Although the GST/HST has been with us since 1990, it continues to be the source of questions from farm clients. This article addresses some of the more commonly asked GST/HST questions related to farming operations.

Zero-Rated Farm Equipment
Many farmers are not sure whether or not GST/HST should be charged on equipment purchases. If GST/HST is not charged, the equipment is considered to be “zero-rated.” Zero-rated equipment must be used for farming and must also meet certain design criteria or specifications concerning size, capacity or power. Where the criteria or specifications are not met, the equipment is subject to GST/HST.

The Canada Revenue Agency has specific rules concerning what qualifies as zero-rated. For example, a tractor must have a rating of at least 60 PTO horsepower to be eligible for zero-rated status, regardless of whether it’s used for farming.

In addition, if the original equipment is altered to the extent that it is no longer designed for farm use, it will be subject to GST/HST. An example would be a farm tractor modified to be used for snow grooming.

When zero-rated farm equipment is sold together with any other normally taxable accessories or equipment, all the items will be considered zero-rated provided they are attached to or installed on the zero-rated farm equipment at the time of sale and form part of the unit. When taxable accessories are not sold together with zero-rated farm equipment, they will not be treated as part of the zero-rated equipment and will be taxed in the normal manner.

If zero-rated farm equipment is rented or leased, GST/HST must be charged. However, when a lease of otherwise zero-rated equipment is entered into with an option to purchase at the end of the lease period, the buyout portion of the payment would normally be zero-rated.

For more information regarding what qualifies as zero-rated farm equipment, visit this site: http://www.cra-arc.gc.ca/E/pub/gi/gi-051/gi-051-e.pdf

Non-Zero-Rated Commodity Sales
Many farmers assume that GST/HST is never collectible on the commodities they sell, but this is not necessarily the case. The CRA indicates that many farm commodities are subject to GST/HST.

Generally speaking, GST/HST is collectible on livestock sales that are not used for human consumption, including commodities such as horses, dogs, cats, mink and other fur-bearing animals.

Some animals, such as rabbits, can either be raised for meat or as pets. If raised for meat, the commodity is zero-rated, while the sale of pets is taxable.

The treatment of hay, silage and fodder crop sales depend on the use and quantity sold. For the sale to be zero-rated, the quantity sold must be more than one large bale or its equivalent. The CRA defines one large bale as 750 kg. What’s more, the hay, silage or fodder crop sold must be used to feed livestock or poultry for human consumption. The sale of hay for horse production would, therefore, be subject to GST/HST regardless of the quantity sold.

The treatment of seed sales also depends on the use and quantity sold. Small seeds in packages exceeding 125 grams, and large seeds such as peas and beans sold in quantities greater than five kilograms, are zero-rated. Additionally, the seeds must be to grow crops suitable for human consumption or feed for farm livestock or poultry. Therefore, certain kinds of turf grass seeds would not, for example, qualify as zero-rated.

Fertilizer qualifies as zero-rated if the amount supplied is in bulk quantities of at least 25 kg, where the total amount supplied is 500 kg or more.
The CRA has an extensive list of other taxable commodities, including cut flowers, sod, processed wool, maple sugar candy, gravel and feathers.

For more information on non-zero-rated commodity sales, check out these CRA publication links:

http://www.cra-arc.gc.ca/E/pub/gm/4-4/4-4-e.pdf

**GST/HST on Residential and Commercial Rentals**

It’s common for farmers to own residential properties on which they collect rental income. According to the CRA and as most farmers are aware, GST/HST should not be charged on residential rental income.

Overlooked by many, however: they should not be incorrectly claiming GST/HST input tax credits on expenses related to those properties, such as capital improvements, repairs and maintenance, hydro, telephone and heat. If they do, they could incur substantial penalties and interest in an audit situation.

For commercial rent, including land and equipment rental, GST/HST is collectible. However, income that is received from sharecropped land is not subject to GST/HST.

**GST/HST New Housing Rebate**

If you recently built a new home or had a very extensive renovation or addition, you may qualify for the GST/HST New Housing Rebate.

This program provides a rebate on part of the GST, or the federal part of the HST paid on the construction or purchase of most newly constructed or substantially renovated houses used as a primary place of residence. Only homes with a market value of less than $450,000 qualify for this federal rebate. The rebate is available for both individually owned homes and residential rental property owned by individuals or corporations.

