



Wealth
Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES



Sean Fraser
Investment Advisor
Tel: 705-759-1171
sean.a.fraser@rbc.com

RBC Dominion Securities
432 Great Northern Rd., Suite 300
Sault Ste. Marie, ON P6B 4Z9
Tel: 705-759-1171
Fax: 705-759-0699

Transferring your farm to the family

Leaving your farm to your family in a tax-efficient manner

Statistics Canada conducts the Census of Agriculture (Census). The latest Census, completed in 2016, indicated that over half of all farmers in Canada are age 55 or over. As such, succession planning is becoming very important. The Census also found that in 2016, 8.4% of farm owners 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 a good time to start thinking about succession planning. There are generally two ways to divest of your farm assets, selling to a third party or transferring the farm to family members. This article discusses the mechanisms available to transfer your farm to your family members in a tax-efficient manner. For a discussion of the opportunities to reduce or minimize tax when selling your farm to a third party, ask your RBC advisor for a copy of the article titled, "Selling the farm and the lifetime capital gains exemption".

Any reference to spouse in this article also includes a common-law partner.

Keeping the farm in the family

Your farm may be your most valuable asset and you may rely on it to fund your retirement and achieve your other financial goals. You may decide to pass your farm to your spouse or children during your lifetime so that they can continue operating what you've built. When doing so,

it's helpful to understand there are strategies to minimize your tax liability and maximize your wealth.

Canadian tax rules allow the transfer of qualified farm property to your spouse or children on a tax-deferred basis. Additionally, you may be able to use your lifetime capital gains exemption (LCGE) when you transfer farm property to certain family

members. This article discusses the tax implications of transferring qualified farm property during your lifetime to your spouse and/or children and includes a brief contrast of how these transfers differ from transfers to other individuals.

Transferring farm property to your spouse

You may roll over certain capital property at your adjusted cost base (ACB) to your spouse, or to a qualifying spousal trust, at any time during your lifetime, provided both you and your spouse or the spousal trust are resident in Canada at the time of the transfer. Capital property that can be rolled to a spouse includes qualified farm property. Your spouse will receive the farm property with an ACB equal to your ACB or, in the case of depreciable property, including Class 14.1 property (e.g. goodwill, farm quotas), equal to your undepreciated capital cost (UCC). This will allow you to defer your capital gains tax and recapture of capital cost allowance (CCA) until your spouse sells the property or passes away.

Qualified farm property that's eligible for this rollover includes land, buildings, machinery, shares of a family farm corporation and an interest in a family farm partnership. Inventory does not qualify for a rollover, and if you transfer inventory during your lifetime, you must transfer it at its fair market value (FMV). If you plan to transfer farm inventory to your spouse, and the inventory assets are significant, you may consider transferring these assets over a number of years instead of in a single year. This way, you're able to spread the income over a number of years, and ideally, have it taxed at lower graduated tax rates than you would if you realized the income all in one year. Another strategy could be to transfer the farming assets, including inventory, to a family farm corporation, and then transfer the shares of this corporation to your spouse on a tax-deferred basis.

You may trigger the attribution rules if you transfer the above-mentioned farm property to your spouse at its ACB or at its UCC. When your spouse eventually sells the property, any capital gains or recapture of CCA, generated on the sale of the farm property by your spouse, may be taxable to you.

To avoid the attribution rules, you may sell the farm property to your spouse at FMV and they must pay you FMV considering using their own funds. When your spouse sells the farm property, any future capital gain will be taxable to them. In this situation, you may be able to multiply the LCGE by selling the qualified farm property to your spouse at FMV and allowing the future growth to accrue to your spouse. You could use your LCGE to minimize, or potentially eliminate, your tax liability arising from the sale of the qualified farm property to

You may roll over certain capital property at your adjusted cost base (ACB) to your spouse, or to a qualifying spousal trust, at any time during your lifetime, provided both you and your spouse or the spousal trust are resident in Canada at the time of the transfer.

your spouse. When your spouse sells the qualified farm property, they can also use their LCGE to shelter the gain realized upon that sale.

