

atb.com/wealth

ATB Wealth™

Farm Succession Guide

Table of contents

1 Farm succession introduction 1

2 Gifting versus selling 7

3 Equal versus fair 13

4 Lifetime capital gains exemption 19

5 Credit options 25

6 Intergenerational transfers 30



Farm succession introduction

This series is designed to help you prepare for the farm succession planning process.

We will take a look at the challenges you may face, including gifting versus selling, equal versus fair, the lifetime capital gains exemption, credit options, and the intergenerational transfer of farming property.

Time to make a plan

The 2021 census of agriculture found that the average age of Alberta farm operators was 57. Despite the increasing age of farmers, only 14% of Alberta farm operators had a formal succession plan in place.

In the agricultural industry, succession planning involves the transfer of ownership of the farm to new owners or managers. It often involves the distribution of wealth to children who may or may not be involved in the business.

Succession planning in an agricultural operation can become a complex process for two main reasons:

- An emotional connection to the business can drive decisions, particularly in a multigenerational operation, where it is important to keep the business in the family.
- It can be extremely difficult for a going-concern farm to continue to operate after paying out the preceding generation, or non-farming siblings, at market values.

How a plan can get complicated

How does a farming family start to address these issues? The solution is usually simpler when the next generation doesn't want to take over the business as a going concern. In this case, once financial obligations are met, the balance of the assets can be divided among the successors.

It is also simpler when there is significant equity in non-farm investments that can be transferred to non-farming children without impacting the farm.

Succession planning becomes more complicated when one or more children or beneficiaries want to continue the business, but the bulk of the equity is in the farm.



of farm operators in Alberta have a formal succession plan in place



is the average age of farm operators in Alberta



Is the plan viable?

If you haven't yet drawn up a succession plan and intend to pass the farm down to the next generation, you should think about starting one sooner rather than later.

There are many ways that the plan could play out, so it's important to first fully understand the farm's financial situation. This makes it much easier to decide how to distribute the wealth and work out whether the farm can afford to carry out the succession plan.

If the farm is to continue with the next generation, the succession plan needs to consider how the business will manage the change in equity or cash flow. You will need to take into account the family dynamics, the retirement and lifestyle plans of the current and future farm owners, as well as legal and tax considerations.



Do the kids want the farm?

Drawing up a plan can be a long and complex process and may involve some challenging conversations. The best approach is to first find out which of your kids, if any, want to take over the farm.

You can then work out the best way to transfer the management of the farm and farming assets from parents to child. This will include allocating assets among farming and non-farming children.

While succession planning can be complex, it is essential in order to ensure the smooth transition of ownership and management of the farm.

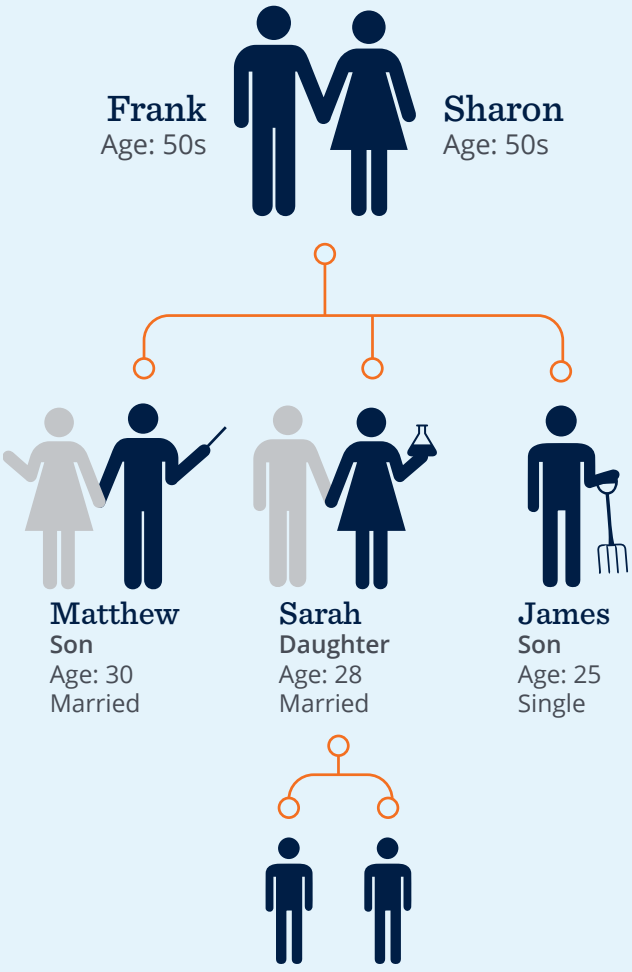
A case study: Meet the Thompson family

Throughout our series, we follow the Thompson family's journey as they prepare their farm succession plan. This case study will highlight their own unique goals, objectives and challenges and help illustrate situations you may also come across. In this first part, we introduce the Thompson family and outline their situation and some of their challenges.