Major changes have to be made to meet the definition of a substantial renovation. Generally, 90% or more of the interior of an existing house is the minimum that has to be removed and replaced to qualify as a substantial renovation, or an addition needs to at least double the size of the livable areas of your existing house.

As part of the application process, you will need to retain and itemize all the invoices you paid for the project. Some provinces also provide a rebate for the provincial portion of the HST or PST. These provinces could have different rules for the program, including the maximum market value of homes that can qualify. Therefore, even if your home is worth more than $450,000 and you do not qualify for the federal rebate, you may still qualify for the provincial rebate.

If you are unsure if you qualify, please contact your local Collins Barrow office and we will help you determine your eligibility, as well as prepare an application for the program if you do qualify. §
Farmer Crosby had a successful mixed farming operation called Penguin Inc., which had accumulated a sizable land mass and investment portfolio. As the farmer and his accountant met to review the company’s year-end financial statements, a familiar topic came up.

“It drives me crazy that you accountants have to record everything on a historic-cost basis,” said the farmer. “My land and buildings are worth substantially more than the financial statements indicate. I tell my banker that every year but I don’t know if he listens, and if he does I certainly don’t think he takes it into consideration.”

And every year Farmer Crosby’s accountant nods his head in agreement and wishes something different could be done. This year, however, he was ready for the question.

“There may be something we can do to help that situation,” he said, causing Farmer Crosby to straighten up in his chair. “We have some new rules called Accounting Standards for Private Enterprises, or ASPEs. They allow for a few changes to financial statement presentation, including a one-time bump-up to fair value of your land, buildings and equipment.”

“What led to this sudden change?” Farmer Crosby, now all ears, asked.

“Canada’s adoption of International Financial Reporting Standards (IFRS),” the accountant said, adding that the reporting and disclosure requirements, though, are only for publicly accountable entities. It’s their introduction that led to the release of ASPEs, which are designed with the cost-benefits of financial reporting in mind for owner-managed businesses.

“How do they work and when can we get started?” asked the farmer.

“Private companies with year ends that begin on or after January 1, 2011 must implement these new standards or choose to adopt IFRS, although earlier implementation is possible,” the accountant replied. “Choosing IFRS — unless you plan on taking your operation public or have a large number of financial statement users — is not a preferable alternative.”

“What kind of information will you need?” asked Farmer Crosby.

“For your July 31, 2012 year end, we need the value of the assets you want to bump as at August 1, 2010, which is the beginning of the fiscal year used in your comparative financial statement numbers. Although this information will be two years old at the date of your 2012 financial statements, it will still reflect a large increase over the original cost of the assets.

“Given that we are preparing review engagement financial statements, we would need some type of information to support the plausibility of the numbers, such as an appraisal. Also keep in mind that the assets can be looked at on an asset-by-asset basis, so you don’t need to revalue everything: equipment, for example, does not commonly increase in value.”

This prompted Farmer Crosby to ask, “Are there any other potential adjustments that would positively affect Penguin Inc.’s financial statements?”

“The other change that could significantly affect your financial statements is that your stock portfolio will now have to be recorded at market value as at the date of your financial statements,” the accountant explained. “Similar to the increase in value of your land and buildings, we will need to go back to August 1, 2010 for your investments to restate the comparative numbers.

“The way the market is these days, this standard may both positively and negatively affect your balance sheet and income statement and, unlike the property, plant and equipment one-time bump-up, must be adjusted annually. The annual adjustment would, however, result in an unrealized gain or loss on the income statement. Because this is a non-cash transaction, financial statement users should be able to remove it from the net income when assessing normal operations.”

“When all this is done, what positive benefits will I see from these changes?” asked Farmer Crosby, still not fully convinced.

“There are a number of financial statement ratios that could be enhanced,” said the accountant. “For example, your debt- to-equity ratio, net tangible worth and working-capital ratio are three of the main ratios that could be positively affected by the restatement. It would also be a good opportunity to sit down with your banker with the restated financial statements to see if the bank could improve any future credit facilities.”
Farmer Crosby then said, grinning, “I suppose my neighbours with the large quota will really be able to take advantage of this.”

“Actually, no,” said the accountant. “The quota doesn’t fall into these new rules and is considered an intangible asset and not property, plant or equipment.”

Farmer Crosby, always the cautious one, finally got around to asking his standard question: “Are there any negative things that could come out of implementing these new standards?”

