Estate Planning for the B.C. Farmer

Sixth Edition

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Estate Planning for the B.C. Farmer

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Preface

Estate planning is an extremely broad subject. It deals with the ultimate transfer of your assets to the next generation as well as the accumulation and management of those assets during your lifetime. If the planning is carried out properly, attention will be given not only to the income tax considerations, which are obviously important, but also to the legal, business and personal considerations which in most family situations have an even greater significance.

The fact that the subject is so broad makes it difficult for farm families to know how to tackle it. Where do you start? What options do you have?

It is our hope that this sixth edition of Estate Planning for the B.C. Farmer, which is much less technical than some of its predecessors, will help you answer these questions. Some of the material is in the format of "questions and answers" which deal with the more common issues that arise in the estate planning process. There are also two illustrations of family farm transfer arrangements in the Appendices.

Even though this latest edition avoids many of the technical issues associated with the subject matter, it is not a publication that can easily be read from start to finish. You may wish to begin updating your knowledge by reviewing the Estate Planning Checklist published by the Ministry in 1993. This is a smaller publication, written by the same author, that is designed to give you an introduction to estate planning.

After this introduction, you might want to read Chapter 1, as well as Chapters 5, 6 and 7 dealing with the transfer of property to children, and any other sections which are of interest to you. If you don't read all the commentary, at least take a look at the questions and answers which are included in most of the chapters. These will help you understand many of the principles that are discussed in the text. After doing this, you should keep this publication in a safe place and use it for reference purposes, as your situation requires.

This publication was written by Derek Fryer, and edited by Clare Scott and Marvin Lenz, each of whom is a chartered accountant. Acknowledgement is gratefully given to Howard Joynt, Farm Management Branch of the Ministry, for his project leadership, and to the following people who provided comments on the publication:

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Farm Management Branch
Ministry of Agriculture, Food and Fisheries
Vernon, B.C.

Table of Contents

Introduction

In the first edition of this publication, written in 1984, the subject matter was introduced by reviewing the script of an imaginary play about a family planning its estate. While the actors were fictitious, the sequence of events was fairly typical of what happens in real-life situations.
Since that play was written, there have been some important tax changes which have reduced some of the tragic consequences that our imaginary family brought upon themselves by not following through with their estate plans. These changes have not lessened the human side of our family's tragedy, however, so the moral of our story is as valid now as it was sixteen years ago.

The central characters in our play are John and Mary Brown who are both aged 62. They have been successful farmers throughout their lives and are considering retirement in the next two or three years.

All their assets are tied up in the farm and they have very little insurance. The farm is now being run by their son Bill, who is aged 35 and lives on the property with his wife and two children. Bill doesn't have an ownership interest at this time but "understands" he will inherit the farm one day.

The parents also have two daughters who are married and not involved in the farming business.

In scene one, John and Mary chat about their future retirement while having dinner. It is not a particularly thoughtful discussion - merely a casual conversation about what might happen in the future. They have done this on several occasions in the past and have never involved their children. They have been told by their solicitor and accountant that they should be making an overall estate plan. Bill has also been encouraging them to do this because he would like to know where he stands. John and

Mary realize they should be doing something but always find a reason to put off a decision.

The one point that they seem to agree on is that Bill should acquire the farm because he has put a lot of work into it. The property was inherited from John's parents so they would like to see it continue in the family if possible. However, there remains the question of how they should deal with their daughters. They want to treat all of their children fairly.

John and Mary have prepared a straight-forward will. It provides that after the death of the two of them, all their assets are to be divided equally among their children.

In scene two, John and Mary are killed in an automobile accident and the children suddenly find themselves in the position of co-owners of the farm. Soon there is disagreement as to how Bill might acquire complete ownership of the farm and because of the constant arguments there is a real possibility that there will be permanent damage to the family relationship.

In scene three, the family has split into bitter factions and the farm has been sold. Income taxes have been paid on income that arose from the sale and Bill has been forced to move off a farm that has been in his family for three generations.

This scenario is unfortunate, but in real life there can be others which are just as bad or worse. Perhaps the parents don't prepare a will with the result that their property is distributed in accordance with the government's rules rather than in accordance with their own wishes. Alternatively, perhaps there is a will, but it's challenged by one or more of the children on the basis that it doesn't make adequate provision for them. There can be other problems too. Perhaps the parents aren't able to transfer the farm to their children on a tax-deferred basis and their family is exposed to a substantial income tax liability.

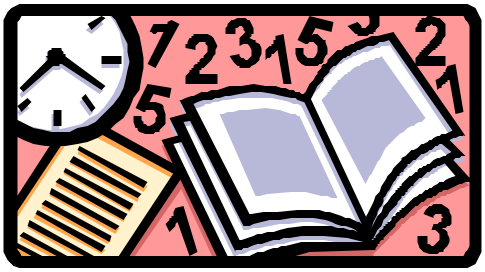
The desire to avoid these and other estate planning problems is the reason this book has been written. We hope it will give the reader an insight as to how to approach estate planning.

The commentary is based upon the Income Tax Act as it stood on November 30, 2000 and the proposed amendments at that time.

Unfortunately, there are many “technical terms” that must be used when explaining the legal and income tax implications of estate planning. The meaning of these terms is set out in the Glossary in the Appendices of this book.

Derek J. Fryer, FCA
January, 2001

1. The Basics of Estate Planning



There is a certain reluctance in all of us to deal with the subject of estate planning because it requires us to consider what is going to happen after we die. Death is not a particularly pleasant subject and we prefer not to think about it. Some of this reluctance may disappear if estate planning is thought of in a broader context as having to do with the accumulation and use of property during one's lifetime, as well as its distribution after death. In fact, this is what it is.

Estate planning is particularly important to you, as a farmer, because you are engaged in a capital-intensive industry. The size of your estate, and the fact that substantially all of your net worth is probably tied up in your farm, create special problems which can be dealt with only through a well-constructed estate plan.

What is Estate Planning?

Estate planning… doesn't deal only with death

Estate planning deals with all aspects of the accumulation, use and distribution of a person's assets. It therefore entails all of the following:

- accumulating and controlling assets;
- providing for an orderly and equitable distribution of assets during lifetime or on death;
- providing adequate retirement income;
- minimizing tax; and
- maintaining sufficient liquidity to pay taxes and other costs at death.

You have a number of "tools" available to you

You have a number of "tools" at your disposal which you can use to achieve all of the above. For instance, you can:

- prepare a will describing how property is to be distributed after your death (see Chapter 2);
- choose a form of business arrangement that minimizes your tax liability and makes it easier to transfer your property to your beneficiaries (see Chapters 3 and 11);
- transfer property during your lifetime or on death and use trusts to hold property for your spouse or child (see Chapters 5, 6 and 7);
- plan your retirement income (see Chapter 10); and
- provide liquidity in your estate with the use of life insurance (see Chapter 12).

What are the Benefits?

The time and effort spent on your estate plan is usually well rewarded in terms of the savings in taxes, estate management costs and property transfer procedures. Equally important, however, is the peace of mind enjoyed by you and your family in the knowledge that the plan has been well thought out and is fair to all.

When Should You Begin to Plan?

Estate planning is a continual process

You should give some thought to estate planning as soon as you begin to accumulate assets. While you are single and relatively young, your planning is likely to consist of safeguarding your valuable assets (such as storing important documents in a safety deposit box) and preparing a will setting out what should happen to your property in the event of your death.

After you marry and start a family the scope of your planning will broaden. You will change the beneficiaries in your will and, perhaps, name a person who would act as guardian to your children if you and your spouse should die suddenly. Your business affairs will probably become more complex and you will want to assess whether a different form of business organization would be beneficial.

Perhaps you will want to consider forming a partnership with your spouse, or carrying on business through a company. Your debts may increase significantly and you may want to reassess the extent of your insurance coverage.

Later on in life, your estate plan will broaden even further because you will then have to decide whether to bring your child or children into the business. Ultimately, you will have to consider your retirement plans and the sale of your farm. Plans may have to be changed periodically in response to external factors such as new government legislation.

It can be seen, therefore, that an estate plan is **not** something that is made and then forgotten. It's an ongoing dynamic process that evolves throughout the middle years of a person's life and requires a periodic check-up in response to changing circumstances.

How Do You Pass on Your Farm?

Your planning in the early years will probably centre around managing your farm and earning sufficient income to support your family. In later years, however, you will have different concerns such as whether any of your children want to take over the farm or whether there will have to be a sale to a person outside the family.

If there is to be a sale to a person outside of the family, you will want to receive the best possible price and reduce your tax liability to the maximum extent possible. The best way of doing this is to ensure that you receive advice from your accountant well before the transaction occurs. In some situations that advice should be obtained one or two years before the proposed sale. This is discussed in Chapter 4.

If the farm is to be transferred to one or more of your children, the issues will be somewhat different. You will still be interested in receiving a fair price and minimizing your tax liability, but there will be a number of other issues as well, including the following:

The issues when the farming child takes over

- do you want to transfer all or only some of your farm property?
- are you looking for an arrangement under which your child is gradually phased-in to the business?
- how can you give your child the opportunity to take over the farm and still treat your non-farming children fairly?

Planning the transfer of the farm to the next generation can be difficult and time consuming. Because you will have spent considerable time, money and energy in acquiring your farm, you will not want to transfer it to your children without being fairly certain that your needs will be looked after, and the transfer will be a success.

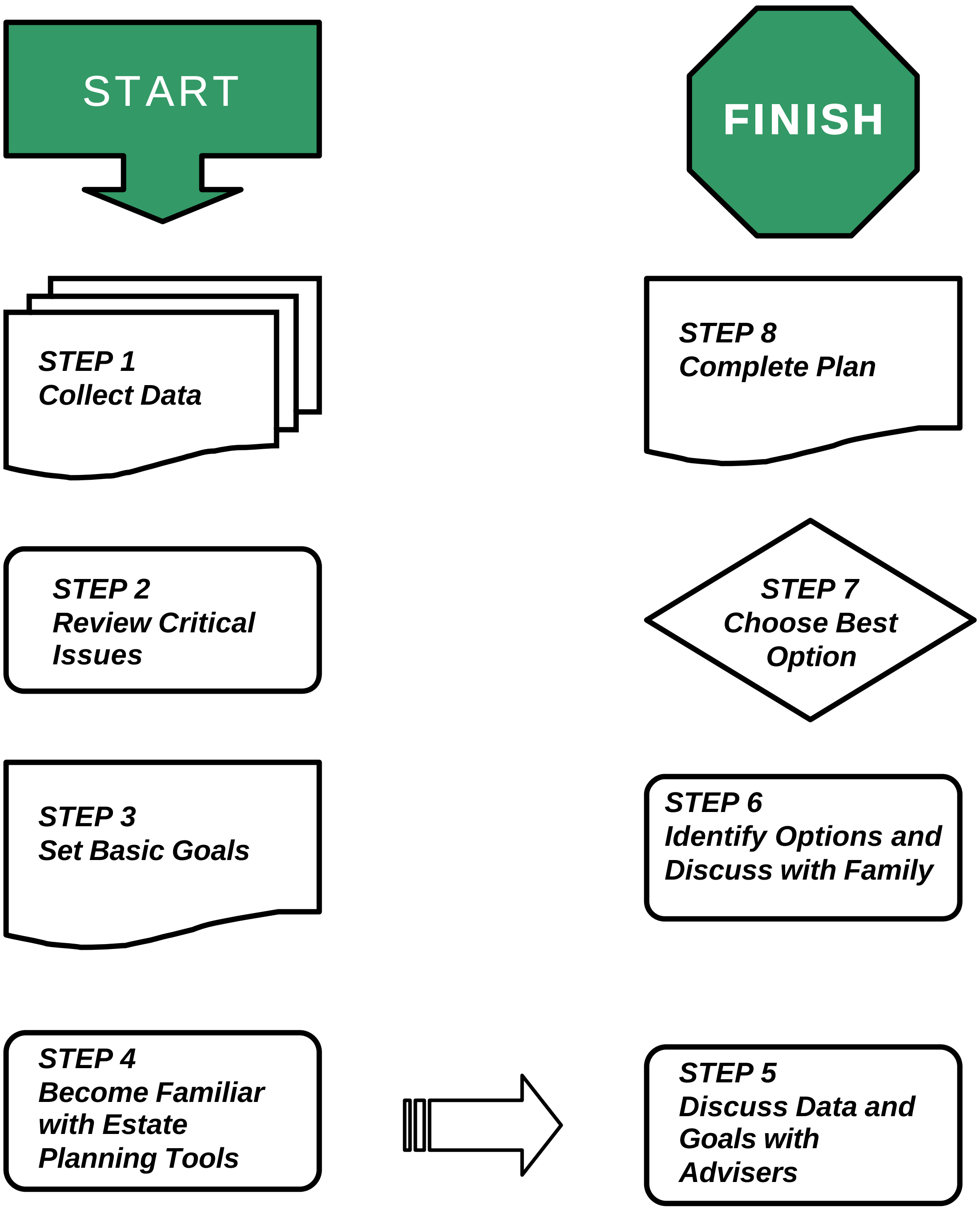
Don't be surprised if the transfer process takes several months, or even a year or more, before you complete it. This is a big step for parents, and it quite often takes a while for everybody to become comfortable with the process as well as the outcome.

Some farm families have difficulty coming to grips with this phase of their estate plan because they are overwhelmed by the many issues that need to be taken into account. Sometimes they put off the discussions that should be taking place; hoping, perhaps, that the decisions will be easier if they are deferred to another day. Usually this doesn't happen.

Use the Estate Planning Checklist to get you started

You will more likely avoid becoming overwhelmed if you don't become too involved in the details early in the process. The Estate Planning Checklist, published by the Ministry in 1993, will help you do this. It sets out eight basic steps in the family farm transfer process and then discusses the first four of the steps in some detail. These eight steps are shown in the form of a diagram on the next page.

The Family Farm Transfer Process



Collect the data

The data you collect in step 1 will include the approximate value of your farm assets and liabilities, the manner in which these assets are owned, particulars concerning your family, details of non-farm assets, insurance policies, etc. You should try to gather this information together in a manner that will facilitate a discussion by the family as well as a review by your professional advisers.

Scan the picture

Step 2 of the process is perhaps the most important. Here you look at a number of broad financial and personal issues that ultimately will shape the way in which the farm is transferred to the children. There won't be a final decision on these issues at this stage, but there should be a discussion of the options and an assessment of the importance of each issue in the overall transfer process. The issues that will be considered will include the following:

- The importance of an "interim" arrangement with the child (such as bringing the child into the farm as a shareholder or partner) rather than a complete sale
- The importance of you continuing to control the farm for a period of time
- The necessity for you to move off the farm
- Your financial needs, both now and in the future
- The ability of the farm to support the family members who are interested in it
- The approach you might take in dealing with your non-farming children

Establish your goals and objectives

In step 3 of the process you will establish some broad goals and objectives. Your plan will not have been "fleshed out" in detail at this point but hopefully you will have arrived at some tentative conclusions in the following areas:

- whether there will be a full or partial sale or, perhaps, some sort of interim arrangement such as a partnership

- whether you want to retain control over the farm
- your income and capital needs in the short and medium term

Look at the "tools" available

In step 4 you should attempt to increase your knowledge of the estate planning "tools" which are at your disposal. These include:

- the "tax tools" (such as the capital gains deduction and farm "rollovers") – see Chapters 5, 6, 7 and 9
- the "security tools" (mortgages, agreements for sale, etc.) – see Chapter 3
- the different forms of business arrangements (proprietorships, partnerships, joint ventures, companies) – see Chapters 3 and 11
- methods of holding property (joint tenancy, tenancy in common and life interests) – see Chapter 3

Your intention here is not to become an expert but to be better able to review the options with your advisers. You might begin by reviewing the brief commentary in the Estate Planning Checklist referred to earlier and then supplement your knowledge by reading portions of this publication.

Analysis and completion phases

Steps 5 to 8 in the process represent the "analysis" and "completion" phases of your plan. Here your advisers will become more involved. The options will be "fleshed out" for your review, and the final plan will be selected and put into effect. Hopefully, you and/or your advisers will be able to use this publication in this phase as well.

Discuss the plan with the family before it's finalized

After a plan is developed in draft form by your professional adviser, you will want to discuss it with the remainder of your family. It is important that all members of your family believe they have been fairly treated. Time spent at this stage can save much anguish during your lifetime and after your death.

If the plan you are developing is to be included in your will rather than being put into effect immediately, a discussion with your family may avoid the possibility of your will being contested under the Wills Variation Act (see Chapter 2).

Tax is not the most important consideration.

Your accountant will naturally be concerned about minimizing your tax liability, **but it must be recognized that tax is not the most important consideration**. You and your spouse must feel comfortable with the plan recommended to you and it must conform to your ideas on how you should deal with your children.

Your estate plan should be flexible. It should, for instance, take into account that your children may change their personal goals and career paths. You should not take irrevocable steps until you are certain that your children have decided what they want to do with their lives.

Provide for an Incapacity

As you become older, you will want to discuss with your lawyer the merits of empowering another person to act on your behalf if you were to become incapacitated. The law in B.C. in this area changed considerably on February 28, 2000 as a result of the introduction of the Representation Act. Essentially, this new Act enables you to sign a **standard** agreement covering matters such as your personal care, the routine management of your financial affairs and certain health care decisions. There is also an **enhanced** agreement which authorizes more significant decisions such as the sale of assets and the refusal of life-supporting medical treatment.

If you have previously made arrangements through a lawyer to give an **enduring** power of attorney to one or more members of your family, the new legislation in B.C. may not be of great interest to you unless, perhaps, you want to take advantage of the provisions dealing with health care. If, however, you have not done this, and you are reaching the age where somebody should be authorized to act for you if you were to become incapacitated, you should arrange a meeting with your lawyer to discuss this matter.

Gift Tax and Succession Duties

No gift tax or succession duties in B.C.

Farmers in British Columbia have to consider the effect of income taxes on their estate plans but, fortunately, they do not also have to wrestle with gift taxes and succession duties. These taxes were abolished in British Columbia in January 1977. Nowadays, therefore, you need not be concerned about the possibility of a gift tax if you should transfer property or cash to a member of your family.

Using Advisers

You are going to need the advice of professionals in developing and implementing your estate plan. The questions that come to mind in this regard are "which professionals can help you?", "when do you consult them?" and "how do you choose the right one?"

Which professionals can help you?

The following is a list of some of the advisers and the areas in which they will be able to help you.

Accountants: If your accountant is very knowledgeable in the areas of taxation and estate planning as they affect farmers, he or she can act as the "quarterback" for your overall plan.

Lawyers: They can advise you on the legalities of the estate planning and business succession arrangements. Agricultural experience is advisable. Ultimately a lawyer will be required to put your estate plan into effect.

Bankers: They can offer advice on how to finance farm succession arrangements as well as retirement planning and the investment of your capital.

Financial planners and consultants: These individuals can also advise on retirement planning and overall financial planning. Some will have a specialized knowledge of insurance products and the manner in which they can be used in your overall estate plan.

Insurance agents: These individuals can advise you on insurance matters. Some have financial planning qualifications that enable them to advise you on a broader range of issues.

When do you consult with them?

There are two schools of thought as to when the outside consultants should be involved. The first is that you should not bring in an outside adviser until you have done your own research and have had some preliminary discussions within the family. For some people, this will be the right approach, particularly if they are able to locate publications such as this one, and the Estate Planning Checklist published by the Ministry of Agriculture, Food and Fisheries in B.C. Others, however, find it useful to have an initial discussion with an advisor to help them focus the discussions within the family. This is particularly true where the parents are approaching retirement and it's time to develop the arrangements for the transfer of the farm to the next generation, or plan for the sale to an arm's length person.

How do you choose the right one?

Your advisers should have an understanding of the issues and problems affecting farmers and, most importantly, you need to feel comfortable talking with them. For some phases of your estate planning, your adviser will usually be your lawyer or accountant. At other times, however, you may need to involve several people, including your accountant, lawyer, banker and insurance agent.

How do you know if you are dealing with the right people? Well, here are some suggestions:

- Ask around. Talk to other farmers who have used advisers and get their suggestions.
- Enquire at seminars and workshops.
- Contact professional associations.
- Ask the Ministry of Agriculture, Food and Fisheries.
- Set up an interview with possible advisers and find out what training they have and their length of experience in dealing with estate planning for agricultural businesses.

Keeping Track of Your Estate Planning Information

As your estate planning changes over time, it is important to keep track of the information that is essential to your arrangements. To some extent, this information will be contained in your will but it may also be contained in other documents such as the following:

- a shareholders' agreement, if your business is carried on through a company
- a partnership agreement if your business is carried on through a partnership
- lease agreements
- financial records
- insurance policies

To assist you in doing this, we have included an insert in this publication entitled "Estate Planning Information" (there is also an extra copy in the Appendices). We suggest you complete it and file it with your will and other valuable papers.

Some Questions and Answers

1. **My wife and I want to bring our son into the business or perhaps sell a portion of the farm to him. How do we begin the process?**

   Well, as mentioned in this chapter, a good starting point is the Estate Planning Checklist, published by the Ministry of Agriculture, Food and Fisheries in B.C. This is a fairly small publication that will give you an understanding of what the family farm transfer process entails as well as provide you with the information you will need to gather together. After you have reviewed this Checklist you may wish to talk with a professional adviser (accountant or lawyer), a farm management specialist at the Ministry or, perhaps, attend an estate planning seminar. These seminars are often provided on a periodic basis by accountants, lawyers, insurance agents and by the Ministry itself.

2. **Which professionals are likely to be able to help us develop an estate plan?**

   This depends on your advisers' experience and qualifications. There are some accountants and lawyers, who have considerable estate planning and taxation experience with agricultural businesses and can guide you through the entire process. If your accountant or lawyer does not have these skills, he or she should be prepared to recommend you to somebody who does.

   Depending on your circumstances, it may be appropriate to involve your bank and insurance agent.

   If you are not sure who to approach, contact your local Ministry office. They will be able to provide you with recommendations as well as some preliminary advice.

3. **Should we have our farming child attend the first meeting with our family's professional adviser?**

   There are no hard and fast rules but generally it's preferable for the parents to have the first meeting with the adviser on their own. This will usually facilitate a more complete discussion of the options available.

2. Will Planning

Introduction

One of the most important documents you execute during your lifetime is your will. Ideally, it's just one of the key elements in your overall estate plan but in some situations it represents the only estate planning that is done. It may have far-reaching effects on your family and business partners so it should be given a lot of thought. A solicitor should always prepare the document in order to avoid potential problems.

What is a will?

Your will is a legally enforceable document that can be altered or revoked during your lifetime. It describes your wishes regarding the distribution of your property and the appointment of executors. It may also deal with other matters such as the appointment of trustees to hold property in trust for your surviving spouse and children and the appointment of guardians for your children.

You will lose your ability to make or amend a will if you are no longer able to understand the nature and extent of the property that forms part of your estate. This might happen for instance, if you were to have a stroke. Because there is always the possibility of this occurring without warning it is important that will-planning be updated regularly.

Failure to prepare a will

You should prepare a will to ensure that your property is distributed in an orderly manner to your family, and other intended beneficiaries, in accordance with your wishes. If you fail to prepare one, your assets can only be dealt with in accordance with the provisions of the Estate Administration Act (see later discussion). This can result in additional worry for your family, a possible delay in the distribution of your estate, an increase in estate management costs and the exclusion of some persons you would have wanted to share in your estate.

Matters that should be considered

In planning your will, you should take into account many factors including the provisions of buy-sell agreements entered into with your business partners, the income tax rules applying on death, the amount of liquid assets in your estate, the manner in which you hold your business assets and the provisions of any marriage agreement. Because these considerations are complicated and they change periodically, you should get into the habit of obtaining professional advice and reviewing your will planning every three or four years. There should always be a review after the following:

Update your will regularly

- a major change in business arrangements (e.g. formation of a company or partnership);
- major changes in the form or mix of assets;
- sale of property;
- major income tax changes;
- birth or death of a child or grandchild;
- children or grandchildren becoming adults;
- emigration of a beneficiary from Canada;
- marriage or divorce; or
- death of an executor, spouse or other named beneficiary.

Discuss your plans with your family

In deciding the terms of your will, you should thoroughly discuss your estate plans with your family. There should be no surprises after your death and your family should be prepared for what is to happen at that point. This discussion can take a considerable length of time and may be assisted by the involvement of professionals such as the family solicitor and accountant, an insurance agent and perhaps a farm management specialist from the British Columbia Ministry of Agriculture, Food and Fisheries.

