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Farm succession planning: Insights into gifting to children

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A common question that we often get as farm tax advisors is whether or not farm property can be transferred to the next generation by way of a gift. This topic is becoming more and more important as nearly half of all farmers in Canada are 55 years of age or older and are preparing themselves for succession. Succession planning is the most discussed topic between farmers and their tax advisors. Contributing to this dilemma is that rising land values is creating significant amounts of wealth and making life difficult for the farmers to equalize their estates when there are active and non-active children involved in the farming business. Succession has become much more difficult, and a traditional solution of life insurance and non-farm assets may not be enough to equalize the estate.

Of course there is not a tailor-made solution to succession of the farm, but it is important to revisit the rules that govern dispositions of property at less than fair market value to a child, which may help achieve a proper balance between siblings. Some advantages of gifting may be: reducing your estate and probate fees, control over who receives the gift and potential income-splitting with adult children. There are, however, certain disadvantages of gifting, such as: loss of control over the assets and associated income, as well as potential attribution of income back to the transferor under various sections of the Income Tax Act (spouse, minor children and vesting period).

The act has rules that allow the transfer of qualified farm property to the next generation on a tax-deferred basis. The farmer may also be able to use their remaining Capital Gain Exemption (CGE) on the transfer. Section 73(3) and 73(4) of the Income Tax Act provides interpretation for the transfer of farm property and shares of a family farm corporation or interest in a family farm partnership, respectively, during the owner's lifetime. In order to take advantage, the farm assets must be located in Canada before the transfer; the child to whom the transfer is made must be a resident in Canada immediately before the transfer; the farm assets must have been used principally in a farming business (generally more than 50 per cent of the time); and the taxpayer or taxpayer's spouse, child or parent must have been engaged on a regular and continuous basis in that farming business. The definition of "child" has an extended meaning and includes daughter, son, grandchild, great grandchild, son-in-law, daughter-in-law, adopted child, step child or their spouses who are residents of Canada. Shares of a family farm corporation or interest in a family farm partnership are qualifying if all or substantially all (90 per cent) of the Fair Market Value (FMV) of the property owned by the corporation or partnership is principally used in the course of carrying on the business of farming in Canada. The upper and lower limits allowed on the transfer of farm assets are as follows:

Type	Lowest Value	Highest Value
Land	Adjusted Cost Base	FMV
Depreciable Property	Proportionate Share of the Undepreciated Capital Cost	FMV
ECP	4/3 of the proportionate share of the Cumulative Eligible Capital	FMV
Shares/Partnership Interest	Adjusted Cost Base	FMV

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Inventory is not eligible for a tax-deferred rollover.

Interpretation Bulletin IT-268R4 further points out acceptable uses of gifting farm property that may aid in estate planning between active and non-active children such as:

- Partial dispositions are allowed
- Land can be severed for a child to build a residence
- Transfer can be made to several children in undivided shares
- Transfer can be done to achieve a joint tenancy or tenants in common
- Property can be transferred to a partnership if each partner is a child of the taxpayer
- Property can be transferred and a life interest can be retained for the spouse or taxpayer and spouse jointly

Another benefit of gifting is to potentially multiply the CGE. However, Section 69(11) of the Income Tax Act prevents the leveraging of the CGE, such that it can prevent a taxpayer from disposing of property for less than FMV if the "main purpose" of the series of transactions is to obtain a benefit of deduction, including the CGE. To avoid this trap, the child should wait at least three years if they want to use the CGE. If the child disposes of the property or makes arrangements to dispose of the property prior to 36 months after the transfer, then the gain could be attributed back to the transferor. The result of attribution back to the transferor can have serious tax implications, especially if the transferor has used up all of their CGE, as well as potential loss of Old Age Security, alternative minimum tax, age credit and other income-tested assistance programs.

There is no requirement that the child carry on the farming business after the rollover in order for the rollover to be valid. However, should the child dispose of the property after three years, the determination of its eligibility for the CGE must be determined at the time of sale. Further, on land transfers in Ontario there are additional requirements that must be achieved in order for the land transfer exemption to apply (i.e. that the land was used in farming immediately before the transfer and the principal purpose of the transfer is to enable the transferee to continue farming).

Generally speaking, the rules governing the transfer of assets at less than Fair Market Value can be complex in addition to the difficulty with the soft issues with respect to the succession plan; in other words, what is fair and equitable for the children of the farmer.

With all succession planning, it is important for the family to decide on the path to succession and allow a Collins Barrow professional advisor to assist them along the way to navigate the potential tax pitfalls and rules that govern inter vivos transfers.

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Collins Barrow regularly publishes *Farm Alert* for its clients and associates. It is designed to highlight and summarize the continually changing farming and agricultural scene across Canada. We always recommend that you seek professional advice before taking specific planning steps.