed-value preferred shares are retractable by the parent, and may be repurchased by the corporation at the shares' fair market value at the time of the freeze. The parent's interest in the property is thus frozen. New common shares of the operating company, or of a holding company, can then be issued for nominal consideration to the children or in trust for the children—thus, future growth accumulates to the benefit of the children. For a more complete discussion, see Maurice C. Cullity, Catherine A. Brown, and Cindy Rajan, *Taxation and Estate Planning*, 4th ed. (Scarborough, ON: Carswell, 1996), 7-13 to 7-17.

is used as a proxy for the existence of an estate freeze. A survey of family business owners and a survey of tax professionals were used to establish the frequency of use of estate freezes. These surveys are described in the second section of the article.

Given the economic importance of family businesses in Canada, the lack of evidence of the use of estate freezes is surprising. The primary reason for this lack of evidence appears to be that freezes cannot be reasonably estimated from available tax data. A business is not required to inform the Canada Customs and Revenue Agency (CCRA) that an estate freeze has been performed, and it is very difficult to draw indirect inferences about the prevalence of freezes from tax data.

The relatively low level of use of estate freezes is examined in the third section of the article. In the fourth section we discuss the financial and non-financial factors that influence the freeze decision. One primary benefit of a freeze is that it allows the future growth in the corporation to be taxed in the hands of the owner's children rather than in the hands of the owner, thus deferring the tax liability on the business's growth. Chu, Feltham, and Mathieu[19] have demonstrated that, in theory, the deferral value of an estate freeze can be very great and that this value can usually be maximized if a freeze is performed as soon as the parent can fully use his or her capital gains deduction. However, professional fees are associated with an estate freeze, and in the fifth section of the article we examine whether the low level of estate freezes can be explained by these two economic factors. Expanding on the valuation model developed by Chu, Feltham, and Mathieu, we estimate the proportion of firms for which the deferral value of an estate freeze exceeds the professional fees (the net deferral benefit). We find that there is a sizable gap between the proportion of family businesses with a positive net deferral benefit (over 90 percent) and the proportion of family businesses that have actually performed a freeze (15.8 percent).

In the sixth section of the article we examine two potential explanations for this gap. First, for an estate freeze to have deferral value, the parent must intend to pass the business on to his or her children. Second, firms may be performing estate freezes later than is financially optimal. Together, these two factors appear to explain a large part of the gap between observed behaviour and that predicted by the model that calculates the net deferral benefit.

TWO SURVEYS

To address the central issues in this paper, we surveyed two groups: family business owners and the tax professionals who advise them. The primary source of data for this article is the survey of family business owners. The survey results are used to determine the proportion of firms that have performed freezes, to estimate the deferral value of a freeze for each family business, and to ascertain the parent's succession intentions and the timing of the freeze.

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19 Ling Chu, Glenn Feltham, and Robert Mathieu, "The Deferral Value of Estate Freezes" (2001) vol. 49, no. 2 *Canadian Tax Journal* 345-67.

The results of the survey of tax professionals who advise family business owners serve two main purposes. First, they are used to estimate the financial costs of an estate freeze (family business owners could not be expected to reasonably estimate these costs). Second, open-ended questions in the survey allow for a better understanding of the estate freeze process and suggest reasons that owners do or do not perform a freeze. Descriptions of the two surveys follow.

The Survey of Family Business Owners

In the summer of 1998, a self-completion questionnaire was mailed to a nationally representative sample of 7,500 Canadian businesses obtained from Dun and Bradstreet.[20] The businesses met the following criteria:

- annual revenues of at least $1 million;
- domestic headquarters only;
- domestic parent companies only;
- not publicly traded;
- not a sole proprietorship; and
- not a partnership.

A total of 765 surveys were returned, representing a 10.2 percent response rate. This response rate is similar to other family business surveys, such as Dunn[21] (a UK study with a 15 percent response rate) and Nager, Aronoff, and Ward[22] (a US survey with a 10 percent response rate). Although some surveys have had higher response rates, they tend to rely on lists from family business organizations such as the Canadian Association of Family Enterprise (where the members are actively involved). The regional distribution of our returned surveys closely matched the distribution of the mailout.

The responding businesses tended to be larger than the average family firm, owing to the $1 million annual revenue requirement. The most frequently reported sales revenue figure was $2 million. One-half of the respondents employed 18 or more full-time workers. Note that the $1 million revenue threshold likely creates a bias in favour of greater tax and succession planning. Smaller firms may be expected to be even less prepared for succession than those we surveyed.

A traditional definition of "family business" includes two elements: family control and family management. For inclusion in our survey, we therefore required that

20 Dun and Bradstreet is a Canadian and international database provider whose data have been used extensively in the business literature, including the family business literature (see, for example, Stanley Cromie, Ben Stephenson, and David Monteith, "The Management of Family Firms: An Empirical Investigation" (1995) vol. 13, no. 4 *International Small Business Journal* 11-34).

21 Patrick Dunn, "Choosing a Successor," *Management Today*, January 2000, 74.

22 Ross W. Nager, Craig E. Aronoff, and John L. Ward, *American Family Business Survey: 1995* (Houston: Arthur Andersen Center for Family Business, 1995).

the respondent's family control the firm and that the respondent work within the firm. Because we are interested in estate freeze behaviour, the sample was further restricted to businesses in which the respondent had a child or children. The result of these restrictions was to reduce the sample from 765 to 673.