After the will is completed and signed, you should leave the original with your solicitor for safe-keeping and should keep a copy for your own records. It may be appropriate to also provide a copy to your accountant and executor.

Legal Formalities

The formalities governing the making of a conventional will are contained in the Wills Act of British Columbia. In general:

Be careful who witnesses your will

- the document must be in writing;
- it must be signed by you, or by some other person in your presence and under your instructions;
- you should sign your will in the presence of two or more witnesses who should be over the age of majority;
- the witnesses should not be beneficiaries named in the will, nor the spouses of those beneficiaries.

This latter point is extremely important. If bequests are made to the witnesses of a will, or to their spouses, they will be forfeited and the property will simply form part of the residue of your estate.

If you have more than one will, the most recent one over-rides the earlier versions. For this reason, it is important your will be dated.

Generally, you must be nineteen years of age or older before you can make a will although a married infant (a person under age nineteen) or a member of the Canadian forces can prepare one irrespective of his age. The person must have the mental capacity to prepare the will and must not be forced or coerced into it.

Revoking a will… marriage may do this

You can revoke a will by making a new one, by destroying or revoking an existing one or by entering into a marriage. (A divorce will not revoke a will but it will have the effect of cancelling transfers of property to the ex-spouse and the appointment of him or her as executor or trustee.) You need not necessarily make a new will each time you want to change it. You may be able to make the change by simply attaching a “codicil”.

If you prepare or update your will shortly before your marriage, you should indicate in the document that it is being prepared or updated in contemplation of marriage. This indicates that you were aware of your upcoming marriage at the time the will was prepared and the marriage itself will not have the effect of revoking it.

Who Should Act as Executor?

Generally, you will want to have your spouse and/or your children act as executors. The decision as to who should be involved will depend on the complexity of your business arrangements and the ability of your spouse and children to deal with them.

If your will establishes a trust for your spouse under which income from the farm passes to the spouse during his or her lifetime, with the farm property passing to your children on the spouse's death, it might not be a good idea for your spouse to act as the sole executor. One or more of your children might also be appointed so that there is a proper balancing of the interests of your spouse and children.

In some cases, it may be necessary to sell assets in order to provide additional cash to the surviving spouse. In that case, it may be preferable to also have independent executors so that your children are not placed in the awkward position of trying to decide whether a sale should be made.

Try to avoid conflict of interest

In some situations, it may be appropriate to have a friend or business associate act as an executor. You should ensure, however, that the business associate is not put in a position of conflict. This might happen if farm assets are to be sold by the estate and the business associate might be one of the buyers.

You might consider naming your solicitor or accountant to act as one of the executors. These persons may be good choices if they have a detailed knowledge of your affairs and beneficiaries, and can afford to spend the appropriate amount of time on estate administration. Often their other commitments prevent them from doing this and you are better off to retain these individuals in their professional capacities rather than as executors.

A trust company may be useful in situations where you have extensive business interests or a trust is to be created that will exist for a long time. It can provide a full service administration package that can rarely be equalled elsewhere. However, the trust company will not always have an office in the area in which you live and this can complicate the administration of your estate. The trust company may also be more costly.

What Should Be in Your Will?

Your bequests may take different forms

You will want to state the manner in which your estate is to be distributed. The distribution may be in the form of a “specific bequest”, a “general bequest” or a “share of the residue” of your estate.

A “specific bequest” is made where a specific property such as an interest in a particular company or a specific parcel of land is left to a beneficiary. If the particular property is sold before your death, the beneficiary will lose his or her inheritance unless that person also shares in the residue of your estate.

A “general bequest” refers only to a sum of money rather than to a particular property.

A "share of the residue" refers to a share of the balance of the estate, after payment of specific bequests, general bequests and all of the estate's liabilities. This residue might be entirely in the form of cash or may include assets such as land which have not been bequeathed to a particular beneficiary and have not been sold in the course of the administration of the estate.

You will want to specify what is to happen to your debts. They may be assumed by one of your beneficiaries or paid out of the residue of your estate.

Use of a trust to protect children's interests

Property passing to your spouse may be transferred directly to your spouse or to a trust for his or her benefit. Use of a trust will ensure that the future entitlement of your children cannot be affected by your spouse's remarriage after your death. You may also use a trust to hold property for infant children.

There is usually a provision setting out what should happen in the event that you and your spouse are killed in a common accident. If there is no such provision, the younger of you is treated as though he or she survived the older and the distribution of the two estates is processed accordingly. Sometimes the will also provides that the bequest to a spouse shall not take place unless he or she survives the testator by, say, 30 days. Where there is a simultaneous death, this provision should have the effect of reducing probate fees.

Include an emergency plan for your farm assets

You may want to consider giving your children the right to acquire certain farm property from your estate at a percentage of its fair market value (see Chapter 7). This makes a useful "emergency plan" that will come into effect if you are unable to transfer your farm during your lifetime.

Executors can elect values at which your children acquire certain farm assets

As discussed in Chapter 7, your executors have the ability to select the value for income tax purposes at which you are deemed to dispose of certain farming assets to your children. The values they select will have an impact on the tax payable by your estate and will determine the cost of the property to your children. It is important that your will give your executors the power to choose these values for income tax purposes. Guidance might also be given to them as to how this choice should be made. In most situations, you will want them to select the highest possible transfer values that will not result in tax being paid by your estate.

If certain assets are to be distributed "in specie", (eg. in their present form - see Glossary), you should ensure that the will gives the executor the power to do this.

Property Not Affected by Your Will

Check the beneficiary designations on your RRSP and insurance policies

Property held in a joint-tenancy arrangement (see Chapter 3), together with the proceeds of insurance policies and registered retirement savings plans for which there are named beneficiaries, do not form part of your estate and are not affected by the terms of your will. These assets pass directly to the surviving joint tenants or to the named beneficiaries, and are unlikely to be available to your creditors. You should check your old insurance policies and registered retirement savings plans to ensure that the "beneficiary designation" is still appropriate.

Because of provisions in the Income Tax Act, you will generally want to designate your spouse as the named beneficiary of your registered retirement savings plan. This is discussed in Chapter 10.

Can Your Will be Challenged?

Spouse or children not adequately provided for can challenge your will

You should be aware that even where you provide for the disposition of your property in a properly-drawn will, the Wills Variation Act in British Columbia may enable your wishes to be varied or set aside by a court if it determines that you have not made adequate provision for your spouse and children. **Some** provision is not necessarily **adequate** provision. This possibility may be of concern to you if your assets are not likely to be divided equally among your children. In many situations, the desire to keep the farm intact and to treat all children equitably, not necessarily equally, means that the inheritance of some children is larger than others.

Disputes can be avoided if you discuss your estate plans with your family and obtain their approval. Where one of the children appears to be treated on a more favourable basis, perhaps because of previous contributions to the farm for which he or she has not been paid, it is probably advisable to include your reasoning in your will. Then, if the matter is contested after your death, the court will be able to take this reasoning into account.

If one or more children are to receive more than their siblings, it may be advisable for you to arrange for the transfer of the extra share during your lifetime. In this manner, you might avoid potential problems under the Wills Variation Act. You may gain other benefits as well because, generally speaking, the transfer of farm property during your lifetime is the preferred method of distributing your estate. Obviously, this is a matter you should discuss with your solicitor, and perhaps your accountant, when you are preparing your estate plan.

What Happens if There is No Will?

Court-appointed administrators will distribute your assets according to their rules

If you die without making a will, provincial laws determine who looks after your affairs and who receives your estate. Undoubtedly there will be increased emotional and financial costs to your family.

If you are survived by a spouse and children, it is quite likely the division of your estate will not be what you would have wanted. If your children are under aged 19, their share will be managed by the Public Guardian and Trustee. If your home is sold, a portion of the sales price may have to be paid to your children rather than being retained by your spouse. These and other potential problems make it extremely important for you to ensure that you have an up-to-date will.

Some Questions and Answers

1. **One of my sons should have an opportunity to buy the farm but I am not ready to sell it to him yet. What should I do?**

   Hopefully you will have an opportunity to complete this transaction during your lifetime but to guard against the possibility that you don't, make sure your will instructs your executors to offer the farm to your son. In considering this possibility, keep the following points in mind:

   - your farming child probably shouldn't be one of your executors, or shouldn't be the only one, so as to avoid a potential conflict of interest
   - you should specify the sale price, or state how it is to be determined (such as a percentage of fair market value)
   - it is probable that if your son purchases the farm, he will be treated for income tax purposes as having acquired some or all of your farming property at your "adjusted cost base" (eg. tax cost – see Glossary), or at such higher values as your executors select (see Chapter 7)
   - if the estate is to take back a note for the unpaid purchase price, you should also state the following:
     - the interest rate that is to apply (this could be a fixed rate, or a rate that is adjusted from time to time in relation to your bank's prime rate)
     - the period over which the note is to be paid off

2. I have made gifts to some of my children that I would like taken into account in dividing up the residue of my estate. How do I do that?

You can use what is called a "hotch pot" clause that instructs your executors to take into account previous gifts. These gifts would be specified in the will so that there is no misunderstanding.

As an example, let's assume the residue of your estate is $500,000; there are two children (John and Anne), and John has received a gift during your lifetime of $100,000. By including the hotch pot provision in the will, John would receive $200,000 from the residue and Anne would receive the remaining $300,000. This would be calculated as follows:

Residue	$ 500,000
Add gift subject to hotch pot	100,000
Adjusted residue	600,000
Entitlement of each child	300,000
Less gift already made to John	(100,000)
John's share of the residue	$ 200,000
Anne's share of the residue	$ 300,000

3. If at the time of my death I still own the farm, I would like my executors to sell the property to my son and to arrange the transfer so that my wife continues to be able to live in our home until she dies. How can I do this?

This can be achieved by arranging for your executors to transfer a "life interest" in the home to your wife, if she survives you.

4. One of our children has received a loan from us which we would like to have settled on our death.

You can provide in your will that on the death of the survivor of you, the loan owing by your child is bequeathed to him or her. This would be a "specific bequest" that would have the effect of cancelling the debt. If you want this specific bequest taken into account in the distribution of the residue of your estate, you can do this through the "hotch pot" clause referred to in the answer to question 2 above.

5. **My husband and I own a parcel of land which is not used in our farming business. We plan to bequeath this property to one of our non-farming children. Any problems here?**

   There may be. As discussed in Chapter 7, capital property such as land that is transferred to a child on your death is treated for income tax purposes as having been sold to that child at fair market value (except where the farm "rollover" rules apply). Tax that is created on this deemed sale at fair market value is normally payable out of the residue of your estate.

   Look at your will and see who receives the residue of your estate. If all of your children share in the residue, and there is no provision in your will dealing with the tax liability on this land, it means that the tax associated with this specific bequest will be shared by all your children. If you decide this is inappropriate, you might want to state in your will that the child who is to receive this non-farming property should be responsible for any income tax relating thereto.

6. **My wife and I want to provide in our wills that should we die while our children are minors, our property is to be held in trust until they become adults. Moreover, if they should die before becoming adults, their share is to be inherited by their brothers and sisters. Is that a problem?**

   It can be. The potential problem here is that there is a “rollover” for income tax purposes on certain farming property passing to children (see Chapter 7) but, generally, it applies only where the property **vests indefeasibly** (see Glossary) in the children within 36 months of death. If one of your children was say, aged 10 at the date of death of the survivor of you and your wife, and your will stated that this child isn't to inherit anything unless he or she becomes an adult, this child's share of the estate would not vest for approximately eight years. Because this time period exceeds 36 months, there may not be a "rollover" for property passing to that child.

There is no problem in stating in your will that if any of your children are minors, their share of the estate must be held in trust until they become adults. But, if the children are very young, and you want to ensure that there is a "rollover" for income tax purposes, you need to go on to state that if the child dies before becoming an adult, the inheritance falls into the deceased child's estate and does not pass to the brothers and sisters.

3. Significance of Ownership and Business Arrangements

Introduction

The manner in which you hold your property can have a significant impact on your estate plan. Your land, for instance, might be:

- owned outright, or
- co-owned –
  - as a joint tenant, or
  - as a tenant in common

These alternate forms of ownership can affect your ability to deal with your land through your will.

Your business might be carried on by a proprietorship, partnership or company. These different arrangements can have a substantial impact on the manner in which you operate your business, the income taxes that you will pay during your lifetime and the form in which your children will receive their inheritance after your death. Before changing any of these business arrangements you should obtain advice from your accountant and solicitor in order to avoid potential tax and legal problems.

Property Ownership

Joint Tenancy and Tenancy in Common

Joint tenants hold undivided interests

A joint tenancy is an arrangement under which two or more persons own a percentage interest in property. The characteristic that distinguishes it from other forms of co-ownership is the **inability** of the joint tenant to dispose of his or her interest in the property through their will unless the joint tenancy is severed before death. On death, the joint tenant's interest **automatically** passes to the other joint tenants.

During the co-owner's lifetime, the joint tenancy arrangement can always be severed and the property can be transferred to strangers, family or to the other joint tenants, in the same manner as other interests in property. It is only on death that the special survivorship characteristic comes into effect.

A husband and wife will often hold property as joint tenants because they intend that their respective interests shall pass to the survivor of them on their deaths. However, business partners will generally not hold their property interests in this manner because they will want to control the distribution of their property after their death.

Tenants in common also hold undivided interests but there are differences

A tenancy in common is also an arrangement under which two or more persons hold an undivided interest in property. As with a joint tenancy, each co-owner has an equal right to **possession** of the property because the property has not been divided in a specific way. Unlike a joint tenancy, however, the **ownership** interest of a co-owner under a tenancy in common need not be equal to that of his co-owners. For instance, a tenant in common could hold a 90% interest in a particular property and his co-owners could hold the remaining 10%.

An individual owning an interest in a property as a tenant in common is able to dispose of that interest just like any other property. When the individual dies, the interest in the property does not pass to the co-owners on the death of the tenant. Instead, it falls into the tenant's estate and is disposed of in accordance with his or her will.

Land owned by a partnership will usually be registered jointly in the names of the partners. In most cases, it will be held in the form of a tenancy in common and not a joint tenancy.

Get some tax advice before changing the registration of your property

If you own a property outright and transfer an interest to another person so that you then hold the property as a co-owner, or if you transfer part or all of your co-ownership interest to another person, you may be treated as having disposed of the property. If so, the property will generally be deemed to have been sold at fair market value unless one of the rollover rules apply (see Chapter 5). There may also be GST consequences; and a liability for property transfer tax, if the property is land.

Keep in mind that even though property held in a joint tenancy passes automatically to the surviving joint tenants on your death, there is still a deemed disposition for income tax purposes, which could result in a tax liability (see Chapter 7).

Joint tenancy arrangements can be an expensive way of avoiding probate fees

Transferring property into a joint tenancy arrangement with a child is sometimes recommended as a way of avoiding probate fees. This can be an expensive solution, however. Not only do you have a potential income tax liability (see above), but there can be other problems as well:

- the property will become subject to your child's creditors
- if your child is married and later becomes divorced, the property may have to be split between you, your child and his or her spouse
- if the property is your principal residence, one half of the principal residence exemption for years after the transfer will be lost if you continue to live in the property
- your child's consent will be required if you want to mortgage or sell the property
- the B.C. Property Transfer Tax may apply if the property is land which does not qualify as farm land. GST may be an issue as well.

Legal and Beneficial Interests

The legal and beneficial owners can be different

In some circumstances, the legal owner of a property will not also be the beneficial owner. The legal owner is the person in whose name the property is registered whereas the beneficial owner is the person who is entitled to the income arising from the property as well as the proceeds from its ultimate sale. In a partnership situation, for instance, the individual partners will likely be the legal owners of the land but the beneficial owner (for income tax purposes, at least) will usually be the partnership itself.

Keep in mind that income tax must be considered whenever there is a change in the **beneficial** owner. Where the property is land, the B.C. property transfer tax must be considered whenever there is a change in the **legal** owner.

Business Arrangements

Sole Proprietorships

If you are a sole proprietor you will usually own all of your farming assets directly, or jointly with your spouse, and will be able to transfer them during your lifetime or through your will. In some situations, the farm is co-owned in a joint tenancy arrangement and will pass automatically to your spouse on your death.

Generally, all of a proprietor's assets will be at risk if a liability is incurred in the course of carrying on the farming business. This should be contrasted with the limited liability that can be obtained through a company.

A simple and flexible arrangement

The transfer of a sole proprietorship to the next generation can be time-consuming and cumbersome because each asset will have to be identified and dealt with. However, for many farmers, the simplicity and flexibility the sole proprietorship offers during their lifetime more than compensates for this problem. Moreover, direct ownership of the farm is more in keeping with their emotional attachment to the land.

A sole proprietorship allows you to operate your business in a reasonably tax-effective manner. This is important, because the minimization of tax is an integral part of any estate plan. Admittedly, as a sole proprietor in British Columbia, you are subject to tax on your farm profits at marginal rates which vary from nil to approximately 50%; however, there are a number of offsetting advantages. If you have a capital gain when you sell your farm, you may be able to claim the capital gains deduction. You can claim the principal residence exemption on the sale of your home and you may be able to offset your farming losses against your off-farm income. You can also offset business or property losses against farming income.

The sole proprietorship gives you considerable flexibility in transferring your farming assets to your children in a tax-effective manner. There are also extensive "rollovers" for farm property transferred to your spouse or to a trust for your spouse, and for property transferred from that trust to your children. These are discussed in Chapters 5 and 7.

Partnerships

If you are a partner in a farming partnership, you are in a different position than a sole proprietor. Even though certain assets used in the business, such as land, may be registered jointly in the name of you and your partners, and it will be necessary to remove your name when you die or dispose of your interest in the partnership, the Income Tax Act may not consider you to be the owner of these individual assets. Rather, depending on the circumstances, the partnership itself may be considered to own them. What you are looked upon as owning is an interest in the partnership itself which, in some respects, is not unlike shares that you might own in a company. When you die, you are treated as having disposed of this partnership interest but not your interest in the individual assets.

A partnership is considered to be a separate entity for income tax purposes…but the partners still pay the tax.

So, for income tax purposes, at least, the partnership is treated as being an entity that is separate from you as a partner. The partnership itself doesn't pay any income taxes because all of its income is allocated to its partners.

If you enter into a partnership you should remember that you become jointly and severally liable for all of the partnership's debts. Accordingly, you should choose your business partners carefully.

Again, there is generally no limitation on your exposure to liabilities that are incurred in carrying on your business. This limitation may exist if you carry on business through a company.

In terms of your ongoing exposure to income tax, the partner in a farm partnership is in much the same position as the sole proprietor.

Be careful about putting assets into or taking assets out of partnerships

Because a partnership is treated for tax purposes as being an entity that is separate from its partners, care must be taken in transferring assets to a partnership or receiving assets from it. Generally, these transfers are deemed to take place at fair market value unless special elections are filed with Canada Customs and Revenue Agency (formerly Revenue Canada) within a prescribed time limit.

If you are a partner in a farming partnership, you have considerable flexibility in transferring your interest to your children and your spouse in a tax-effective manner. This is discussed in Chapters 5 and 7. You have an even greater ability than the sole proprietor to take advantage of the capital gains deduction. This is discussed in Chapter 9.

Joint Ventures

Occasionally farmers will participate in a business with other individuals or companies and will describe the arrangement as being a joint venture rather than a partnership because there is a sharing of particular revenues and expenses rather than the final net profit or loss. In some situations this can be advantageous in that certain restrictive income tax rules applying only to partnerships are avoided.

The question of whether a joint venture is a form of partnership has not been answered with certainty although, generally speaking, if taxpayers say they are carrying on business as a joint venture and not as a partnership, Canada Customs and Revenue Agency will not usually challenge their tax returns. Because there is this uncertainty with joint ventures, and arrangements between persons who carry on a farming business together are normally based on a sharing of net profits, joint ventures are not used very often in B.C.

You could participate in a joint venture as an individual or through a limited company. If you were to participate directly, and wanted to transfer your interest to your spouse or children, you would be considered as having transferred your interest in the joint venture's individual assets.

Companies

Companies (or corporations, as they are sometimes referred to) are treated under corporate and income tax law as being entities which are separate and distinct from their shareholders. If you transfer your shares in a company to your spouse or child, you need only amend the company's share records. Therefore, the transfer is extremely easy. The company can provide continuity for the farming operation. The company might be passed from one generation to the next but the operation of the farm will continue unaffected.

A company can limit your exposure to liabilities that arise in the course of carrying on the farming business. Depending on the circumstances, a creditor may only have access to the assets inside the company and not to assets that you own personally.

A company is a separate entity for income tax and other purposes

If you incorporate your farm you will have to pay more attention to the proper segregation of your personal and business funds. Because the company is a separate entity for tax purposes and there are rules in the Income Tax Act that restrict it from making loans or advances to its shareholders, there will have to be a careful accounting of your draws and personal expenses, and these amounts will have to be repaid or covered off by the payment of a salary or dividend.

Effective January 1, 2001, most farm companies in B.C. will be taxed at approximately 18% on the first $200,000 of taxable farm income each year. This rate can be much lower than the rate applying to an unincorporated farm. Of course, there is a second level of tax when the company distributes its after-tax profits to its shareholders, but this tax isn't paid until a distribution is actually made.

The company itself cannot claim the capital gains deduction

You need to remember that a company is not able to claim the capital gains deduction with respect to the gains arising from the sale of its assets. However, you, as shareholder, are sometimes able to take advantage of the deduction by selling shares of your company. A sale of shares is relatively easy to arrange if the farm is being transferred to your child but is sometimes more difficult if you are selling to a third party.

As a shareholder of a farm company, you have considerable flexibility in distributing your share interest to your children or spouse on a tax-deferred basis. This is discussed in Chapters 5 and 7.

Trusts

Farmers do not often use a trust arrangement because they prefer to keep their affairs uncomplicated and pass **absolute** ownership of their farm to their spouse or children. There will be situations, however, where a farmer decides to transfer the farm to his or her children (either during his or her lifetime or upon death), but wants to

Consider a spouse trust to protect the interests of your children

ensure that the income from the farm is paid to the spouse during the remainder of his or her life. This can be achieved by establishing a spouse trust. The effect of the trust will be that the children will not acquire ownership of the farm until after the death of the surviving spouse. At the same time, the spouse will not be able to dispose of the farm in his or her lifetime or in his or her will, and the children cannot be cut out of the farmer's estate if the spouse should remarry after the farmer's death.

You may want to consider the use of a trust in the event that you should die unexpectedly and property should pass from your estate to a beneficiary who is not yet an adult.

Property passing to a trust becomes the property of the trustee(s). The terms of the trust agreement will determine the manner in which the trustees are able to deal with it. The person you might appoint as a trustee will depend on your personal circumstances. Quite often individuals will appoint one or two of their children and, perhaps, the surviving spouse as well.

Certain types of trusts are deemed to dispose of their capital assets every twenty-one years. This rule does not apply to a qualifying spouse trust (see Glossary).

Trusts have to file tax returns

A trust created through a will (called a testamentary trust) will generally pay tax on its income at the marginal rates applying to individuals. A trust created by an individual during his or her lifetime (called an inter-vivos trust) will generally pay tax at a flat rate of approximately 50%.

Trusts are sometimes used as substitutes for wills

Traditionally, individuals use a will to distribute assets which they own at death. If they do this, they have to accept that the Province of B.C. will levy a probate fee (currently 1.4% for estates in excess of $50,000), and there is the possibility that a spouse or child could apply to the Court to have the will varied under the Wills Variation Act (see Chapter 2).

As a result of these problems, some individuals have transferred assets to a trust during their lifetime (an inter-vivos trust) so that on their death the property passes directly to the persons named in the trust document and does not fall into the individuals' estates. The problem with this type of planning has always been that, for income tax purposes, a transfer of property to a non-spousal trust usually results in a deemed sale of that property at fair market value. This can result in a significant tax liability.

As a result of proposed changes to the Income Tax Act, this type of planning will be easier to carry out for individuals aged 65 or over. It will be possible, for example, to transfer property to a trust for the benefit of your children, while retaining the income from the property during the lifetime of you and your spouse, without incurring a tax at the time the arrangement is set up.

While these new trust arrangements (sometimes referred to as alter-ego and joint partner trusts) will be useful in some circumstances, it appears from the draft legislation they may not incorporate the special "rollover" that is available for income tax purposes when farming assets are transferred to a spouse trust and then to the children (see Chapter 7 – Bequests to Children Through Spouse Trusts). Because of this, these new arrangements may not be appropriate for most farm families.