The spousal rollover is automatic unless you decide to elect out of it. The election can be made on a property-by-property basis, which allows you to specify which properties will be rolled over to your spouse and which properties will be disposed of at their FMV when there are capital gains.

Transferring farm property to a child

At any time during your lifetime, you may transfer certain qualified farm property, such as farmland, an interest in a farm partnership or shares of your family farm corporation, to your child or children, at its ACB or, in the case of depreciable property, at its UCC. Child includes biological children, adopted children, stepchildren, grandchildren, great-grandchildren and their spouses who are residents of Canada immediately before the transfer. Alternatively, you may transfer certain qualified farm property to your child or children at a value between its ACB and FMV, unlike a transfer to your spouse, where you can only elect to transfer at ACB or FMV. If you're electing to transfer the property at an amount that's above ACB, it's important to document the elected transfer price. Speak with a qualified legal/tax advisor regarding this matter.

Similar to the rules for spouses discussed earlier, the ability to transfer property at cost does not apply to farming inventory.

In order to qualify for the transfer to your children, the following conditions must be met:

- Before the transfer, the property was land or depreciable property of a prescribed class in respect of a farming business carried on by you in Canada;
- Your children are residing in Canada immediately before the transfer; and
- The farm property is used principally in a farming business in which you, your spouse or any of your children or parents are actively engaged on a regular and continuous basis.

The requirements above indicate that the property must be **used principally** in farming business carried on in Canada by one of these individuals who is **actively engaged on a regular and continuous basis**. These conditions are described in more detail in the article titled “Selling the farm and the lifetime capital gains exemption”. Please ask your RBC advisor for this article.

Transferring qualified farm property to a child at a value between ACB and FMV

When transferring qualified farm property, such as land, an interest in a farm partnership or shares of a farm corporation to your children, you may consider triggering a capital gain to use your LCGE. This may minimize or eliminate your capital gains tax and your child will receive the farm property at a higher ACB for tax purposes. It may also make sense to trigger a capital gain if you have unused capital losses to offset your gain. Since your children receive your farm property at a higher ACB, they may realize a smaller capital gain when they later dispose of it. This can result in less overall tax being paid by your family. In addition, your children may also have the opportunity to use their own LCGE when they dispose of the property, giving your family the ability to multiply the use of the LCGE.

Note that if you transfer your property to your children at less than FMV, intending to take advantage of the LCGE, they should hold the property for at least three years. If your children sell, or arrange for the sale of the property, within three years of the date of the transfer, you will be deemed to have transferred your property to your children at FMV. This may result in additional tax liability for you and your children. Further, if your children are younger than 18 years old when the farm is sold to a third party, you're deemed to have realized the gain instead of your children.

Estate freeze

To allow your adult children to participate in the operation and growth of your family farm, you may want to consider an estate freeze. An estate freeze refers to a transaction where you lock in or “freeze” the value of appreciating assets. The intent is to transfer the future growth of the assets and their associated tax liability to other taxpayers, usually family members. An estate freeze is implemented by exchanging property that's likely to grow in value (e.g. common shares of your business) for property with no growth potential (e.g. fixed-value preferred shares of your business). For example, you freeze the value of an appreciating family farm corporation, and transfer the future growth of the corporation to other individuals, usually your adult children. Estate freezes generally make sense only when there's an expectation that the corporation will grow in value and where there's a clear successor or next generation of owners.

To allow your adult children to participate in the operation and growth of your family farm, you may want to consider an estate freeze.

An estate freeze may be structured to allow you to retain control of your farm. Let's assume you've accumulated sufficient wealth such that you no longer require additional growth from your family farm corporation and your adult children are interested in participating in the future growth of the farm. If you simply transfer the family farm corporation shares to them, your children will become the controlling shareholders. By implementing an estate freeze, you can retain control by exchanging your common shares of the family farm corporation for preferred shares with voting rights and a redemption value equal to the FMV of the company on the freeze date. Your children can then purchase new non-voting common shares at a very low price. Since your preferred shares have a fixed value, all of the future increase in the value of the farm will attribute to the common shares. The result is that your children will participate in any future growth in the value of the farm business while voting control remains with you. You may also be able to trigger a gain and shelter it with your LCGE when you exchange your common shares.