The Survey of Tax Professionals

An in-depth survey of 10 tax experts (1 lawyer and 9 chartered accountants) was conducted from December 1998 to March 1999.[23] To complete the survey, we met individually with participants at their work sites for one to two hours. To make our results as representative as possible, we administered the survey to professionals at large firms (national firms) and small firms (including two sole practitioners) in large, medium-sized, and smaller urban areas.

On average, the tax professionals we surveyed had practised accounting or law for 17 years and had specialized in tax for 13 years (with a range from 3 to 23 years). Each participant had taken the Canadian Institute of Chartered Accountants' in-depth courses and/or obtained a master's degree in taxation. The second selection criterion was that the participants work extensively in estate and succession planning. On average, the 10 participants spent 36 percent of their time on estate and succession planning (with a range from 15 to 80 percent). The respondents had performed an average of 16 freezes over the previous two-year period; the median was 13 freezes.

ESTIMATING THE LEVEL OF USE OF ESTATE FREEZES

To our knowledge, this article is the first to quantify the level of estate freezes performed in Canada. After preliminary discussions with tax professionals and family business owners, we decided not to ask family business owners directly whether an estate freeze had been performed, but rather whether the children had an equity interest in the family business. Our concern was that many family business owners would not understand the term "estate freeze" even if one had been performed. In an estate freeze, growth shares are issued for the benefit of the children, either

23 Ten respondents is, admittedly, a small sample size. However, we believe that it is sufficient for its purpose in this article. The primary purpose of conducting the tax professional survey was to determine the present value of professional fees. As discussed further in the section entitled "Determining the Proportion of Firms with a Net Deferral Advantage," we find that results are largely invariant to assumptions about costs. That is, the proportion of firms with a positive net deferral value changes little whether the highest cost, lowest cost, or an average cost is applied. Other factors, such as the assumed firm growth rate, have a far greater effect. Further, we observed that little additional information would be gained through significantly expanding our sample size. In discussions with professionals within a single firm, it appeared that a common firm-level practice tended to be followed. Interviewing several partners from one of the large accounting firms would not appear to provide significant additional information; statistical power would only be increased artificially.

directly or in trust.[24] Although children's share ownership is necessary to perform a freeze, children could still have an equity interest without a freeze having been performed. However, the practitioners we interviewed felt that when the children held common shares it was almost always as a result of a freeze.[25] Children's share ownership therefore places an upper boundary on the number of freezes performed—that is, share ownership is a necessary but not a sufficient condition. Note that the operational definition of an estate freeze in this article—that the children have an equity interest in the business—includes both full and partial freezes.

In total, 15.8 percent of business-owner respondents with children (106 of 673) have involved their children in the ownership of the family business. The implication is that fewer than one in six of the surveyed Canadian family businesses have performed an estate freeze. Recall that these businesses have at least $1 million in annual revenues (the percentage would almost certainly be even less for smaller firms).[26] Informal discussions with family and business owners and tax practitioners (prior to this study) suggested that a sizable number of family businesses had not performed estate freezes. However, we were surprised by the magnitude of the actual number—over 84 percent had not performed a freeze.[27]

FACTORS IN THE FREEZE DECISION

In the introduction, we noted that one primary benefit of a freeze is that it allows the future growth in the corporation to be taxed in the hands of the owner's children rather than in the hands of the owner, thus deferring the tax liability on that growth. In other words, an estate freeze provides a tax-deferral advantage. Other potential benefits as well as costs flow from an estate freeze.

We asked the 10 tax professionals the following question: "What are the major advantages to performing an estate freeze?" Their responses fell into four categories:

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24 Respondents were asked whether their children or a family trust were shareholders—not whether they held common shares. The result may therefore overstate the number of freezes performed, because it may include family businesses with children or family trusts that hold shares that do not participate in the growth of the firm (that is, preferred shares).

25 Some professionals noted that parents sometimes provide common shares to the children at the time of incorporation. This is mathematically and economically an estate freeze (typically, a partial freeze) at the time of incorporation, although the term "estate freeze" is not usually applied.

26 That the number of freezes increases with the value of the firm is demonstrated in table 5.

27 We also asked the 10 tax professionals surveyed what proportion of their family business clients had performed estate freezes. We expected that their response would not reflect the experience of the general population of family businesses. First, a family business tax professional is more likely than a general practitioner to raise the issue of estate freezes with his or her clients and recommend a freeze. Second, some clients will have come to these professionals for the primary purpose of having a freeze performed. On average, the tax professionals responded that just over 50 percent of the businesses represented by their accounting or law firm that could perform a freeze had performed an estate freeze in the past. Interestingly, this percentage varied greatly across the professionals surveyed (from 18 to 85 percent). These results suggest that estate freezes are recommended far more frequently by some tax professionals than by

1. the deferral of taxation of future gains;
2. the capital gains exemption;
3. income splitting; and
4. non-financial family benefits.