“There are certainly items we would need to consider,” the accountant replied. “If you increase the value of the buildings, the effect of an increase in amortization would have to be taken into account. Also, although these changes will not affect your current tax liability with the Canada Revenue Agency, we need to monitor what the increase in assets might have on the Large Corporations Tax. There could also be an increase to the future income tax disclosure on your financial statements, although the option will exist to record your taxes as per the taxes payable method.

“Finally, in the year of transition there is a rather significant first-time adoption note, as well as the requirement to disclose the policy choices made. I can assure you, however, that the disclosure required is a lot less than that required to implement IFRS.”

Farmer Crosby sat quietly reflecting for a moment and then remarked, “I can’t imagine that we wouldn’t at least explore the opportunity to make our financial position look better.”

The accountant gave farmer Crosby a list of items to begin compiling for his July 31, 2012 year end and sent a much happier client on his way.

For advice relating to the affect of ASPE on your operations, please contact your Collins Barrow adviser.

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**Alternative Minimum Tax**

**POTENTIALLY A NASTY SURPRISE**

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Implemented in 1986, the Alternative Minimum Tax is often referred to as Canada’s “other” tax system. An alternate method of calculating tax payable, it came into effect to guard against situations in which high earning individuals might be in a position to pay little or no tax by using certain deductions or “tax preferences” to reduce a large portion of their income.

In normal years the majority of Canadians are not subject to the AMT. In agriculture tax situations, however, the AMT most often arises when farm property such as land is sold. The impact can be substantial on retiring farmers selling their businesses and incurring sizable capital gains in a taxation year.

To minimize the tax payable, the majority of farm families in this situation look to use their lifetime $750,000 capital gains deduction as an effective long-range tax planning strategy. The deduction amount is really a misnomer since it pertains only to the taxable portion, or $375,000 at present. The other half is non-taxable in regular tax calculations. The non-taxable portion is a tax preference that is adjusted to calculate the AMT.

To calculate your AMT, begin with your regular taxable income for the year and adjust for certain tax deductions and preferences that were allowed in calculating it. For example, with capital gains you take your regular income and add 60% of the non-taxable portion of your capital gain and subtract $40,000 to give you your net adjusted taxable income. The latter is taxed at 15% federally to arrive at the gross amount of federal tax payable.

Provincial AMT is then calculated by multiplying the federal AMT tax payable by the provincial rate. The provincial AMT rate varies by province, ranging from a low of 33.67% in Ontario to a high of 57.5% in Prince Edward Island and Nova Scotia.
In any given year, the income tax payable is the greater of regular tax or the AMT. As a credit against future regular tax, you can carry forward over seven years the amount by which the AMT exceeds the regular tax. A long-range tax plan can help in ensuring that this credit against future regular tax does not go unused. Without long-range tax planning, the consequences of the AMT can affect the after-tax dollars slated for your retirement.

Let’s look at two farm families, the Smiths and the Jones’s. The Smiths’ normal operation averages taxable farm income of $40,000, while the Jones’s average $80,000. Both families plan to disperse assets, resulting in a $750,000 capital gain. What will the AMT mean for each of them? Please see the accompanying table to find out.

Under the regular tax column, note that the amount due and payable in both family situations does not change as a result of realizing the capital gain. The capital gain deduction has effectively kept the tax payable the same. The substantial increase in tax due and payable appears in the AMT column.

What the examples of the two families show is the AMT’s general effect when a large capital gain is recognized in a taxation year.

In normal years, the AMT is not a major concern, nor is it in high net income years — unless, that is, you have reduced your income by making a substantial Registered Retirement Saving Plan contribution.

(Also worth noting: several items under the regular tax column have been adjusted to calculate the AMT, though we will leave that for another article. The rates shown are approximate and Ontario based. The provincial portion of the total tax payable will vary by province or region.)

Other facts about the AMT to consider:

- It is not applied in the year of death
- The deemed capital gain on eligible capital property, such as a quota, is not subject to it

The rules specific to capital gains and the use of the capital gains deduction are complex. The purpose of this article is simply to remind farm families of the two-tax system. If you are considering business management activities that could trigger a capital gain, it’s wise to have a Collins Barrow adviser and a financial planner on your management team.

Most important, give yourself time to plan since time will increase your options when it comes to minimizing the tax consequences. The tax law, as it relates to a taxable capital gain and the AMT, does have an upside: increasing the potential returns and advantages of good planning. §