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INTELLIGENT FARMER™

lorkovicwealth.com

Farm advisors helping your family make important decisions.

SUCCEEDING IN YOUR FARM'S SUCCESSION

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SUCCEEDING IN YOUR FARM'S SUCCESSION

For agriculture to prosper in the future, it is important to have a successful transfer from one generation to the next. Tax and other issues must be considered to ensure your farm lives on the way you've envisioned.

Some of the items that require discussion when developing a succession plan are:

- Will the parents transfer complete ownership?
- How will management decisions be made?
- If the parents are retiring, what are their income expectations?
- Can the farm afford to pay off any debt the parents take back on the transfer of ownership?
- How will non-farming children be treated?

The following is a review of some of the tax rules relating to farm transfers both before and upon death and we have also looked at family dynamics and how it affects succession planning.

Tax issues

Transferring the farm property prior to death

The basic rule for asset transfers to children for proceeds less than fair market value is that the parent is considered, for tax purposes, to have disposed of the property at fair market value. However, for the transfer of certain farm property (which includes land, depreciable property and eligible capital property such as quota, but does not include inventory) a special rule exists. Providing the farm property was, before the transfer, used principally in the business of farming (usually means more than 50%) and a family member was actively involved, the assets can generally be transferred at cost, fair market value or any value in between. Note that for depreciable property and quota, the cost amount will be the undepreciated capital cost. The ability to transfer at any price up to fair market value results in a great deal of flexibility when trying to maximize the tax position of the parent and the child.

If any capital gains are triggered, the $1,000,000 capital gains exemption may be available to offset the gain. If the exemption is used to increase the cost base of depreciable property or quota, special rules prevent such an increase from being available for future tax depreciation by the child. However, the increased amount or cost will be used to calculate any capital gains the child may have on their own sale or transfer in the future.

Transferring the farm property upon death

In general, a taxpayer, upon death, is deemed to dispose of everything owned immediately before death. However, a number of provisions allow properties to be transferred at cost so that no immediate taxes are owing.

Special rules allow certain farm property to transfer to a child on death at cost, fair market value or any value in between. One of the conditions is that the farm property must "vest indefeasibly" to the child within 36 months of death. This basically means the child must have absolute ownership with no strings attached within 36 months of death.

Inventory

No special provisions exist to allow farm inventory to pass between parents and children without tax. For transfers to children, often a note is taken by the parent (assuming cash basis reporting is used for tax purposes). Such a note allows the parent to take into income the value of the inventory only as payments on the note are received. This spreads out the income over a number of years.

Capital gains exemption

Access to the $1,000,000 capital gains exemption on qualified farm property for the parents is always a consideration when a transfer is being contemplated. When claiming the capital gains exemption, be mindful of potentially triggering of alternative minimum tax. And although the exemption might reduce or even eliminate the tax liability, the taxable capital gain arising from the sale of farm property is considered income that may affect income tested benefits, such as Old Age Security (OAS). Again, proper planning can reduce or eliminate these adverse consequences.

Family dynamics

While tax considerations certainly need to be addressed in any succession plan, one cannot ignore the impact of the family dynamics in this process. Family business advisors indicate that over 80% of family business transition failures can be attributed to the unawareness of and/or inability of business families to adequately address family dynamics.

Working together as a family contains many advantages, such as a shared history, awareness of one another's strengths and weaknesses, and trust and care for each other. Families who learn to work well together can have a successful business now as well as in the future.

However, there are also challenges. The ability to communicate effectively, resolve conflicts, make decisions and differentiate the family and the business can have a profound effect on the success of the business. The potential for conflict among family members and between generations is most likely to surface during the following three periods:

- During the successor's entry into the family business;
- During the succession planning process; and
- During the retirement of the founder.

Communication

Communication, or lack of it, is a common problem for families in business together. Family members that work together have the added complexity of needing to communicate at three different and distinct levels:

1) As family members on an emotional level;

2) As owners on a strategic level; and

3) As managers on an executive level.

This can be very challenging. Regular family/business meetings can greatly improve communication which in turn will increase productivity and build strong relationships.

Founders

In some cases, founders have difficulty in "letting go." They have difficulty in talking about succession, giving up control and refuse to make contingency plans for the business. The inability to let go can be very harmful to the family, the business and succession.

The following are some reasons founders have given to why they can't let go:

- "Nobody can run the business as well as I can."
- "The business is my major source of income – I need to protect it."
- "I have more than one capable child who can take over and I don't want to have to choose."
- "I need someplace to go."
- "The children want to change the way the business is run."
- "I don't know that what I'll do after – I have no hobbies or other interests."
- "People don't live long after retirement."

In order for the business to succeed during and after succession, founders must accept the fact that it is time to begin transferring the business to the next generation.

Farm family styles

Recognition of different "business styles" can help when two or more individuals are working together. Research has categorized two fundamental approaches to farming: the "expander" and the "conservator."

The expanders have entrepreneurial drive, high ambition, vision and high need for control. They are greater risk takers, willing to leverage to expand their business. Retirement is not planned.