The Thompsons

Frank Thompson, a third generation farmer in northern Alberta, and his wife Sharon, have jointly operated a family farm for over 30 years. They are in their late 50s.

Frank and Sharon have three adult children: Matthew (30), Sarah (28), and James (25). Matthew and his wife, Ashley, are both teachers and currently have no children. Sarah and her husband, Dave, have twin boys. Sarah works part-time as a lab technician. Neither Matthew nor Sarah have any interest in actively participating in the family farm. After completing a bachelor of science in agriculture, James (currently single), has been working full-time on the farm alongside his parents.



Asset and liability summary

Frank and Sharon own 11 quarter sections of farmland and rent a further six. They estimate the value of the farmland they own (excluding buildings) to be approximately $4,125,000.

They bought five of these quarter sections in an arm's length purchase early in their marriage and a further five from Frank's parents 15 years ago. The final quarter section, which includes Frank's parents' home, was purchased last year after Frank's mother moved to a long-term care home.

In addition to the farmland, Frank and Sharon have the following assets:

- Principal residence located on their farmland, worth approximately $250,000
- Additional residence (Frank's parents' home) worth approximately $100,000, currently occupied by James on a rent-free basis
- Farm buildings and equipment worth approximately $275,000
- RRSPs worth approximately $400,000 each
- TFSAs worth approximately $75,000 each
- Cash and non-registered investments worth approximately $150,000

Frank and Sharon have a term loan used to buy the final quarter of land. The current balance of the loan is approximately $350,000. They have no other significant liabilities.



11 quarter sections of farmland
$4,125,000



Principal residence
$250,000



Additional residence
$100,000



Buildings and equipment
$275,000



RRSPs (each)
$400,000



TFSAs (each)
$75,000



Cash and non-registered accounts
$150,000



Term loan
$350,000



Starting to consider a succession plan

The recent death of Frank's father has prompted Frank and Sharon to consider their own succession plan. Frank and Sharon's current wills were prepared seven years ago and are fairly straightforward, naming each other as the sole beneficiary and their three children as equal contingent beneficiaries. No other planning has been done to date.

In the next part of this series, we take a look at the topic of gifting versus selling.



Gifting versus selling

When deciding on how to transition a family farm, owners generally have two options. The first is to gift farming assets to the next generation. The second is to sell farming assets, either to a third party or next generation. In this article, we will focus on farming assets being transferred to the next generation.

Timing

In either situation, the question that follows is usually when is the appropriate time to transfer the farming assets: in the parents' lifetime or on death. When considering the best timing for the transfer, there are a number of considerations, some of which may include:

- **Will the parents need income to fund their retirement?**
- **Do the parents want to continue to work on the farm?**
- **How profitable is the farm?**
- **How will assets be distributed among non-farming children?**
- **What are the farming children's personal circumstances and access to financing?**

In order to arrive at the right answer for each family, it is important to ensure the parents have a good understanding of the thoughts and wishes of their children. It's also important for the parents to set expectations of the next generation. Communication reduces the possibility of conflict among the children, particularly after the parents are gone and no longer able to explain their rationale.

The decision to gift

If the parents want to gift farming assets to the farming child or children, it is important to document their intention so that it is clear down the road and to other family members (often in the context of their estate), that the assets were intended to be a gift.

From an estate planning perspective, the question also arises if that gift should be taken into account in the distribution of the parents' estate assets. For example, should the farming child's share of the estate be reduced by the amount of the gifted farm assets? If so, valuation of those assets becomes a consideration in terms of the time at which the assets should be valued and the valuation method to be applied.

Selling the farm

If, however, the parents choose to sell farming assets to a farming child, the focus would be more on how to structure that sale. They would need to consider the selling price, the terms of repayment, and how to protect the assets if the child changes their mind about farming or gets divorced.

Again, documentation of all these considerations is important. For estate planning purposes, subject to the structure used, the question may become whether any outstanding debt owed by the farming child is forgiven and if that is to be factored in as part of the farming child's inheritance.

