TAX BULLETIN

TAX PLANNING FOR CANADIAN FARMERS

Canadian agriculture is big business. There are hundreds of thousands of farms in Canada with annual cash receipts in excess of $54 billion.

Canadian agriculture is also an industry in transition. The 2011 census indicated that almost half of Canadian farmers were 55 or older and approaching retirement. At the same time, the trend in Canada is towards larger and fewer farms. Over the next several years, many farmers will be faced with decisions about the future of their farming operations.

As a farmer, you understand these trends well. And when you're faced with decisions about your future, it's important to understand the tax implications of the decisions that you will be required to make. That's why we at BDO Canada LLP have prepared this bulletin — to focus your attention on the tax issues that are important to you so that you can make sound tax and financial decisions as you calculate your annual taxable income and as you look towards your retirement.

This bulletin is divided into two sections. First, we will review annual tax issues you need to consider to ensure that you are minimizing the tax you pay. In the second part of the bulletin, we will look at the unique tax issues that you as a farmer will have to deal with as you approach retirement and either sell your farm or transfer ownership to the next generation.

Note that this bulletin is geared towards farmers whose primary source of income is from farming. If you are a part-time or hobby farmer, many of the ideas discussed may not be appropriate and you should speak to your BDO Advisor.

Annual tax planning issues

Like agriculture, the income tax environment is very dynamic. Tax rules are constantly changing. If you want to minimize your annual tax bill, it's important that you review your income tax strategies annually with your BDO advisor. If you use the cash method to calculate your taxable income, which most farmers do, this annual tax-checkup should take place before your year-end and not when your tax return is prepared — at that time, it will be too late to implement tax planning strategies for that year.

March 2017

CONTENTS

There are three main areas that you should look at when reviewing your tax situation. We'll call these the three pillars of tax planning. They are:

- **Income tax deferral**

If you are able to defer the recognition of income for tax purposes to a future year, this will reduce the taxes that are payable currently. While you will eventually have to pay tax on this income, you can achieve savings in the form of reduced financing costs if you don't have to pay this tax now. You may even achieve actual tax savings if you can defer the recognition of any income deferred to a year where your marginal tax rates will be lower.

This is a particularly important tax planning area for farmers who have the ability to report income for tax purposes using the cash method. By electing to use this method, farmers are effectively able to defer the recognition of income for tax purposes by deducting the costs of their inventory purchases currently. The tax on this income will effectively be deferred until the farming operation is scaled down.

We'll discuss this important area in more detail below.

- **Income splitting**

Income splitting is the process of redirecting income within a family group to take advantage of the lower tax brackets, deductions and credits available to each family member. Canadian personal income tax rates are graduated with the top marginal tax rate between 47% and 54% (depending on the province/territory). If income that would otherwise be taxable at the highest rates can be reported in other family members' hands who pay tax at lower rates, tax savings will be achieved. The total tax on family income will be the lowest when each family member earns approximately the same level of income.

With respect to farmers, income splitting could be as simple as ensuring that all family members are paid a reasonable salary for their contributions to the farming business. There are also more complicated tax strategies that can be employed which would involve the use of corporations and family trusts.

If you would like to learn more about income splitting strategies, ask your BDO advisor for a copy of our bulletin titled *Income Splitting* or visit our website (www.bdo.ca) for a copy.

- **Use all available tax incentives**

The Canadian tax rules contain a number of provisions that are favourable for farmers. These include generous investment tax credits for farmers doing research in areas such as crop development and livestock hybrids or special tax rules relating to the deduction of certain costs such as tile drainage or forced livestock destruction.

Ask your BDO advisor if there are any special incentives that might be available to you.

Income tax deferral

As we mentioned above, farmers are in a unique position to defer the recognition of income for tax purposes. This is due to their ability to use the cash method to report income for tax purposes.

Under the cash method, farmers only have to report the actual cash receipts from the sale of farm products in their taxable income. Most businesses must report their income on an accrual basis, which means that they also have to report sales billed for which they haven't yet received cash as income. In addition, farmers can deduct expenses on a cash basis — this means that they can deduct the cost of purchasing inventory such as seed or livestock, even if they are still on hand at year-end. Income for tax purposes can be further reduced by other deductions as well, such as tax depreciation (known as capital cost allowance or CCA).

