Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

The family farm and Will planning

Addressing farm succession in your Will

Please contact us for more information about the topics discussed in this article.

The 2016 Census of Agriculture indicated that over half of all farmers in Canada are 55 years of age or older. As such, succession planning is becoming very important. The Census also found that in 2016, 8.4% of farms nationally reported having a written succession plan. Among sole proprietorships, 4.9% had a written succession plan compared with 16.3% of family and non-family corporations. If you haven't already done so, it may be time for you to start thinking about succession planning. This article discusses addressing farm succession planning in your Will.

The term "spouse" used in this article also refers to common-law partner or same-sex partner.

Estate planning for your farm

Your farm may be your most valuable asset and may be a significant part of what you leave your family upon your passing. This article discusses the integration of your farm into your estate plan so that you may leave your farm assets to your loved ones in a tax-efficient manner.

You may want to retain ownership of your farm property during your lifetime and gift it to your family members as part of your estate. If so, it is important to have an estate plan in place that addresses your farm assets. Depending on whom you wish to inherit your farm, there may be tax strategies available to minimize or eliminate immediate taxes upon your passing. The first step in ensuring your farm assets pass to your intended beneficiaries is to draft your Will.

What is a Will?

A Will is a legal document that can help ensure that your assets pass according to your wishes after your death. Your Will only becomes effective on death. You can change the terms or revoke your Will during your lifetime if you have the mental capacity to do so.

Your Will should name your executor(s) (liquidators in Quebec), the individual(s) and/or institution (e.g. trust company) that will act on your behalf to carry out your wishes. Without a Will, the courts may appoint an administrator for your estate, who may not be the individual or institution you would have chosen. Also, your estate will be distributed in accordance to the provincial or territorial intestacy rules which may differ significantly from your wishes.

An estate plan that incorporates a Will can allow you to communicate instructions and strategies to your executors. This may include, for example, providing sufficient income for your spouse and children to maintain their lifestyle. Your legal professional can draft your Will in a way that allows your executor to implement tax strategies for the transfer of your farming assets. There are different tax implications and opportunities depending on whom you name as beneficiary of your farm property. This article discusses the implications and strategies available if you are leaving farm property to your spouse, child and other individuals.

Leaving farm property to your spouse

Leaving farm property to your spouse is the easiest way to achieve a tax deferred transfer of your farm assets. Upon death, you are generally deemed to have disposed of all of your capital property at fair market value (FMV) immediately before death. However, a rollover is possible if assets are left to your spouse. If your spouse inherits your farm property, they will receive it at your adjusted cost base (ACB), with no immediate income tax implications. They may defer the taxes payable on the unrealized gains on your farm property until they sell the farm property or pass away.

Electing out of the spousal rollover

While it normally makes sense to defer the capital gains tax as long as possible, you may want to trigger the gain in some cases. For example, if you have not used your lifetime capital gains exemption (LCGE), you may be able to do so regardless of how you have structured the ownership of your farm (e.g. owning the farm assets personally or through a corporation) on death. The LCGE may allow you to realize up to $1 million of capital gains on the deemed disposition of your farm tax-free. Your executor may file an election so that certain qualified farm property (e.g. land, depreciable property, shares in a family farm corporation, or an interest in a family farm partnership) transfers to your spouse at its FMV rather than at your ACB. This allows your spouse to inherit the qualified farm property at FMV and the FMV becomes the ACB of the property in your spouse's hands.

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Electing out of the rollover may also make sense where you have unused capital loss carryforwards that expire upon your death. The election may allow your spouse to reduce the total taxes payable on the eventual disposition of the farm property.