All of the participants replied that a major advantage (most respondents indicated that it was "the" most important factor) of a freeze was the deferral of tax on future gains. One-half of the respondents stated that the capital gains deduction was a major benefit, and one-half stated that income splitting was (or had been before the February 16, 1999 federal budget) a major advantage of performing an estate freeze. Finally, each of the participants cited at least one non-financial family benefit as a major advantage in freezing. Two main non-financial benefits emerged. First, a freeze brought the next generation into the business, enticed younger family members to become involved, and provided ownership and wealth consistent with the level of effort. Second, by virtue of performing a freeze, the family was forced to create a succession plan—that is, the owner had to address succession issues.

We asked the tax professionals what they considered to be the major disadvantages of an estate freeze. Like the advantages, the disadvantages they cited fell into four categories:

1. professional costs;
2. a concern that the parent would have sufficient wealth;
3. a potential loss of control; and
4. family harmony.

All 10 respondents recognized that estate freezes could be financially costly in terms of both one-time and annual expenses. Moreover, professional costs might be incurred well before the benefits are received. In terms of wealth, most respondents expressed a concern that if the freeze was performed too early, the parent might not have accumulated enough money to live comfortably in the future. Other respondents mentioned the corollary possibility that the children might gain too much wealth. Five respondents mentioned a potential loss of control by the parent. Seven respondents raised the issue of family harmony, including the potential adverse effects on the family of the parent's choosing a successor.

The decision to perform an estate freeze may involve more than a simple weighing of benefits and costs. Before a family business owner can make the decision, he or she must understand what an estate freeze is. When asked, "What percentage of your family business clients would have a basic understanding of what an estate

others. These differences do not appear to be related to either the size of the firm the professional worked for or its geographic location. As we discuss in the section entitled "Explaining the Gap," it appears that the primary difference between tax professionals is in the advice given, which in turn appears to be related to the professional's beliefs concerning costs—in particular, non-quantifiable family costs.

freeze is?" the average percentage cited by the 10 tax professionals was 76 percent. Therefore, some family businesses may not freeze, or may freeze at a later date, because the owner is uninformed (does not have adequate knowledge).

In the following two sections we address other possible reasons that relatively few family businesses have performed estate freezes. We first examine whether the level of use of estate freezes may be explained by two economic factors discussed above—the deferral value of a freeze and the present value of professional fees.

DETERMINING THE PROPORTION OF FIRMS WITH A NET DEFERRAL ADVANTAGE

In this section, we determine the proportion of family businesses in our sample for which an estate freeze will have a positive net deferral value—that is, the deferral value exceeds the present value of professional fees. First, we calculate the expected deferral value of an estate freeze for the surveyed family businesses. In calculating the deferral value, we assume that the parent intends to pass the family business on to his or her children. The validity of this assumption is examined later in the article. Second, the present value of professional fees in performing an estate freeze is estimated on the basis of the survey of tax professionals. Finally, we estimate the proportion of firms in the family business survey with a positive net deferral value (the difference between the deferral value and the professional fees).

The Deferral Value of an Estate Freeze

The deferral value of an estate freeze was modelled by Chu, Feltham, and Mathieu.[28] A brief description of the setting, model, and implications follows.

The Model

Chu, Feltham, and Mathieu assumed that an individual owns all the shares in the family corporation and is contemplating passing this corporation on to his or her children. The parent can perform an estate freeze whereby the children would hold the common shares in the company, or the parent can retain the current ownership structure. If the parent does not perform an estate freeze and chooses to retain the current ownership structure, he or she will pay tax at the time of the disposition on his or her common shares. If the parent does perform an estate freeze, he or she will pay tax at the time of redemption or on the disposition of his or her preferred shares. The capital gain will reflect the fair market value of the firm at the date of the freeze, excluding any additional increase in value after that date. (Note that the parent's tax liability will be lower if an estate freeze is performed.) At some point in the future, the children themselves will dispose of their shares in the corporation. At that time, they will have to pay taxes on their capital gain, reflecting the difference between the value of the shares at that date and the adjusted cost base of the shares.

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28 Supra note 19.

Chu, Feltham, and Mathieu demonstrated that on the assumptions set out above, and assuming that the parent's and children's marginal tax rates are the same and do not change over time, the value of an estate freeze without the capital gains exemption is

$$\textit{Freeze value} = v \cdot t \cdot (1-t) \cdot \left[(1+r)^{n_p} - 1\right] \cdot \left[(1+r)^{n_c - n_p} - 1\right] \quad (1)$$

where

- v = the fair market value of the shares at the time of the freeze (for example, today),
- t = the parent's and children's marginal tax rate on capital gains or on a deemed dividend,[29]
- r = the expected rate of growth in the value of the business (that is, the expected rate of return),
- n_p = the number of years from now until the parent sells or passes on control of the company to the children in the absence of an estate freeze, and
- n_c = the number of years from now until the children sell the shares or pass them on to their own children.

Equation 1 reflects the difference between the after-tax value of the shares in the family business with an estate freeze and the after-tax value without an estate freeze. From this equation we see that the deferral value of an estate freeze depends on the current value of the business, current and future tax rates for the parent and the children, the growth rate of the company, and the length of time until the shares are sold or passed on by the parent and the children. It follows from equation 1 that the deferral value of a freeze will always be positive if the children are expected to remain shareholders of the corporation longer than the parent would remain a shareholder ($n_c > n_p$); if the expected growth rate of the corporation is positive ($r > 0$); and if the parent's and children's marginal tax rate is positive ($t > 0$).[30] These are necessary conditions for an estate freeze to have positive deferral value. The implications of the first necessary condition—that the parent will pass the business on to his or her children—is examined in greater detail below, in the section entitled "Explaining the Gap."