It is important to calculate your expected taxable income before the end of the year so that you can consider certain tax planning strategies. These include:

Decrease taxable income computed under the cash method

Once you have calculated your projected income, you may want to reduce what you will have to report for tax purposes. Under the cash method, this can simply be done by incurring additional cash expenditures prior to the end of the year. This is an effective tax deferral tool. For example, you may decide to buy additional inventory supplies for next year or livestock which can all be deducted for tax purposes when they are paid for.

It's important to note that the Canada Revenue Agency (CRA) has strict rules that must be complied with if an expenditure is going to be allowed as a deduction under the cash method. They have stated that a deduction can only be taken for amounts purchased pursuant to a binding contract with a supplier. To determine if a binding contract exists, you need to consider the following:

- The cash expenditure must relate to specifically identified goods which exist or are to be exclusively produced for the farmer;
- The expenditures must be reasonable in relation to the size of the farmer's operation; and
- The goods must be delivered to the farmer or the supplier must have the capacity to deliver the goods.

In addition, the goods must be consumed in the farming operation by the end of the following taxation year in order to get a deduction in the year the goods are purchased.

Increase taxable income computed under the cash method

Taxable income reported under the cash method can be increased on a discretionary basis by a farmer, if he or she decides to report more taxable income for that year. Taxable income can be increased by adding the fair market value of any unsold inventory on hand at the end of the year. Note that there is a mandatory add-back to taxable income for the lower of the cost or fair market value of any unsold inventory on hand at the end of the year, if the cash method produces a loss for tax purposes. The purpose of this rule is to prevent farmers from generating losses under the cash method that could be used as a deduction against off-farm income or to reduce taxes in prior years.

You may be wondering why we are suggesting increasing taxable income in a year when there is no requirement to do this. Actually, in some cases, this is good tax planning. A farmer may have low taxable income in a particular year and therefore may want to increase their income to have it taxed at lower marginal tax rates than it would be if it was taxed in the future. It may also make sense if the farmer is planning on retiring or downsizing in upcoming years. When the farmer retires or downsizes, they will likely be faced with high taxable income calculated under the cash method, which may be taxed at the highest marginal tax rates at that time.

Let's consider a simple example to demonstrate a situation where it makes sense to increase taxable income currently. Farmer A reports income on the cash basis. For the next three years, he will have no taxable income as computed under the cash method as he is reinvesting any profits in his farm by making the appropriate expenditures prior to his year-end. In year four, due to downsizing, he will have taxable income computed under the cash method of $160,000. As the 29% federal marginal tax rate will apply to approximately $20,000 of this income, he will pay roughly $33,000 of federal tax on this income in year four. He may also not have fully utilized personal tax credits that were available to him in years one to three.

However, if Farmer A anticipated the downsizing in year four and decided to increase his income in years one to three by $40,000 each year (using the election to include a portion of the value of his inventory in taxable income), he will reduce his taxable income in year four to $40,000 as well. Because of lower marginal tax rates that will apply to this income over the four year period, his total tax burden over the four years will be reduced to approximately $4,300 per year or $17,200 in total — a $15,800 federal tax saving! There would be an additional provincial tax saving which will vary by province. There could be other benefits as well associated with this strategy, such as increased RRSP contribution room.

Annual income tax instalment

Unincorporated self-employed farmers, whose chief source of income is farming, are only required to make one income tax instalment annually — due on December 31st of each year. Instalment notices are mailed in November by the CRA.

The CRA calculates your instalment based on the taxes you paid for the prior year. If you pay this amount, you will not be subject to any interest or penalties for paying insufficient tax instalments. However, if your income has decreased, paying this amount would result in you overpaying your taxes for the current year. You will only get a refund when you file your tax return in the spring.

Your BDO advisor can help you determine what you should pay annually for your income tax instalment, if we review your annual tax situation with you prior to the end of the year.

These planning strategies highlight the need to sit down with your BDO advisor each year, before the end of the year, to discuss annual tax planning strategies.

Additional downsizing strategies

As we noted above, using the cash method for reporting income for tax purposes is really a tax deferral strategy. When a farmer retires or downsizes, income reported under the cash method will be high as income will have to be reported on the sale of inventory, the purchase of which had been deducted in previous years, and no (or reduced levels of) inventory are being purchased which could be deducted for tax purposes in the current year.