Some Questions and Answers

1. **Some of my assets are owned jointly with my wife. Do we have a partnership?**

   Not necessarily. In order for there to be a partnership between you and your wife there has to be more than the co-ownership of property. There has to be an intention to create a business relationship. You and your wife do not have to be involved to the same degree, but her contribution should stem from her desire to carry on business with you rather than from your marital relationship. The best evidence of a husband/wife partnership is a partnership agreement.

2. **My wife and I file our income tax returns on the basis we carry on business as a partnership but not all of our assets are owned jointly. Do we have a problem?**

   This will depend on the circumstances; however, it certainly is a matter that you should discuss with your accountant. It is important to determine whether a partnership exists, whether your assets are owned by the partnership, or by both of you as partners or by only one of you. It can have a significant impact on the income tax that might be payable when you sell them.

3. **Will a company help me transfer our farm to our child?**

   That depends on a number of factors including the value of your farm, the amount of your accrued gain and the number of children. Companies can be useful where:

   - the accrued gain on your farm is considerably in excess of your available capital gains deduction (see Chapter 9); or
   - your farm is very profitable; or
   - you have several non-farming children

   The use of companies is discussed in Chapter 11.

4. **When my wife and I die, there will be an unequal division of our estate. How can we minimize the possibility of one of our children challenging our will?**

   Clearly this is a matter you should discuss with your lawyer. One possibility you may want to discuss with that person is to hold some of the property in a joint tenancy arrangement with the intended beneficiary. When you die, this property would pass directly to the surviving joint tenant, without passing through your estate and, therefore, the transfer could not be challenged by any other beneficiary. You would need to receive advice on the tax or other implications of arranging for your beneficiary to acquire a joint tenancy interest in your assets.

5. **My wife and I would like to bring our son into our partnership but we want to do this so that, for the time being, he doesn't share in any of the existing value. In other words, we want him to share only in the future profits and future increases in value. Can we do this?**

Yes you can, by making sure that your partnership agreement sets out clearly each partner's entitlement.

Remember that when you bring a child into a partnership, particularly one where the rights of the partners are not equal, you will almost certainly have to change to a "double-entry" bookkeeping system. Under a "double entry" system you will keep track not only of your income and expenses but also your assets, liabilities and partner equity accounts. This system will enable you to determine at any point in time the equity that your child has accumulated in the farm, compared to your own. This may not involve much additional work on your part but it will increase your accounting costs.

4. Selling the Farm to a Person Other Than a Spouse or Child

Introduction

At some point, the farm will change hands – these will be key elements of your overall plan

The sale of your farm during your lifetime will be one of the key issues in your estate plan. If your circumstances are such that you must sell to a person other than a spouse or child, your main objectives will be to:

- maximize the sale price
- pay the least amount of tax

Get expert advice before the sale

There are many issues to take into account in an arm's length sale that cannot be dealt with in a publication of this nature. The critical issue is to ensure that you obtain advice before you enter into the transaction. Depending on your circumstances, this advice should, perhaps, be obtained one or two years before the transaction occurs. Certainly, it should be obtained before you sign any agreements.

The existence of the capital gains deduction will be a significant benefit in most arm's length sales. This important tax concession is discussed in Chapter 9.

What are the Income Tax Rules?

Capital Property

Two-thirds of gains on capital property are subject to tax

The tax arising on the sale of farm property will depend on the nature of the asset. If the property is a capital asset such as land, buildings, equipment, shares in a farm company or an interest in a farm partnership, there will be a capital gain to the extent that the sale proceeds exceed the total of the "adjusted cost base" of the property (see Glossary) and the costs of disposition. A portion of this gain (called the taxable capital gain) is included in your income. For sales prior to February 28, 2000, the taxable portion was three-quarters. For sales in the period February 28, 2000 to October 17, 2000, the taxable percentage is to be reduced to 66 $^{2}/_{3}$% and for sales subsequent to October 17, 2000 it is to be reduced to 50%. There are additional rules applying to the 2000 taxation year if a taxpayer has gains or losses in 2000 that have different taxable portions.

A portion of your quota gains will also be treated as a taxable capital gain (see below). This taxable gain, together with the taxable portion of gains from the other properties referred to above, are usually eligible for the lifetime capital gains deduction (see Chapter 9).

Buildings, Machinery and Equipment

As discussed under the heading "Capital Property" (see above), the buildings, machinery and equipment that you use in your business are called capital properties. Generally, if you sell these assets for an amount that exceeds their adjusted cost base (eg. tax cost – see Glossary), the excess is treated as a capital gain.

This type of asset is also referred to as depreciable property because it can be depreciated or written off for income tax purposes. This tax depreciation is referred to as capital cost allowance.

The depreciable properties that you acquired after 1971 are depreciated on a reducing balance basis. The rate that is used depends on the tax class that applies to the particular asset.

The depreciable properties acquired before 1972 are generally depreciated on the straight line basis.

Some of your previous claims for capital cost allowances can be recaptured

If you sell buildings, machinery or equipment depreciated on the **reducing balance basis**, the depreciation claimed in previous years can be included in your income in the year of sale (i.e. “recaptured”) if the sale proceeds exceeds your undepreciated capital cost (eg. depreciated value – see Glossary). If the asset was acquired before 1972 and depreciated for income tax purposes on the **straight-line basis** there is no recapture of prior years' depreciation.

Where the sale proceeds of property depreciated on the reducing balance basis in a particular tax class are less than the undepreciated capital cost of the property, and you have no other property of that class, the excess will sometimes be deductible from your income as a "terminal loss".

Quota

Quota gains can be eligible for the lifetime capital gains deduction

As mentioned above, a portion of the gain on the sale of your quota is treated as a taxable capital gain that is usually eligible for the capital gains deduction. Unfortunately, the quota rules are complicated, particularly since the government proposed in its 2000 federal budget that the capital gains inclusion rate be reduced from three-quarters to two-thirds, and in the October 18, 2000 mini-budget it proposed a further reduction from two-thirds to one-half. If you are proposing to sell quota you should obtain advice from your accountant beforehand as to the tax consequences. In general terms, the result will be as follows:

a) you will have to include as ordinary income an amount equal to your previous quota write-offs. This will not be eligible for the capital gains deduction;

b) there will be a capital gain (three-quarters, two-thirds or one-half of which will be taxed) to the extent your proceeds exceed the total of the cost of quota acquired subsequent to 1971 and the value of quota owned at the end of 1971. The taxable portion of this gain will usually be eligible for the capital gains deduction.

Livestock and Other Inventories

If the property is livestock or feed and you use the accrual basis of accounting for tax purposes, the sale proceeds will be included in your income in the year of sale whether or

The taxation of livestock proceeds depends on whether you follow the accrual or cash basis of accounting

not you receive the full sale proceeds in that year. If you use the cash basis of accounting for tax purposes, you have to report as income in the year of sale only the actual proceeds you receive during the year, even though the entire inventory may be sold. Proceeds not reported in the year of sale are reported in the year they are actually received.

What Happens if You Are Not "Cashed Out"?

You can reduce your gain if you are not "cashed out"

If you sell your farm but are not "cashed" out at the time of sale, you may claim a reserve in respect of the unpaid sale price in computing the capital gain on assets such as land, buildings, shares of farm companies, and partnership interests, but not quota. The effect of this reserve will be to spread your gain over two or more years and, perhaps, reduce your overall tax liability. Unfortunately, the reserve cannot be claimed for a period of greater than five years (ten years, in some circumstances, if the transferred property is sold to a child).

Planning the Sale

You may want to consider selling your farm before the year in which you reach the age of 65 so as to avoid (or reduce to the extent possible) the clawback of your Old Age Security payments (OAS - see Chapter 10). You shouldn't focus on this item alone, however. You need to remember that if you accelerate the reporting of your farm gains so as to avoid a recapture of your OAS you may become subject to the alternative minimum tax (see Chapter 9).

The most important point to remember is to seek professional advice well in advance of the proposed sale date.

Purchase of a Replacement Farm

Upon retirement, you may want to sell the family farm and buy a scaled-down operation to keep you busy during your retirement years.

You may be able to reduce your tax if you buy a replacement farm

Depending on your circumstances, it may be possible to defer some of the tax arising on the sale of the original farm by taking advantage of the replacement property rules in the Income Tax Act.

What Security Do You Receive?

Mortgage or agreement for sale

If you sell your farm and take back debt on the transaction, you can structure the arrangement as an agreement for sale or secure the amount owing to you by having the purchaser grant a mortgage. If the contract is structured as an agreement for sale, title to the property remains with you until the debt is repaid. If a mortgage is used, title passes to the purchaser and you take back the mortgage as evidence of the debt. If there is a default under the agreement for sale or mortgage, you have the right to commence court action for the cancellation of the agreement for sale or for foreclosure under the mortgage.

Some Questions and Answers

1. **I am a sole proprietor and I am thinking about selling my farm to my neighbour. What factors can affect the income tax I will pay?**

   The income tax issues that you need to consider are too detailed for a publication of this nature but they will include the following:

   - allocating the sale price between your assets so that you:

     (a) maximize your principal residence exemption;

     (b) reduce your recaptured depreciation; and

     (c) maximize the capital gains deduction you and your spouse can claim (see Chapter 9).

- allocating the cash that you receive between the assets that are sold so that you maximize your ability to defer income tax
- choosing an appropriate sale date to defer the maximum amount of tax
- considering what other steps can be taken to spread the income from the sale over two or more years so as to reduce income tax
- considering the payment of retiring allowances to your spouse and other members of the family who have been employed on the farm
- considering the merits of acquiring a replacement farm

2. My farm is carried on by a company. What issues do I need to consider before selling to my neighbour?

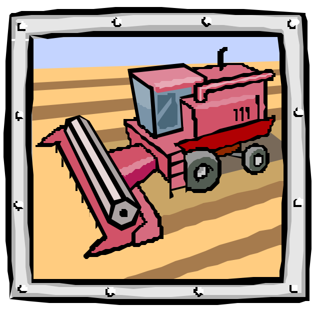
Again, a detailed review of this matter is beyond the scope of this publication, but the issues that should be considered would include the following:

- assessing the merits of selling shares rather than assets
- determining a range of values at which your shares might be sold so that on an after-tax basis, you would be in an equal or better position than selling assets
- considering the availability of the capital gains deduction on a share sale and how your claim might be maximized (see Chapter 9)
- if there is, or should be, a share sale, considering how to remove assets that you want to retain

- considering the payment of a retiring allowance to members of the family who have been employed in the business

5. Transferring the Farm to Your Child During Your Lifetime

Introduction



At some point in your lifetime, you will want to give up being a full-time farmer. When that time arrives, you will need to have created a pool of retirement capital that will enable you to live comfortably for the rest of your life and provide an inheritance for your children. You are not going to be able to do this unless you sell some or all of your farm property.

If you sell your farm to an unrelated person, the issues you need to think about are summarized in Chapter 4. If, however, you sell to a child, the issues are usually quite different. Here, you don't necessarily want to receive the "full price", although you do want to receive a "fair one". You have to think about your child's ability to pay the price you are looking for and, most important, you have to be satisfied that the overall arrangement enables you to deal fairly with all of your children.

Fortunately, there are some special rules in the Income Tax Act that enable you to transfer most of your farm property to a child at less than fair market value. If these special rules didn't exist, you would be taxed as though you received fair market value for any assets you transfer to a child. If this happened, the costs of transferring a farm to the next generation would increase dramatically.

If you are going to transfer your farm to your child, there are a great many issues to think about. Review the commentary in this Chapter (and, perhaps, Chapter 8 dealing with non-farming children) and then review the examples discussed in Appendix 1.

How Do You Decide What Form the Transfer Will Take?

As mentioned in Chapter 1, there are some basic issues that have to be decided early in the process. These include the following:

- Is there only one child who is interested in the farm?
- If there is more than one child, will the farm support the extra families?
- Do you want to transfer only a portion of the farm at this time?
- Do you want an interim arrangement such as forming a partnership with your child?
- Will you need to move off the farm?
- What are your financial needs in terms of up-front capital payments, and payments to meet your ongoing living needs?

These issues can be difficult enough. But if you combine them with the tax issues, and the troublesome question of how to be fair to all of your children, the process often seems overwhelming.

Because of this, it is important to take the process one step at a time and not to become too involved in the details early in the planning. As recommended in Chapter 1, make use of the Estate Planning Checklist. It sets out eight steps in the family farm transfer process and discusses the first four in some detail.

Grooming Your Successor(s)

In transferring the farm to your children, you need to do more than address the “mechanics” of the transfer. You also need to take the time to prepare your child to take over the business. If you don’t do this, its quite possible your farm will be poorly managed. This will obviously impact the financial well-being of your successor(s) but it can affect you as well because it is very likely, to some extent at least, that your financial security will be dependent on the success of the farm.

There is a discussion of this subject in a publication issued by the Canadian Farm Business Management Council entitled "Managing the Multi-Generational Family Farm". Essentially, the authors talk about the value of the following strategy:

- providing for off-farm education and on-farm mentoring
- developing a step by step process that will enable your successor(s) to learn and, ultimately, manage all aspects of the business. This includes providing opportunities to manage labour, solve personnel problems, understand financial information and make purchasing decisions

What Are Some of the Key Issues in the Transfer Arrangements?

If there will be bank financing, the arrangement has to be "bankable"

If there will be bank financing (which is sometimes the case so that you can receive a down payment), the overall arrangement has to be bankable.

A "bankable" arrangement is one which your child can take to his or her bank and get the financing that is necessary. The arrangement with you has to be such that (a) the bank will have adequate security, and (b) your child will be able to make payments to the bank and still have enough money left over to meet personal needs and look after the continuing improvements to the farm.

What is "bankable" depends to some extent on the assets you are selling. If, initially, you decide to sell only your operating assets, the bank will not be able to secure their loan with a mortgage. This may mean the bank's lending limit will be lower (which means you will receive a lower down payment) and your child will have to pay off the loan at a faster rate. Of course, if you retained ownership of the land, you could guarantee your child's bank debt and provide the bank with a collateral mortgage as security for your guarantee. This should allow your child to obtain the financing on more favourable terms but, because your farm would then be at risk, you would want to consider this carefully.

Make sure the down-payment is sufficient

The down payment that you receive will have to be sufficient to enable you to make the transition to retirement. This transition may include moving from the main farm and building a new home. Make sure that you have the capital to do this sort of thing.

Where you are not cashed out (which is usually the case), you will usually take back an agreement for sale or a mortgage that will set out the repayment terms and the interest that will apply. You will have to take into account the ability of the farm to generate the payments that are provided for in the agreement. If your child will have difficulty in making the debt repayments, you may decide to accept a low interest rate or may even agree to charge no interest in the first few years of the agreement. Quite often, there will be an acceleration clause that will require the agreement for sale or mortgage to be repaid if your child sells the property. **This is particularly important if there is a low interest rate, or the outstanding balance is not secured very well.**

Pay-out should be accelerated if your child sells the farm

If you sell only the operating assets, or the arrangement is substantially funded by your child's banker, it is unlikely you will be able to structure the deal as an agreement for sale or obtain a mortgage. Any debt owed to you will likely be evidenced by a promissory note. However, even in these circumstances, you can obtain security by arranging for a General Security Agreement to be prepared and for notification of this security interest to be registered in the provincial registry. You should ask your lawyer to advise you on these matters.

If you sell property to a child at less than fair market value, you are likely to do so on the understanding that he or she will farm the property for a reasonable period of time. If there is any concern this might not happen, you may want to discuss with your lawyer the provisions that might be included in your overall plan to deal with the matter.

Will there be a problem with your in-laws?

One of the concerns that always arises in a sale to a child is "What happens if his or her marriage fails?" Will your son- or daughter-in-law end up taking a substantial portion of your farm – perhaps even more than your own non-farming children? There is no ready answer to this concern. Perhaps you should defer the sale of your farm until you have had an opportunity to see how your child's marriage will work. If you are going to sell the farm in stages (operating assets first, real property later), perhaps you should make the initial sale at a high value so that your child's equity is relatively small. You have to recognize, however, that this may result in a significant tax liability.

If you sell to your farming child at substantially less than fair market value, it might be possible for you to include wording in the legal documents making it clear that this is a gift you want to confer on him or her alone. This may influence a court in deciding how the property should be split between your child and his or her spouse if their marriage should fail. However, since this is not likely to improve your relationship with your son- or daughter-in-law you may be very reluctant to consider this possibility.

Will the arrangement allow you to deal fairly with your other children?

This is another of the key concerns when a farm is transferred to the next generation. If you have non-farming children, their inheritance may not be equal to that of your farming child but, hopefully, the overall arrangement will be equitable. The steps you can take to achieve an equitable arrangement are described in Chapter 8.

Special Income Tax Rules Applying to a Sale to a Child (the "Rollover Rules")

The accrued income tax liability can be huge

Every farm in Canada has an accrued income tax liability. This liability represents the tax that will be paid at some point in the future on the difference between the cost of the assets for income tax purposes and their fair market value. For farms that have been transferred within a family for two or more generations, this liability can be huge. In most situations, this accrued income tax liability has to be dealt with when the business is sold. This is particularly true where the sale is to a stranger.

The fair market value rule that applies to most taxpayers

To make sure the government collects all the tax on the accrued gains, there is a rule in the Income Tax Act that, in most cases, deems a parent to receive fair market value whenever property is sold to a related person such as a child. This means that if a parent were to sell a property to a child at less than fair market value, he or she would generally be treated as having received fair market value and would be taxed accordingly.

Fortunately, as a farmer, this fair market value rule doesn't apply to the majority of your assets. As discussed below, you have the ability to sell certain of your assets to a child at less than fair market value, and only be taxed based on what you receive.

The "rollover rules" that apply to certain farm property

The rules that deal with this special tax concession are often referred to as the "rollover rules". The reason they have been given this name is that they provide you the opportunity of "rolling over" an asset to your child without paying tax on all of the accrued gain.

You can arrange for a "complete rollover" to a child by selling the property at your cost or by gifting it (see Chapter 6 for a commentary on gifts). In this situation, all of your accrued income tax liability would be deferred to the next generation.

As an alternative, you can arrange for a “partial rollover” of your property to a child by selling it at a value between your cost and fair market value. In this situation, only a portion of your accrued income tax liability would be deferred to the next generation.

Very often it makes sense for you to sell certain property to a child at a value between cost and fair market value so that you can use your capital gains deduction (see Chapter 9 for details). Let’s assume, for example, that you own land that has an adjusted cost base (eg. cost for tax purposes – see Glossary) of $200,000 and a current fair market value of $500,000. Let’s assume also that you have already used $400,000 of your capital gains deduction and have only $100,000 available to you for this transaction.

If the “rollover rules” weren’t available, then irrespective of whether you gifted the land to your child, or sold at less than fair market value, you would be treated as having received $500,000. On that basis, you would realize a capital gain of $300,000 and could only shelter $100,000 with your capital gains deduction.

If, however, the land was eligible for the “rollover rules”, you could sell it for $300,000 and only realize a capital gain of $100,000 which would be fully offset by the capital gains deduction. If you took this approach, the remaining $200,000 capital gain would be deferred to the next generation.

Clearly, the fact that you have the ability to use your capital gains deduction when you sell your farm to your child doesn’t mean that the “rollover rules” are no longer important. The reasons for this are as follows:

1. The “rollover rules” enable you to avoid recaptured depreciation on buildings and equipment by allowing you to transfer this type of property at its undepreciated capital cost (see Glossary). You should remember that the capital gains deduction does not apply to recaptured depreciation.

2. The "rollover rules" enable you to avoid the recapture of write-offs previously claimed on your quota expenditures.

3. As discussed above, the capital gains deduction available to you may not be sufficient to fully offset the taxable portion of the accrued capital gains on your assets.

In looking at the "rollover rules" you should keep in mind the following:

Not all farm assets are eligible for the rollover

- Only certain properties are eligible for "rollover" to a child (see below). The qualifying properties do not include livestock.

- The child must be resident in Canada immediately before the transfer.

- The term "child" includes a grandchild, great-grandchild, daughter-in-law, son-in-law and certain other persons.

The properties which are eligible for the "rollover" are as follows:

- Land[1]

- Buildings, equipment etc. depreciated on the reducing balance basis[1]

- Eligible capital properties (e.g. quota)[1]

- Shares in a family farm corporation (See Glossary for definition)[2]

- Interest in a family farm partnership (See Glossary for definition)[2]

Notes

1. The property must be owned by you directly and, before the transfer, it must have been used principally

The rules are complicated and must be examined closely

in the business of farming in which you, your spouse or any of your children were actively engaged on a regular and continuous basis. For this purpose, property that is leased to a family farm corporation or a family farm partnership (see Glossary) is treated as having been used in farming.

2. Shares in a family farm corporation (as defined) and interests in a family farm partnership (as defined) are eligible for rollover to a child. Note, however, that terms similar to “family farm partnership” and “family farm corporation” are also used in connection with the capital gains deduction rules (see Chapter 9), but the definitions are different. Conceivably, this could mean that shares of a farm company will be eligible for the capital gains deduction but not the rollover. The same could be true for an interest in a family farm partnership. This makes it important for your accountant to continually monitor the status of your business.

The status of your land depends on how it has been used in the past

Note that in determining whether land, buildings or equipment are eligible for "rollover", you don’t look to the use of the property immediately before its sale. What you need to do is to determine whether during the time you have owned the property, it has been used principally (eg. mainly) in the business of farming in which members of the family (see above) were actively engaged on a regular and continuous basis.

As an example, let's assume you have owned a parcel of land for 15 years. You farmed the property for only five years and have rented it to a person outside the family for ten years. In this situation, the property may not be eligible for the "rollover", but, as mentioned in Chapter 9, it may be eligible for the capital gains deduction.

Rollover and your principal residence

Canada Customs and Revenue Agency takes the view that the rollover rules do not apply to your principal residence located on the farm. However, the gain on the sale of the residence will often be exempt from tax under the general principal residence rules or will be taxed at a nominal amount because of the special rules applying to farmers' residences.

Certain assets cannot be sold at less than fair market

As mentioned previously, the "rollover rules" do not apply to livestock. They also do not apply to your feed inventories, supplies and depreciable property written off on the straight-line method.

Forgiving Debt After the Sale

If you sell property to your child and decide at a later time to forgive a portion of the debt arising on the transaction, you need to obtain some advice on the application of the forgiveness of the debt rules in the Income Tax Act. These rules can result in your child having to include a portion of the forgiveness in his or her income.

Always get advice if you are thinking about forgiving debts owed to you by your children

Consider "forgiving" debts through your will

There will not be a problem if you, in effect, "forgive" a debt by bequeathing it to the child in your will. In that situation, the forgiveness of debt rules do not apply.

Keep the Tax Rules in Perspective

Don't let your desire to avoid tax cause you to do something you might regret later.

While the "rollover rules" described in this chapter can be very useful there are situations where they can cause a lot of grief. **Consider, for instance, the situation where you sell your farm to your son or daughter at considerably less than fair market value and your child's marriage goes on the rocks.** In effect, you would have made a gift to your son or daughter which may end up in the hands of your son-in-law or daughter-in-law. **Consider also what would happen if your child runs into financial difficulties** - there is a possibility that some or all of your gift would end up in the hands of one of your child's creditors. **Finally, consider what would happen if your child were to decide to give up farming shortly after you transfer the farm**. You would likely want your gift back again - but could you get it?

Unfortunately, you may not be able to fully protect yourself from **all** of these potential problems. You should, however, be aware these problems may arise and you should judge not only the **timing** of the transfer but also the **conditions** on which it is made.

Some Questions and Answers

1. **I own land and buildings which are now being farmed by my son. The land cost me $100,000 and now has a value of $250,000. The buildings have been depreciated to $30,000 and now have a fair market value of $150,000. I want to sell the property to my son without paying tax. What are my options?**

   - Assuming your land qualifies for the $500,000 capital gains deduction (see Chapter 9), you can sell it to your son at its fair market value of $250,000. The capital gain of $150,000 can be offset by claiming the capital gains deduction. You would need to check whether (a) the alternative minimum tax might apply (see Chapter 9); (b) whether there would be any recapture of your social benefits (eg. Old Age Security); and (c) whether you can use the deduction without having to pay tax - see Chapter 9.

   - Assuming your farm buildings qualify for the special "rollover rules" applying to children, you could sell them to your son at their depreciated value of $30,000. If you sell them for a value that is higher than $30,000 some or all of the depreciation you claimed in previous years would be "recaptured". This recaptured depreciation would be included in your income and would not be eligible for the capital gains deduction.