Testamentary spousal trusts

You may also choose to have your farm assets rollover to a testamentary spousal trust. This means that the testamentary spousal trust may receive the farm assets at your ACB without any immediate tax implications. This is a trust established for the benefit of your surviving spouse through the provisions of your Will. The following conditions must be met in order for the rollover to take place at your ACB:

- The transfer of property must occur as a consequence of a your death to a trust created in your Will;
- Your surviving spouse must be entitled to receive all income from the testamentary spousal trust during their lifetime. In addition, no other person may obtain the use of any of the income or capital of the trust during your surviving spouse's lifetime;
- The trust must be resident in Canada immediately after the time the property is vested indefeasibly in the trust;
- You (immediately prior to death) and your spouse must be residents of Canada;
- The property vests indefeasibly in the trust within 36 months of your death. Generally, property vests indefeasibly when the acquirer (i.e. in this case, the trust) has absolute and unconditional legal or beneficial ownership in the property.

If you wish to have your spouse inherit the farm on your passing but want your children to receive the farm once your spouse passes away, you may want to consider a testamentary spousal trust. When your spouse passes away, the trust may be able to distribute the farm property to your children (based on directions in your Will) at a value between the ACB and the FMV on the date of death of the surviving spouse, as elected by the trustee.

It is important to consult with a qualified legal advisor to assist you in drafting your Will as well as obtain advice as to how the trust should be administered if you decide to employ this strategy.

Leaving your farm property to a child or children

You may also be able to avoid a deemed disposition on death when you transfer farm property to a child or children if the following conditions are met:

- The child is or children are residing in Canada just before your death;
- The farm property is situated in Canada;
- The farm property, before your death, was used principally in a farming business in which you, your spouse or any of your children, or parents were actively engaged on a regular and continuous basis; and
- The farm property is transferred to your child as a consequence of your death and becomes vested indefeasibly in your child within 36 months after your death (a longer vesting period may be granted under special circumstances).

A child, or children include(s) children, stepchildren, adopted children, grandchildren, great grandchildren and their spouses who are residents of Canada. The conditions for "used principally" and "actively engaged on a regular and continuous basis" are the same as those discussed in the article titled "Selling the Farm and the Lifetime Capital Gains Exemption". Please ask your RBC advisor for a copy this article.

Even if the assets qualify for a rollover, in some cases you may want to transfer the qualified farm property to your child at a value between its ACB and FMV. This may make sense where you have an unused LCGE to offset any accrued capital gains on your qualified farm property or you have capital loss carryforwards that expires upon your death. By electing out of the rollover, you may allow your child to reduce the total taxes payable when your child disposes of the property.

For qualified farm property that is depreciable property you can choose to transfer the property to your child at any value between its undepreciated capital cost (UCC) and its FMV. Please note though, that if you transfer at a value higher than the UCC, it may result in taxable income to you, known as recapture, which cannot be sheltered by the LCGE.

> As part of your estate plan, you may wish to leave farm assets to your minor children. However, one of the criteria that you must meet in order to be able to rollover farm property to your children at death, is that the property must vest indefeasibly in the child within 36 months after your death.

Alternative minimum tax (AMT)

One of the potential issues with triggering capital gains on the transfer of farm assets during your lifetime and using the LCGE is the application of AMT. AMT does not, however, apply in the year of death. For situations where the LCGE is available, or a deceased individual has significant capital losses, it may be more tax-efficient to trigger a gain when transferring the farm assets to your spouse or the child on death. This may allow your spouse or your child to receive the property with a higher ACB, while having little or even no tax impact on the estate.

Family farm corporation

Note that each share of a family farm corporation is considered a single property. As a result, transferring shares of a family farm corporation at death to either your spouse or children provides additional flexibility for tax planning. For example, an executor may choose to rollover some shares of your family farm corporation at the ACB and transfer the remaining shares at FMV in order to trigger sufficient capital gains to use your LCGE and/or your remaining net capital losses.

Minor children considerations

As part of your estate plan, you may wish to leave farm assets to your minor children. However, one of the criteria that you must meet in order to be able to rollover farm property to your children at death, is that the property must vest indefeasibly in the child within 36 months after your death. This may cause an issue if you leave your farm assets to your children via a testamentary trust and the trust only distributes the property to them when they reach the age of majority or at an age where you feel they will be mature enough to own the farm property directly.