In the past, the tax rules contained a number of provisions that eased the high tax bills associated with retirement or downsizing. Canadian tax rules used to contain a number of provisions that allowed farmers to average the income they reported for tax purposes over a number of years. Unfortunately, these averaging provisions are no longer available.

When you are considering downsizing or retiring, it's even more important to turn to your BDO advisor for help. There are tax planning strategies that can help farmers who report income on a cash basis to deal with unexpected or permanent downsizing of their farming operations. These strategies could be as simple as liquidating your inventory around your year-end, to spread the income inclusion for tax purposes over two years. They could also be more complicated, such as a strategy involving the transfer of inventory to a new corporation, which must be structured carefully. Talk to your BDO advisor if you are approaching retirement or are planning to downsize your farming operation.

Incorporating your farming business

Not all farmers can benefit as extensively by using the cash method as a means of deferring tax. This is due to the fact that it is not practical for them to make significant farm input purchases at year-end, to defer tax as described above. Examples of these types of farming operations include vineyards, orchards, poultry farms, dairy farms and breeding operations.

These farmers will usually find that they have higher annual taxable incomes than those farmers who can benefit significantly from using the cash method. In cases where taxable income is significant, the transfer of the farming business to a corporation may provide some tax benefits.

The main advantage to incorporating is the availability of the small business deduction for private corporations controlled by Canadian residents on income up to the small business limit. Generally, the small business deduction applies to the first $500,000 of business income (which would include farming income). The small business limit is currently $500,000 federally and in all provinces except Nova Scotia and Manitoba. The small business limit in Manitoba is $450,000. In Nova Scotia, the limit is $350,000. Ask your BDO advisor for a copy of our annual tax rate publication titled *Tax Facts* or visit our website (www.bdo.ca) for a copy of the most recent version.

The small business deduction ensures that the corporation will pay a reduced corporate tax rate on business income. This low corporate tax rate ensures that there are more after-tax dollars in the corporation to reinvest in the farming business.

The small business deduction is really only a deferral of tax. When the after-tax profits of the company are paid out to the shareholders (the farmer) as a dividend, tax on the dividend income will have to be paid. In the past, the corporate tax together with the tax on the dividend would have approximated the amount of tax that would have been paid if the farmer had earned the farming income directly. Until the dividend is paid out to the shareholders, which may be many years after the income is earned, this layer of tax would be deferred.

You should note that corporations can also elect to use the cash method to report their income for tax purposes. Therefore, farmers who do benefit significantly from using the cash method will not lose this advantage if they incorporate their farming operations.

One downside to incorporating your farming business is that corporations do not have a capital gains exemption available to them. So, to benefit from the exemption, you would have to sell the shares of your corporation. The exemption, available only to individuals, basically ensures that you do not pay tax on the first $1,000,000 of capital gains arising from the disposition of qualifying farm property (which includes real estate and farm quota). If a farming property or quota is transferred to a corporation and it increases in value, a capital gains exemption cannot be claimed if these assets are sold. However, if these assets already have an accrued gain that could be realized on a transfer to a corporation, it is possible to use your capital gains exemption to increase the cost of the qualifying property for tax purposes and create the ability to take cash out of the company on a tax-free basis, to the extent of the gain realized. There are downsides to this type of planning as well — as such, it is often advisable to maintain ownership of real estate and quota personally and only transfer farm inventory and equipment to the corporation. The real estate and quota can then be leased to the company.

Please note that many marketing boards have rules regarding incorporation and they may not allow the quota to be kept outside the corporation. If you are considering incorporating, talk to your BDO advisor to see if you should be transferring your farm real estate and quota to the company. The capital gains exemption is discussed in further detail in the second part of this bulletin.

Incorporation may provide income splitting benefits as well, if other family members can be introduced as shareholders either directly or through a family trust. This type of planning is discussed in greater detail in our bulletin titled *Income Splitting*, which we referred to earlier.

There are many other tax and non-tax issues that you need to consider before you make the decision to incorporate. For more information, ask your BDO advisor for a copy of our bulletin *Incorporating Your Farm Business* or visit our website (www.bdo.ca) for a copy.