   - In total therefore, depending on the circumstances, you could receive $280,000 for the land and buildings without being subject to tax.

- If you sold your property for $280,000 so as to avoid tax on recaptured depreciation, you would, in effect, be making a considerable gift to your son because you would be transferring property to him that has a value of $400,000. The value of the gift wouldn't be as high as $120,000 because your son would be inheriting the depreciated value of your buildings (only $30,000). Nevertheless, there would be a gift and you would need to decide if one should be made at this time.
- You will need advice with respect to GST and the possible application of the B.C. Property Transfer Tax.

2. **Included in the assets I want to transfer to my son is my livestock which has an estimated value of $150,000. What can I do?**

Livestock cannot be "rolled" from a parent to a child. In other words, for tax purposes, it has to be sold at fair market value. However, if you are a cash basis farmer, you can defer tax on the sale by ensuring that the sales price for the livestock is not paid at the time of sale. You would accept a note as evidence of the unpaid sales price and would include amounts in income only as the note is paid off.

If the note is unpaid at the time of your death, you could bequeath it to your child. If that happens, you or your estate will not pay tax on the livestock and your child will not get a deduction for it.

It's important in these arrangements to ensure you do not accept the note in satisfaction of the amount that is owed to you. The note must be issued only to evidence the unpaid sales price.

If you do accept the note in satisfaction of the amount that's owed to you, you will be treated for income tax purposes as having received payment. You will then be subject to tax on your livestock sale even though you wouldn't have put any cash in your pocket.

Another possibility that you might want to discuss with your accountant is the “rollover” of your livestock to a partnership of you and your child.

3. My wife and I carry on business in partnership. Can we use the "rollover rules" to transfer our individual farm assets to our child?

Not immediately. Remember that a partnership is treated as an entity that is separate from the partners, much like a company is separate from its shareholders. You, as individuals, can use the "rollover rules" when you transfer qualifying assets to your children but your partnership can’t.

In this situation you have two options which you should discuss with your accountant. The first is to transfer your partnership interests to your son (in much the same way as you would transfer the shares of a company) and the second is to unwind your partnership and then transfer individual assets.

Again, you will need advice on GST, the B.C. Property Transfer Tax, the income tax election that has to be filed on the unwinding of a partnership, the refundable minimum tax and the potential recapture of social benefits.

4. My wife and I carry on business in partnership and want to transfer all of our assets to our son with the exception of one parcel of land which we would like to retain. Our accountant tells us that all our farm assets are considered to be owned by the partnership and not by us as individuals. What do we do?

One possibility would be to withdraw the land from the partnership and to sell your remaining partnership interests to your son. The withdrawal of the land would be treated as a sale by the partnership to you at fair market value. The capital gain arising from this transaction may be eligible for the capital gains deduction.

Again, you would need advice on GST and the other non-income tax matters referred to above.

5. **I farmed my land and buildings for approximately thirteen years but for the past ten years I have rented them to my neighbour. Does this property qualify for rollover to my son? Does it qualify for the $500,000 capital gains deduction?**

   The answer at this time is probably yes to both questions although you should discuss the situation with your accountant to confirm that conclusion.

   While the property appears to qualify for the “rollover” rules now, it may not qualify in three or more years if you continue to rent it. At some point, its “principal use” (measured over time) will change from farming to rental and the requirements of the “rollover” rules will no longer be met.

6. **My farming business is carried on by a company. Can I transfer my shares in that company to my son on a "rollover" basis?**

   Provided the shares qualify for the "rollover" rules and your son is resident in Canada, the answer is probably yes. A key question will be whether or not at least 90% of the company’s assets consist of assets which have been used **principally** in the business of farming. That business can be carried on by the company itself or by certain members of your family. Note that it is not simply the current use of the company’s assets that has to be examined, but the principal use that has been made of them over all of the years they have been owned by the company (or by certain members of the family).

7. My farming business is carried on by a company, but the land and buildings are owned by me personally. Are the land and buildings eligible for "rollover" to my child?

Your land and buildings will be looked upon as having been farmed by you during the period they are rented to your farming company, so the answer to this question is probably yes. It is important, however, that your farming company qualify as a family farm corporation (see Glossary). If, for any period of time, your company doesn't qualify as a family farm corporation, you will be treated as not having farmed the property during that period.

One situation where this issue needs to be examined carefully is a nursery operation. If land is made available to a company that carries on a nursery business, you will have to look at the operations of the company to see whether its assets are related to the farming activities, or to the purchase of nursery stock for resale. If more than 10% of the fair market value of the company's assets represents property used **primarily** in the purchasing and retail activities, the company may not be a family farm corporation. If that is the case, the growing operation should probably be carried on outside of the nursery company (by the individual shareholders or by a separate company) so that the status of the land is not tainted.

6. Gifts to Your Family During Your Lifetime

Introduction

If you have sufficient retirement capital, you may want to consider gifting some property to your children rather than selling it to them. You may recognize for instance that your farming child will have difficulty "making ends meet" in the first few years and the removal of debt servicing costs on particular assets may make a considerable difference. Alternatively, you may feel your child has earned a "gift" as a result of the contribution he or she has made to the farm in previous years for which there has not been appropriate remuneration.

Gifts – the transfer of property or cash without any payment in return

The type of gift we are discussing here does not include the sale of property at less than fair market value, which is reviewed in Chapter 5. This chapter deals only with the transfer of property or cash to your family without receiving any payment in return.

You can make a gift to a member of your family by forgiving all or a portion of a debt that is owed to you. As discussed in the questions and answers in this Chapter, this can have some bad tax consequences, so you need to receive advice from your accountant before you take this step.

If you have sold a substantial portion of your farm you may want to consider the gifting of liquid assets to your children (e.g. cash) so that the income earned thereon is taxed in their hands and not yours.

You can have your gifts taken into account in your will

If a gift is made to only one of your children, you may want to view it as being a payment on account of the distribution the child will receive on your death. You can deal with this in your will by placing a value on the gift and stating that the other children should receive an equivalent distribution out of your estate before the residue is divided among all your children.

You may want to transfer property to your spouse so that he or she can become further involved in your farming business.

Implications of Making Gifts to Your Spouse or Child

Income attribution rules need to be considered

A gift of cash has no tax implications except that if the gift is made to your spouse, or to a child who is a minor, the "attribution rules" (see Glossary) may have the effect of causing you to be taxed on the income earned on the gift. For income tax purposes, a child is a minor until the year he or she reaches the age of 18. These rules are discussed in Chapter 10.

Property other than cash that is gifted from one person to another is generally considered to be disposed of at fair market value and the person making the gift has to account for the income tax that is payable. There are some important exceptions, however, in respect of properties transferred to a child or a spouse.

Certain farming assets can be gifted to children without tax

Qualifying farm properties (see Glossary) which can be **sold** to your **child** at less than fair market value (see Chapter 5) may also be **gifted** to your **child** without you having to pay tax. Where properties are gifted, they simply transfer on a "rollover" basis and your child inherits your cost for income tax purposes.

All capital properties can be "rolled" to a spouse

All capital assets such as land, buildings, equipment, shares in a family farm corporation and a partnership interest may be gifted on a "rollover" basis to your **spouse** (a spouse, for this purpose, includes a common-law spouse). You can elect to have the rollover rules not apply for any or all these types of properties. Eligible capital properties (e.g. quota) will also transfer on a rollover basis if you cease to carry on the farming business and transfer it to your spouse. This might happen, for instance, if you are injured and unable to continue working.

Property which does **not** transfer on a “rollover” basis between spouses during their lifetimes includes the livestock, inventories and accounts receivable of a cash basis farmer. If a cash basis farmer gifts this type of property to his spouse he or she is deemed to have received proceeds equal to its fair market value and will have to include this amount in income.

If you transfer property to your spouse, attention will have to be given to the effect of the attribution rules (see Chapter 10). In summary, any income of an investment nature that your spouse realizes from the transferred property (including taxable capital gains arising from the sale of the property) will generally be attributed back to you. Business income will generally not be attributed, however.

Some Questions and Answers

1. **If I gift cash to my adult children, are there any income tax or gift tax implications?**

   In short, the answer is no. There are no gift taxes in B.C.

2. **I own a parcel of land which I bought for $250,000 and now has a value of $400,000. I have used it in my farming business, so can I gift it to my son and take advantage of the capital gains deduction?**

   The answer to this question depends on whether the land is eligible for "rollover".

   If we assume the land **is** eligible for the “rollover”, it will simply “roll” to your son at your cost of $250,000 and there will be no capital gain. If you want to trigger a capital gain you would have to sell the property to your son at an amount above $250,000 and up to

$400,000. If your son does not have the funds to pay the selling price, you could take back a promissory note from him. If you don't want any payments, you could alter your will to bequeath your son's promissory note back to him after your death. In this situation, you and your son would want to consider the Wills Variation Act (see Chapter 2).

If we assume the land **is not** eligible for the "rollover" it would be deemed for income tax purposes to have been sold at fair market value. In this situation there would be a capital gain of $150,000 and, depending on your circumstances, you may be able to take advantage of your capital gains deduction.

Don't forget to ask your advisers about the GST and the B.C. Property Transfer Tax.

3. I have sold my farm property to my son and would now like to consider the possibility of forgiving some of the money that he owes me. Is that a good idea?

If you forgive an amount that is owed to you then, depending on the circumstances, the debt forgiveness rules can result in some nasty tax consequences to the person who benefits from the forgiveness. In this case, because the debt is associated with the purchase of a business asset, the debt forgiveness rules **will** apply so as to reduce any tax losses that your son is carrying forward. To the extent the forgiveness exceeds these losses there may be a reduction in the tax values of certain assets that he owns. Conceivably, this forgiveness may even result in income on which he will have to pay tax. Because of this, you might consider bequeathing a portion of the debt to your son in your will. If you "forgive" debts in this manner, there will be no tax consequences to him.

If you decide to alter your will, you should ask your lawyer whether there might be any problem under the Wills Variation Act (see Chapter 2).

4. I own land that I bought in 1975 and farmed for only 10 years. Since 1985, when I retired from farming, the property has been rented to a neighbour. Can I gift this land to my children without any tax consequences?

Because your land has been farmed by you for only ten years and rented for fifteen, Canada Customs and Revenue Agency will likely consider that your land has **not** been used principally (eg. chiefly) in the business of farming during the period you have owned it and, in which case, it will **not** be eligible for "rollover" to your children. If, instead, the property had been farmed for fifteen years and rented for ten, there would not be a problem at this time.

If the property has lost its “rollover” status, and you proceed with the gift, you will be treated as having disposed of the property at fair market value. This may not necessarily result in tax because even though the land does not qualify for the rollover, it may qualify for the $500,000 capital gains deduction.

Remember if there are any buildings on the property which have been depreciated on the reducing balance basis, some or all of this depreciation may be recaptured.

Because the property is not being farmed by you, the B.C. Property Transfer Tax will apply.

Don't forget GST, the alternative minimum tax and the possible recapture of your Old Age Security payments.

7. Transferring the Farm to Your Family Through Your Will

Introduction

Transferring assets through your will is known as bequeathing. Assets transferred in this manner are treated for income tax purposes as having been disposed of immediately before your death. Because of (a) the capital gains deduction (see Chapter 9) and (b) the extensive "rollover" rules applying to properties transferred to spouses and children this “deemed disposition” will not usually result in a substantial tax liability for your estate.

Before dealing with the special rules that can apply to bequests of farm property to members of your family, let’s review the general rules that apply when a person dies. **These rules apply where the deceased person has no spouse or children. They can also apply where there are children but the farm property does not qualify for the special rollover (see Special Rules for Children).**

The General Rules (Where the “Rollover” Doesn’t Apply)

Generally, property passing to a person other than a spouse or a child, and property passing to a child that is not eligible for the “rollover”, is deemed to be disposed of at fair market value

1. If there is no “rollover”, capital property such as land, shares in a company and stocks and bonds, etc. will be deemed to be disposed of at fair market value and the taxable capital gains or allowable capital losses realized on this disposition will have to be included in your final income tax return.

   Depending on your circumstances, your executors will probably be able to claim the capital gains deduction to offset some or all of these taxable gains (see discussion in Chapter 9).

If you are not survived by a spouse, or the property is not eligible for "rollover" to a child, there can be recaptured depreciation

2. If there is no "rollover", depreciable property (eg. buildings and machinery) **written off on the reducing balance basis** is also deemed to be disposed of at fair market value. Taxable capital gains, recaptured depreciation or terminal losses arising on this disposition will be included in your final income tax return.

Special rules may apply to livestock and accounts receivable

3. If you are a cash-basis farmer, your livestock, inventories and accounts receivable (called "rights and things" in the Income Tax Act) are given special treatment. Your executors will have three options.

   a) All or a part of the value of the rights and things can be included in your final income tax return together with your other income; or

   b) Your executors can elect within certain time limits to include the rights or things in a separate tax return for the year of death and a second set of personal exemptions can be claimed; or

   c) If the rights and things are transferred to a beneficiary within certain time limits, the value is included in the beneficiary's income when the rights and things are disposed of.

4. Your eligible capital property (e.g. quota) is deemed to be disposed of on a rollover basis.

These are the general rules; now, let's take a look at the special rules that apply where (a) property is bequeathed to your spouse (or to a trust for your spouse), and (b) qualifying farm property is bequeathed to your children.

Special Rules for Spouses and Trusts for Spouses

Generally, property bequeathed to your spouse or to a qualifying trust for your spouse (called a spouse trust) is deemed to transfer on a "rollover" basis. If your executors

In most cases, there is a "rollover" for property passing to your spouse, or to a trust for his or her benefit

chose not to have these "rollover rules" apply, they can file an election with your final income tax return. The effect of this election will be that your property is deemed to be sold at fair market value. Each property can be treated separately. Some properties can be "rolled over" while others can be elected upon and will be disposed of at fair market value. This gives your executors considerable flexibility in putting your estate and your beneficiaries in the best possible tax position.

Property must vest indefeasibly

To qualify for the "rollover", the property passing to your spouse, must "vest indefeasibly" in him or her not later than thirty-six months after the date of death. A longer period may be allowed by Canada Customs and Revenue Agency if it is reasonable in the circumstances. The term "vested indefeasibly" means that your spouse must obtain a right to absolute ownership which cannot be defeated by a future event.

If you are planning to use a spouse trust, you need expert legal advice

If you want to use a spouse trust and have property transferred to it on a "rollover" basis, the terms of the trust must be such that all income of the trust arising before your spouse's death is received only by the spouse. No person other than your spouse should be able to obtain the use of any income or capital of the trust during his or her lifetime.

This requirement is sometimes not met because of technical problems in the drafting of the will. Remember, that Canada Customs and Revenue Agency may discover these problems because a copy of the will is normally requested to be filed with your final tax return.

Special Rules for Children

Certain farm assets can be "rolled" to your children

"Qualifying farm properties" which can be transferred to your children on a "rollover" basis during your lifetime (see Chapter 5) can also be transferred to them on a "rollover" basis on your death. As mentioned previously, these properties are land, depreciable property written off on a reducing-balance basis, eligible capital properties (e.g.

quota), shares in a family farm corporation and an interest in a family farm partnership. The land and depreciable property must have been used before your death principally in the business of farming in which you, your spouse or any of your children was actively engaged on a regular or continuous basis. Property will be considered to be used in a farming business if it is rented to a family farm corporation or a family farm partnership (see Glossary).

As mentioned previously, the terms "family farm corporation" and "family farm partnership" referred to above are not to be confused with the terms "share of the capital stock of a family farm corporation" and "interest in a family farm partnership". The latter two terms are used only in connection with the capital gains deduction rules. Conceivably, a company could be treated as a family farm corporation for purposes of the capital gains deduction rules but not for purposes of the "rollover" rules. The same type of problem could also apply to a partnership. Your accountant should be asked to monitor the status of your partnership or company for income tax purposes, and to make recommendations if your business no longer qualifies for either the "rollover" or the capital gains deduction.

Your executor can elect to have certain assets transferred to your child at an amount that is higher than the "rollover" value

Your executors can choose to have your "qualifying farm properties" disposed of to your children at any amount between their cost amount (see Glossary) and their fair market value. This decision can be made on a property by property basis. One or more properties can be "rolled" to a child; others can be transferred at a higher value. In this respect, your executors have almost the same flexibility as you would if you disposed of these assets during your lifetime.

It is important to note that the assets for which your executors can choose the transfer values include all the "qualifying farm properties" listed in Chapter 5 except eligible capital property (eg. quota). This latter asset always transfers on a "rollover basis" when it is transferred to a child through a will.

No minimum tax in the year of death

Because your executors can select the transfer values of most assets passing to the next generation and can claim the capital gains deduction to offset any taxable capital gain included in your income, the strategy will generally be to select the highest possible transfer value that doesn't result in tax being paid by your estate. Fortunately, it's no longer necessary for your executors to worry about the minimum tax because this tax no longer applies in the year of death.

Farm assets "rolled" to children must vest indefeasibly within 36 months

Land, depreciable property (eg. buildings and machinery) written off on a reducing-balance basis, shares in a family farm corporation and an interest in a family farm partnership will not be eligible for the "rollover" and will be deemed to be transferred at fair market value **if it does not vest indefeasibly in your child within thirty-six months of the date of death**. Again, Canada Customs and Revenue Agency may permit a longer vesting period if it is reasonable in the circumstances. Where there is a will, this vesting provision will not be a problem because the property is treated as having vested immediately after your death.

If you are a sole proprietor and will **not** have sufficient liquid assets to satisfy the cash bequests to your children or other members of your family, you could instruct your executor to place a mortgage on your farm land before distributing the land to your farm child. The proceeds of the mortgage could then be paid into your estate and used to fund your cash bequests. One of the problems with this arrangement is that, assuming the land "rolls" to your farm child, the "tax cost" of the land will **not** be increased by any portion of the mortgage placed against it by your executors. Furthermore, Canada Customs and Revenue Agency has stated that your farming child will not be able to deduct interest paid on the mortgage. This is because the mortgage cannot be related directly to the acquisition of the land by the farming child.

Consider giving your farming child the option of purchasing farm assets from your estate

A better method of generating liquid funds in your estate is to arrange for your farming child to have the option of purchasing certain farm assets from your estate. If your farming child is required to pay interest to the estate or to a bank, it should be deductible for income tax purposes. Provided the assets consist of land, depreciable property written off on a reducing balance basis, shares in a family farm corporation or an interest in a family farm partnership (see Glossary), this purchase need not be made at fair market value.

Irrespective of the **actual** sales price, your executors have the ability to **elect for the sales price for tax purposes** to be any amount between the property's cost and its fair market value. The amount chosen will be the proceeds in your final return and the cost to your farming child. Generally, your executors will choose the highest amount that will not result in tax.

An illustration of this election mechanism is contained in question 3 at the end of this chapter.

Bequest to Children Through Spouse Trusts

If you were to die before transferring the farm to your children, you might want your spouse to enjoy the income from the farm during his or her lifetime and to have the property pass to your children on your spouse's death. You can achieve this by using a spouse trust. On your death, your farm (if it qualifies – see below) will pass into the trust on a "rollover" basis. When your spouse dies, the property will pass out of the trust to your children at any value selected by the trustee that is between its cost amount (see glossary) and its fair market value. The property that is eligible for this treatment is land, depreciable property written off on a reducing-balance basis, shares in a family farm corporation and an interest in a family farm partnership.

Some Questions and Answers

1. **I own 90 shares in our family farm company on which there is an accrued capital gain of $750,000. If I were to bequeath these shares to my children, how could my executors use my $500,000 capital gains deduction without triggering tax on the extra gain?**

   Assuming your shares are eligible for the "rollover", your executors could elect to have them disposed of by you at a value that results in a capital gain exactly equal to your unused capital gains deduction.

   You should make sure that your will empowers them to make this election.

2. **Can my executors make use of my capital gains deduction by electing to transfer my quota to my son at a value that results in a taxable capital gain?**

   No. Quota always transfers on a "rollover" basis.

3. **What happens if instead of bequeathing my farm land to my son, I authorize my executors to sell it to him?**

   In this situation, provided your son acquires the property within 36 months of your death, and the property qualifies for "rollover", the result will be as follows:

   - if your personal representatives do not make an election with respect to the property, it will "roll" to your son
   - if your representatives do make an election, it will transfer to your son at the value specified in the election (which cannot be in excess of fair market value)

To illustrate this further, let's assume the following:

- your land has no buildings on it
- it is eligible for "rollover"
- the adjusted cost base (tax cost – see Glossary) is $200,000
- its fair market value is $500,000
- your son has an option to acquire it for $300,000 which he exercises shortly after your death

In these circumstances, the situation would be as follows:

a) if no election is filed, you would be deemed to have disposed of the land at $200,000 and your son will be deemed to have acquired it at the same price. This tax result is not altered by the fact that your son would have paid $300,000

b) your personal representatives can elect for the land to be disposed of at anywhere between $200,000 and $500,000. The elected proceeds to you will become the cost to your son. Again, the elected proceeds of disposition will not be altered or affected by the fact that your son pays $300,000.

If the elected proceeds results in a tax liability to your estate, your personal representative would have to receive advice from your lawyer or accountant as to which of your beneficiaries would bear the tax. This would be determined by the wording in your will. Generally, your executors would want to avoid this situation.

If you have not used your $500,000 capital gains deduction and your land qualifies for this deduction, your representatives would probably elect a transfer price of $500,000. **This will not result in a tax liability to the estate and will give your son a tax cost**

of $500,000 rather than the $300,000 which he paid for the property.

Your son would not have to pay the purchase price in cash. You could provide in your will that your son could issue a promissory note to your representatives in satisfaction of the price. This note could provide for interest and, in which case, the interest expense should be deductible to your son provided he uses the land in a business. If appropriate, the promissory note could be secured by a mortgage.

8. Dealing With Your Non-Farming Children

Introduction

Being fair to the non-farming children is not always easy

If you have one or more non-farming children and you want to give your farming child the opportunity to take over your farm, it is sometimes difficult to make an arrangement that treats all of your children equitably. The reasons, of course, are as follows:

- like most farmers, you may have substantially all of your capital tied up in the farm
- the child or children who would like to take over the farm may not have a great deal of capital
- ultimately, a substantial portion of the inheritances of the non-farming children may have to be financed from the farm's cash flow

Equitable vs. Equal

In considering this matter, a distinction has to be made between equitable and equal arrangements. An equitable arrangement will not necessarily be an equal one. It will, however, be one that is reasonably fair, taking into account all the circumstances.

A conclusion as to what is equitable will differ from one family to the next and will be based on a number of factors including the following:

- the importance of the farming child receiving the farm intact
- the contribution the farm child has made to the business relative to the remuneration and other benefits he or she has enjoyed

- the standard of living and prospects of the non-farming children
- the benefits all children have received to date (eg. loans, university tuition, etc.)
- the resale value of the parents' assets (farm and non-farm)
- the future cash flow from the farm

Sometimes parents resolve this issue by determining a dollar value for the inheritance of the non-farming children and structuring their will so that this inheritance is received. Some parents have taken a slightly different approach by saying that the non-farming children's inheritance should be capped by determining the level of additional debt that the farm could amortize over, say, a ten or fifteen year period, after the parents retire or die. The amount of this debt is then inherited by the non-farming children.

What are Some of the Options for Dealing With the Non-Farming Children?

The most obvious technique for dealing with this issue is to segregate your non-farming assets and to ensure they are inherited solely by your non-farming children. Usually, however, this will result in a less than equitable arrangement and, in which case, it will be necessary to create other assets which your non-farming children can inherit.

In an unincorporated farm, the additional possibilities would include the following:

- selling farm assets that are not essential to your business
- leasing assets (such as farm land) to your farm child and bequeathing the ownership to your non-farming children (perhaps including in the lease arrangement a

purchase option which your farm child could exercise at some future time, based on conditions stipulated by you in the option agreement)

- arranging for your farm child to purchase the farm from you during your lifetime, with the intention of bequeathing a portion of the sales price to your other children

The leasing and purchase arrangements must cash flow

Clearly, the leasing and purchasing arrangements would have to be based upon the cash flow from the farm. Remember that cash flow is not the same as profits. The annual profit from your farm might be substantial but if you already have significant bank debt, a considerable portion of this cash flow will already be tied up.

An additional possibility if there is a company

In a corporate farm, there is the possibility of giving your non-farming children a non-voting share interest in the company that could be repurchased over a period of time. This possibility is discussed in Chapter 11.

