

QUATE Non-Family Succession Request

BCMMB Response

August 27, 2018

The Milk Board would like to offer the following points of clarity regarding **Recommendation “E”** from the quota review (2017-18), to provide a complete response to the questions submitted by the BCFIRB on May 30, 2018.

Recommendation “E” requested that the BCMMB be able to **add a farm employee to the exempt transfer policy with an ownership limit of 5%.**

In its letter of direction on succession planning and non-exempt transfers dated May 30, 2018, the BCFIRB cited the following:

The original policy objectives behind the “exempt persons” list and related Quota Exchange direction was to support family farm succession planning and procedurally fair, inclusive access to quota. In recognition of changing succession structures and the significant contributions of non-family members to farms, the Milk Board and Egg Board have considered the extension of the “exempt person” list.

Therefore, the original policy objectives for the exempt persons list was to establish a policy to support family farming. The exempt persons list identifies specific family relations that can conduct a direct transfer of quota to continue an existing dairy farm or start a new one. The Milk Board orders defines an exempt person as follows;

“Exempt Person” means a Producer’s: (a) spouse; (b) child; (c) child and the child’s spouse; (d) niece; (e) niece and the niece’s spouse; (f) nephew; (g) nephew and the nephew’s spouse; (h) grandchild; and/or (i) grandchild and the grandchild’s spouse.

The Board recognises that for the exempt persons list to be relevant and effective, it needs to remain limited to its original purpose. Changing the definition of the exempt persons list to include a non-related party will not meet the original objectives of the exempt person provision creating a grey area resulting in policy failure.

The Board supports its original submission (Recommendation “E”) as there is a need for non-family succession in the dairy industry, specifically to serve the public interest. However, it became obvious through the development of policy objectives that one policy category of exempt transfers is required meeting specific purposes; (1) to meet the original objectives for family succession - exempt person list and (2) to meet new policy objectives for non-family succession - exempt transfer sale.

The responses provided below are based on Recommendation “E” with the understanding that the proposed structure for exempt transfers discussed above.

1. What are the benefits and risks to industry and sound marketing policy of further expanding the list of persons who are exempt from BCFIRB directed transfer assessments?

The benefit of an exempt transfer sale is that it creates a policy state that supports a transfer of shares under prescribed conditions which enables a non-related person to become invested in a business unit.

This type of policy provides congruence between business practices in British Columbia and the Milk Board orders. For example, it is a standard business practice to issue, buy/sell shares in a business unit to generate capital or to keep valuable resources involved with the success of the company. Currently, due to the limitations on quota ownership, farm business units can only allow exempt persons to hold these shares and this creates a succession inequity in the industry.

The Milk Board reviewed the current structure types of business units in the dairy industry (i.e. sole proprietorships, partnerships and corporations) and found that 70% were in fact in corporate structures and will eventually require a non-succession policy provision to continue farming.

An exempt transfer sale could minimize nonsensical costs in the system today and provide options to industry costs (i.e. capital gains /land transfer tax) when ownership changes must occur.

Business practices aside, a very real consequence of family only succession is the limited opportunity for farms without a successor on the exempt transfer list. A farming operation can involve many individuals (i.e. direct relations, distant relations, farm employees etc.). If an owner/operator has no family successors then the reliance on the non-family successors increases, i.e. they become family. If this individual develops a short/long-term illness or is injured and is unable to physically work, what options does this producer have?

The producer could try and retain help through a salary increase but realistically there could be cashflow limitations based on the amount of quota, debt and operating expenses on the farm. The reality-based option for the long-term is to sell the farm and put the quota on the exchange.

At first glance this process appears typical but let's examine what can happen. If farm land is sold, the land is not likely to remain a dairy operation. There are competing interests for land in many regions in BC and this creates another challenge for new entrants (the public) in the industry. Therefore, the province loses another dairy farm and the quota gets redistributed amongst the existing farms. In the end, you could have a smaller number of farms managing larger quota volumes.

In the example described above, the exempt transfer sale policy would have allowed an exempt transfer of shares to occur within the business unit and provide the opportunity for non-family ownership. Ownership gives a sense of pride and purpose in any environment and ensures long-term interest. Many young farm employees will have the opportunity to be a part of a business unit which will enhance the dairy labour force and reduce challenges to enter the dairy industry.

Although it is not part of the Boards strategic plan to maintain a specific number of dairy farms in the province, the Board has an obligation to ensure there are no unintended consequences that arise from their decisions, such as a reduction in the number of farms.

Milk supply is the Boards primary responsibility and having a lower number of larger farms can create issues to the supply chain (i.e. disease, fire etc.). This objective is important to producers but also to processors for available milk supply and consumers for fresh, high quality milk.

British Columbia needs to continue to source its own milk and increase its production of industrial product, without farms to supply milk, and all stakeholders are impacted.

To summarise, the benefits to the province long term are simple; (1) separating the policy to clarify exempt transfer sale and exempt person list will meet specific objectives for family succession and non-family succession, removing any overlap;(2) the policy expansion provides the opportunity for dairy farms to remain in the industry maintaining dairy farms in BC and minimizing supply risks to the processors and consumers; (3)Business units can operate in congruence with the business tax and corporate policies without incurring nonsensical costs;(4)Lastly, it provides an opportunity for a farm employee to become a part of the business unit, ensuring long-term interest.