Long-Term Planning Issues

The first part of this bulletin looked at the unique issues that farmers face when calculating their annual taxable income. That's only one area of tax planning. It's also important to deal with some important tax issues as you approach retirement and are making decisions about the future of your farm.

Before you think about tax, however, it's important that you think carefully about what your goals are and what you want to happen to your farm. This is often more difficult than it sounds. Your farm is likely the most significant asset that you own. You will want to ensure that you make the right decisions for you and your family when deciding what to do with your farming business. You will also want to ensure that you are adequately provided for in retirement.

Usually, you will be faced with the following scenarios as you approach retirement:

- The farm could be sold to third parties, with the after-tax proceeds available to you in your retirement.
- The ownership of the farm will be transferred to your children, with the desire to keep it as a family farm.
- You may continue to own the farm until your death, at which time your farm will become part of your estate.

Deciding which course of action is right for you will likely not be an easy decision. You will have to discuss this with your spouse and your children. You will likely be faced with a number of issues that take time to work out. For example, if your desire is to keep the farm as a family farm, you will have to decide how to transfer ownership to the next generation and treat all of your children fairly, taking into account that some of your children may have no interest in farming as a career. This will also raise issues as to how to finance this transition to ensure that you have sufficient funds in your retirement without burdening your children with excessive debt.

For more information on succession planning and estate planning, contact your BDO advisor.

No matter which course of action you take, however, it's important to properly consider taxes as you undergo this process. Through careful tax planning, and by taking advantage of various tax provisions of benefit to farmers, you can maximize the amount of equity in your farm that you and your family ultimately get to keep.

Below is a discussion of some of the more important tax issues that you need to be familiar with as you are making decisions about the future of your farm.

Taxation of capital gains

Capital gains that have accrued since December 31, 1971 are subject to income tax. Capital gains are realized when ownership of capital assets is transferred for proceeds that exceed the original cost and selling expenses.

Only 50% of any capital gains you realize are included in your taxable income. If the value of property held at December 31, 1971 exceeds the original cost, you can use this higher amount in computing your capital gain. Capital gains are also realized for tax purposes on any capital property you own on your death — at that time, you are deemed to dispose of all your capital assets at their fair market value.

However, there are some significant exceptions to these rules, which are important for farmers. These include the following:

- Capital gains on your principal residence can be all or partially exempt from tax;
- If you transfer ownership of assets to your spouse, either during your lifetime or on your death, this can be done at cost, which means no capital gains will be realized until your spouse disposes of the property (we'll call these rules the "spousal rollover" rules);
- Ownership of capital property used in your farming business, such as land and most buildings, can be transferred to your children at cost, which means that no capital gains will be realized until your children sell the property (we'll call these rules the "intergenerational rollover" rules);
- And finally, each individual taxpayer is entitled to realize $1,000,000 of capital gains tax-free on qualifying farm property during their lifetime. The lifetime exemption is reduced to $900,000 if you previously took advantage of the $100,000 capital gains exemption that used to be available on all types of capital property (the $100,000 exemption was repealed in 1994). It will also be reduced for any exemptions claimed on the sale of qualifying small business corporation shares, which are also a qualifying asset. This benefit is realized through the claiming of a capital gains exemption when gains are realized for tax purposes. Qualifying property includes real property and quota used in a farming business, as well as shares in a family farm corporation or an interest in a family farm partnership.

A note of caution. To take advantage of any of the above exemptions from tax on capital gains requires careful tax planning. The tax rules that must be complied with are complex. For example, for an asset to qualify for the $1,000,000 capital gains exemption, there are important tests that must be met. It's also important to get good tax advice if you own property that has been farmed by family members in the past. Even if it is not currently being farmed by a family member, it may still be considered to be qualifying farm property and therefore any gains would be eligible for the capital gains exemption when it is sold. It's important to work closely with your BDO advisor to ensure that you will benefit from these exemptions where appropriate.

This bulletin does not contain a detailed discussion of these rules. Rather, we will focus on how they can be used to meet your long-term planning objectives.

Maximizing your capital gains exemption claims

As we noted above, each Canadian resident individual is entitled to one $1,000,000 lifetime capital gains exemption that can be claimed against capital gains realized on transfers of ownership of qualifying farm property. It makes sense that if you, your spouse and your children realized capital gains on the sale of your farm and claimed their own capital gains exemptions, your family's overall tax bill on the sale of your farm can be significantly reduced.