An implication of the model set out in equation 1 is that it is advantageous to perform an estate freeze at the earliest possible time. In fact, in the absence of the capital gains exemption, the deferral value of a freeze is maximized if it is performed

29 It is assumed in this model that the tax rate on capital gains is the same as the tax rate on dividends. These rates were approximately equal at the time the surveys were performed (1998 and 1999). Subsequent reductions in the capital gains rate add noise to this model.

30 For an example of the use of this model, see Chu, Feltham, and Mathieu, supra note 19, at 350-53.

at the time of incorporation. Note, however, that when the capital gains exemption is introduced, it affects both the deferral value of the estate freeze and the optimal timing.[31]

For the family businesses surveyed in this study, the introduction of the capital gains exemption into the model will likely have little effect on the deferral value of a freeze, although it will affect the timing. Chu, Feltham, and Mathieu demonstrate that, on reasonable assumptions, the parent's and the children's exemption will not affect the deferral value of a freeze. For a business with moderate value (for example, v > $500,000) that the children will run for a reasonable period of time (for example, $n_c - n_p > 10$), the capital gains exemption is unlikely to affect the value of a freeze—that is, the value of a freeze will be the same with or without the exemption. However, the exemption may affect the timing of a freeze. The deferral value of an estate freeze is maximized at the time that the parent can just fully utilize his or her capital gains exemption—typically, where his or her share value is $500,000. Note that, in an apparent contradiction to the above theory, owners of six firms with a value less than $500,000 had provided an ownership interest to a child (see table 5). It is reassuring that this number is small (representing only 9 percent of the firms valued at less than $500,000). There are reasonable explanations for these shareholdings. First, if the parent's shares are not eligible for the capital gains exemption (that is, they are not qualified small business shares), or if the parent has previously used his or her capital gains deduction, the deferral value of a freeze may be greater if the freeze is performed before the firm's value is $500,000. Second, a freeze may have been performed before the capital gains exemption was introduced. Third, the children may have been issued shares at the time of incorporation. Fourth, the value of the business may have declined following a freeze. Finally, for a few of these firms the child may have acquired shares by means other than through a freeze; for example, the child may have purchased existing common shares from the parent at fair market value.

Estimating the Deferral Value

On the basis of data from the survey of family business owners, the deferral value of an estate freeze is estimated for each family business using the model developed by Chu, Feltham, and Mathieu. The variables in this model are measured as follows. Respondents were asked to estimate the current fair market value of their firm within one of seven response categories. The current value of the business, v, was determined as the midpoint of the range. The number of years until the parent would sell or pass on control of the company to the children, n_p, was defined by the number of years until the parent was expected to retire (the midpoint of the range). However, where the parent indicated that he or she never intended to retire, a life expectancy (80) less the business owner's age was used. To estimate the number of

31 For an in-depth analysis of the properties of this model, see Chu, Feltham, and Mathieu, supra note 19.

years until the children would sell the shares or pass them on to their own children, n_c, we used a typical age for retirement (65), less the age of the oldest child. The implicit assumption is that the parent intends to pass the family business on to his or her child (rather than, for example, sell the firm to a non-family member). (This assumption is examined further in the section entitled "Explaining the Gap.") Finally, the capital gains tax rate, t, is assumed to be 25 percent (50% inclusion rate × 50% marginal tax rate).

Although the assumptions on which the variables described above are based can affect the value of a freeze (for example, using the midpoint of a range) they are of far less importance than assumptions concerning growth. The growth rate, r, is varied from 3 to 9 percent. In a 1998 survey of Canadian organizations,[32] the median long-term projection for real growth in gross domestic product is 2.5 percent; the projected inflation rate (the expected increase in the consumer price index) is 2.1 percent. When these numbers are combined, the nominal projected rate for Canada is 4.6 percent. It is usually assumed that small business will grow at a rate faster than the economy. Given this assumption and the projections set out above, average long-term growth rates of 5 to 7 percent are probably the most realistic estimates.[33]

The deferral value of an estate freeze for the surveyed businesses is presented in table 1.[34] Note that the dollar values provided are future values (valued at the parent's expected retirement date). The percentage increase in the value of the business from performing a freeze is also given, because it is easier to interpret. For almost all family businesses, the increase in future value from performing an estate freeze is very large, both in absolute terms and as a percentage of the business's value. For example, if the business's expected growth rate is 7 percent, the average increase in value from performing a freeze is approximately $7 million—an increase in expected value of 12.08 percent. Note that the average deferral value of a freeze is affected greatly by the business's growth rate. For example, the average increase in value from performing a freeze increases from 4.17 percent where the firm's expected growth rate is 3 percent to 15.14 percent if the growth rate is 9 percent. This result, an empirical application of the model developed by Chu, Feltham, and Mathieu, confirms their conclusion that the deferral value of an estate freeze will be large for most family businesses.

Estimating the Professional Fees for an Estate Freeze Model

Chu, Feltham, and Mathieu modelled the deferral value of a freeze without including the associated professional fees. In discussions with professionals before we conducted

32 KPMG, *17th Annual Canadian Survey of Economic Expectations* (Toronto: KPMG, 1998).

33 This growth assumption appears to be consistent with the expectations of respondents to the family business survey—for example, 54 percent of the respondents believed that sales revenue in their business would grow by over 5 percent in the following year; only 9 percent believed that sales revenue would decline.

