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Tax and Succession Planning for Growers

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Speaker

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Tax and succession planning strategies

Capital gains deduction
- $1,250,000 capital gains deduction on qualified farm property and shares
- Preparing corporation for claiming capital gains deduction

Intergenerational transfer
- Transfer to children/grandchildren at an elected amount between cost and fair market value
- Bill C-208 planning for shares of corporations

Sale to a third party
- Asset sale
- Share sale
- Hybrid sale

Other considerations
- Changes to capital gains inclusion rate effective June 25th
- Utilization of family trusts

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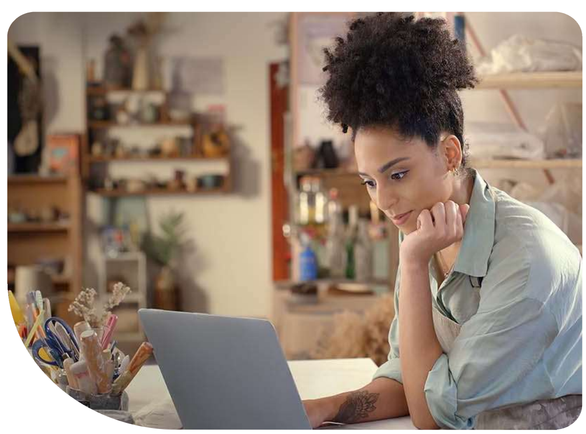
Capital gains deduction

- Ability to shelter up to $1,250,000 of a capital gain from tax related to the sale of transfer of certain assets



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Lifetime capital gains exemption (LCGE)
Key definitions

Qualified farm property pre-1987

- Acquired by the individual before June 17, 1987 **and no 1994 election made.**
- In at least 5 years during which property was owned by **a qualifying owner**, the property was used more than 50% in the business of farming in Canada by **a pre-1987 qualifier;** OR
- In the year of disposition, property was used more than 50% in the business of farming by a **pre-1987 qualifier**

Qualified farm property post-1987

- Property owned continuously for at least 24 months before disposition by any combination of qualifying users and:
- In **at least two years** during ownership:
  - **Gross revenue** of qualifying owner from farming must be greater than all other sources of income
  - Property was **used more than 50% in a farming business** where a qualifying user was actively engaged OR
  - Throughout a period of at **least 24 months,** property was used in a farming business in which a qualifying user was actively engaged by either a Family Farm Corporation of Family Farm Partnership

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Lifetime capital gains exemption (LCGE)
Key definitions

Qualified family farm corporation "FFC"

- A Canadian controlled private corporation
- In any 24 month period
  - > 50% of fair market value of property owned by corporation was used more than 50% of the time in carrying on a farming business by an eligible farmer
- At time of sale > 90% of fair market value attributable property used more than 50% of time in the course of carrying on a farming business by an eligible farmer
- Potential need for Holding Company to maintain the FFC status
  - Hold non-active assets in a holding company
  - Could consist of investments, rental properties, life insurance

Qualified small business corporation "QSBC"

- Same requirements as a FFC, but not farming assets

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Preparing corporation for claiming capital gains deduction (Purification)

- Transfer non-business assets out of corporation to a holding company
  - Consideration of safe income and possible capital gains triggered
  - Better to do on an annual basis
- Dividends and bonuses to remove excess cash and investments
  - Immediate tax implications
- Payout liabilities of company to reduce excess cash
- Consider owning real estate in separate corporation

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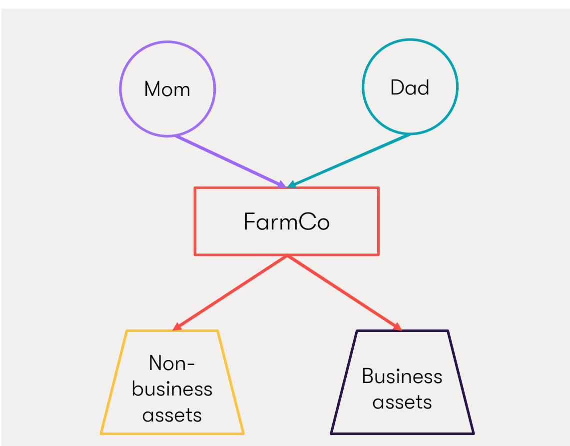
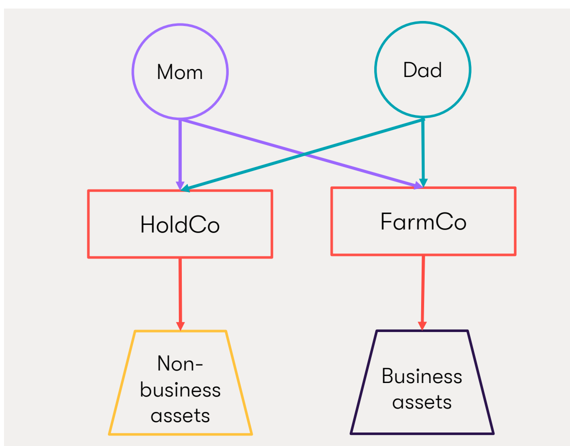
Examples