The conservators tend to achieve success through hard work and a more cautious approach to debt and expansion. They stray from debt thereby usually passing down the farm to the next generation with little or no debt. They tend to plan for retirement making succession much easier.

Recognizing these styles as they apply to parents and children alike will assist the family recognizing the potential hurdles to overcome in the succession planning process.

The transfer of a family farm to the next generation is an issue that most farmers face at some point in time. Your accountant or other tax professional can assist with this process by facilitating discussion, illustrating alternatives, as well as implementing and monitoring any plan that has been put in place.

Thomas Blonde
Partner - Baker Tilly GWD

REDUCE YOUR RISK, BOOST YOUR BUSINESS, IMPROVE YOUR RATES:

Six ways to protect your farm and make your banker happy too.

As a farmer and business owner, sometimes it can feel like your banker speaks another language, but when you're applying for a loan to build a new barn or buy a new piece of equipment or ground, there are a few key aspects you can focus on to improve your business and even impact your lending rates.

Carson Burtwistle
Agricultural Manager,
RBC Royal Bank

Management skills and financial health are two vital aspects of any successful business, we touched on these broadly in Intelligent Farmer Issue #3. This issue, we'll dive deeper into one important aspect of managing any business:

Mitigating risk.

The main reason to mitigate risk is to protect your business and ensure it is sustainable as it grows. Managing risk associated with rising interest rates, volatile markets, unpredictable weather, and various other factors is crucial to maintaining a business that provides wellbeing to your family and your employees. For many farmers, the thought of going out of business or taking a loss provides motivation to have risk management strategies in place, but did you know that protecting your farm also makes you a better manager in the eyes of your lender?

What does the bank look for in regards to risk management on your farm?

Your account manager wants to know that you have a strategy in place, that you have a plan for years when the weather doesn't co-operate or the markets go the wrong way. You don't want to lose your shirt and we don't want you to lose it either.

Six tools to protect your farm and make your banker happy too:

1. Crop insurance, Agri-Invest/ Agri-Stability, Ontario's Risk Management Program (RMP) and other government support programs: There are various support programs from the federal and provincial governments to help cover costs when things don't go quite right.

2. Forward contracting/ Pre-paying: Price looks good? Why not consider locking it in? Whether it is the price for your finished livestock or the grain in the bin, if the price is good, forward contracting can eliminate the risk of the price dropping. Visa-versa, if the price of an input can be locked in ahead of time, you can prevent an unexpected increase to your cost of production. Both locking in prices for inputs and your finished product can help protect your profits and prevent losses.

3. Commodity hedging: Consider working with a broker to hedge the risk of increasing input costs or decreasing market prices. Though somewhat more complicated than locking in a price with a forward contract, futures and options contracts can be great tools to protect profit margins.

4. Diversification: As the old saying goes; "don't put all your eggs in one basket." Diversifying can be as simple as planting a variety of different crops and as complex as growing your farm into multiple sectors of agriculture. This way, if one part of your business might be taking a loss, there are other sources of income to cover expenses.

5. Foreign exchange: Canadian agriculture is heavily reliant on exports, if you're in the business of importing or exporting, make sure you're getting the best exchange rates and locking them in when they look good. A swing in the global economy and exchange rates could all of the sudden mean your input costs have increased significantly or your selling price has hit rock bottom.

6. Fixing interest rates: With interest rates recently trending upwards, fixing rates for longer periods of time is a strategy that some business owners are choosing to take. While there are no guarantees which way rates will trend in the next five to 10 years, locking in rates means you know how much interest you will be paying for a pre-determined period of time. You can plan around this expense and be confident your rate won't increase during that time.

Risk is always a hot topic in agriculture, it's the nature of the industry. Markets rise and fall, as weather changes throughout each growing season, but these swings don't mean that your bottom line has to take a huge hit or that your business has to struggle. Try to research risk mitigation tools that may work for your farm. Your RBC Agriculture Account Manager can point you in the right direction for any of the strategies mentioned and refer you to people with-in RBC that can execute strategies around hedging, foreign exchange and fixing interest rates.

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2019 HANDY FINANCIAL PLANNING FACTS

The following is a summary of some common financial planning-related information.
Any values noted below are for 2019 unless stated otherwise.