34 Note that the deferral value is calculated on the assumption that the freezes are full and not partial. The deferral value will be overstated in the case of partial freezes.

TABLE 1 Future Value of an Estate Freeze and Percentage Increase in Value over No Estate Freeze

	Expected rate of growth, r, in the value of the business							
	$r = 3\%$		$r = 5\%$		$r = 7\%$		$r = 9\%$	
	FV $(000)	% ↑	FV $(000)	% ↑	FV $(000)	% ↑	FV $(000)	% ↑
Mean	411	4.17	1,971	8.35	6,999	12.08	21,881	15.14
Median	179	4.05	784	8.32	2,470	12.35	6,849	15.62
Minimum . . .	4	0.58	13	1.47	28	2.61	51	3.93
Maximum . . .	7,438	10.25	41,921	18.12	173,733	23.67	627,078	27.26

our survey, we identified and classified the one-time and annual financial costs of a freeze. The net present value of the cost of a freeze (costs discounted to the time of the freeze) was estimated as follows:

$$Cost = a + q\left[b + \sum_{i=1}^{n_p} \frac{c}{(1+R)^i}\right] + d + p\left[e + \sum_{i=1}^{n_p} \frac{f}{(1+R)^i}\right] + g \qquad (2)$$

where

a = the professional costs of performing an estate freeze without a holding company;
q = the probability of using a holding company;
b = one-time holding company costs;
c = the annual cost of a holding company;
d = the cost of valuation of the company;
p = the probability of using a trust;
e = one-time trust costs;
f = the annual cost of a trust;
g = any additional financial costs; and
R = the firm's cost of capital.

It was assumed that the annual payments related to the trust and the holding company structures would continue to be paid until the time at which the parent would otherwise have sold the company, n_p years from the time of the freeze.

On the basis of our survey of tax professionals, we estimated the average cost of a freeze for each of the 10 respondents. The mean net present value of costs (averaged across the 10 respondents), with a discount rate of 7 percent, was $31,814. Note that this value varied significantly across professionals—from $10,308 to $60,584.[35]

35 This professional fee model is, admittedly, simple. First, it does not adjust for factors such as firm size or the complexity of a freeze. Second, this model calculates an expected value across

Determining the Net Value of a Freeze

The deferral values estimated by the use of equation 1 and presented in table 1 are not directly comparable to the costs derived in equation 2, because the deferral value is measured n_c years from present and the professional fees are at their present value. To compare these amounts, the deferral value may be discounted to present.

Table 2 presents the percentage of firms that would have a positive financial net present deferral value of a freeze (that is, the discounted value of V^t minus *Cost* is positive) varying the expected growth rate. These proportions are determined on the assumption that the professional fees are assigned to family businesses by random assignment (each firm was assigned randomly to one of the 10 professionals); average cost (the mean value is assigned); the highest cost; or the lowest cost. For example, where average cost is assigned, the cost of an estate freeze to all family businesses in our sample is assumed to be $31,814. Results are presented for expected growth rates of 3, 5, 7, and 9 percent; it is assumed that the firm's expected growth rate and the cost of capital are the same rate.[36]

Note that where the business's expected growth rate, r, is 5 or 7 percent (the most realistic rates), the cost of a freeze outweighs the deferral benefit in very few cases. For example, if the business's expected growth rate is 7 percent, the net value of a freeze will be positive in over 97 percent of cases where random assignment is used and 99 percent of cases where the average cost is applied. Even where the business's expected growth rate is very low (3 percent), if the average cost is applied, the net present value is negative in less than 19 percent of all cases. Note that the above analysis probably overstates the number of family businesses for which the costs exceed the deferral benefit of a freeze. This is because the rate used to discount the costs, R, is assumed to be the same rate as the business's growth rate, r. However, the growth rate for family businesses probably exceeds their discount rate because they tend to grow faster than the overall economy. This would reduce the cost relative to the deferral value.

These results suggest that for most of the businesses in our sample there is a net financial benefit to performing an estate freeze—that is, the deferral benefit of a freeze outweighs the present value of professional fees. However, the proportion of firms that have performed an estate freeze is much lower than the proportion

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freezes that use or do not use a holding company and/or a trust. This is an abstraction, because any particular freeze will, or will not, use a holding company and/or a trust. Finally, these costs would be paid by the corporation, and are likely tax-deductible (with the effect that the costs are overstated).

36 The percentage of small businesses with positive net value of an estate freeze is not appreciably affected by the choice of firms' expected growth rate relative to their cost of capital. Note that if the growth rate is greater than the cost of capital, the percentage of firms that have positive net present value of an estate freeze increases (for example, if $r = 7\%$ and $R = 5\%$, using maximum cost the percentage rises from 97.46% to 99.37%). Conversely, if the growth rate is less than the cost of capital, the percentage of firms that have positive net present value decreases (for example, if $r = 7\%$ and $R = 9\%$, then, using maximum cost, the percentage falls from 97.46% to 97.33%).