Another option that may help you maintain control over the growth shares is to consider using a trust to hold the shares you're planning to issue to your children. Your children can be the beneficiaries of the trust. This may provide for flexibility in dealing with the future ownership of the shares. For example, if only one of your children is interested in the farming business, you can direct all of the shares in the trust to be distributed to that child. If you're setting up a trust with your children as beneficiaries, it's important to be aware of the attribution rules. If the attribution rules apply, any income and capital gains earned in the trust could potentially be attributed back to you. Speak with a qualified tax and legal advisor if you're considering using a trust to hold shares of your corporation.

By implementing an estate freeze, you may be able to limit your accrued capital gain on the property and transfer future capital gains to your intended beneficiaries without triggering immediate tax consequences. Aside from the deferral of capital gains tax, the other benefit of the strategy is that it allows you to plan for the tax that will be payable upon the eventual disposition of the property, including the deemed disposition on death. By capping your accrued capital gains on the transferred property, you and your professional advisors can estimate the tax liability and look at strategies for funding it.

Alternative minimum tax (AMT)

AMT may impact your tax liability for the tax year in which you claim the LCGE. AMT aims to ensure that every Canadian individual pays a minimum amount of tax. The calculation of AMT is based on an “adjusted taxable income” which seeks to remove the advantages of certain tax-preferential items such as capital gains. If the AMT calculated is greater than your regular tax liability, the AMT becomes your tax liability for the year. The difference between the AMT that you have to pay in a year and your regular tax liability can be carried forward for seven years to reduce your future regular income tax liability when your taxes payable exceed your AMT. You should speak with a qualified tax advisor to determine if AMT will be a factor when you claim the LCGE. Ask your advisor for a copy of the article titled, “Alternative Minimum Tax (AMT)” for more information.

When you transfer your farm to your child and trigger a capital gain in order to use your LCGE, you are at risk of triggering AMT. Although you can apply the unused AMT credits in future years, you may be able to reduce or eliminate AMT by employing the capital gain reserve strategy. This strategy allows you to spread the recognition of capital gains from the sale of farm property, over a maximum of five years if the sale is structured properly. Please note that a 10-year reserve period is provided for a properly structured transfer of farm property to a child. For more details regarding this strategy, speak to a qualified tax professional.

Considerations when transferring farm assets to children

Before you transfer your farm to your children, give some consideration to whether they’re 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.

Alternatively, you may want to consider holding the operating assets of your farm in a corporation and holding the farmland in another corporation. By separating the different assets, you can leave the corporation holding the operating assets to your children who are interested in the farming business and leave the corporation with the farmland to the non-farming children.

Prior to implementing any strategy, it’s 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

Before you transfer your farm to your children, give some consideration to whether they’re 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.

children are interested in farming and ensure all family members are aware of the succession plan.

Family law planning

In some provinces, family law legislation allows certain assets (or the value of the assets) received as a gift or inheritance, including farm property, to be excluded from the pool of assets subject to division on marriage breakdown. This exclusion may be maintained if the inherited or gifted asset is kept separate from and is not commingled with other marital assets. If you inherited farm assets and transfer part or all of them to your spouse for tax planning purposes, the assets may no longer be excluded from the division of assets on marriage breakdown. Consult a qualified legal professional regarding the family law legislation in the province where you live.

Financing

A key part of your succession plan is financing the change in ownership. Do you require the money now to fund your current lifestyle or at a later date to support your retirement? If you sell the farm assets to your children, think about how much and how soon they can pay you. If you can afford to receive payment over a number of years, the children can avoid a large capital outlay that may be a financial burden to them, and you can take advantage of the capital gain reserve strategy to defer the taxes payable on your capital gain.

The children’s ability to obtain the right financing is a key factor in the successful execution of the succession plan. It can have an impact on the future success of the farming business and is critical in structuring the right deal for you and your children. There are a variety of financing options available. Getting the most desirable financing option depends on the historical and projected financial performance of the farm operation, the business cash flow to support debt repayment, the capital structure of the farm and the assets available as collateral.