GOVERNMENT LIMITS	
RRSP — maximum annual deduction limit	$26,500 for 2019; $26,230 for 2018
RRSP — withholding tax on withdrawals	10% (20% in Quebec) for amounts $0 – $5,000 20% (25% in Quebec) for amounts $5,001 – $15,000 30% (30% in Quebec) for amounts over $15,000
TFSA — maximum annual contribution limits	$5,000 each year 2009 – 2012 $5,500 each year 2013 – 2014 $10,000 for 2015 $5,500 for 2016 – 2018 $6,000 for 2019
TFSA — maximum contribution limit since inception	$63,500 from 2009 – 2019
IPP — Employment earnings required to contribute the maximum	$151,278 for 2019; $147,222 for 2018
YMPE — yearly maximum pensionable earnings	$57,400
CANSIM rate	2.39%
GOVERNMENT BENEFITS	
CPP/QPP — maximum benefit at age 65	$1,154.58 per month
CPP/QPP — early maximum benefit at age 60	$738.93 per month (36% max reduction or 0.6% per month)
CPP/QPP — deferred maximum benefit at age 70	$1,639.50 per month (42% max increase or 0.7% per month)
CPP/QPP — maximum employee and employer contributions	CPP $2,748.90 each annually / QPP $2,991.45 each annually
CPP/QPP — maximum self-employed contributions	CPP $5,497.80 annually / QPP $5,982.90 annually
OAS — maximum benefit for Q1 at age 65	$601.45 per month
OAS — deferred maximum benefit for Q1 at age 70	$817.97 per month (36% max increase or 0.6% per month)
OAS — clawback rate	$0.15 for every $1 of net income above $77,580; the full OAS is eliminated at a net income of $125,696
EI — maximum annual premiums for employee and self-employed	$860.22 ($663.75 in Quebec due to separate maternity and parental benefits)
EI — maximum annual insurable earnings	$53,100

TAX		
Federal basic personal amount	$12,069 (base) $1,810 (credit)	
Federal age amount	$7,494 (base) $1,124 (credit)	
Net income threshold for age amount	$0.15 for every $1 of net income above $37,790; the full age amount is eliminated at a net income of $87,750	
Federal tax brackets and rates based on taxable income	Taxable income	Federal rate
	Up to $47,630	15%
	Over $47,630 up to $95,259	20.5%
	Over $95,259 up to $147,667	26%
	Over $147,667 up to $210,371	29%
	Over $210,371	33%
Eligible dividends (most public companies)	Gross up is 38%; taxable amount is 138%; Federal tax credit is 15.02% of taxable dividend	
Non-eligible dividends	Gross up is 15%; taxable amount is 115%; Federal tax credit is 9.03% of taxable dividend	
Lifetime Capital Gains Exemption (LCGE)	$866,912 for qualified small business corporation shares $1,000,000 for qualified farm or fishing property	
EDUCATION — RESP		
Maximum contributions	Unlimited annual contributions up to a lifetime maximum of $50,000 per beneficiary	
Annual basic CESG (grant) limit	20% on first $2,500 of contributions per beneficiary (up to a maximum of $500)	
Annual additional CESG limit	Additional 20% on first $500 of contributions per beneficiary (up to a maximum of $100), if net income is $47,630 or less; Additional 10% on first $500 of contributions per beneficiary (up to a maximum of $50) if net income is between $47,631 and $95,259	
Maximum lifetime CESG limit	$7,200 per beneficiary	
Maximum annual CESG if unused carry-forwards	$1,000	
DISABILITY — RDSP		
Maximum contributions	Unlimited annual contributions up to a lifetime maximum of $200,000	
Annual CDSG (grant) limit	$3,500 grant per $1,500 contribution if 2017 net income is $95,259 or less; $1,000 grant for $1,000 contribution if 2017 net income above $95,259	
Annual CDSB (bond) limit	$1,000 if 2017 net income is $30,000 or less; A portion of the $1,000 if 2017 net income is between $30,000 and $47,630; No bond if 2017 net income is over $47,630	
Maximum lifetime CDSG and CDSB limit	$70,000 for CDSG and $20,000 for CDSB	
Maximum annual CDSG and CDSB if unused carry-forwards	$10,500 for CDSG and $11,000 for CDSB	
U.S. LIMITS		
U.S. estate and gift tax exemption	$11,400,000 USD	
U.S. gift tax exemption — non-U.S. married spouse	$155,000 USD	
U.S. gift tax exemption — children/others	$15,000 USD	
GOVERNMENT LINKS		
Canada Revenue Agency website	http://www.cra-arc.gc.ca/	
Canada Revenue Agency General Help Line for Individuals	1-800-959-8281	
Phone number and website for CPP and OAS queries	1-800-277-9914 https://www.canada.ca/en/employment-social-development/corporate/contact/index.html	
Phone number and website for QPP queries	1-800-463-5185 http://www.rrq.gouv.qc.ca/en/services/nous_joindre/Pages/nous_joindre.aspx	

It starts with getting to know *you,* your *family,* and your *business.*

Our growing group of farming clients looks to us for advice that goes beyond the challenges of agricultural production. You've worked hard to get your operation to where it is today. One day - whether in one year, 10 years, when you pass away, or at some other time - someone else will run this operation. ***No two families are the same, so neither should their transition plans.***

Let's grab a cup & chat.

Lorkovic Wealth Management of RBC Dominion Securities believes that sound financial advice encompasses far more than just investment advice. Therefore we look at your total financial situation and offer you a comprehensive range of investment, financial, tax minimization, insurance, wills and estate planing, and legacy creation services.

An extended team of specialists supplements your core team of dedicated professionals. We draw upon the expertise of this group – on your behalf – as circumstances dictate.

Contact us today at 519-747-5541 or visit lorkovicwealth.com and find out how we can help you put a plan in place that you can be confident about.




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