TABLE 2 Percentage of Family Businesses with Positive Financial Net Value of an Estate Freeze

$$\left[\frac{V_t}{(1+R)^{n_c}} - Cost > 0\right]$$

	Firm's expected growth rate, r, and cost of capital, R			
Financial cost of a freeze	$r = R = 3\%$	$r = R = 5\%$	$r = R = 7\%$	$r = R = 9\%$
Random assignment[a]	88.29	92.96	97.16	98.95
Minimum cost	95.96	99.85	100	100
Average cost	81.89	96.14	99.40	99.85
Maximum cost	68.56	92.51	97.46	99.55

[a] After the firms were randomly ordered, each firm was assigned a professional such that each professional's costs were used in determining whether the value of a freeze exceeded the financial costs.

predicted by the model. Only about 16 percent of family businesses have performed an estate freeze; using conservative assumptions, it would be in the financial interest of over 90 percent of these firms to have done so. In the following section we explore the non-financial reasons for this gap.

EXPLAINING THE GAP

In this section we examine potential explanations for the sizable gap between the proportion of family businesses that would benefit financially from performing an estate freeze (those with a positive net deferral advantage) and the proportion that have actually performed a freeze. Recall that in the section entitled "Factors in the Freeze Decision" we examined the disadvantages of performing an estate freeze. Respondents to the survey of tax professionals mentioned wealth, control, and family harmony considerations. These considerations can affect both the intent of the family business owner (for example, if family harmony is a primary concern, the parent may choose to sell the business outside the family), as well as the timing of actions (the parent may choose to delay a freeze until he or she has "sufficient" wealth). Two possible explanations for the gap are explored in this section. First, for an estate freeze to have positive deferral value, the parent must intend to pass the business on to his or her children; we will therefore examine parental intention with respect to succession. Second, firms may ultimately be performing estate freezes, but performing them later than the date that will maximize the deferral value.

Keeping the Business in the Family: Parental Intention

As demonstrated above, few of the family businesses in our sample have performed estate freezes, although the estimated deferral value from a freeze usually far exceeded the associated professional fees. It is important to note, however, that the conclusion that a freeze has positive deferral value is dependent on the underlying assumption that the parent will pass the business on to his or her children, who will then retain the company. The net deferral value of a freeze will be negative if the children do not remain shareholders of the corporation longer than the parent would have remained a shareholder (that is, if $n_c - n_p = 0$).

To explore the validity of the assumption that parents want their children to succeed them, we asked the business owners about the importance of keeping the business in the family. The results are presented in table 3. Surprisingly, only 34.8 percent of the respondents indicated that it was important to keep the business in the family; 39.5 percent of the respondents said that keeping the business in the family was not important, and the remaining 25.7 percent were not sure. It is clear that a significant proportion of Canadian family businesses will not be passed to the owners' children; consequently, in those cases an estate freeze would not provide a positive net deferral value. What is even more surprising is that as parents approach retirement, keeping the firm within the family becomes significantly less important to them ($\chi^2 = 14.69$, *d.f.* = 6, $p = 0.023$). To illustrate, 29 percent of respondents within 5 years of retirement answered that it was important to keep the business within the family, compared with 42 percent of respondents who would not retire for at least 15 years.[37]

If the parent does not intend to keep the business within the family, what does he or she envision doing with it? After "undecided" owners are removed from the base, 50 percent of owners who are within 5 years of retirement want to maximize the firm's value and then sell it, as opposed to only 20 percent of owners who will not retire for more than 15 years ($\chi^2 = 60.05$, *d.f.* = 18, $p = 0.000$). The relationship between parental intention and the performance of a freeze is directly examined in table 4.

If the parent believes that it is important that the business remain within the family ($\chi^2 = 38.26$, *d.f.* = 2, $p = 0.000$), or if the parent envisions keeping the business within the family ($\chi^2 = 58.00$, *d.f.* = 2, $p = 0.000$), it is significantly more likely that an estate freeze will have been performed (as proxied by the children having share ownership).

Table 4 shows that a small number of family businesses (17 of 179) performed estate freezes even though the parent did not intend to pass the firm to the children. There may be reasonable explanations for these freezes. First, a parent may have planned to pass the business on to his or her children but then later changed his or her mind. This explanation is consistent with the results shown in table 3. Second, the performing of an estate freeze prior to the sale of the firm may enable both the parent and the children to utilize their respective capital gains exemptions, with

37 As an interesting aside, one may expect that the parent's intention regarding succession is related closely to the involvement of family members (the spouse and children) in the business. If so, we would expect to see greater importance placed on the business remaining in the family when family members work within it. This assertion can be largely dispelled through examining table 3. First, one sees that having the spouse work within the firm has almost no effect on the level of importance of keeping the firm within the family. Second, where the child works within the firm, the parent is significantly more likely to consider it important that the firm remain within the family, but still less than one-half (48 percent) consider it to be of importance.