In a nursery operation, and in some other larger businesses, it may be possible to segment the operation so that the farming child inherits the farm activities and one or more of the other children are involved in the wholesaling or retailing activities. Depending on the circumstances, this segmentation may be very desirable in any event so that the farming portion of the business is treated as such for income tax purposes.

Use of Insurance

Most of the options discussed above involve the creation of a non-farming asset after you retire or die. There is, however, an alternative which is to pre-fund your non-farming children's inheritance by purchasing life insurance on the life of you and/or your spouse. There is a brief discussion on insurance policies in Chapter 12, but in order to illustrate how insurance might be used to deal with your non-farming children it is worthwhile looking at an example.

Solving the problem with insurance

Assume the following:

1. You and your wife carry on business in partnership.
2. The total adjusted cost base (eg. tax cost – see Glossary) and fair market value of your interests in the partnership are $300,000 and $1,200,000 respectively.
3. You have an insurance policy for $400,000.
4. You have two sons who will carry on the farm, and two daughters who are not involved in the farm.
5. You need $600,000 of retirement capital.
6. The farm is eligible for “rollover” (see Chapter 5).

In this situation, you might proceed as follows:

1. You might sell your partnership interests to your sons during your lifetime for $600,000. Under the proposed rules, this would precipitate a taxable capital gain of $150,000 (50% x $300,000); however, on the assumption that you and your spouse have not previously used your capital gains deduction (and that the minimum tax rules do not present a problem), there should be no taxes payable. Your sons will receive a gift by acquiring their partnership interests at less than fair market value but this would not result in a tax.
2. You might provide in your wills that after the death of the survivor of you, the residue of your estates should be divided among all of your children in a manner that would recognize the earlier gift to your sons. As your sons would have inherited a portion of your future tax liabilities and may have contributed value to the farm, you may look upon the gift as being something less than $600,000 - perhaps $400,000. On this basis, the first $400,000 of the residue of your estate (the

insurance proceeds) would be distributed to your daughters and the balance would be distributed equally to all of your children.

To evaluate this option, it's necessary for you to take into account the cost of insurance. Unfortunately this is difficult to do because there are a great many insurance products available and the premiums are affected by the insured's personal circumstances. However, in order to provide you with a very general idea of what the cost might be on a $400,000 policy, we have summarized below certain information provided by an insurance broker in 1996 from a review of the term insurance products then offered by the major insurers. The figures quoted are based on the assumption that the insured person is a male, is in good health and is a non-smoker. His wife is four years younger, in good health and is also a non-smoker.

	Estimated Annual Premiums *		
		Level Term Insurance To Age 100	
Age at Which Policy is Taken Out	Regular Term Insurance (Note 1)	Insured Only (Note 2)	2nd to Die (Note 3)
40	$ 561	$ 2,035	$ 935
50	1,150	4,200	1,697
60	2,750	8,525	3,135

* information supplied by Glenn Devereaux, Mat Hassen Financial Services, Armstrong, B.C.

Notes

1. The regular term insurance is available only up to the age of 75 and is convertible to permanent insurance if the conversion option is made by age 65. The premiums noted are those applying in the initial ten year period only. Premiums in subsequent renewal periods are higher.

2. The level term insurance provides a level guaranteed premium to age 100. It does not have any cash values but at age 100 it provides a choice of either (a) a cash

payment of the face amount or (b) the continuation of the paid-up coverage past age 100 to the date of death.

3. The premium for the 2nd to die policy (joint and last to die) is much lower because the insured's family will not receive the insurance proceeds until the death of the farmer and his or her spouse.

If the insurance solution sounds attractive, you should review Chapter 12 and contact your insurance agent. Remember that you need to look for a permanent policy rather than a term product that expires at say aged 65 to 75.

Some Questions and Answers

1. **Is it better to pre-fund my non-farming children's inheritance with insurance or let my farming child take care of this after I'm gone by buying the farm from my estate?**

   These aren't the only options but, if they were, you would need more information before being able to reach a decision.

   If your farming child is going to be obliged to go to the bank to fund the purchase from your estate, the total cost (principal and interest) could be very substantial. In these circumstances, depending on your age and health and the cash flow from your business, it may be more attractive to fund at least a part of the non-farming children's inheritance with insurance.

   Before making any decision, you will need to find out whether you and your spouse are insurable. After you pass that hurdle and you are given some quotations on the products that are available, you, your accountant and your insurance agent should be able to arrive at a decision.

2. **If I knew my son was going to continue farming after my death, I would be less concerned about the distribution of my estate being "skewed" in his favour. But if he sells shortly after I die, then I would consider my other children to have been "short-changed". What can I do?**

This is a tough one. Obviously, you cannot control what happens after you die.

If you want to have some sort of adjustment mechanism that comes into effect if your son liquidates the farm, it may be possible to arrange for a portion of his inheritance to be held within your estate for a period of time. If he liquidates within this period, the inheritance would be re-directed to your other children. If, for instance, your farm was incorporated, you could arrange for some of the shares to be held in the estate in this manner.

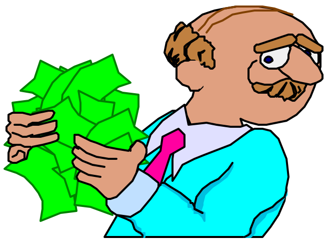
One of the difficulties with this type of solution is that, generally, for the farm property to transfer to your son on a "rollover" basis for income tax purposes, it has to "vest" in him within 36 months of your death (see Chapter 7). Perhaps this 36 month period is long enough for your purposes? If it isn't, the problem could perhaps be avoided by ensuring that the property retained in the estate does not have an accrued gain. In a corporate situation, examples would be:

a) a shareholder loan account

b) shares that will not appreciate in value (eg. fixed value shares) that have an adjusted cost base (eg. tax cost – see Glossary) that is equal to their fair market value

9. Capital Gains Deduction

Introduction



The capital gains deduction is a generous tax exemption requiring careful attention to the detailed rules

One of the most important tax benefits available to you is the ability to avoid tax on up to $500,000 of capital gains arising on the sale of certain farm properties. This is a cumulative exemption that applies over your lifetime in respect of sales after 1984.

Because this is a generous tax exemption, there are complicated rules in the Income Tax Act which are intended to ensure the benefit is available only to persons who meet all the requirements. As a result of this complexity, you need to ensure that you receive appropriate advice well before entering into any transaction that is designed to take advantage of the exemption.

It is important to note the exemption is available only in respect of **capital** gains. Therefore, income arising from the sale of your livestock is not eligible; nor is recaptured depreciation on your buildings and quota.

The $500,000 limit refers to the gross gain and not the taxable portion. As a result of the 2000 federal budget in February 2000 and the mini-budget in October 2000, the government is proposing that the taxable portion of capital gains realized after October 17, 2000 be reduced to one-half. If this change is enacted, the effect of the deduction (where there is a one-half income inclusion) will be to exempt from tax up to $250,000 of taxable capital gains.

Remember the deduction is not available to a company. If you have incorporated your farm the only method by which you can benefit from the deduction is to sell the shares of your company.

Also remember the deduction applies to each individual. If you and your spouse own the farm jointly, **each of you** may be entitled to the $500,000 deduction.

Property Eligible for the Deduction

The farming assets eligible for the $500,000 deduction are, generally speaking, restricted to those owned by an individual and a partnership, an interest in which qualifies as an interest in a family farm partnership (see Glossary).

The types of property that are eligible are generally restricted to the following:

Qualifying property includes land, buildings and quotas

1. Land and buildings used in a farming business by
   - the individual, his spouse, his parent or any of his children;
   - a company, a share of the capital stock of which is a "share of the capital stock of a family farm corporation" (see Glossary) of the individual, his spouse or any of his children; or by
   - a partnership, an interest in which is an "interest in a family farm partnership" (see Glossary) of the individual, his spouse or any of his children.

Investments in partnerships and companies can qualify too

2. A "share of the capital stock of a family farm corporation" (see Glossary);
3. An "interest in a family farm partnership" (see Glossary); and
4. Quotas used in a farming business.

Note this listing excludes machinery and livestock.

Land and buildings, acquired before June 18, 1987 will be treated as farming property provided it was used principally (ie. chiefly) in farming by an individual, partnership, or corporation mentioned in paragraphs 1 - 3 above:

- in the year the property was sold, or
- in at least five years during which the property was owned by the farmer, his spouse, his parent or his child.

Tougher rules for land, buildings and quota acquired after June 17, 1987

Where the land, buildings or quota was acquired (or is deemed to be acquired) after June 17, 1987, the rules are tougher to meet. First, there is a two-year holding requirement; second, there is a two year "use" test; and finally there is a requirement that during that period, the individual, his spouse, child or parent, as the case may be, are **actively engaged in the business of farming on a regular and continuous basis**. These additional requirements will not usually be a problem for the full-time farmer. However, the fact they exist makes it even more important to check on the status of your farm property before you sell it.

When the government eliminated the basic ($100,000) capital gains deduction, it gave individuals an opportunity to file an election with their 1994 income tax return in order to take advantage of the deduction they had not used. Essentially, the election had the effect of deeming individuals to dispose of, and then re-acquire, properties (such as land) that were specified in the election.

An election filed in your 1994 tax return may affect the way in which the deduction applies

The reason for mentioning this is that if you specified your farm land in a capital gains election filed with your 1994 return, your property will now be looked upon as having been sold and then re-acquired in 1994. As a result, the post-June 17, 1987 capital gains deduction rules will apply when you sell the property even though you may have purchased it before June 18, 1987.

Sale of timber may be eligible for the deduction

It appears that in some circumstances, the sale of timber by an individual from land that has been used in the business of farming may qualify for the deduction, even though the land itself is not sold. Accordingly, if you are proposing to remove trees from land that has been farmed, you should obtain advice before the transaction occurs.

It is important to note there are differences between the nature of the shares of a company which are eligible for the $500,000 capital gains deduction and those which are eligible for the "rollover" from parent to child. The same is true for an interest in a farm partnership. The differences are not likely to affect too many real-life situations but conceivably, shares of a farm company (or an interest in a partnership) could be eligible for the deduction but not the "rollover".

The capital gains deduction is not affected by the claiming of an exemption in respect of the gain on the sale of your principal residence.

What About Rental Property?

Depending on the circumstances, land and buildings which are rented to your child or spouse for use in a farming business may qualify for the exemption. This can also be true for land rented to a company or partnership.

Even where your land is currently rented to a person outside of the family, the previous use of the property by you, your spouse or a child may enable you to make use of the exemption.

The Deduction May be Multiplied

In certain circumstances, it may be possible to make greater use of the family's capital gains deduction by gifting an interest in certain farm property to an adult child (or children) resident in Canada and for the whole family to sell their respective interests at a later time. Clearly, this type of planning should be considered well before a sales transaction is entered into. Moreover, there are a number of issues that would have to be considered before taking this step, not the least of which is the general anti-avoidance rule in the Income Tax Act.

Where property is registered in the name of only one spouse, it is possible on occasion to use the principles of constructive or resulting trusts to support the view that both spouses have an interest in the property. If this can be supported, both spouses might be entitled to the capital gains deduction, instead of one. If your farm is registered in your name alone but both you and your spouse have contributed substantially to the purchase of the property, or you have always considered the farm to be jointly owned, you may wish to discuss this matter with your lawyer.

What Happens if You Claim a Reserve in Respect of the Unpaid Sales Price of Your Farm

If you sell capital property in exchange for debt, you may be entitled to claim a reserve for income tax purposes in respect of the unpaid proceeds. If you are able to claim a reserve, it would have the effect of spreading your capital gain over a number of years. The length of the period over which the reserve is available depends on the nature of the property, the terms of the sale and whether or not the purchaser is your child.

If the property being sold is one for which the $500,000 deduction is available (eg. land, buildings, shares of a family farm company or an interest in a family farm partnership) the capital gains deduction can be claimed in each year in which a portion of the capital gain is included in income.

What Happens if Your Partnership is Not a Family Farm Partnership?

As noted previously, the $500,000 deduction is available in respect of qualifying land and buildings owned by a partnership, an interest in which qualifies as a family farm partnership (see Glossary). If the partnership does **not** qualify as a family farm partnership (perhaps because substantially all of its property is **not** used in the business of farming in Canada), then the taxable capital gain on the sale of any land, buildings or quota owned by the partnership, or the sale of the partnership interest itself, is not eligible for the $500,000 deduction. **This could make a tremendous difference in the tax that would be payable, so you need to have your accountant review the status of your partnership before you sell. If your partnership doesn't qualify, your accountant should be asked to identify the steps necessary to remedy the situation.**

A non-qualifying partnership creates problems

Can You Always Claim the Deduction?

You need to be aware there is a rule in the Income Tax Act that restricts your ability to claim the deduction if you have deducted "investment expenses" (see Glossary) from your income in 1988 and subsequent taxation years or if you have deducted capital losses from your other income. This rule will not likely affect too many farmers but could affect you, for example, if you have borrowed to acquire shares in a family company. The interest on your borrowings will be treated as an "investment expense" and unless on a cumulative basis, this expense is offset by "investment income" (see Glossary) a portion of your future taxable capital gains will be subject to tax.

Be careful if you have any investment expenses such as interest

Your accountant will know whether this will be a problem for you and, if it is, whether it can be dealt with prior to the sale. This is another matter to be checked before you commit yourself to a deal.

Don't Forget the Refundable Minimum Tax

In response to political pressure from people who were upset about certain individuals receiving substantial income

A special refundable minimum tax can apply if you realize a large capital gain

without paying "a fair tax", the government introduced a "refundable alternative minimum tax". This tax obliges many taxpayers to make two tax calculations each year. The additional one was intended to apply primarily to individuals who avoid paying tax by investing in tax shelters of one kind or another. However, the rules are such that the calculation is also required if you realize a significant capital gain on the sale of your farm.

In most situations involving the transfer of a farm from a parent to a child, it should be possible to alleviate the effect of the minimum tax, if the proper planning is done before the transaction is carried out. Where the farm is being sold to a person outside the family, the scope for planning may not be as significant.

Fortunately, the refundable minimum tax rules will not apply to a taxable capital gain on the sale of quota, nor will they apply to any gains arising from the deemed disposition on death.

How Can I Get the Minimum Tax Back?

The minimum tax can be recovered against your future tax liability

As indicated by its name, the minimum tax is intended to ensure that all Canadian individuals pay at least a minimum amount of tax. Individuals with substantial incomes must calculate their taxes under the regular method and under the alternative method and pay whichever is the higher. If the alternative tax is higher, the amount of the excess can be carried forward and deducted from the regular tax liability in the next seven years. The carry-over of these additional taxes cannot reduce a taxpayer's liability to an amount that is below his minimum tax for the year.

Because of this seven-year carry-forward, any minimum tax that is paid on the sale of the farm will often be recovered in full in the years following the sale. Any minimum tax that is not recovered before death is no longer recoverable.

Don't Forget the Other Implications of Realizing Capital Gains

If you realize a capital gain on the sale of your farm, there can be other implications as well. These include the following:

- there may be a "clawback" of your old age security pension
- there may be an impact on your income supplements or child tax credits

Some Questions and Answers

1. **We are considering the transfer of our farm to our son in the next two to four years and we will want to take advantage of the capital gains deduction. We are concerned, however, that the deduction might be taken away before we can use it. Do you have any advice?**

   This is a concern to many farmers, as they near retirement. The capital gains deduction is an extremely valuable tax concession; one wonders whether it will remain in the Income Tax Act over the long term particularly when:

   a) the deduction contributes significantly to the ever-increasing complexity of the Income Tax Act;

   b) the deduction has probably **not** contributed significantly to new investment in Canada (which was the primary objective) but has, on the other hand, enabled persons who have already accumulated substantial gains to realize them without paying tax; and

   c) a committee, commissioned by the federal government to review our income tax system, has recently recommended that the deduction be eliminated.

Clearly, we can only guess as to whether these and other reasons might cause our government to remove the deduction and, if it does, whether it will be done so that it applies only to gains that accrue in the future or to all gains that are realized after the change is made.

Now that the taxable portion of capital gains is to be reduced to 50%, the refundable alternative minimum tax is more of an issue. If you take steps to lock in your full $500,000 deduction, the refundable tax might be $40,000 or more. Given that the benefit of the capital gains deduction is now reduced to approximately $125,000 (because of the reduced taxable portion), it is more difficult to justify the triggering of a capital gain that would expose you to this tax (unless, of course, you sell your property and have the cash to pay the tax).

Nevertheless, if the availability of the deduction is vital to your estate plan, or you are concerned that your property may cease to be eligible for the deduction, you may wish to look at whether you can reorganize your farm so that:

If you need the capital gains deduction, consider using it now

a) you crystalize at least some of your accrued capital gains now and take advantage of your capital gains deduction and

b) you facilitate the ultimate transfer of your farm to your child.

The way in which you might use some or all of your deduction will depend on the manner in which your farm is organized. The possibilities include the following:

Sale to Partnership

If, for instance, you operate as a sole proprietor, you might consider transferring your assets to a partnership in which you and your spouse are the partners. You could arrange for your son to become a partner (without necessarily acquiring any of the existing value), or defer this to a later time.

Sale to Spouse

Another option might be to transfer certain property to your spouse and elect out of the “rollover” rule that normally applies.

Use a Company

You could also consider the transfer of some or all of your assets to a company. If you already have a company, you might discuss with your accountant the possibility of reorganizing the capital so that you crystalize some of the accrued gain on your shares and take advantage of your deduction.

2. **I inherited our farm from my husband and, since that time, I have rented it to my son. Would the capital gains deduction apply if I were to sell it?**

The answer to this question depends to some extent on whether you inherited the farm after June 17, 1987. If you did, then it is likely you will be eligible for the deduction provided:

a) you and/or your husband have owned the property for more than two years; **and**

b) for a period of at least two years, prior to your husband’s death, his gross farming income exceeded his net income from all other sources and, during this period, he was actively engaged in the business on a regular and continuous basis; **or**

c) for a period of at least two years, while your son rented the farm, his gross farming income exceeded his net income from all other sources and, during this period, he was actively engaged in the business on a regular and continuous basis.

If you inherited the farm before June 18, 1987, you will likely be eligible for the deduction if:

a) the property is farmed by your son in the year of sale, or

b) the property has been farmed for at least five years in the past by your son or your husband.

Because this is a very complex matter you should always have an experienced adviser review all the facts and give you a written opinion. If you inherited the farm before June 18, 1987, the adviser may want to examine your 1994 personal income tax return to determine whether you filed a capital gains deduction election in that year. If you did, the status of your land may be affected.

3. My wife and I own the farm land jointly but I have always reported the farm activity on my return. Can we both claim the capital gains deduction if we were to sell the farm?

On the surface at least, the answer to this question is probably yes. If the land has been used in farming to the extent required by the Income Tax Act (and this depends on the date it was acquired), the fact that your wife owns a half interest and has not been involved in the business (except perhaps as an employee) does not prevent her from claiming the deduction.

An issue in this situation will be whether you have, in effect, “transferred” or gifted a half-interest in the land to your wife after 1971. If you have, it is possible your wife’s share of the capital gain would be “attributed” to you and you would not be able to take advantage of her deduction. Much will depend on **when** the property was purchased, whether the purchase was made from funds that both of you had accumulated and the extent to which you have repaid the purchase debt from funds generated by the farm.

Because this is a complicated area you should make sure you discuss it with your accountant.

4. **Does the $500,000 capital gains deduction apply to my machinery and equipment?**

   Unfortunately no. Remember also that the deduction cannot be used to offset recaptured depreciation.

5. **Our farm land has always been registered in my husband's name alone, and he has always reported all of the farm income. However, we have always considered this to be a family business. I have been heavily involved in many aspects of it and a portion of the farm assets was acquired with my money. Can both of us benefit from the capital gains deduction?**

   This is not entirely out of the question - much depends on all of the background circumstances. At the present time, your husband is the legal owner of the land but it's possible that both you and your husband are the beneficial owners (see Chapter 2 for a brief discussion on this matter). Keep in mind that it is the beneficial owners of property who must account for the capital gains on the sale of the property and, depending on the circumstances, have the opportunity of using the capital gains deduction. If you are planning to sell the farm and the taxable capital gain will exceed your husband's capital gains deduction, it might be worthwhile meeting with a lawyer who is experienced in these matters. In preparing for this meeting, write out a very detailed history of your farm, including the dates on which the major assets were acquired, and the extent to which funds have been invested in the farm by each of you.

10. Retirement Income Planning

Introduction

Your financial security during your retirement years will be an important factor in your overall estate plan. It will influence the manner in which you transfer your farming property to your children because the capital realized from this transaction will provide you with a substantial portion of your retirement income. The possible ways of transferring the farm to your children are discussed in Chapters 5 and 7.

In planning your retirement, you will have to consider whether you will need to purchase a new home off the farm. You will also have to think about your activities during retirement and, if your children take over the farm, whether you can help them by staying on or near the property. Ideally, you will continue to be involved in the family business on a part-time basis so there is a gradual transition to retirement.

Ensure you have adequate retirement income before finalizing your plan

In assessing your need for retirement capital you should take into account the effect of inflation. As we saw a few years ago, a prolonged period of inflation at rates in the range of 6% - 10% can significantly erode an individual's purchasing power. A retired farmer who is debt-free will probably be shielded from the effects of inflation to some extent, particularly if he or she continues to live off of the land. However, even in this situation, inflation must be considered.

In developing your estate plan, you should estimate your annual retirement income from sources such as government pensions, your RRSP and income from the sale or leasing of farm assets. You should compare this income to your estimated level of expenditures during retirement, ensuring that a "cushion" exists for inflation and emergencies of one sort or another. Keep in mind that your living costs might increase during retirement as a result of your increased ability to travel.

The estimates should not be left until the last minute. They will have to be reworked at the time you are planning to retire but they should be done on a preliminary basis much before that time so that you are able to give an appropriate amount of thought to your options. Avoid placing yourself in the position of having agreed to an overall estate plan with your family and then discovering that it doesn't provide you with adequate financial security.

Income From Farm Assets

The manner in which you receive income from your farming assets during retirement will depend to a significant extent on whether your business is carried on through a company. It will also be influenced by whether you continue to be involved with the business (as might be the case if a child takes over) and the manner in which you sell your farming property.

If, for instance, your farm is carried on through a company and the business is taken over by a child, your cash flow could come from the following sources:

- wages or directors' fees from the company itself, if you continue to be involved in its business
- dividends on shares that you continue to hold
- payments on debt owed by your child in respect of the purchase of your shares
- payments from the company in respect of the purchase of your shares

If you have an unincorporated business that is partially or completely taken over by a child, there can again be a variety of income sources. The possibilities in this scenario include the following:

- a share of the profits, if you continue as a partner after retirement
- a wage, if your role is that of a part-time employee
- payments on debt owed by your child in respect of the purchase of your interest in the business

Where you transfer your business to a child, you will have the ability to decide the extent to which the ongoing payments will be income in nature (such as interest, wages, directors' fees, dividends) or will be capital (payments on account of the sale price). Clearly, the tax consequences to you will vary significantly depending on whether they are income or capital. This will be particularly true if the sale is structured so that you can use your capital gains deduction and receive tax-free payments from your child (see Chapter 9).

Avoid living off capital, if you can

Equally important is the extent to which you need these ongoing payments to meet your basic living needs. Ideally, your living needs should be financed by your income payments so that the capital payments can be retained for reinvestment.

Registered Retirement Savings Plans (RRSPs)

This type of private pension plan is well known to most individuals. In enables farmers and other individuals who have "earned income" (see Glossary) to set aside money for their retirement in a tax-sheltered plan and to deduct their contribution in calculating their income for tax purposes. The amount that can be set aside each year is known as the RRSP "contribution limit".

In general terms, an individual is able to contribute to an RRSP up to 18% of his or her "earned income" of the previous year. The maximum contribution for any year is currently fixed at $13,500, which is reached when your "earned income" is $75,000 or higher.

To the extent you do not contribute the maximum in any year, the excess can be carried forward and deducted in a subsequent year. You can contribute the maximum but defer the deduction of the contribution to a subsequent year, if that would result in a larger tax saving for you.

Contributions for a particular calendar year can be made at any time in the year or within 60 days after the end of the year.

RRSP's must now mature by the end of the calendar year in which you reach the age of 69. At that point, you must decide how you intend to draw down your retirement capital. Essentially, the options are as follows:

- lump sum withdrawal (not usually desirable)
- life annuity
- term annuity to age 90 or
- transfer to a registered retirement income fund (RRIF)

The RRIF is by far the most popular choice these days; largely because of the flexibility you have as to the manner in which you receive payments and the fact that you can continue to enjoy a tax deferral on monies inside the RRIF (see later discussion).