The Canada Revenue Agency has indicated that property held in a trust for a minor child can still be considered to have vested indefeasibly in the beneficiary if, among other

things, the absolute ownership of the property is gifted and the trust does not allow for a future event to change the individual's ownership of the property.

As such, if you wish to leave your farm assets to your minor child via a testamentary trust and the asset is not distributed to the minor child within 36 months after your death, the requirement to 'vest indefeasibly' can still be met provided the minor child's ownership rights cannot be defeated by any future event (i.e. it is an irrevocable trust and your Will does not dictate, nor does the trustee have the discretion to select, to whom the property will pass).

You may also wish to consider leaving farm assets to your minor child via a testamentary trust, as opposed to an outright gift, to avoid any requirement for a guardianship appointment to manage the farm assets on your child's behalf.

Considerations when transferring farm assets to children

Before you bequeath your farm to your children, consider whether they are interested in operating your farm. If some of your children are not interested in farming, it may not make sense to transfer the assets to your children in equal shares. Instead, you could transfer the farm assets to the children who have an interest in the business and provide an equivalent of other assets to the non-farming children. Prior to implementing any strategy, it is a good idea to discuss farm succession matters openly with your children. Regular family meetings are an important part of farm succession. These will help you determine which of your children are interested in farming and ensure all family members are aware of the succession plan.

Leaving farm property to other individuals

Leaving your farm property on death to individuals other than a spouse, parent or child will result in a deemed disposition at FMV. This may trigger capital gains or recapture, which will need to be included in your final tax return. To the extent that any of the assets transferred are qualified farm property, your executor may be able to use the LCGE on your final tax return, if available to reduce or eliminate your tax liability. Your beneficiary will receive the farm assets with an ACB equal to the FMV of the farm assets on the date of your death.

In certain circumstances, if the child originally acquired farm property from a parent, the farm property may be transferred back to the parent upon death of the child on a rollover basis.

Estate planning involves not only the transfer of your assets on your death but a variety of other personal considerations. A Will is not the only document you should have prepared. A Power of Attorney (POA) or Mandate in Anticipation of Incapacity in Quebec for property and for personal care is also a common element of a comprehensive estate plan.

Other estate planning considerations

Probate tax

If your farm assets pass through your Will, they are generally subject to probate. Probate is the process by which the court confirms the validity of the deceased's Will and the authority of the executor (liquidator) to carry out the terms of the Will. In general, when an executor applies to court for probate, a tax must be paid to the provincial government. The probate tax rates vary among the provinces. Depending on your province of residence and the value of your assets, your estate may need to pay significant probate taxes. One way to avoid probate tax on your farm assets is to transfer your farm property to your spouse, children, or other individuals during your lifetime. This way, they will not form part of your estate and will not be subject to probate tax on your death.

Power of Attorney

Estate planning involves not only the transfer of your assets on your death but a variety of other personal considerations. A Will is not the only document you should have prepared. A Power of Attorney (POA) or Mandate in Anticipation of Incapacity in Quebec for property and for personal care is also a common element of a comprehensive estate plan.

Give your family and yourself peace of mind by consulting a legal professional, who specializes in Will and estate planning, to prepare a thorough and up-to-date Will and POA. This can help avoid unnecessary stress and expense at the time of your death, or in the event of incapacity, and ensure that your wishes are carried out.

Conclusion

With 193,500 farms in Canada, farming is an important part of Canada's economy. If you own farming property, it is important to plan an exit strategy while taking

into account tax, retirement and business succession considerations. If you decide to retain ownership of your farm throughout your lifetime, consider planning strategies for the time when your heirs inherit your farm. If you decide to leave your farm to your spouse or your children, there are tax-deferral opportunities available to help reduce the possibility of leaving your estate with a large tax liability. A properly drafted Will can help your executor distribute your farm and other property according to your wishes on your death.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax, or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal, and/or insurance advisor before acting on any of the information in this article.

Wealth Management

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