Transferring farm property to other individuals

Transfers of farm property to individuals other than your spouse or your children results in a disposition at

FMV, whether or not the property meets the criteria of qualified farm property. You may consequently realize capital gains and/or recapture of CCA on such transfers. If the assets transferred are qualified farm property, you may, however, be able to use the LCGE to reduce or eliminate your tax liability.

Income tested benefits

Although the LCGE may reduce or even eliminate the tax liability on the sale of your farm property, the capital gain you realize may still affect your income tested benefits. For example, old age security (OAS) is clawed back if an individual's income is greater than a certain threshold. A taxable capital gain arising from the sale of farm property is considered income, for OAS purposes, even if the LCGE is used. As such, capital gains resulting from the sale of farm property that have been offset with the LCGE may still reduce certain government benefits.

Summary

For farm owners who wish to transfer their farm assets to their spouse or children during their lifetime, there are several tax strategies available to minimize the tax burden

For farm owners who wish to transfer their farm assets to their spouse or children during their lifetime, there are several tax strategies available to minimize the tax burden and create more family wealth.

and create more family wealth. If you would like to take advantage of these strategies, consult with qualified legal and tax professionals to ensure that a transfer during your lifetime meets your financial and personal goals.

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

This document has been prepared for use by the RBC Wealth Management member companies, RBC Dominion Securities Inc. (RBC DS)*, RBC Phillips, Hager & North Investment Counsel Inc. (RBC PH&N IC), RBC Global Asset Management Inc. (RBC GAM), Royal Trust Corporation of Canada and The Royal Trust Company (collectively, the "Companies") and their affiliates, RBC Direct Investing Inc. (RBC DI) *, RBC Wealth Management Financial Services Inc. (RBC WMFS) and Royal Mutual Funds Inc. (RMFI). *Member-Canadian Investor Protection Fund. Each of the Companies, their affiliates and the Royal Bank of Canada are separate corporate entities which are affiliated. "RBC advisor" refers to Private Bankers who are employees of Royal Bank of Canada and mutual fund representatives of RMFI, Investment Counsellors who are employees of RBC PH&N IC, Senior Trust Advisors and Trust Officers who are employees of The Royal Trust Company or Royal Trust Corporation of Canada, or Investment Advisors who are employees of RBC DS. In Quebec, financial planning services are provided by RMFI or RBC WMFS and each is licensed as a financial services firm in that province. In the rest of Canada, financial planning services are available through RMFI, Royal Trust Corporation of Canada, The Royal Trust Company, or RBC DS. Estate and trust services are provided by Royal Trust Corporation of Canada and The Royal Trust Company. If specific products or services are not offered by one of the Companies or RMFI, clients may request a referral to another RBC partner. Insurance products are offered through RBC Wealth Management Financial Services Inc., a subsidiary of RBC Dominion Securities Inc. When providing life insurance products in all provinces except Quebec, Investment Advisors are acting as Insurance Representatives of RBC Wealth Management Financial Services Inc. In Quebec, Investment Advisors are acting as Financial Security Advisors of RBC Wealth Management Financial Services Inc. RBC Wealth Management Financial Services Inc. is licensed as a financial services firm in the province of Quebec. The strategies, advice and technical content in this publication are provided for the general guidance and benefit of our clients, based on information believed to be accurate and complete, but we cannot guarantee its accuracy or completeness. This publication is not intended as nor does it constitute tax or legal advice. Readers should consult a qualified legal, tax or other professional advisor when planning to implement a strategy. This will ensure that their individual circumstances have been considered properly and that action is taken on the latest available information. Interest rates, market conditions, tax rules, and other investment factors are subject to change. This information is not investment advice and should only be used in conjunction with a discussion with your RBC advisor. None of the Companies, RMFI, RBC WMFS, RBC DI, Royal Bank of Canada or any of its affiliates or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. ®/™ Registered trademarks of Royal Bank of Canada. Used under licence. © 2021 Royal Bank of Canada. All rights reserved. NAV0162 (02/21)