You can contribute to your spouse's plan instead of your own, or you can allocate your contribution between them Contributing to a spousal plan is a useful method of "splitting income" between you and your spouse that can result in the saving of income taxes during retirement. Your ability to contribute to a spouse plan is not affected by whether you are over aged 69. All that is required is that your contribution is made before the end of the year your spouse reaches age 69. It should be remembered that

Be careful if your spouse withdraws funds from a plan you have contributed to

if your spouse withdraws funds from a spousal RRSP, this withdrawal will, in some cases, be included in your income, to the extent you have contributed to that or any other spousal plan in the same year, or the preceding two years.

Your executors will be able to make a final contribution to your spouse's RRSP within 60 days of the end of the year in which you die (assuming, of course, you had not previously made a contribution for that year and the contribution is made before the end of the year in which your spouse reaches the age of 69).

Take a retiring allowance from your company and put it in your RRSP

If you have a farm company, you might arrange for the company to pay you a retiring allowance when you retire. A considerable portion of this allowance may be transferred directly to your RRSP. The rules dealing with this issue are fairly complicated so you should make sure you receive advice before you proceed.

You are able to designate a beneficiary in your RRSP and, if you do so, that person will receive the proceeds of the plan after you die, rather than your estate.

There will be tax on your death if your spouse, or a financially dependent child or grandchild, is not the beneficiary of your plan

It is important for you to remember that if the beneficiary of your RRSP is a person other than your spouse, or a financially dependent child or grandchild, the amount in the plan at the date of your death (including the commuted value of any annuity you might have been receiving from the plan) will be included in your final income tax return.

If, on the other hand, your RRSP funds do pass to your spouse, or a financially dependent child or grandchild, there will be no adverse tax consequences. If your plan **had not matured**, there will be a refund of the amount in the plan which your spouse, or the dependent child, can then contribute to his or her own RRSP. If your plan **had matured** and you had started receiving annuity payments, these payments will simply pass to your spouse, or the dependent child, (assuming the plan provided for this) and will be taxable in his or her hands as received.

If there is going to be tax on your RRSP, check who is going to have to pay it

Where there will be a tax liability in your estate because the RRSP will be inherited by someone other than a spouse or financially dependent child or grandchild, you should discuss with your lawyer or accountant the person(s) who will be responsible for this tax. This will depend on the wording of your will. This issue can be important where the person inheriting your RRSP does not share in the residue of your estate.

There are a myriad of plans – choose the right one for you

All of the financial institutions offer several different types of RRSP's. Their performance may vary considerably as will the rules dealing with administration fees, the ability to withdraw capital, etc. Some of the plans will invest in common stocks, others will invest in fixed income securities, mortgages or bank deposits. Because there are so many different plans and their relative performance can have a significant impact on the amount of funds you will have on retirement, you should be prepared to shop around for a plan that suits you and, perhaps, consult with a financial adviser. There are a number of booklets on the market that will assist you in doing this.

Registered Retirement Income Funds (RRIF's)

As mentioned earlier, the most popular retirement option with RRSP's is to transfer the accumulated funds to an RRIF. In some respects, an RRIF is similar to an RRSP. The RRSP is a tax-sheltered fund that accumulates monies that you set aside for your retirement whereas an RRIF is a tax-sheltered fund that holds your retirement capital as you gradually draw it down. Both types of funds can be self-administered.

Under the current rules applying to RRIF's:

- you can have more than one plan at a time;
- they can be established at any time;

- there will be a minimum withdrawal computed on a formula basis, but you will be able to withdraw a greater amount if you wish;
- the withdrawal period no longer has to end at age 90; and
- funds are transferable from one plan to another.

As with RRSP's, an RRIF can be established through several different financial institutions, including banks, credit unions, trust companies and life insurance companies.

Canada Pension Plan

The Canada Pension Plan is an earnings-related contributory plan that provides for a retirement pension and certain supplementary benefits. Contributions based on income are required from the age of 18 to the age of 65 (or 70 if you continue to work and do not apply for your retirement pension). If you are aged 65 and over you can, if you wish, draw your retirement pension whether or not you continue to work and receive income. You may also arrange for a portion of your pension to be received by your spouse. Any amount transferred to your spouse will not have to be included in your income for tax purposes. Finally, under certain circumstances, you can arrange to receive your pension when you reach the age of 60. Your pension is discounted by 1/2% per month for each month before your 65th birthday.

The retirement pension is 25% of your "average monthly pensionable earnings", adjusted to reflect the final three-year maximum pensionable earnings. The "average monthly pensionable earnings" represents your total pensionable earnings from the start of the Plan, or from age 18, whichever is later, averaged over the period you have contributed to the Plan and expressed on a monthly basis. The maximum retirement pension is earned by making contributions at the maximum level throughout your working life.

If you are self-employed, your contribution for 2000 was 7.8% of the difference between your net earnings for the year (not exceeding the maximum pensionable earnings of $37,600) and your annual exemption of $3,500. This contribution rate is scheduled to increase each year until, in 2003, it reaches 9.9%. If you are employed by a farm company, one-half of the contribution is made by you and the other is made by your company.

The present maximum pension under the Canada Pension Plan is approximately $750 per month.

Old Age Security

The Old Age Security Pension, known as the Old Age Pension (OAS), is a flat rate pension that is payable to any person who meets the age and residency requirements. The amount paid is adjusted each quarter to reflect the increase in the Consumer Price Index.

The pension becomes payable when you reach the age of 65. Individuals who were aged 25 or more on July 1, 1977 and arrived in Canada prior to that date will be eligible for the full pension if they reside in Canada without interruption for the ten years preceding the date they apply for the pension. Individuals who did not reside in Canada prior to July 1, 1977 or were not aged 25 on that date will receive a reduced pension unless they reside in Canada for at least forty years after age 18.

The maximum monthly old age security pension payable on October 1, 2000 was $428.79 per month.

The Old Age Pension can be “clawed back” by the government

Some or all of your OAS payments will be "clawed back" by the government in the form of an additional tax, if your income exceeds a threshold amount ($53,960 in 2000).

Keep in mind that if you realize a large capital gain, the taxable portion will be included in your income and could result in a "clawback" of some or all of your OAS income for that year even though the gain might be fully offset by your capital gains deduction.

Tax Credits

The credits that will be of interest to you during your retirement include the following:

Age credit is income-tested

Age credit: Available to each person who is aged 65 or older. This credit is income-tested with the result that it begins to reduce where the individual's income exceeds approximately $26,000 and is eliminated when income reaches approximately $49,000.

Pension credit: Available to a person aged 65 or over in respect of the first $1,000 of qualifying pension income. Qualifying income includes an annuity from an RRSP and payments from an RRIF but does not include Canada Pension and OAS payments. The credit is available to a person under age 65 in respect of a more limited range of pension income.

If you or your spouse are not able to use certain of the personal credits, they may be deducted by the other person.

Income Splitting

The reduction of income taxes is always one of the objectives in estate planning, and can sometimes be achieved by splitting income within the family. When we talk about "income splitting" we are referring to transactions that have the effect of directing income to other members of your family that might otherwise have been received by you. To the extent this income is subject to a lower tax than would have applied had you received it, there is an overall tax saving.

Income splitting can save taxes…but there are some roadblocks

Unfortunately, the government is aware of the potential benefits from income splitting and has introduced a number of anti-avoidance rules into the Income Tax Act to block this type of planning.

The anti-avoidance rules that are most often encountered are called the attribution rules (see Glossary). These rules provide that if you transfer or loan property to your spouse, or to a person who subsequently becomes your spouse, any income or taxable capital gains realized from the transferred or loaned property, or from property received in exchange for the transferred property, will be attributed to you for purposes of the Income Tax Act. The income or taxable capital gains may legally belong to your spouse but will be taxed in your hands. This rule applies only while both of you are alive, remain married and are residents of Canada.

A similar rule applies to transfers made to minors. If you transfer or loan property to a minor, the income earned on it in years before the year in which the minor reaches the age of 18 will be taxed in your return. Any taxable capital gains realized from the disposition of the transferred property will generally not be attributed back to you.

These rules also catch an interest-free or low-interest loan to an adult child if one of the main purposes of the loan is to reduce or avoid tax.

Finally, the attribution rules apply not only to direct loans or transfers to your spouse or children but also to certain indirect transfers through a trust or a company.

The news is not all bad, however, because it is still possible to split income within the family without being caught by these rules. The acceptable transactions include the following:

- the purchase of property by one spouse from the other, at fair market value, so that future income accrues to the purchasing spouse
- a loan to a spouse that bears interest at a rate equal to the lesser of the commercial rate and the rate prescribed in the Income Tax Act
- one which has the effect of transferring business income to a spouse
- the payment of a reasonable salary or directors' fee for services rendered to the family business
- splitting CPP payments with a spouse
- contributing to a spousal RRSP
- gifts of cash to adult children (see Chapter 6)
- gifts of qualifying farm property to adult children (see Chapter 6)
- contributions to registered educational savings plans for a child

11. Use of Companies in Estate Planning

Introduction

A company is sometimes looked upon as an expensive and more cumbersome vehicle in which to carry on a farming business. In some respects this may be true yet a company can be extremely useful in estate planning.

In illustrating this to you, let's take a quick look at one of the estate planning scenarios that is discussed in Appendix 1. Assume, for the moment, that you have a dairy farm with the following assets that you want to pass to your child:

	Fair Market Value	Tax Value[1]
Land	$ 650,000	$ 150,000
Buildings	200,000	100,000
Equipment	150,000	50,000
Livestock	225,000	Nil
Quota	2,000,000	120,000
	$ 3,225,000	$ 420,000

(1) This is the value **above which** there will be an income inclusion (eg. taxable capital gain, recaptured depreciation, etc.), if the property is sold.

Based on the above information, you can see the following:

a) If you sell all of your assets to your child at fair market value, you will have a large capital gain. There will also be other amounts on which you will have to pay tax including recaptured depreciation and income from the sale of livestock. You may not have used all of your capital gains deduction but there is still going to be a large income tax liability.

b) If you reduce the selling price of your land, buildings, equipment and quota (the "rollover" properties) so that you eliminate most or all of your tax liability, you will likely have to give your child a significant gift. Do you want to do that? What happens if your child's marriage fails? Does this gift make it difficult for you to deal equitably with all of your children?

One of the possible solutions here is to use a company. Your child could set up a company to acquire your assets and, provided the transaction is carried out properly, there need not be any immediate gift to your child and there needn't be any immediate tax liability either. This is discussed more fully in Appendix 1.

A company may provide flexibility in your estate plan

Avoiding a gift or a substantial tax liability on a transfer to a child isn't the only reason you might want to consider a company. A company can enable you to defer income taxes and pay down debts at a faster rate. Finally, it can be useful if you have several non-farming children and relatively few non-farming assets and you are trying to develop an equitable estate plan.

As discussed below, the transfer of your farm to a company may mean you are less able to use the capital gains deduction in the future. The relative importance of this consideration will depend primarily on the extent to which the fair market value of your land, buildings and quotas exceed your cost for income tax purposes at the time of incorporation, and the length of time before the farm might be sold.

Income Tax Deferral

As explained in Chapter 3, most Canadian-controlled private companies carrying on a farming business in B.C. will pay tax at an approximate rate of 18% on the first

$200,000 of taxable farm profits each year, commencing January 1, 2001. If the farm company is associated (as defined in the Income Tax Act) with other companies, this $200,000 limit is shared among them.

If your farm's profits exceed your living costs, there is the opportunity for a tax deferral

Because most family farm companies in B.C. are, or will be, taxed at only 18% on the first $200,000 of farm profits, there is a significant opportunity for tax deferral if farm profits exceed the shareholders' living requirements. In this situation, the extra profits can be retained in the company to pay down debt or purchase new assets. If the farm is not incorporated and the income is earned by the farmer directly, the extra profits will be taxed at personal rates which can reach as high as 49%. Accordingly, at the top personal rate there can be a deferral of approximately 31% of tax.

The Impact of a Tax Deferral if You Have Considerable Debt

The ability to defer tax can be useful to you if you have recently incurred substantial debt to acquire farm property. Whether you operate your farm as a proprietorship, a partnership or through a company, the principal payments on your debt must be made out of after-tax income. In a proprietorship or partnership situation, the tax rate will vary from approximately 24% to 49%, which means there will be between 51% to 76% for debt payments.

With a low tax rate your company may be able to pay down debt at a faster rate

If your farm is incorporated, the debt repayments will likely be made out of income that has been taxed at only 18%. Accordingly, there will be approximately 82% of your income for debt payments.

What about the Impact of the Capital Gains Deduction on Companies?

As discussed elsewhere in this publication, it's sometimes difficult to sell shares of a farm company to a person

Sale of your company to a third party may be difficult

outside your family. A purchaser usually wants to purchase the individual farm assets so he or she can write off as an expense the amount paid for livestock, and depreciate the amount paid for quota, buildings and equipment. If the purchaser buys your shares he or she can only write off as an expense the balances in your company.

You may be able to arrange a share sale if you sell your shares at a discount that compensates the purchaser for the lost tax write-offs. Provided your shares qualify as the shares of the capital stock of a family farm corporation (see Glossary) you will be entitled to the $500,000 capital gains deduction.

Even after selling your shares at a discount, you may have more cash in your pocket than you would have done had you caused your company to sell its assets and distribute its cash to you. The fact remains, however, that in most cases, you will have to take a discount on your shares in order to structure a share deal. In other words your before-tax sale price will be lower than it would have been had you not incorporated and had you, instead, sold assets while you were still an individual. If this is the case, it seems that you may be better off not to incorporate because as a sole proprietor or a partner in a partnership, you would receive the full value of your assets and may still benefit from the capital gains deduction. What therefore, are the possible compensating factors that would make you want to consider a company? Well, there are several, and they include the following:

- The accrued **capital** gains on your land, buildings and quota may be less than $500,000 and, in which case, you would not use all of your capital gains deduction if you did not incorporate. On the other hand, if you did incorporate and sell shares, you may use more of your deduction. This is because you would be able to convert what would have been a taxable sale of livestock or taxable recapture of depreciation on your equipment and buildings into a capital gain on the sale of your shares, some or all of which might be offset by the capital gains deduction.

- As mentioned above, by incorporating your farm and selling shares, you convert what would have been ordinary income (livestock proceeds, recapture, etc.) into a capital gain. Because only a portion of capital gains are subject to tax, there is a potential tax benefit even where the capital gain on your shares exceeds your capital gains deduction.

- You can crystallize your accrued capital gain on your land by transferring it to your company at fair market value (you would need to consider the implications of the alternative minimum tax, see Chapter 9). This would enable you to take advantage of your capital gains deduction now and prevent the government from taking it away by future tax changes.

- You could also crystalize the accrued gain on your quota in the same way and take advantage of your capital gains deduction. Here, however, you need to remember that:

  a) there will be a recapture of your previous quota write-offs, and

  b) the "step-up" in the quota value to the company cannot be depreciated for income tax purposes to the extent that it's represented by a gain that's covered by your capital gains deduction.

How do you decide what to do?

So what are the conclusions with respect to the use of companies and the capital gains deduction? Clearly your decision is much more complicated than it was previously, but there are some general principles that you should keep in mind:

1. The capital gains deduction, while still extremely valuable, has less value than it used to when a higher portion of your capital gain was subject to tax. If you have an accrued capital gain of at least $500,000, which

ordinarily would be taxed at the top rate, the deduction is worth approximately $125,000 in tax savings (based on the proposed 50% inclusion rate for capital gains). If each of you and your spouse have accrued capital gains of $500,000, the potential savings double.

2. It is not necessary to use a company to take advantage of your capital gains deduction. A transfer of your assets to a partnership will sometimes be the better option because you can go from there to a company, or simply unwind the partnership, without incurring tax, provided you follow all the rules. Therefore, look at this option first.

3. Look at other non-company options such as transferring some of your capital property to your spouse and electing out of the "rollover" rule. Make sure you don't trigger recaptured depreciation and ask for advice on the impact of the attribution rules (see Chapter 10).

4. If the bulk of your accrued capital gain is on land, by all means look at the merits of incorporation because you can “lock in” your accrued deduction when you transfer your farm to the company. Bear in mind, however, that any future increases in your land value will not be protected by the capital gains deduction unless you can sell shares of your company.

5. If (a) your overall accrued capital gain (or quota gain) is significant, or (b) it is likely that a sale of the farm will occur within the short to medium term but not in the next few months, look at the benefits of incorporation. Bear in mind that to utilize the deduction on your quota you will have to suffer the recapture of your previous quota write-offs. If this recapture is significant the incorporation will be less attractive, particularly if the future sale may not occur for several years.

Perhaps keep some of your assets outside the company

As a final comment, it may be possible in some circumstances for you to incorporate but retain certain properties outside the company (such as land) which you could sell at a future time and claim the capital gains deduction. Generally speaking your land would continue to be treated as a property that qualifies for the capital gains deduction provided your company is such that its shares qualify as the shares of the capital stock of a family farm corporation (see Glossary).

Dealing with Non-Farming Children

As discussed in Chapter 8, one of your most difficult estate planning problems is to develop a plan that treats your non-farming children equitably (not necessarily equally) and allows your farming children to continue operating your business. Sometimes, these objectives cannot be reconciled and you, your executors or your children are obliged to sell a substantial portion of the farm to persons outside the family. In some situations, however, the use of a company provides the answer to your problem. This is illustrated in the examples discussed in Appendix 1.

Other Matters to Consider with Companies

Principal Residence

Keep your principal residence outside the company

If you are going to incorporate, you will want to consider whether you should keep your principal residence outside the company. If you continue to own it personally you will retain the ability to claim the principal residence exemption on the home and up to 1/2 hectare of land, and will continue to be eligible for the home-owner's grant.

In the past, the decision as to whether to retain the principal residence outside the company was sometimes influenced by whether the home was on a small acreage with a separate legal title. If it was situated on a large acreage together with the farm buildings, the entire property was often transferred to the company because there was a concern that perhaps the principal residence portion could not, by itself, be left outside the company and, if the whole property was left outside, it would not qualify for "rollover" to the farmer's children. This latter concern is no longer a problem because the Income Tax Act provides that property leased by an individual to a company that qualifies as a family farm corporation of the individual, his spouse or his child (see Glossary) qualifies for the "rollover".

Some farmers who have built their homes on the main farm have attempted to keep their principal residences outside their company by transferring to the company only a partial interest in the property. The undivided interest they retain is equal to the proportion of (a) the value of the home plus 1/2 hectare of land to (b) the value of the whole property. Canada Customs and Revenue Agency has indicated that it doesn't consider this arrangement to be valid in a strictly legal sense. However, if the farmer's solicitor is prepared to use it and the farmer recognizes that it may complicate his or her financing arrangements at some point in the future, there may not be much to lose by trying it.

Is the principal residence restricted to a half-hectare?

Another complicating factor as far as residences are concerned is that some farmers have been able to convince our Tax Courts that they should be able to treat much more than a half hectare of land as being part of their principal residence. While the law in this area is still unclear in some situations, it appears that significant acreages may, in their entirety, be included as part of a residence if (a) the parcel is equal to the minimum lot size or (b) it exceeds the minimum lot size but the excess cannot be subdivided. It is difficult to determine at this time how our Courts will ultimately deal with this matter and how the government might respond if it concludes the decisions are too favourable to taxpayers. In the meantime, however, if your residence is on a title that is separate from the main farm, it may make sense to leave it outside of the company so that you have the maximum flexibility with respect to your principal residence claim when the property is sold.

Potential Double Tax

If you transfer property to a company which has increased in value since you bought it, and an income tax election is filed so that the transaction is completed on a "rollover basis", there is a possibility that your accrued profit will be subject to a double tax. It will be taxed in the company when the company disposes of the property and it will be taxed a second time when you or your heirs dispose of the shares that were issued by the company in exchange for the property.

As a practical matter, this is not usually viewed as a significant problem for a farmer because the shares of a family farm corporation (as defined in the Income Tax Act) can be transferred from one generation to the next on a rollover basis. If the farm is to be sold in the near future or a significant portion of the shares issued by the company for the transferred property are to be redeemed in that period, your adviser should give more attention to this matter.

Provincial Sales Tax

There are many exemptions but it still applies to some assets

Provincial sales tax should not be a significant concern if you incorporate your farm because the majority of your assets will be exempt from tax. However, the tax could still apply to automotive equipment and certain other assets if the incorporation is not structured properly. This is a matter that you should discuss with your accountant.

B.C. Property Transfer Tax

This tax will apply in some farming situations

Ordinarily, this tax will not be a problem on the incorporation of your farm; however, it could apply in certain situations. There is an exemption for a "family farm" if it is transferred to a "related individual" or to a "family farm corporation" but because these terms are defined very strictly, it is always necessary to check if your situation fits the exemptions.

Because this is a tax that applies to the purchaser, it will not usually be of concern if you sell to an arm's length person. It will, however, be an issue that your accountant or lawyer should look at if you are selling to a member of your family or to a family company.

Where the tax does apply, it is calculated at the rate of 1% on the first $200,000 of value and 2% of the remainder. This is calculated on a property by property basis.

B.C. Capital Tax

Effective for years ending after March 31, 1994, the government introduced an exemption from the B.C. Capital Tax for family farm corporations, as defined. The exemption is worded fairly broadly and should extend to most family farms.

If you are considering the use of a company, your accountant should make sure the exemption from capital tax will apply.

Goods and Services Tax (GST)

GST won't be a significant problem provided the company is registered

The GST must always be considered when you transfer some or all of your assets to a company. However, provided the company is registered before the transaction is carried out, this tax will not usually be a significant problem.

Need for Professional Advice

Make sure your advisers have the necessary tax expertise

It is extremely important for you to receive advice from a lawyer and a qualified accountant before incorporating your farm and setting up your estate plan. One or both of these individuals should be thoroughly experienced in tax matters. This advice should be obtained well in advance of the transaction.

The transaction will have to be structured carefully so that it fits within the rules in the Income Tax Act dealing with “rollovers” to companies. A special income tax election will have to be filed with Canada Customs and Revenue Agency within prescribed time limits.

The need for care cannot be over-emphasized. If the transaction is structured incorrectly, you could be exposed to a tax penalty.

12. Life Insurance

Introduction

Life insurance can play a useful role in your estate plan provided your insurance needs are correctly identified and the product you buy meets those needs. Unfortunately, this is easier said than done because there are many different products available. In assessing your needs, you should rely on the advice you receive from your professional advisers such as your accountant, lawyer, government agricultural representatives and, most important, your life insurance agent.

There are two basic kinds of insurance

Basically, there are two types of insurance available - **temporary** insurance, also called term insurance, and **permanent** insurance.

Term Insurance

Temporary insurance becomes much more expensive as you get older

Term insurance is available in a variety of terms. The most common are one year term, five year term, ten year term and twenty year term. The policy is renewable at the end of the term in accordance with a schedule that is known when the policy is entered into. As you get older, the premiums increase. In the latter years of your life, term insurance becomes very expensive, because of your increased risk of death.

If the policy has a guaranteed renewal clause, it may be renewed without a medical examination. If it has a conversion clause, it may be converted into permanent insurance even though you may become uninsurable. Most term policies sold today have guaranteed renewal and conversion clauses; however these clauses are not always the same. You should check, for example, whether the renewal rates are guaranteed or are subject to market conditions and whether there is any guarantee as to the type of permanent product that you are allowed to convert to.

The important aspect of most term insurance is that it is not permanent. It has to be renewed and it will only be of benefit if the policy is in force when you die. If your health deteriorates and you become uninsurable without having a guaranteed renewal and convertible clause, your policy will terminate. Many years ago, term insurance policies were not normally available beyond the age of 65. Now there are a number of products on the market that are available up to age 75 and, in the case of Term to 100, up to age 100.

It is possible to buy certain types of term insurance through a group plan. The most common example is mortgage insurance which is often available through banks, credit unions or other financial institutions. Group insurance may also be available through certain farm producer groups and Chambers of Commerce.

Permanent Insurance

Permanent life insurance, also known as "whole life" or "ordinary life", covers you for as long as you live. You pay the same premium (a level premium) throughout the life of the policy. The premiums are higher than term insurance premiums in the beginning and lower later on. In effect, you pay a higher amount than needed to meet the insurance risk in the early years and a lower amount than needed later. The excess accumulates as cash values, which are invested by the life insurance company. The cash values, together with the interest they earn, are needed along with future premium payments to carry the policy in later years.