What steps can you take to ensure that all family members can take advantage of their $1,000,000 capital gains exemption? This can only be accomplished if you properly plan as you approach retirement. Let's look at a couple of examples where it may be possible to maximize your family's exemption claims.

Transfer ownership of farming property to your spouse

Above, we noted that the ownership of capital assets could be transferred to your spouse at their tax cost. You would think that by taking advantage of this rule, prior to a sale of your farm, you could transfer ownership of some of your farming assets to your spouse prior to the sale, without realizing any capital gains on that transfer. You and your spouse would realize the capital gains on the sale of your farm and you would both be entitled to claim your capital gains exemptions.

However, it's not that easy. It is likely that our tax law would ensure that the capital gain realized by your spouse in the above situation will be attributed back to you and taxed in your hands (these rules are known as the attribution rules). This is due to the fact that you did not realize any capital gains when you transferred ownership of property to your spouse. Therefore, the above transfer will not accomplish anything.

Are there situations where the attribution rules won't apply? In some circumstances there are. Remember that on your death, you are deemed to dispose of all of your capital assets at their fair market value at that time. However, to the extent that ownership of these assets transfers to your spouse, you can take advantage of the spousal rollover rules and transfer certain assets that would qualify for the capital gains exemption to your spouse at cost. When your spouse sells these assets, they would report the capital gain for tax purposes and likely be entitled to claim their capital gains exemption. The attribution rules do not apply if the property is transferred to your spouse as the consequence of your death.

This enables your executors to do some tax planning after your death. They could ensure that you realize capital gains on your death to take advantage of your capital gains exemption by electing for some qualifying farm property to be disposed of at its fair market value on your death. They could also ensure that any gains in excess of your available exemption on other qualifying property are transferred to your spouse, through the use of the spousal rollover rules, ensuring that these gains will be reported in their hands when the property is ultimately sold. This will allow your spouse to use their capital gains exemption at that time. Therefore, through some careful planning on your death, it is possible to get access to both your spouse's and your capital gains exemption.

There is one important point we'd like to note as well. If you are contemplating a sale of your farm, and your spouse has never reported any income from your farming activities on their tax return, it may still be possible to report some of the capital gains in their hands. Check the legal registration of the farm's deed of title. If the deed is registered jointly and the registration took place prior to 1972, or if your spouse contributed to the purchase of the farm with their own funds, it may be possible to report part of the gain on the sale of qualifying farm property on their tax return. This will enable both you and your spouse to claim your capital gains exemptions against the gains realized on the sale of your farm.

If you are a younger farmer, it may be advisable to ensure that your spouse also has an ownership interest in your farming property. It's important that your spouse pay for this interest with their own funds. If your spouse also has an ownership interest, future gains on your farming property will accrue to the benefit of both of you, making it easier to claim both of your capital gains exemptions in the future when the farm is sold or passed on to the next generation.

These techniques are complicated and require careful tax planning. Consult with your BDO advisor to see if they can apply to you.

Transfer ownership of farming property to your children

Above we talked about getting access to your spouse's $1,000,000 capital gains exemption. Like your spouse, your children also have a $1,000,000 lifetime capital gains exemption available to them as individuals. However, it will be wasted unless they own qualifying farm property or shares of a qualifying small business corporation on which a capital gain is realized in their hands.

Like with your spouse, however, similar planning can be done to get access to your children's exemptions on a sale of your farm, taking advantage of the "intergenerational rollover". Let's assume that you've used up your exemption on qualifying farm property. Now, let's first consider a transfer of ownership of other qualifying property to them on your death. This property can be transferred to your children at your tax cost (meaning that you will not have to report the capital gain on your death) using these rollover provisions. On the ultimate sale of this property, your children will report the capital gain on their tax return and will be entitled to claim their capital gains exemption to reduce or eliminate the tax on the gain. Therefore, the family's overall tax bill on your death will be reduced through these planning steps by taking advantage of the "intergenerational rollover" to maximize the capital gains exemption claims made by your family.