TABLE 3 Keeping the Business in the Family

Importance of business remaining within family	Years until parents' retirement: Total response	0-5	6-10	11-15	>15	Spouse works in the family firm	Child works in the family firm
Important, %	34.8	29	35	28	42	34	48
Not important, %	39.5	49	42	42	26	39	29
Not sure, %	25.7	22	24	30	32	27	23
Percent	100	100	100	100	100	100	100
Total number of respondents	661[a]	164	186	149	84	302	316
χ^2			14.69			0.28	49.35
d.f.			6			2	2
p			0.023			0.870	0.000
Owner's future vision of the business							
Sell, %[b]	27.2	38	32	26	10	26	19
One child, %[c]	13.4	19	13	10	6	15	21
Partnership, %[d]	17.2	15	16	12	24	18	25
Caretaker, %[e]	2.7	1	2	3	6	2	3
Like public, %[f]	3.2	3	3	4	5	3	4
Not decided/Other, %	36.3	26	34	45	50	36	29
Percent	100	100	100	100	100	100	100
Total number of respondents	658[a]	161	189	146	84	304	315
χ^2			60.05			4.67	64.14
d.f.			18			6	6
p			0.000			0.586	0.000

[a] The number of total respondents varies as a result of missing data.
[b] Sell—maximize economic value, then sell.
[c] One child—one child operates the business and has voting control.
[d] Partnership—children as co-owners and co-managers.
[e] Caretaker—qualified children operate business on behalf of all children.
[f] Like public—family-owned but professionally managed by outsiders.

the result that a greater proportion of the firm's value will be tax-free when the firm is sold. Third, freezes may have been performed for income-splitting (dividend-splitting) purposes.

It is important to note that even where a parent intends to keep the business within the family, an estate freeze will have been performed in only about 30 percent of family businesses (see table 4). Therefore, while parental intention explains a part of the difference between family businesses that perform a freeze and those that do not, other factors are also clearly at work: recall our earlier conclusion that, on conservative assumptions, over 90 percent of family businesses would have positive net deferral value from an estate freeze.

TABLE 4 Relationship Between Owner's Intentions and Estate Freezes

		Freeze performed (as measured by number of firms in which children have share ownership)	
Importance of business remaining within family	N	Percentage that owns shares	Number who own shares
Important	230	27	62
Not important	260	12	30
Not sure	170	6	10
Total	660[a]	15	102
χ^2		38.26	
d.f.		2	
p		0.000	
Owner's future vision of the business			
Keep business in family	240	30	72
Sell business	179	9	17
Not sure	239	6	15
Total	658[a]	16	104
χ^2		58.00	
d.f.		2	
p		0.000	

[a] The number of total respondents varies as a result of missing data.

The Timing of a Freeze

It follows from the model in Chu, Feltham, and Mathieu that the deferral value of an estate freeze is maximized if it is performed at the time that the parent can just fully utilize his or her capital gains exemption—typically, where his or her share value is $500,000. In other words, a freeze usually has greater net deferral value the earlier it is performed. However, as noted above, there may be legitimate reasons for delaying an estate freeze—for example, wealth, control, and family harmony. In addition, the family business owner may not understand the process and effects of an estate freeze.

If freezes are performed at a time that maximizes the net deferral value (that is, consistent with the model in Chu, Feltham, and Mathieu), the proportion should be constant in the age of the parent, the age of the oldest child, the parent's proximity to retirement, and the value of the firm (so long as it is greater than $500,000). Using the survey of family business owners, we examine these relationships. The results are presented in table 5. The prevalence of estate freezes increases by a significant amount in three of the four variables. For example, while only 5 percent of parents under the age of 35 have performed an estate freeze, 60 percent of those aged 65 and older have. Other demographic measures—the age of the oldest child and the number of years to retirement—provide similar results. In family businesses valued between $500,000 and $1 million, only 14 percent of parents have performed estate

TABLE 5 Prevalence of Estate Freezes (Percentage and Number of Firms), by Age of Parent, Age of Oldest Child, Years to Retirement for Parent, and Value of the Business for Firms in Which Children Have Ownership Interest

	Age of parent					
	Under 35	35-44	45-54	55-64	Over 64	Total
Percent	5	5	11	25	60	16.8
Number	(1[a] / 21[b])	(8 / 159)	(27 / 242)	(38/ 151)	(31 / 52)	(105 / 625[c])
$\chi^2 = 99.2$, $d.f. = 4$, $p = 0.000$						
	Age of oldest child					
	Under 10	10-19	20-29	30-39	Over 39	Total
Percent	5	3	14	26	58	16.8
Number	(3 / 65)	(5 / 159)	(31 / 216)	(34 / 129)	(32 / 55)	(105 / 624[c])
$\chi^2 = 104.7$, $d.f. = 4$, $p = 0.000$						
	Years to retirement					
	Over 15	11-15	6-10	Within 5	Never	Total
Percent	7	5	15	23	39	16.6
Number	(5 / 71)	(7 / 137)	(27 / 180)	(37 / 160)	(26 / 66)	(102 / 614[c])
$\chi^2 = 47.7$, $d.f. = 4$, $p = 0.000$						
	Value of the firm (millions of dollars)					
	Under 0.5	0.5-1	1-5	5-10	Over 10	Total
Percent	9	14	19	19	27	17.4
Number	(6 / 69)	(18 / 128)	(51 / 275)	(14 / 72)	(15 / 55)	(104 / 599[c])
$\chi^2 = 8.8$, $d.f. = 4$, $p = 0.065$						

[a] Number of family firms reporting children with ownership interest in this category.
[b] Number of family firms reporting children in this category.
[c] The number of total respondents varies as a result of missing data.

freezes (recall that, in general, estate freezes should be performed when the firm value is at least $500,000); in family businesses valued at over $10 million, 27 percent of parents have performed a freeze.