Universal Life Insurance

Universal life can cover you for as long as you live, but it's your choice. These flexible policies allow you to increase, decrease or stop your premiums altogether. Usually you also have the option of increasing or decreasing the amount of coverage. Premiums are paid into a fund that earns interest at current rates, but these rates may not be guaranteed. A charge is deducted from the fund to cover (a) the cost of the insurance risk the company has assumed and (b) the expenses. The insurance continues for as long as there is enough money in the fund to pay the charges as they come due.

Combinations

You can combine different kinds of insurance. For example, you can buy whole life insurance for lifetime coverage and add term insurance for the period of your greatest needs. Usually the term insurance is on your life, but it can also be bought for your spouse or children.

The important aspect of most term insurance is that it is not permanent. It has to be renewed and it will only result in a death benefit if the policy is in force at the time the death occurs.

Joint and Last to Die

Joint and Last to Die policies can be much cheaper

Insurance companies have developed policies that pay out only on the death of the survivor of a husband and wife. These are called "Joint and Last to Die policies". They are useful products because very often a family will **not** need liquid funds to pay income taxes or to finance bequests to children until both parents are dead. Depending on the circumstances, this type of policy can be considerably cheaper than a conventional one that is payable on the death of one of the parents.

Use of Insurance

Life insurance has several possible uses in your estate plan. It may be purchased for one or more of the following reasons:

1. To provide coverage on farm bank loans.

2. To fund a buy-sell agreement between you and your partners or, if there is a company, the other shareholders. Many agreements between partners and shareholders have a buy-sell clause requiring each of the parties to hold insurance on the other party to ensure that cash is available to the surviving party to enable that party to fulfill the requirements of the agreement.

3. To provide funds for your estate's liquidity. Depending on the circumstances, your death may generate the need for funds to meet outstanding tax liabilities created by the deemed disposition of capital property on death or to pay gifts under your will. Liquidity may also be required to cover probate costs, legal fees and final expenses.

4. If you have non-farming children, life insurance can be very effective in equalizing your estate. Naming your non-farming children as the beneficiaries of a life insurance policy may enable you to achieve a more equitable distribution of your estate and reduce the likelihood of challenges to the estate distribution under the Wills Variation Act of British Columbia. (An example of how insurance might be used for this purpose is discussed in Chapter 8.)

5. Depending on the size of your farm, there may be a situation where the operation's success is largely dependant on the contribution of one individual. The sudden death of this key person can be as disastrous to the operation as his or her sudden resignation. Key person insurance can help protect the farm operation from this financial risk.

6. To provide a tax-sheltered investment. Universal Life policies have become a popular tax planning tool to shelter assets during an individual's lifetime. When you retire, it is possible to use this policy as collateral for a series of loans, thus establishing a tax-free income stream. Most institutions will lend against this type of policy at a preferred rate. When you die, the bank loan would be paid off using the tax-free death benefit from the policy, with the remainder of the insurance proceeds going to your beneficiaries.

7. To facilitate charitable giving. You might consider purchasing a policy and assigning ownership to a registered charity. You will then be able to treat the insurance premiums as charitable donations.

Tax Implications

The federal Income Tax Act contains many complex rules concerning the taxation of life insurance policies which cannot be discussed in a publication of this nature. From an estate planning standpoint, the tax-free mortality gain is the most attractive feature of life insurance. It means that, properly arranged, a large pool of tax-free dollars can be made available upon the death of a life insured person to cope with the expenses and other financial obligations arising as a consequence of his or her death.

If you dispose of a policy during your lifetime, the policy gain (i.e. the excess of the proceeds of the disposition over the adjusted cost basis as determined under the Income Tax Act) will generally be subject to income tax. There is an ability in some situations, however, to transfer a policy to a child or to a spouse on a "rollover" basis.

Policy loans are treated for income tax purposes as being proceeds of disposition of the insurance policy with the result that an amount will be included in income to the extent that the loan exceeds the adjusted cost basis of the policy. Because of this, it is usually better to use the insurance policy as collateral and obtain a loan from an institution other than the insurer.

The cost of some or all of your premiums can be tax deductible if the policy is required by your lender

Generally, premiums paid on life insurance policies are not deductible for income tax purposes, although a deduction will be permitted for some or all of your premium where the policy is required by your financial institution as collateral for a business loan. The amount of the deductible premium in any year will be determined based on the relationship between the face value of the policy and the balance owing on your loan from time to time during that year.

If a farm company is to be the beneficiary of an insurance policy that is payable on the lives of one of its shareholders, it is always important to confirm with your accountant that the existence of the policy will not prevent the company's shares from being eligible for the capital gains deduction or the tax-deferred rollover to your children. This will not usually be a problem unless the policy has a large cash surrender value.

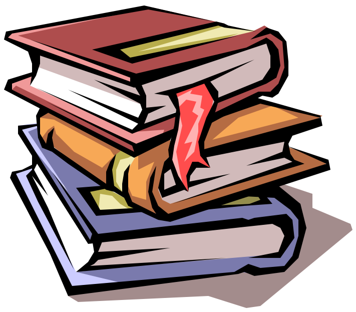
Where a company is the beneficiary of an insurance policy on the life of a shareholder and the insurance proceeds are used to redeem the shares of the deceased person, special income tax rules come into play. Because of the complexity of these rules, you should always receive expert advice before arranging for your company to purchase insurance on your life or the lives of individuals in your family.

Conclusions

Due to the multitude of products on the market, you will need the advice of an insurance professional to help determine your needs and clarify which products meet your objectives. You will be well advised to select an insurance professional with the appropriate professional qualifications and training who can offer ongoing periodic reviews of your situation.

13. Implications of Family Law

Introduction



"Family assets" must be divided if there is a marriage breakdown

Approximately four out of every ten marriages end up in the divorce courts these days so it is important you have some understanding of the provisions of the Family Relations Act in B.C. This Act sets out the manner in which a family's assets are divided between a husband and wife in the event of a marriage breakdown. Because it can have a significant effect on an estate plan you should ask your solicitor for advice when he prepares or updates your will.

The basic premise of the Act is that marriage is an economic partnership through which each spouse is entitled to share in the financial rewards of the other's efforts. The Act establishes a category of assets called "family assets" that must be divided between the spouses in the event of a marriage breakdown. There is a presumption that family assets will be divided on an equal basis unless it would be unfair having regard to criteria set out in the Act itself.

The classes of assets that are defined as being "family assets" are as follows:

a) any property owned by a spouse and ordinarily used for **family** purposes; and

b) assets owned by a spouse and used for **business** purposes, if the spouse who does not have an interest in the property has made a contribution in money or money's-worth to the acquisition of the asset.

Category (b) above is extremely broad because a contribution towards the acquisition of the property is deemed to include any savings realized by the family through a spouse's effective household management or child - rearing responsibilities. In many cases, it will be

On farms, virtually any type of asset can be a family asset

difficult to argue that a spouse has not made at least some contribution in this sense to all the assets acquired during marriage. This will be particularly true on a family farm where the spouse not only maintains the home but usually helps with farm chores and business management as well. As a result, virtually any type of asset can constitute a family asset for purposes of the Family Relations Act.

It appears that a spouse can acquire the right to share in a particular property even though it might have been owned by the other spouse before the marriage or might have been obtained by that spouse from his or her parents. This is particularly true where the marriage is of reasonably long duration - say ten years.

Issues that complicate and lengthen divorce proceedings are disputes over valuations and maintenance, and arguments as to whether family assets should be apportioned other than on a 50:50 basis.

Tax Implications of the Division of Family Assets

As mentioned in Chapters 6 and 7, the Income Tax Act contains provisions that enable certain property to be transferred between spouses on a "rollover" basis unless the transferor spouse elects to not have the "rollover" rules apply. These provisions also apply where there is a division of property pursuant to a provincial statute such as the Family Relations Act. Despite the existence of these rules, however, the division of family assets can result in income tax problems. The problems arise because either the particular asset is not covered by the spousal "rollover" rules or the court directs that the asset be transferred to a person other than a spouse.

Looking at the position of a farmer, income tax problems can arise in the following situations:

1. Where quota is transferred to the farmer's spouse it will usually be treated as having been sold at fair market

value. Fortunately, a portion (perhaps all) of the quota gain is likely to be treated as a taxable capital gain that is eligible for the capital gains deduction. If, as part of the settlement, the farmer ceases to carry on farming and his spouse commences to carry on the business, there will be a “rollover” (see Glossary) for income tax purposes.

2. Livestock and other inventories transferred to the farmer’s spouse (or his children) will also generally be treated as having been sold at fair market value.

3. Land and buildings transferred to a **trust** for the benefit of the farmer's spouse will not transfer on a rollover basis unless the provisions of the trust meet the requirements of the Income Tax Act.

Attribution Rules

Generally, if property is transferred to a spouse, and the acquiring spouse does not pay fair market value, income and capital gains on the property are taxed in the hands of the original owner. Similar rules apply where property is transferred to a child under age 18 except that generally, they do not apply to capital gains realized on the disposition of the transferred property. These provisions are discussed in more detail in Chapter 10.

Special rules apply where property is transferred to a spouse on the breakdown of a marriage

Where property is transferred to a former spouse the attribution rules do not apply. Where the transfer is made to a spouse who commences to live apart by reason of a breakdown in the marriage, the rules are as follows:

a) **Income from the transferred property**: Income ceases to be attributable after the spouse commences to live separate and apart.

b) **Taxable capital gains**: Taxable capital gains cease to be attributed after the spouse commences to live separate and apart, provided the individual who transferred the property files an election, completed by both spouses, to the effect that the attribution rules shall not apply. This election must be filed with the return for the year in which the separation occurs.

Planning

In some cases, a straight-forward division of the family assets of a farmer will result in a significant tax liability and it will be in the interests of both parties to see if they can restructure the distribution so that the tax is deferred.

A person who is contemplating marriage, perhaps for the second time, may want to review with his or her solicitor the extent to which the provisions of the Family Relations Act can be avoided, or limited, by entering into a marriage agreement. Discussing this sort of agreement with a “bride or bridegroom-to-be” may not be easy because it is tantamount to saying "I love you but ...". However, these agreements are being used more often these days.

Where property is being transferred by parents to their son or daughter and there is some concern over the Family Relations Act, the parties may want to consider making it clear in the documents that the transfer is being made to their child and not to his or her spouse. This may have the effect of reducing the spouse’s claim on the property if there is a marriage breakdown at some future time.

14. Administration of the Estate

Introduction

The administration of an estate involves the collection, management, and realization of the property of a deceased person and the distribution of that property to the beneficiaries of the estate. It will be carried out by the deceased's executor (or administrator if there is an intestacy) with the help of a solicitor.

As discussed in Chapter 2, your executors will normally include your spouse and one or more of your children. If they are **not** able to fully understand your business affairs the family's accountant or solicitor might be involved as well.

The administration of your estate may take up to six months, or even longer, because there will be a substantial number of assets to locate, value and transfer to the intended beneficiaries. The job will be somewhat easier if the farm is incorporated because the distribution of the farm property will be accomplished by simply recording the transfer of your shares in the company's share records.

Proper planning makes your executor's job easier

You should look upon the administration of your estate as the final test of your estate plan. You will not be around to see if your plan passes this test but your family and friends will. If your planning is effective, your executors' job will be made much easier.

The steps you can take to help your executor are as follows:

1. Ensure that all members of your immediate family are aware of, and in agreement with, the provisions in your will and know where the will is kept.

2. Ensure that your will takes into account all changes in your business and family situation; it is expressed

clearly, and it provides for the disposition of your assets in an orderly and reasonable manner.

3. Ensure your executor is aware that he or she has been named and that there are alternates in the event he or she is unable or unwilling to act.

4. Maintain a listing of major assets and liabilities and ensure your spouse and children know where it is kept. This listing should include the street address or legal description of real property owned, a description of the major farm equipment and its location, bank account numbers and details on insurance policies, etc.

5. Keep valuable papers such as land title documents, mortgages, agreements for sale, share certificates, bonds, savings account pass books and insurance policies in a safe place and ensure that your spouse and children know where they are.

Role of the Personal Representative (Executor)

Your executor (or the administrator if there is no will) has significant responsibilities. He or she will usually delegate much of the work to a solicitor or accountant, but ultimate responsibility remains with that person.

The executor's initial responsibility will be to make appropriate funeral arrangements and to request a solicitor to apply to the court for Letters Probate. This document confirms the validity of your will and the executor’s appointment. If there is no will, an administrator would apply for Letters of Administration. If the executor appointed in your will is unwilling to act and there are no alternates, an administrator would again apply for Letters of Administration with Will Annexed.

An administrator may be required to post a bond with the court. This requirement can be dispensed with in special circumstances.

Your executor has much to do

In dealing with your estate your personal representative will do the following:

- determine the nature and value of your assets and liabilities
- advertise for information on debts that he or she is not aware of
- calculate and pay the income tax liability relating to your final return and your estate
- obtain a clearance certificate from Canada Customs and Revenue Agency evidencing that all income taxes have been accounted for
- obtain the consent of your beneficiaries or pass the accounts through court
- convert your assets to cash and distribute the proceeds or, if empowered to do so, distribute them “in specie” (see Glossary)
- set aside the assets or funds which are to be retained
- pay all legal fees and other costs of settling your estate and
- account to your beneficiaries, and to the court if required to do so, for all actions in connection with the administration of your estate.

Your personal representative is allowed to receive a percentage of the gross value of the assets of your estate as compensation for the services he or she performs. This gross value would not include property which passes to your beneficiaries outside of your estate (see later comments).

Role of the Solicitor

The solicitor's function is to act on behalf of your executor or administrator. This person will normally advise your personal representative on legal matters affecting the administration of your estate, prepare the application for Letters Probate or Letters of Administration, prepare the documents required in connection with the conversion of assets to cash or the distribution of property to beneficiaries, and assist in the preparation of the financial accounts of your personal representative.

Property That Does Not Become Part of the Estate

Certain property passes directly to your beneficiaries, rather than through your will, and does not, therefore, become part of your estate. The distinction is significant because property treated in this manner is not usually available to creditors.

Assets that do not become part of your estate include the following:

- property held in a joint tenancy arrangement (see Chapter 3);
- proceeds from life insurance policies which have named beneficiaries; and
- proceeds from a registered retirement savings plan or a registered retirement income fund which has a named beneficiary.

Tax Liability of the Deceased

As discussed in Chapter 7, you are deemed to have disposed of most of your assets immediately before your death and the resulting taxable capital gains, allowable capital losses, recaptured depreciation, etc. are included in your final tax return. Because of the capital gains deduction (see Chapter 9) and the extensive "rollovers" available to you in respect of property bequeathed to a spouse, a spouse trust or a child (see Chapter 7), this deemed disposition will not usually result in a significant tax liability.

Special rules for livestock, inventories and accounts receivable…if you are on the cash basis

If you compute your income for tax purposes on the cash basis, the livestock, feed inventories and accounts receivable that you bequeath to a beneficiary are given special treatment under the Income Tax Act. These properties, together with certain other assets such as uncashed bond coupons, (described in the Income Tax Act as “rights or things”) may be included in your final return, or in a separate return on which a second set of personal exemptions is claimed. If the rights or things are distributed to your beneficiaries within one year of death or within 90 days after the mailing of the Notice of Assessment for the year of death, whichever is later, the value of the rights or things is included in your beneficiaries’ income in the year in which they dispose of the properties. This rule has the effect of providing a rollover for livestock, inventories and accounts receivable bequeathed to your beneficiaries.

Capital gains deduction increases your executor’s responsibilities

As a result of the capital gains deduction, and the ability of executors to select the values at which certain farm assets are deemed to be disposed of for tax purposes when they are transferred to a child (see Chapter 7), your personal representatives have an added responsibility when they arrange for the preparation of your final return. Assuming the will empowers them to do so, they will generally want to select the highest permitted transfer values that will **not** result in taxes being paid by your estate.

The farming assets which are eligible for this treatment are the “qualifying farm properties” (see Glossary) except quota. The transfer value selected for each asset must be between its “cost amount” (see Glossary) and its fair market value. In determining the optimum transfer value your personal representatives must take into account your unused capital gains deduction. Fortunately, they no longer have to consider the possibility of you being subject to the alternative minimum tax.

Capital gains reserve can flow through to spouse

If you had sold farm property during your lifetime and had been carrying forward a capital gain reserve in respect of the unpaid sale proceeds, the taxable portion of the reserve must be included in your final return as a taxable capital gain. If the debt on which the reserve has been claimed is bequeathed to your spouse, the reserve flows through to the spouse provided a special election is filed with Canada Customs and Revenue Agency.

If you realize allowable capital losses in the year of death, or in the preceding year, they can generally be deducted from income from any source without restriction. Ordinarily, these losses, if incurred after May 23, 1985, may only be deducted from taxable capital gains. If you have claimed the capital gains deduction in any year, the allowable capital losses which can be deducted from income other than capital gains is reduced by the amount of the deduction.

Gifts made to registered charities in the year of death, or bequeathed to them in your will, are eligible for a tax credit in your final return or in the return for the previous year.

Filing of Returns and Payment of Tax

The deadline for filing a tax return for a deceased individual depends on whether that person carried on a business in the year of death.

	Filing Deadline	
Taxation Year	Where There Is a Business	Where There Is No Business
Year ending prior to date of death	If death occurs before June 16 – within 6 months of death	If death occurs before May 1 – within 6 months of death
	In other cases, by June 15	In other cases, by April 30
Year of death	Generally later of 6 months after death or June 15 of following taxation year	Generally, later of 6 months after death or April 30 of following taxation year

If your will creates a spouse trust, the final return may be filed up to eighteen months after the date of your death. If there is a separate return for rights or things, it must be filed by the later of one year from the date of death and the date that is ninety days after the mailing of the Notice of Assessment in respect of the final return.

Your estate must file a return

Your estate must also file a return. If the administration is completed in less than a year there will be only one return covering the period of administration. If it extends beyond one year, a separate return will have to be filed for each "taxation year". The "taxation year" of an estate is the period for which the accounts are ordinarily made up. Usually, the taxation year of the estate will end on the anniversary of the date of death or on December 31. The taxation year cannot exceed twelve months and after the year-end has been established it cannot be changed except with the permission of Canada Customs and Revenue Agency.

Generally, the tax owing by a deceased individual for the year of death is due on the later of 6 months after death or April 30 of the following year. However, to the extent that the deceased has amounts included in his income in respect of rights or things or in respect of taxable capital gains or recaptured depreciation arising from the deemed disposition of capital property owned at death, the personal representative can elect to pay the tax in up to ten annual instalments. The government charges interest on the unpaid tax.

Clearance Certificate

It is important that your personal representative obtain a clearance certificate from Canada Customs and Revenue Agency before distributing your estate to your beneficiaries. If your personal representative fails to do this he or she will become personally liable for the unpaid taxes, interest and penalties.

Accounting Records

Except where your personal representative is the sole beneficiary, he or she must keep accurate accounts summarizing the administration of your estate. The accounts will generally include an inventory of the original estate assets, details of all money received and disbursed and a summary of the assets on hand. The supporting books and records should be maintained until all clearance certificates have been issued.

Conclusions

Estate planning is a broad subject that is especially important to you, as a farmer. The capital-intensive nature of your business means there is a need for a well-thought-out estate plan. If you neglect this job your family may suffer considerable anguish and there may be financial penalties as well.

A good estate plan will not be "hashed out" on an "overnight" basis after an initial consultation with a lawyer or accountant; nor is it something that remains static except in the very late stages of your life. A good estate plan will have to be discussed by your family over a considerable period of time. It will incorporate the considered opinions of all members of your immediate family. Your solicitor and accountant will be able to make a useful contribution in the early stages by recommending how you should approach the planning process. They will also be able to advise you of the estate planning tools at your disposal.

A good estate plan will evolve over time. It will be flexible while your children are growing up and deciding what they want to do. It will ensure you are well provided for during your retirement and your children are treated equitably.

The time you devote to estate planning will be repaid many times over in the increased peace of mind of your family and the savings in your taxes, estate management costs and property transfer procedures.

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Appendix 1

Illustrations of Family Farm Transfer Arrangements

An Unincorporated Dairy Farm

Situation

Alan is a dairy farmer aged 63 who is contemplating retirement. He has a son, John, who would like to take over the farm and three daughters who have married and moved off the farm. Most of the farm assets were acquired by Alan alone but there is one parcel of land on which his residence is located that is owned jointly with his wife Elaine. This additional parcel is ten acres, most of which is used in the farming business.

John and his wife already live on the main farm.

Virtually all of Alan and Elaine's assets are tied up in the farm. The particulars of these assets are as follows:

	Fair Market Value	Tax Value[1]
Main Farm (50 acres)		
Land	$ 650,000	$ 150,000
Buildings	200,000	100,000
Equipment	150,000	50,000
Livestock	225,000	Nil
Quota	2,000,000	120,000
	$ 3,225,000	$ 420,000
Additional parcel (10 acres)		
Land	200,000	50,000
Residence	150,000	100,000

(1) Represents the cost (or depreciated cost) for income tax purposes. Sale proceeds in excess of this amount will result in an income inclusion to Alan and/or Elaine (except for the residence).

What Are the Options?

Well, the first option might be to sell the main farm, equipment, livestock and quota at fair market value. This is not likely to be acceptable, however, because there would be a large tax liability. Alan's capital gains deduction would offset the capital gain on the land but there would still be a substantial income inclusion in respect of the quota and livestock, and the recaptured depreciation on the buildings and equipment.

An alternative would be for Alan to sell his land at fair market value so as to make use of his capital gains deduction, and to sell his buildings, machinery and quota at his tax values. The livestock would have to be sold at fair market value but because Alan reports his income on the cash basis, he wouldn't have to pay tax on this sale until he received the proceeds.

If the transaction were structured on this basis, the sale price would be $1,145,000, calculated as follows:

	Fair Market Value	Sale Price
Main Farm		
Land	$ 650,000	$ 650,000
Buildings	200,000	100,000
Equipment	150,000	50,000
Livestock	225,000	225,000
Quota	2,000,000	120,000
	$ 3,225,000	$ 1,145,000

The problem with this arrangement is that Alan and Elaine would be giving John a very substantial gift by allowing him to acquire the farm at such a large discount. Alan and Elaine would have to consider whether it is appropriate to make this kind of gift at this stage. What happens if John's marriage should fail? Would his equity in the farm ($2,080,000, before tax) be viewed as a family asset that would have to be divided between him and his wife on a 50/50 basis? What happens if John decides to give up farming after three or four years? Will he have received more than he should have done?

It is likely these issues would concern Alan and Elaine and would cause them to reject this option.

A third option would be for Alan to sell his livestock, machinery and quota to John and to rent the main farm. The quota could be sold at a value that would enable Alan to use his capital gains deduction and the equipment could be sold at his tax value. Again, the livestock would have to be sold at fair market value but Alan could defer tax until he received the sale proceeds.

If the transaction were structured on this basis, the sale price would be approximately $895,000, calculated as follows:

	Fair Market Value	Sale Price
Equipment	$ 150,000	$ 50,000
Livestock	225,000	225,000
Quota	2,000,000	620,000[1]
	$ 2,375,000	$ 895,000

(1) The sale price would likely be higher if there was a recapture of previous quota write-offs.

This is likely to be a better arrangement for the family because the gift to John is considerably smaller. It is not necessarily the best option, however, because Alan would have to include in his income the amount of his previous quota write-offs. This could result in a substantial tax liability.

A fourth option that may be more attractive to Alan and Elaine would be to transfer the farm assets to a company on a "rollover" basis. This type of arrangement could be put in place so that:

a) There would be no income tax payable at the time the farm is transferred to the company (except perhaps some refundable minimum tax if Alan sells his land at fair market value – see (b) below). An income tax election would have to be filed with Canada Customs and Revenue Agency.

b) Alan might make use of his capital gains deduction by electing to transfer his land to the company at its fair market value of $650,000. As mentioned above, he would have to consider whether there would be a liability for the refundable alternative minimum tax.

c) Alan would avoid tax on his other assets by electing to transfer them at his tax value.

d) On the assumption Alan elects to transfer his land at fair market value, he would receive the following consideration from the company:

Debt (which can be repaid free of tax)	$ 920,000
Fixed value, non-voting shares	2,305,000
	$ 3,225,000

e) Some or all of the future increase in the value of the farm would accrue to John through his ownership of the growth shares in the company.

f) The company would be controlled by Alan (and Elaine perhaps) through a separate class of voting, fixed-value, non-participating shares.

g) Alan and Elaine would receive an annual cash flow from the company to meet their living needs. This cash flow might be received in the following manner:

- directors fees
- wages
- interest on the debt owed to Alan
- dividends on the shares owned by Alan or
- debt repayments

h) Alan and Elaine would retain ownership of the additional parcel of land on which their residence is located. The farm portion of the property could be used by the company. Perhaps the company or John could be given a first right of refusal in the event the property is offered for sale after the death of the survivor of Alan and Elaine, or at the time they vacate the property, if earlier.

i) Alan would have an ability to gift some of the non-voting, fixed value shares to John, either during his lifetime or through his will.

j) Alan and Elaine would have the ability to bequeath the following assets to their three daughters through their wills:

- whatever remains of the $920,000 debt owed by the farm company (the terms of repayment could be specified in the parents' wills);
- the additional parcel of land (if, subsequent to Alan and Elaine's death, this parcel were to be sold by the daughters to John then, depending on the circumstances, any capital gain realized by them might be offset by their capital gains deductions); and

- some of the non-voting, fixed value shares. Depending on the circumstances, these shares would probably transfer to the daughters on a "rollover" basis.