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Intergenerational transfer

- Minimize the application of income tax on a transfer of property to the next generation, and maximizing after-tax funds available

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Key concepts: Intergenerational rollover

Qualifying transfer

Can be to children/ grandchildren **only**

Qualifying property

Property has been **used principally** (>50% of years and >50% of acres) in a farming business in which the individual, spouse, child, or parent was actively engaged on a regular and continuous basis, or shares of a FFC

- Can apply either while living or upon death
  - Careful when structuring will
- Property transfers at amount between cost and fair market value (elected amount)

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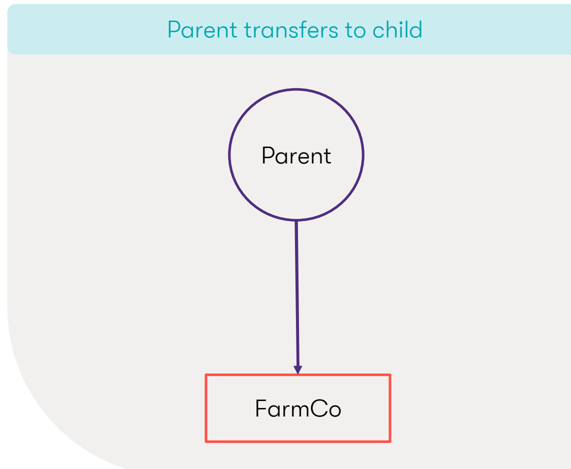
Scenario #1

- FarmCo is qualified family farm corporation (“FFC”) and meets both the 50% and 90% active business asset test.
- Parent wishes to retire and transfer FarmCo to Child.
- Child is currently active in the farming business and wishes to purchase FarmCo.
- FarmCo’s value (per valuation) is $2 million



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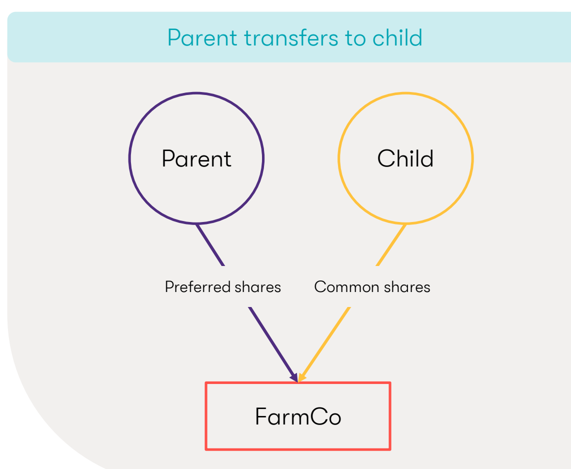
Scenario #1 (cont’d)

- Parent exchanges his common shares for preference shares worth $2M
- Child subscribes for new common shares
- Parent redeems a portion of his shares annually
- Parent leaves preference shares to children in his will
- If FarmCo continues to qualify as a FFC, the transfer of the shares of FarmCo on death can occur at an amount between FMV and cost.
- Parent transfers the preference shares of FarmCo to Child on death at an elected amount of $1.25 million to utilize his LCGE.
- Disadvantage: the increase in cost of the shares will likely never be utilized



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Bill C-208: Tax planning

- Applies to transfers of FFC's from parents to children.
- Effective date of June 29, 2021
  - amendments effective January 1, 2024
- Applied to genuine transfer of a business

