The Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Wealth Management

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.

On July 18, 2017 the federal government released a consultation paper proposing a number of strategies which target private corporations with regards to income splitting, multiplication of the lifetime capital gains exemption, holding a passive investment portfolio inside a private corporation, and converting a private corporation's regular income to capital gains.

Generally, effective for 2018 and later taxation years, the government has proposed to limit income sprinkling to family members receiving "reasonable" compensation from a private corporation. The proposed measures extend the tax on split income rules (often known as "kiddie tax") to adults and limit the multiplication of claims to the lifetime capital gains exemption.

The government is also seeking input on possible measures to eliminate the tax advantage of investing undistributed earnings from an active business in a private corporation. If enacted, these measures may result in a disincentive for investing passively within a corporation.

The strategies discussed in this article may be affected by the proposed measures in the consultation paper and the accompanying proposed legislation. If you are an owner of a private corporation you should consider the potential impact of the proposed measures and discuss the implications with your qualified tax advisor.

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.

The federal and provincial tax legislations referenced in this article are current as of June 2017.

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Retaining ownership of the 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 ways to integrate your farm into your estate plan so that you can leave your farm assets to your loved ones in a tax-efficient manner. Specifically, there are methods available such that upon your passing, your loved ones may be able to receive your farm assets without any immediate tax implications to them or your estate.

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 so your wishes are carried out even if unforeseen circumstances occur, such as disability or premature death. Depending on whom you wish to inherit your farm, there may be tax strategies available. 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. Until then, you can change the terms or revoke your Will as long as you are mentally competent.

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 intestacy rules in your province 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 so that your wishes are realized. 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 savings and deferral 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-efficient transfer of your farm assets. Upon your passing, if your spouse inherits your farm property, they will receive it at your adjusted cost base (ACB), with no immediate income tax implications. The taxes payable on the unrealized gains on your farm property are deferred until your spouse sells the farm property or passes away.

Your executor, however, may have the option to 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 fair market value (FMV). If the election is made, your

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spouse will inherit this at FMV and the FMV becomes the ACB of the property in your spouse's hands. This may make sense where you have an unused LCGE to offset any accrued capital gains on your qualified farm property or you have a capital loss carryforward that expires upon your death. The election may allow you and your spouse to reduce the total taxes payable on the eventual disposition of the farm property.

Your executor may decide whether to make the election for each qualifying farm property. For example, the executor may choose to rollover certain assets to your spouse at its ACB and to elect to have other property transferred at FMV.

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

- 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 inherit the farm once your spouse passes away, you may 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, if certain conditions are met.

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 transfer farm property to a child or children on a tax-deferred basis on death 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

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.

- 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).

For the purposes of this discussion, a child, or children includes 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". Please ask your RBC advisor for this article.

Even if the assets qualify for a rollover, your executors may instead choose to transfer all or part of the qualified farm property to your child at any 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 a capital loss carryforward that expires upon your death. The election may allow you and your child to reduce the total taxes payable because your child receives the farm property at a higher ACB resulting in fewer 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 will result in additional taxable income known as recapture which cannot be sheltered by the LCGE or reduced with capital losses.

Alternative Minimum Tax (AMT)

One of the drawbacks of triggering capital gains on the transfer of farm assets during your lifetime and using the LCGE is the potential application of AMT. AMT does not, however, apply in the year of death. So 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 the child inheriting the property. This can allow your child or children 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 can 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.

Before you bequeath your farm to your children, give some consideration to 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.

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 prefer to leave your farm assets to your children via a testamentary trust and only distribute 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 CRA 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.

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, give some consideration to 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 a fair 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 to individuals other than a spouse, parent or child on death will result in a deemed disposition of the property at FMV on the date of death, whether or not your property meets the criteria of qualified farm property. 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. 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.

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.

Other estate planning considerations

Probate tax

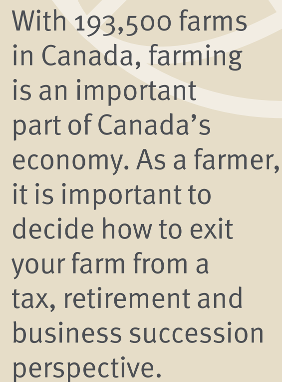
If your farm assets pass through your Will, they will generally be subject to probate. Probate is the process by which the court confirms the validity of the deceased's Will and the authority of the executor (liquidator) to carry out the terms of the Will. In general, when an executor or liquidator applies 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 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.

A POA is a legal document in which you give another person(s), referred to as the attorney/mandatary, the power and authority to act on your behalf. Having a POA in place is important in the event you become incapacitated and cannot perform your normal daily tasks, for example, paying bills and managing your investments. A POA for property allows the attorney(s) you appoint to make decisions on your behalf about your financial and property matters. You can grant broad powers in this document, or restrict your attorney's power to specific defined circumstances. A different legal document may be used in some provinces to make personal care decisions. In some provinces, you can execute one document authorizing your attorney to act on your behalf in relation to financial and property matters as well as personal care matters.

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.



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Conclusion

With 193,500 farms in Canada, farming is an important part of Canada's economy. As a farmer, it is important to decide how to exit your farm from a tax, retirement and business succession perspective. 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 ensure your farm and other property is distributed according to your wishes on your death.

This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information is not intended to provide legal or tax 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 advisor before acting on any of the information in this article.

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

Wealth Management

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