  Subsequent to the parents' death, these shares would be re-purchased by the company or acquired by John. At that point, there would be income tax consequences to the daughters, or to John, that would have to be evaluated.

  To prevent the daughters' shareholdings from de-stabilizing the farm, Alan and Elaine would have to establish before their death the manner in which the daughters would be able to liquidate their investment. This would probably be accomplished through some sort of share repurchase agreement that would be entered into with the company and John.

As part of the overall arrangement, Alan could have the company purchase insurance (on a joint and last survivor basis) on the lives of himself and Elaine. He would have to seek advice from his accountant so that the policy didn't disqualify the company as a family farm corporation. After the parents' deaths, the company would receive the insurance proceeds and could use them to repurchase the shares inherited by the daughters.

By using insurance, John would be relieved of his obligation to buy-out his siblings. **Equally important is the fact that, depending on the circumstances, the daughters could have their shares repurchased without any tax implications.** Therefore, the insurance has two benefits. First, it can fund the buy-out of the non-farming children and second, in the right circumstances, it can eliminate the income tax that would otherwise apply when the non-farming children dispose of their shares.

An Incorporated Nursery

Situation

Mark and Diane are aged 62 and are looking to bring their three children into their nursery operation. There are two components to the business. The first is the growing operation which is carried out on five 20 acre parcels and one 10 acre parcel. The product is shipped on a wholesale basis to nurseries located throughout Western Canada as well as to the family's three nurseries located in B.C. The growing operation is supervised by Mark with the help of his son John.

The nursery operation is run by Diane with the help of the other two children, Bob and Mary. Approximately 30% of the nursery's products are grown on the family's property; the remaining 70% are purchased for resale.

The nursery operation is operated by a family company (Nursery Co.) that is owned equally by Mark and Diane. The six parcels of land are also owned by Mark and Diane.

The 10 acre parcel is used almost exclusively by Nursery Co. There is no formal lease arrangement; the land is simply made available to the company. The other five parcels are used exclusively to grow product for the other nurseries.

Mark and Diane would like to bring Bob and Mary into the Nursery Co. and to give John an ownership interest in the growing operation. Unfortunately, Bob's marriage is in difficulties at the moment and there is no certainty it will last very much longer.

Mark and Diane live on a property that is separate from their farm.

Some Preliminary Comments

Nursery Co. is unlikely to be a family farm corporation because a substantial portion of its assets are likely associated with the purchase and resale of nursery products (rather than the sale of products that are grown by the company). If this is the case, the consequences will be as follows:

- the shares of the company will not be eligible for "rollover" to the children
- the shares of the company may qualify as the shares of a small business corporation and, in which case, the capital gains deduction may be available
- the parcel of land that is used by Nursery Co. may not be qualified farm property. If this is the case, it will not be eligible for "rollover" to the children and it may not be eligible for the capital gains deduction either.

It is possible Nursery Co. might become a family farm corporation if it were to acquire the parcel on which it grows its products. Whether this is the case would depend on whether more than 90% of the value of Nursery Co.'s assets would then represent property that is used principally in the growing and selling of company-produced product. We will assume the value of purchased inventories is such that the above test would not be met and Nursery Co. would still not qualify as a family farm corporation.

What Are the Options?

An important element of any plan that Mark and Diane might put in place should be to arrange for the parcel of land used by Nursery Co. to qualify as farm property for purposes of the "rollover" rules and the capital gains deduction. In the circumstances, the most appropriate way of doing this might be for Mark and Diane to proceed as follows:

a) Transfer the six parcels of land to a new company (Grower Inc.) that will be operated as a family farm corporation for income tax purposes. This company will grow products for sale to Nursery Co. and the arm's length nurseries. (Mark and Diane would continue to own their residence.)

b) The parcel used to supply product to Nursery Co. would be "rolled" to the new company in exchange for debt and non-voting fixed value shares. An election would have to be filed with Canada Customs and Revenue Agency.

c) The parcels used to grow produce for other nurseries might be transferred at or near fair market value so as to make use of a portion of Mark and Diane's capital gains deduction. If this were to happen, the consideration to Mark and Diane might consist entirely of debt that can be paid to them free of tax.

In deciding this matter, Mark and Diane would want to take into account that the accrued gain on their investment in Nursery Co. will be taxed at some point (see below). This being the case, they may want to set aside a portion of their capital gains deduction to offset this future gain.

Mark and Diane would have to receive advice on the application of the refundable alternative minimum tax.

d) The company would be controlled by Mark and Diane but some of the growth shares would be issued to John.

e) Ultimately, all of the growth shares would likely be inherited by John. The additional shares could be gifted or bequeathed to him in the future, without income tax consequences, provided Grower Inc. remains a family farm corporation.

f) If necessary, to make the inheritances equitable, Bob and Mary could acquire some of the non-voting shares of Grower Inc. There would have to be an arrangement entered into beforehand setting out how these shares are to be repurchased by the company. This repurchase might be funded with life insurance on the lives of Mark and Diane.

g) Grower Inc. would maintain its family farm status by using all of its land to grow products for resale and by ensuring Mark, Diane or John are actively involved on a regular and continuous basis.

h) At some point, Mark and Diane might be prepared to give up their voting interest in Grower Inc. or Nursery Co. so that the two companies would no longer be associated for income tax purposes and each of them would be entitled to the low rate of tax on the first $200,000 of active business income.

In regard to Nursery Co., Mark and Diane need to recognize that because the entity is not a family farm corporation, they will not have the ability to transfer their shares to their children on a "rollover" basis. If the company is still owned on their deaths, the survivor of them will be deemed to dispose of their shares at fair market value and there may be a tax liability on the capital gain resulting therefrom. Whether a tax liability will exist will depend to some extent on whether the shares of the company qualify as "shares of a small business corporation" and, as such, are eligible for the capital gains deduction. It also depends on whether this deduction still exists at the time of death. Because of this, Mark and Diane may want to consider the following:

a) A freeze of their interest in the nursery company under which they would exchange their voting common shares for non-voting fixed-value shares.

b) Depending on the circumstances, it may be advantageous to structure the "freeze" so that Mark and Diane are treated for income tax purposes as having disposed of their shares to the company at or near fair market value. The resulting capital gain would be offset by claiming the capital gains deduction (provided the shares qualify as shares of a small business corporation).

   As an alternative, Mark and Diane might choose to use all of their capital gains deduction on the transfer of land to Grower Inc. (see above) and deal with the accrued liability on their shares in Nursery Co. in another manner. They could, for instance, decide to gradually redeem their freeze shares over their retirement years (perhaps in lieu of receiving a salary) so that on their death, the tax liability would be substantially eliminated. Professional advice would be essential because there are several issues to be considered.

An election may have to be filed with Canada Customs and Revenue Agency.

c) Mark and Diane would control the company through a separate class of voting, fixed-value shares.

d) A family trust might be created to acquire some or all of the growth shares. Because these shares would have no value when issued, they would be issued for a nominal price. The beneficiaries of the trust might be limited to Bob and Mary and, in which case, the trustees would be Mark and Diane.

Because the trust would be discretionary, Bob would not have any entitlement to the trust's property until Mark and Diane exercise their discretion and distribute it to him. Accordingly, his future interest should not be exposed to a claim from his wife if their marriage should fail.

Mark and Diane would have to realize that because trusts (other than spouse trusts) are generally treated as having disposed of their assets at 21 year intervals, this trust would have to be wound-up before the end of the 21 year period.

e) Mark and Diane would continue to receive an annual cash flow from the company in the form of:

- dividends on their freeze shares;
- directors fees;
- wages; or
- a repurchase of their freeze shares.

f) The trust would be wound up within 21 years and, at that point, Bob and Mary would acquire the shares owned by the trust. The distribution from the trust would not result in income tax.

g) Mark and Diane could bequeath the remainder of their non-voting fixed-value shares to Bob and Mary. If they made use of their capital gains deduction on the estate freeze, there may be little or no tax liability in respect of this asset on their death.

h) To the extent there is an accrued tax liability on the shares of Nursery Co., Mark and Diane’s will would provide that this liability is to be borne by Bob and Mary.

Appendix 2

Estate Plan Information

Advisers and Other Persons

	NAME	TEL #	ADDRESS
Accountant			
Bank			
Executors			
Insurance agent			
Solicitor			
Witnesses to will			
Others			

(Update periodically)

Cut out and retain with records

Business Information

ITEM	#	LOCATION
Chequing accounts		
Safety deposit box		
Savings accounts		

Important Agreements or Other Documents

ITEM	LOCATION
Shareholder agreement	
Partnership agreement	
Powers of Attorney	
Leases	
Other	

(Update periodically)

Cut out and retain with records

Major Assets

REAL ESTATE	
PROPERTY ADDRESS	**% OWNED**

MORTGAGES AND AGREEMENTS RECEIVABLE			
PRINCIPAL AMOUNT	**PROPERTY ADDRESS**	**MORTGAGOR/ PURCHASER**	**LOCATION OF DOCUMENTS**

TERM DEPOSITS, SHARES, BONDS AND OTHER INVESTMENTS		
PRINCIPAL AMOUNT OR # OF SHARES	**DESCRIPTION OF INVESTMENT**	**LOCATION OF SECURITY**

(Update periodically)

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Major Assets (continued)

FARM MACHINERY, EQUIPMENT AND VEHICLES		
ITEM	YEAR, MAKE AND MODEL	LOCATION

(Update periodically)

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Assets (continued)

FARM MACHINERY, EQUIPMENT AND VEHICLES		
ITEM	YEAR, MAKE AND MODEL	LOCATION

LIVESTOCK	
NUMBER	DESCRIPTION

(Update periodically)

Cut out and retain with records

Insurance

INSURANCE POLICIES			
PRINCIPAL AMOUNT	INSURANCE COMPANY	POLICY #	LOCATION OF POLICY

Liabilities

MORTGAGES AND AGREEMENTS PAYABLE		
PRINCIPAL AMOUNT	PROPERTY ADDRESS	LOCATION OF DOCMENTS

BANK LOANS	
PRINCIPAL AMOUNT	NAME AND ADDRESS OF BANK

INSURANCE POLICY LOANS			
PRINCIPAL AMOUNT	INSURANCE COMPANY	POLICY #	USE OF FUNDS

(Update periodically)

Cut out and retain with records

Leased Property

NAME AND ADDRESS OF LANDLORD	ADDRESS OF LEASED PROPERTY	RENEWAL DATE

Credit Cards

COMPANY	CARD #

Suppliers with Charge Accounts

NAME	ADDRESS

(Update periodically)

Cut out and retain with records

Location of Will

ADDRESS	PERSON TO CONTACT

Date Information Last Updated:

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(Update periodically)

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Appendix 3

Glossary of Terms Used in Estate Planning

Adjusted cost base: The "tax cost" that is used to determine the capital gain or capital loss realized on the disposition of a capital property. (See definition of capital property.)

The adjusted cost base (ACB) of land will generally be the amount paid for it although adjustments are required in certain situations. If the land was acquired before 1972, its ACB will generally be determined by reference to its fair market value at the end of 1971 (V-day value).

The ACB of buildings and equipment, etc. will generally be the amount paid for it.

The ACB of an interest in a family farm partnership (see definition of family farm partnership) is determined for each partner by reference to the cost of the interest, the capital contributions made to the partnership, the partner's share of profits and losses and his or her drawings. If the partnership existed at the end of 1971 there are some extremely complicated transitional rules to take into account.

The ACB of shares in a family farm corporation (see definition of family farm corporation) will generally be the amount paid for them although adjustments are required in certain circumstances. If the shares were acquired before 1972, their ACB may be determined by reference to their fair market value at the end of 1971 (V-day value).

Administrator: An individual or corporation appointed by a court to administer the estate of a person who dies without making a will, or the estate of a person who dies with a will, but without anyone prepared or able to act as executor.

Agreement for sale: A sale transaction in which the seller receives the sale price over a period of time and retains title to the sold property until all payments are received.

Allowable capital loss: The deductible portion of the capital loss realized on the sale of a capital property. (See definition of capital property.)

Attribution rules: The rules in the Income Tax Act that require income from a property or a capital gain or loss from the disposition of a property to be included in the tax return of a person who does not own the property. These rules apply in certain situations where funds or property are transferred by an individual to his or her spouse or to his or her minor child.

Bequest: A gift received from an individual through a will.

Buy-sell agreement: An agreement between business partners or shareholders which sets out important matters concerning their business relationship, including the manner in which the interests of each of the partners or shareholders are to be purchased on retirement and on death.

Canada Pension Plan: A compulsory social security programme of the federal government that provides a retirement pension and certain other benefits.

Capital beneficiary: A person who is entitled to a share of the **assets** held in a trust. (See definition of trust.) The interest of a "capital beneficiary" must be distinguished from that of an "income beneficiary". (See definition of income beneficiary.)

Capital cost allowance: The deduction that is allowed for income tax purposes in respect of the reduction in value of buildings, machinery and equipment that occurs through its use. This deduction is often loosely referred to as "depreciation" or C.C.A.

Capital property: A property that is acquired for investment purposes, or use in a business, that will give rise to a **capital** gain, and not an **income** gain, if it is sold at a profit. Land, buildings, machinery, equipment, shares in a farm corporation and an interest in a farm partnership will usually be capital property to the farmer.

Clearance certificate: A certificate to be obtained from Canada Customs and Revenue Agency by the personal representative of a deceased taxpayer before distributing the assets of the estate. Failure to obtain the certificate can make the personal representative personally liable for the deceased's outstanding tax liability.

Codicil: An addendum to a will.

Cost amount: A term meaning the "tax value" of a particular property.

The "cost amount" of typical farming properties is as follows:

Land	- its adjusted cost base (see definition of adjusted cost base);
Buildings, equipment, etc., depreciated on the reducing balance basis	- its undepreciated capital cost (UCC) for tax purposes (see definition of UCC);
Buildings, equipment, etc., depreciated on straight line basis	- its adjusted cost base (see definition of adjusted cost base):
Intangible assets	- 4/3 times the amount such as quota of the cumulative eligible capital (see definition);
Interest in a family farm partnership	- its adjusted cost base (see definition of adjusted cost base);

Shares in a family farm corporation	-	their adjusted cost base (see definition of adjusted cost base).

Cumulative eligible capital: The amount of a taxpayer's undepreciated expenditures made after 1971 on intangible assets such as quota. (These intangible assets are called eligible capital properties - see later definition.)

Earned income: The income that may be contributed (within limits) to a registered retirement savings plan in the year following the year in which it is earned.

Eligible capital property: Intangible properties (such as quota or goodwill) acquired in connection with a business. At the present time, three-quarters of the expenditure on such properties is added to the taxpayer's cumulative eligible capital and depreciated for tax purposes.

Family assets: The assets which, under B.C. Family Law, must be divided between a husband and wife in the event of a marriage breakdown, unless the court otherwise orders.

Family farm corporation: A farming corporation (company) that meets certain tests in the Income Tax Act so that its shares may be transferred from one generation to the next on a "rollover basis". (See definition of "rollover".) All or substantially all of its assets must have been used principally in carrying on a farming business in Canada and the farmer, his spouse or one of his children must have been actively involved in that business on a regular and continuous basis. A holding company will qualify as a family farm corporation in certain situations. (Refer to separate definition of a "share of the capital stock of a family farm corporation" used in connection with the capital gains deduction rules.)

Family farm partnership: A farming partnership that meets certain tests in the Income Tax Act so that the partners' interests may be transferred from one generation to the next on a "rollover basis". (See definition of "rollover".) All or substantially all of its assets must have been used principally in carrying on a farming business in Canada and the farmer, his spouse or one of his children must be actively involved in that business on a regular and continuous basis. (Refer to separate definition of an "interest in a family farm partnership" used in connection with the capital gains deduction rules.)

Family Relations Act: The legislation in British Columbia that deals with the division of assets that occurs when there is a marriage breakdown.

Formal will: A document, usually type-written, setting out an individual's wishes regarding the disposition of assets after his or her death, signed by the individual and two witnesses in the presence of each other.

Guaranteed renewal clause: A clause in a term insurance policy requiring the insurer to renew the policy even when the insured's health deteriorates. (See definition of term insurance.)

Income beneficiary: A person who is entitled to share in the income earned on assets held in trust. (See definitions of trust and capital beneficiary.)

Income-splitting: An arrangement which has the effect of transferring income from a "high tax-rate" person to a "low tax-rate" person so that the overall tax liability is reduced.

"In specie": Assets are distributed from an estate "in specie" if they are distributed in their present form. (The alternative would be to sell them and distribute the cash proceeds.)

Interest in a family farm partnership: A term used in connection with the capital gains deduction rules to describe a partnership interest that entitles the holder to the $500,000 capital gains deduction. The term is similar (**but not identical**) to the term "family farm partnership" (see Glossary) which describes a farming partnership that entitles the partners to transfer their interests to their children on a rollover basis. For purposes of the capital gains deduction, the partnership need not carry on the business of farming itself. Its property may be used in the business of farming by the individual partner, his or her spouse, children or parent or certain other entities. Throughout a period of at least two years more than 50% of the value of its assets must represent property that has been used principally in the business of farming in Canada and the partner, his or her spouse, child or parent must have been actively engaged in that business on a regular and continuous basis. At the time of sale of the interest, at least 90% of the value of its assets must represent property that has been used principally in the business of farming in Canada.

Inter-vivos: An "inter-vivos" transaction of a particular person is one carried out during his or her lifetime rather than after death.

Intestate: The term used to describe the estate of a person who dies without leaving a will.

Investment expenses: Expenses which may restrict an individual's ability to use the capital gains deduction. These expenses include net rental losses, interest on funds borrowed to acquire passive investments, losses from interests in limited partnerships and 50% of certain tax shelter deductions (see definition of investment income).

Investment income: Income of an investment nature that offsets investment expenses and makes it easier to use the capital gains deduction. This income includes dividends, interest and income from rental properties (see definition of investment expense).

Issue: All persons descended from a common ancestor.

Joint tenancy: A form of co-ownership under which the interest of a deceased person automatically passes to the co-owners.

Letters of Administration: A court-approved document giving a person the right to administer the estate of a person who dies without leaving a will.

Life annuity: An annuity that is payable throughout the life of the annuitant. There may be a guaranteed minimum pay-out period or a "joint and last survivor option" under which payments continue until the death of the survivor of the taxpayer and his or her spouse.

Life estate: An interest in property limited in time to the life of a particular person.

Old Age Security: The "old age" pension payable by the federal government to persons who meet the age and residence tests.

Permanent insurance: A type of life insurance that continues its coverage through to the death of the person insured. (See definition of term insurance.)

Personal trust: A term used in connection with the capital gains deduction rules which is defined to include testamentary trusts (see Glossary) and most inter-vivos trusts.

Per stirpes: The basis of dividing the share of a deceased beneficiary amongst his or her descendants according to their relationship to the deceased. (e.g. A father dies and is survived by his son and two children of his deceased daughter. On a per capita basis each would receive one-third whereas on a per stirpes basis the son would receive one-half and each grandchild would receive one-quarter.)

Principal residence: An owner-occupied home that can be sold at a profit without paying income tax.

Qualifying farm assets: A term used in this publication to describe the farming assets that can be transferred by an individual to his or her child on a rollover basis (see Glossary for meaning of "rollover"). The property is:

- land;
- buildings, equipment, etc. depreciated for income tax purposes on the reducing balance basis;
- eligible capital property (e.g. quota) (see definition);
- a family farm corporation (see definition); and
- a family farm partnership (see definition).

The land, buildings and equipment, etc. must be owned by the individual and, prior to the transfer, must have been used by him, his spouse, or any of his children principally in the business of farming in Canada. Moreover, the individual, his spouse or his children must have been actively engaged in the business on a regular and continuous basis.

Registered Retirement Income Fund: A fund administered by a financial institution and registered with Canada Customs and Revenue Agency, into which an individual can transfer his or her accumulated registered retirement savings plan monies on retirement. The individual would then withdraw amounts from the fund throughout the remainder of his or her life.

Registered Retirement Savings Plan: A plan offered by a financial institution and registered with Canada Customs and Revenue Agency that allows an individual to save for his or her retirement by contributing amounts to the plan each year. Within limits, the amount contributed is deductible from the individual's income and compounds free of tax while it is held in the plan.

Representation Agreement Act: B.C. legislation that came into force in 2000 that significantly expands upon the scope of enduring powers of attorney.

Reserve: A deduction that may be claimed for income tax purposes in a particular year where a taxpayer sells a property and the sale price is payable over a period that extends beyond the end of that year.

Rights or things: The term given to items such as livestock, inventories and accounts receivable of a "cash-basis farmer" that are given special treatment in the final income tax return of a deceased individual.

Rollover: A term used in this book to describe a transfer of property in which the person disposing of the property is not automatically taxed as though he or she received fair market value. Property disposed of in a "rollover" transaction is usually treated as having been transferred at a value between its cost amount (see Glossary) and fair market value.

Share of the capital stock of a family farm corporation: A share in a farm corporation (company) that entitles the shareholder to the $500,000 capital gains deduction. The term is similar (**but not identical)** to the term "family farm corporation" (see Glossary) which describes a farming corporation that entitles the shareholders to transfer their shares to their children on a rollover basis. For purposes of the capital gains deduction, the corporation need not carry on the business of farming itself. Its property may be used in the business of farming by the individual shareholder, his spouse, children or parent or certain other entities. Throughout a period of at least two years more than 50% of the value of the company's assets must generally represent property that has been used principally in the business of farming in Canada; and the farmer, his spouse, child or parent must have been actively engaged in that business on a regular and continuous basis. At the time of the sale of the share, at least 90% of the value of the company's assets must generally represent property that has been used principally in the business of farming in Canada.

Siblings: Brothers or sisters.

Sole proprietorship: A business carried on by an individual.

Spouse: For purposes of the Income Tax, a spouse includes a common-law spouse.

Spouse trust: A trust established by a taxpayer for the benefit of his spouse. Property transferred to such a trust is deemed to be disposed of for income tax purposes on a "rollover basis" if certain requirements are met.

Taxable capital gains: The taxable portion of the profit realized on the disposition of a capital property. (See definition of capital property.)

Tenancy in common: A form of co-ownership under which the co-owner's interest can be gifted, sold or bequeathed to any person.

Term annuity: An annuity payable for a specified number of years.

Terminal loss: The undepreciated capital cost (UCC) of a particular fixed asset class that can be deducted from income when all assets of that class have been disposed of. (See definition of UCC.) There are rules which restrict the deduction of a terminal loss by a corporation, trust or partnership in certain situations.

Term insurance: A type of life insurance that is usually less expensive than other types and is renegotiated on the policy anniversary date. It becomes progressively more expensive as the individual becomes older and may become non-renewable if the individual's health deteriorates and there is no guaranteed renewal clause in the policy. (See definitions of guaranteed renewal clause and permanent insurance.)

Testamentary trust: A trust established by the will of a deceased individual. (See definition of trust.)

Testator/Testatrix: The person who makes a will (testator - male; testatrix - female).

Trust: An arrangement under which assets are set aside by an individual and administered by a trustee for the benefit of another person.

Undepreciated capital cost (UCC): The undepreciated expenditures in respect of buildings, machinery and similar properties, calculated by asset class and written off on a reducing balance basis.

Vest indefeasibly: A property "vests indefeasibly" if the person acquiring it obtains a right to absolute ownership in such a manner that the right cannot be taken away by any future event.

Wills Variation Act: A statute in British Columbia that allows a court to vary the provisions of a will if it considers that the testator has not provided adequately for his or her spouse or children.