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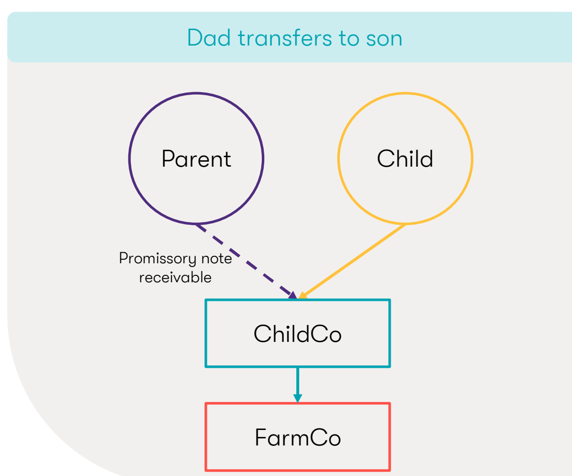
Scenario #2

- Parent sells his common shares to ChildCo for $2 milllion
- Parent receives a promissory note of $2 million from SonCo
- Parent realizes $2 million capital gain and can shelter $1.25 million from tax. The remaining $750,000 capital gain can be brought into income over 10 years.
- Advantage: Utilization of capital gains exemption to extract value from corporation as opposed to just increasing cost base of shares.



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Third party sale

- Goals in a third-party sale likely differ from intergenerational transfers
- No gifting
- Less flexibility with receiving proceeds
- Need to consider needs of Purchaser more

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Types of sale

1. Asset sale
2. Share sale
3. Hybrid sale

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Considerations and tax implications

Asset sale	Share sale	Hybrid sale
Involves corporation selling assets directly to Purchaser, resulting in corporate tax payable, and personal tax payable when funds are extracted	Involves shareholders selling shares of corporation and realizing a capital gain	Involves the corporation selling assets and individuals selling shares
Generally preferred by Purchaser as get full cost base in assets acquired and do not assume inherent risks in corporation	Generally preferred by Vendor as allows for ability to claim CGE, no recapture tax on sale of depreciable assets, and the tax rate on capital gains is typically less	Can allow both Purchaser and Vendor to obtain benefits, but structuring is more complex, and need right fact pattern for the Vendor to make sense
38.62% combined personal & corporate tax rate	26.76%/35.69% personal tax rate	Tax rate varies depending on situation
Other considerations: - Land transfer tax - CDA and RDTOH - Deferral – timing of taxable dividends	Other considerations: - AMT & OAS Claw back - Capital gains reserve - Deferral - Safe income	Other considerations: - Complex - Timing is important - Often works best when only some assets are being sold

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Third party sale: Other considerations

Multiplying access to capital gains exemptions

- Utilization of family trust or giving ownership of common shares to children

Difference to asset sales if owned corporately vs. personally

- Typically, more tax-efficient to earn personally **but** could get deferral, if owned corporately

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06 Other considerations

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Change to capital gains inclusion rate

Effective June 25, 2024, capital gains inclusion rate increased from 50% to 66.67%	The change affectively increases the tax rate personally by approximately 9%, and corporately by approximately 10%
Individuals entitled to $250,000 annual exemption	Exemption not available to corporations, so now incentivized to realize capital gains personally
If ability to claim reserve need to consider forgoing future reserve to pay tax at 50% inclusion rate	Need to compare the tax savings with the ability to defer tax, and impact on small business deduction

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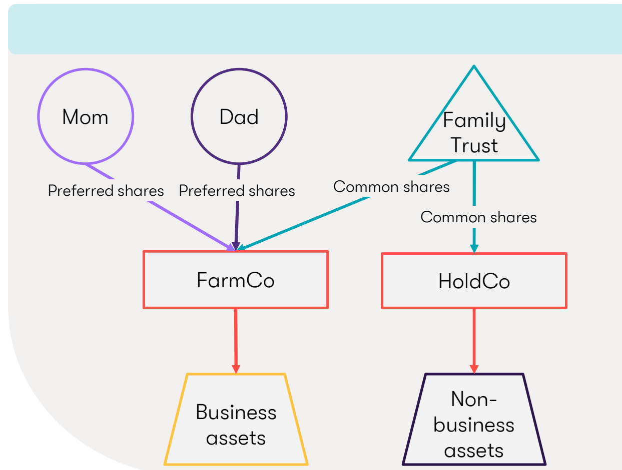
Details of family trust

- Relationship between three parties
  - Settlor
  - Trustees
  - Beneficiaries
- 21-year life span for tax purposes
- Income can flow through a trust to beneficiaries
- If income is retained in a trust, it will be taxed at top marginal rate
- Main benefits related to succession planning:
  - Ability to purify an operating company to maintain QSBC or FFC status
  - Multiplication of CGE
  - Freeze estate tax liability



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06 Questions

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