Note that these rules are complicated and it's important to work with your BDO advisor to ensure that your farming property will qualify for these rollover provisions and the capital gains exemption. A good example of complications that can arise are the rules relating to family farm corporations and partnerships. In order for the shares of a corporation or an interest in a partnership to qualify for the lifetime capital gains exemption, it's critical that "all or substantially all" of the value of the assets in the corporation or partnership be attributable to property that was principally used in a farming business that a family member was actively engaged in. It's often easy to run afoul of these rules. For example, if there has been a buildup of assets in the corporation that are not used in the farming business, the "all or substantially all" test may not be met at the time the ownership of the shares or partnership interest are transferred, meaning that the gain will not qualify for the capital gains exemption. These types of problems can usually be solved, as long as you work closely with your BDO advisor.

It may also be possible to take advantage of your children's capital gains exemption on the sale of your farm during your lifetime, as long as you plan carefully in advance of any sale. Again, this planning takes advantage of the "intergenerational rollover" rules and involves the transfer of ownership of qualifying farm property to your children under these provisions prior to any sale. However, this type of planning is complicated and requires you to work closely with your BDO advisor.

For the rollover to work, you must be willing to gift any accrued gain to your children. The full benefit of the "intergenerational rollover" can only be realized if you transfer ownership of your qualifying farm property to your children for consideration that does not exceed your tax cost. If they have to pay more than this amount, then your deemed proceeds on this transfer will equal the consideration that you charge (but cannot exceed the fair market value at that time), meaning that you will have to report a capital gain. This is an important issue to consider, particularly in situations where farming property has been in your hands for a long time and the cost is very low.

There are two other important points to note:

- First, you should transfer ownership to your children more than three years prior to the sale of your farm. If the sale or the arrangements for the sale occur within three years of the transfer, the first transfer to your children will be deemed to occur at the fair market value of your farm property, meaning that the advantages of the "intergenerational rollover" will be eliminated.

- Secondly, it's important that the children are 18 years of age or older in the year that the farm is sold to a third party. If they are minors when the property is sold, you will be deemed to have realized the gain instead of your children, and your plan to utilize your children's capital gains exemptions will not have worked.

There are other income and non-income tax issues that you need to consider as well. For example, the transfer of real property to your children may trigger land transfer tax in certain provinces, which is usually an undesired result.

It's important to review this type of planning carefully with your BDO advisor to see if it makes sense for you as you approach retirement and are considering the sale of your farm.

Some points about the capital gains exemption

If you plan to realize capital gains on your farming property and claim your lifetime capital gains exemption, there are some additional issues that you need to discuss with your BDO advisor. Even though no income tax has to be paid on a capital gain when the exemption is claimed, there can be other negative tax consequences. These include:

- **Old Age Security (OAS)** A taxable capital gain (even one against which the exemption is claimed) will increase your net income for tax purposes. If you are 65 or older and receiving OAS, the benefits you receive will be reduced when your net income exceeds $74,788 (for 2017). Your OAS benefits will be completely eliminated when your net income exceeds approximately $121,000. Similar problems can arise for recipients of guaranteed income supplements.
- **Age Credit** Similarly, the age tax credit, available to you when you are 65 or older, is reduced by 15% of your net income in excess of approximately $36,400 (varies by province).
- **Alternative Minimum Tax (AMT)** A large capital gain may trigger an AMT liability on your tax return. Although this tax will be refundable in future years when regular income tax exceeds AMT, this can cause you cash flow problems when you have to pay this tax for the year in which the capital gain is triggered.
- **Cumulative Net Investment Loss (CNIL)** You will not be able to claim your capital gains exemption to the extent that you have a CNIL balance. A CNIL is the cumulative total of your investment expenses less your investment income since 1987.
- **Allowable Business Investment Losses (ABILs)** An ABIL is a loss on an investment in shares or debt of a small business corporation that qualifies as a business investment loss, one-half of which would be allowable as a deduction against income from all sources, not just against capital gains. You may not be able to claim your full capital gains exemption to the extent you have claimed any ABILs in past taxation years.
- **Other Benefits and Credits** Employment insurance and other benefits will be clawed back when your net income exceeds a certain threshold. For purposes of determining these benefits, taxable capital gains increase your net income, even when the exemption is claimed. The same issue arises when determining whether you are eligible for certain provincial tax credits, as eligibility depends on the level of your net income.