From a risk perspective, any transactions conducted using the exempt transfer sale provision will remove potential quota sales from the quota exchange. The next question will examine this risk in detail.

1. What are the benefits and risks to industry and sound marketing policy of further expanding the list of persons who are not required to transfer quota on Quota Exchanges (as per BCFIRB's 2006 direction to the Milk and Egg Boards regarding quota transfers and the "exempt persons" list)?

As part of the 2005 specialty review, the Milk Board was directed to ensure all quota is sold on the quota exchange to respect a system of fairness, transparency and inclusivity. This policy change, effectively eliminated private transfers with a few exceptions (1) Individuals listed on the exempt person list could transfer quota directly down the family tree; (2) Partial Farm sales provide an opportunity to acquire a portion of quota in a lump sum with the flexibility of merging to an

existing operation if 50% of the quota is sold on the quota exchange; (3) Whole farm sales allow a 100% transfer providing that no quota is merged with another farm for 10 years.

Many of the Boards policies are developed to encourage the sale of quota on the exchange which establishes equal opportunity for quota access. Producers who downsize or leave the industry are all required to put all sellable quota on the exchange. Any exceptions (noted above) have specific requirements that limit the flexibility appreciated when selling on the exchange.

The exempt transfer sale policy will not encourage the sale of quota on the exchange, but this policy is not designed for those leaving the industry but rather focuses on securing farms that want to stay in the industry for the long term. These farms do not want to leave the dairy industry but could require policy assistance to stay.

Therefore, the objective of this policy is to support business units for long-term production through non-family succession and the apparent risk is the requirement to transfer quota on the exchange.

The magnitude of any risk requires evaluation. How big is the risk (i.e. how many transfers will occur) and can it be mitigated? Similar discussions took place during the development of the whole farm sales and farm sales policies. The Board changed the both policies in 2015 after the Quota Governance and Policy Review and since its implementation, there have been 2 whole farm transactions and 5 farm sales.

The Board believes the rigid criteria for qualification and the final review by the Board tends to deter any inappropriate applicants and only serious candidates submit a request for transfer. Using a similar process, any exempt transfer sales will be evaluated with firm criteria to ensure that any transfers that should be going through the exchange continue to do so.

During the quota review, producers were clear in their feedback that Board involvement is necessary to conduct non-family transfers. In short, to mitigate any risk, the Board will use the criteria presented and conduct a final evaluation to determine if the non-family transfer should occur. Producers can always appeal if the approval is denied, providing a fair process for all.

This policy caters to those without exempt status successors who want to continue farming and have employed individuals who could continue the farm for years to come. By coupling both the exempt person list and the exempt transfer sale the Board will be able to provide fair policies to all producers.

2. Are the Milk Board and Egg Board criteria for the inclusion of non-family members on the “exempt persons” list inclusive, effective and strategic? Why or why not?
 - 5 years of verified service using T4s
 - The farm must provide the primary source of income
 - The employee must be in a management or senior type role
 - Residency must be in BC
 - Ownership limit is 5% on the farm
 - All transfers require Board approval

The Milk Board is not requesting the addition of non-family members to the exempt persons list as noted in the introduction.

- a. Are the specific criteria proposed by the Milk and Egg Boards too restrictive or not restrictive enough (bearing in mind there are no restrictions on family members)? Why?

Although no policy can contemplate every possible risk, there is importance in recognizing a long-term policy goal. The objective of the exempt transfer sale is to ensure opportunity is given to an individual who meets specific criteria to ensure long term resources for the farm. The criteria established ensures the policy applies to an individual who is committed to the longevity of the farm. The requirements are not restrictive but rather specific to support non-family succession in a transparent manner.

- b. Are there other criteria (different or in addition to) that should be considered? Why?

There should be consideration to remove the prescribed number of 5% as the ownership limit. From our discussions and review of business units in the province, we have established that all situations are different. The number of shares that may need to transfer on a large operation will be different to those that need to transfer on a small operation to satisfy the individual circumstance. A practical and relevant policy may encourage long term success and less appeals based on the request.

3. If the risks out-weigh the benefits of including non-family members on the “exempt persons” list (can transfer quota without assessment and do not have to transfer quota on the Exchange), are there other means of reducing quota-related barriers to non-family succession that commodity boards and/or BCFIRB should consider?

The policy presented separates the exempt person and the exempt transfer sale; Recognising this policy structure, allows the Milk Board to provide opportunities to

non-family succession without compromising the original objectives of the exempt person list.

Exempt Transfers

“Exempt Transfer Sale” means a transfer of ownership (i.e. 5%) within a business unit (i.e. sole proprietorships, partnerships and corporations) where the transferee must have (a) 5 years of verified service using T4s (b) the transferors farm must provide the primary source of income to the transferee (c) the transferee must be in a management or senior type role and (d) the transferee must reside in British Columbia; subject to the transfer provisions of the consolidated order and Milk Board approval.

“Exempt Person” means a Producer’s: (a) spouse; (b) child; (c) child and the child’s spouse; (d) niece; (e) niece and the niece’s spouse; (f) nephew; (g) nephew and the nephew’s spouse; (h) grandchild; and/or (i) grandchild and the grandchild’s spouse.