These results suggest that for at least some family businesses, factors beyond deferral value and professional fees affect the timing of estate freezes: it appears that many family businesses do not freeze at the time that will maximize the deferral value, but rather are delaying the freeze.

From the survey of tax professionals, we gained further insight into the reasons that some family businesses may delay estate freezes. Perhaps the most interesting result was the existence of two beliefs about the optimal timing of a freeze. The first was that, while there may be other considerations, one should usually freeze as soon as it is financially optimal to do so—that is, if the company is growing (is successful) and there is a significant accrued gain, a freeze should be performed.

Proponents of this belief argued that freezes can be structured to fully protect the interests and financial wellbeing of the parent. Such a structure would typically include voting control and the creation of discretionary trusts. The second belief was that a freeze should occur only when the parent has a clear idea about succession.[38]

On average, the tax professionals reported that in 60 percent of cases the parent had determined his or her successor at or before the time of the freeze. However, this statistic is not representative. Four professionals reported that in at least 90 percent of cases a successor had been chosen, while four reported that in less than 30 percent of cases a successor had been chosen. Similar evidence of this dichotomy may be seen in the responses to questions related to the length of time that the parent will continue to run the company and the length of time the parent will retain voting control.

The Combined Effect of Parental Intention and the Timing of a Freeze

What is the combined effect of parental intention and timing in the decision to perform an estate freeze? To answer this question, let us focus on businesses that are reasonably close to succession and are owned by a parent who wants to keep the business in the family. In approximately two-thirds of cases where the parent's eldest child is over the age of 39, an estate freeze has been performed by owners who reported that "family ownership is important" (22 of 33 firms) and by owners who "[intend] to keep the firm within the family" (28 of 43). Note that the use of different measures of proximity to succession (age of parent or years to retirement) produces very similar results: about 2 in 3 family businesses will ultimately perform an estate freeze in cases where the business is to remain within the family.

As a reliability check of these results, let us return to the survey of tax professionals. On average, the tax professionals responded that just over 50 percent of the family businesses represented by their firms that could perform a freeze had performed an estate freeze in the past. However, this percentage varied greatly across the professionals surveyed (from 18 to 85 percent). Perhaps of greater interest, participants responded that 59 percent of firms that had not performed a freeze could be expected to do so in the future. This estimate also varied across professionals (from 25 to 100 percent). When these results are combined, on average the professionals believed that almost three-quarters (74 percent) of all Canadian-controlled private corporations either have performed or eventually will perform an estate freeze.

To summarize, parental intention and timing together appear to explain in large part why most family businesses surveyed have not performed estate freezes. Recall our conclusion that there is a positive net deferral advantage for over 90 percent of firms in our sample to perform an estate freeze. In this section we have found, on the basis of our survey of family business owners, that most parents (67 percent)

38 Of the 10 tax practitioners surveyed, five respondents fell within each category. It is interesting to note that those who argued for earlier freezes (freezing when it was financially optimal), tended to have been in practice longer (21 years versus 13) and to spend a greater proportion of their time in estate planning (47 percent versus 25 percent).

who intend to leave the business to the children will in fact ultimately perform an estate freeze. Note, however, that we have not yet explained the entire gap.

CONCLUSIONS AND LIMITATIONS

Family businesses, the dominant form of business in Canada, account for a significant portion of Canada's wealth and employment. Estate freezes facilitate the passage of ownership of family businesses from one generation to the next (the time at which these businesses are most vulnerable). Although the importance of estate freezes is widely recognized in tax practice, the degree of their use and effectiveness has not previously been studied. Our research sought to document the frequency of use of estate freezes among family businesses and to explore alternative explanations for this level of use (or non-use).

The use of estate freezes was first examined. We demonstrated, consistent with anecdotal evidence, that relatively few family businesses have performed freezes—only 15.8 percent in our family business survey. We then examined alternative explanations for this low level of use.

We first examined whether the level of use of estate freezes can be explained by two financial factors—the deferral value of a freeze and the present value of professional fees. We found that for over 90 percent of family-owned businesses, there was a positive net deferral value in performing a freeze—that is, the deferral value exceeded the associated professional fees for almost all firms. Why, if there was a financial incentive for over 90 percent of family businesses to have performed a freeze, had less than 16 percent done so?

Two explanations for this gap were examined—parental intention and timing. To our surprise, we found that a large percentage of Canadian family business owners do not intend to pass their firms on to their children. This result is even more pronounced as the parent approaches the date on which succession would occur. As retirement nears, and perhaps as adult children establish other careers and interests, the focus for many owners shifts from succession within the family to maximizing the value of the business and then selling it to outsiders. It is likely that most parents intend to pass on their wealth to their children, but not the business itself. A second explanation for the low incidence of estate freezes relates to timing: it was clear from this study that many family businesses do not perform an estate freeze when it is financially optimal to do so; rather, they delay the freeze decision. Together, these two factors—parental intention and delay—appear to explain why a significant proportion of family businesses have not performed an estate freeze. The effect of parental intention and timing on the freeze decision is consistent with the concerns about wealth, control, and family harmony raised by some respondents in our survey of tax professionals.

As with any research, there are limitations to this study. For example, estate freezes were measured indirectly through child share ownership, and professional fees were not linked back to firm characteristics. Nevertheless, we believe that this research adds to the body of knowledge about Canadian family businesses and contributes to a greater understanding of their estate freeze behaviour.