Talk to your BDO advisor before you trigger any capital gains to ensure that you understand the impact that these gains will have on the above.

Family farm corporations

What if your farm is owned by a corporation? This is not that uncommon. As we noted above, the $1,000,000 lifetime capital gains exemption on qualifying farm property is only available to individuals and not corporations.

All is not lost, however. Shares of family farm corporations can also qualify for this exemption. Therefore, if your farming business is owned through a corporation, it's important that you consider structuring the sale of your farm as a sale of shares of the company and not as a sale of the farming property that is owned by the company. On the sale of shares, you may be able to claim your capital gains exemption as long as "all or substantially all" of the assets in the corporation are used in the farming business. Note that if this test is not met, it may be possible to remove the redundant assets from the corporation prior to a sale to ensure that the shares are qualifying property. And with careful planning, you may also be able to utilize the capital gain exemptions of your spouse and children as previously discussed.

Keep in mind that the purchaser of your farm will likely prefer to purchase your farming property directly from the company, rather than purchasing the shares of your family farm corporation. This is due to the fact that the amount that they pay for your shares will be reflected in the tax cost of their shares, which will only be of benefit to them when they dispose of them. However, if they buy the assets directly, the amount they pay will be reflected in the tax cost of the individual assets they have purchased which they may be able to write-off for tax purposes as they run the farming business. Therefore, the purchaser may ask for a price discount if you insist on selling them shares.

Note that these difficulties can often be overcome if the main asset of the farm is non-depreciable land. Through careful tax planning, the purchaser can usually purchase shares and then reorganize their affairs to transfer the amount that they paid for the shares to the tax cost of the underlying land held in the corporation.

If your farming business is owned through a family farm corporation, talk to your BDO advisor before making any decisions to sell your farming business.

Farm partnerships and retirement

If you are a partner (perhaps with your spouse) in a farm partnership, you should always seek tax advice from your BDO advisor before you sell your farming assets. Through careful planning, it may make sense to transfer certain assets such as farm livestock inventory to a corporation before liquidation, allowing you access to reduced corporate tax rates applicable to active businesses conducted in privately held companies controlled by Canadian residents. It may be possible to improve on this plan by transferring your interests in the family farm partnership to the corporation and take advantage of the capital gains exemption for qualifying farm property on any capital gains that are triggered. In certain cases it can also be advantageous to "wind-up" the partnership on a tax-deferred basis so each partner owns an undivided interest in the actual farm assets prior to their sale.

This type of tax planning is sophisticated and requires careful tax planning advice. Talk to your BDO advisor to determine how to best wind-up a farming business carried on through a partnership.

Retiring allowances

As you approach retirement and take steps to wind-up your farming business, it may be possible to reward key employees of your business that will be retiring as well, including family members. This involves the use of retiring allowances.

A retiring allowance can be paid to employees of your farming business in recognition of long-term service. If your farming business is incorporated, it may also be possible to pay you, the principal owner, a retiring allowance as well on your retirement. The amount paid, as long as it is reasonable, will be a deduction against farming income for tax purposes, which could be particularly useful as you wind-up farming operations and the income arising on the sale of inventory and capital assets has to be reported for tax purposes.

The retiring allowance will be employment income to the individual who receives it. However there is an added benefit. The recipient can transfer a retiring allowance to their RRSP, within certain limits for years of service prior to 1996. If it is transferred to their RRSP, the amount will not be taxable until the amounts are withdrawn from their RRSP, which could be several years in the future.

It's important to emphasize that the amount of the retiring allowance must be reasonable in the circumstances, considering the length of time the individual has been employed in the business, as well as the amount they have been paid and the services they have performed while they were employed. However, when it can be used, a retiring allowance can be a very effective tool to get an income tax deduction now and to boost the amount of funds available in an employee's RRSP in their retirement.

This is only a brief discussion of some long-term tax planning opportunities that may be available to you. Talk to your BDO advisor to discuss your own unique situation

Summary

As a farmer, you have many unique tax issues that you need to consider. It's important that you take the time to consider both short and long term planning issues that will help to minimize the tax that you and your family have to pay.

BDO Canada LLP is proud of our long association with Canadian farmers. If you have any questions about your tax situation or any items discussed in this bulletin, talk to your BDO advisor today.

The information in this publication is current as of March 1, 2017.