If the farming child is receiving financing from their parents or a financial institution to purchase farming assets, it's often wise to take out disability and critical illness insurance to protect themselves and the farm if they are ever unable to work.

It's also important to understand that each family's circumstances are unique. That's why it's essential to have honest and open communication within the family as well as seek legal and tax advice.

The Thompson family case study

Throughout our series, we follow the Thompson family's journey as they prepare their farm succession plan. You can read more about the Thompsons' background earlier in this guide.

James is interested in owning farmland

Frank and Sharon's youngest child, James, who works with them on the family farm, tells them he's interested in owning his own farmland. This leads Frank and Sharon to make their first succession planning decision.

James is considering buying a quarter section of land that recently came onto the market. His living expenses have been relatively low over the last year, because he has been living in his grandparents' former home on a rent-free basis. This has allowed him to save a considerable amount of money, which he wants to use as a down payment on some farmland.

While Frank and Sharon are pleased that James wants to take this next step in his farming career, they would prefer to see him take over the family farm when they retire. They're worried that, if he establishes himself elsewhere, he may not want to do that.

Discussing each other's hopes and expectations

Frank and Sharon still intend to work another 10 years and are not yet ready to fully transition. They meet with James to discuss where they all see themselves in five to 10 years. They discuss the size of James's down payment, his plans to repay the financing and what he expects to earn from his farming investment.

After the meeting with James, Frank and Sharon talk to their other children, Matthew and Sarah. They discuss the possibility of James purchasing a quarter section of their farmland and also get confirmation from them that they themselves have no interest in owning or managing the farm.

After these discussions, Frank and Sharon feel certain that making an offer to sell a quarter section to James will not result in any conflict or hard feelings in the family. They prepare an offer to sell James the quarter section that they most recently purchased, which is also where James is currently living.



To gift or not to gift

Frank and Sharon have two options: they could gift the land to James or sell it to him. While they do want to help James establish his farming business, there are a number of reasons they don't want to make an outright gift to him.

Firstly, James is willing and able to invest his own capital. Secondly, James is young and still in the very early stages of his farming career: he could change his mind in the future. Thirdly, they're not comfortable making such a big gift to one child without doing the same for their other children. Finally, they themselves got started in farming by investing their own funds and feel that this motivated them to be successful. The proceeds from the sale of the farmland will also help fund their own retirement.

The sale goes through

Frank and Sharon offer to sell James the land and home for its fair market value of $475,000. They propose a $100,000 down payment with the balance payable in equal annual installments over 15 years. As an incentive for James to buy family farmland, they offer the loan on an interest-free basis.

They include a clause that would give them the right to buy back the farmland at fair market value should James decide to sell while the loan is still in place. James accepts the terms of their offer.

Frank and Sharon invest the $100,000 down payment received from James in their non-registered account. Their assets now include a $375,000 loan receivable from James and a total of $250,000 in cash and non-registered investments. We will examine the tax consequences of this transaction later in this guide.



Loan receivable
$375,000



10 quarter sections of farmland
$3,750,000



Principal residence
$250,000



Additional residence
$0



Buildings and equipment
$275,000



RRSPs (each)
$400,000



TFSAs (each)
$75,000



Cash and non-registered accounts
$250,000



Term loan
$350,000

Indicates additions or changes



In the next part of this series, we take a look at the concept of equal versus fair.



Equal versus fair

When it comes to the distribution of a farming estate to the next generation, one of the hardest questions is whether equal is fair.

The problem for many farming families is that a large portion of a farm estate often consists of fixed assets. These include farmland, equipment and inventory, most of which are essential for the farming operation to continue. Furthermore, farmland across Alberta has increased in value over the years.

The challenges of maintaining a farm

As a result, where the farmland is split between farming and non-farming children, it can be difficult for the farming children to buy out the non-farming siblings while keeping the farm operating as a viable business. Farms are also getting larger to remain viable, which means more fixed farming assets are required to operate a farm. This is partly because there is a "minimum viable size" whereby there is sufficient productive capacity for the farm to generate adequate net returns to maintain the farming operation.



If productive assets are taken out of the farm operation and distributed to non-farming children or retained by the parents, the farm may no longer have the capacity required to continue operating. Also, if there are multiple children interested in joining the farm operation, can the farm support more than one family? This can only be answered by getting a clear picture of the farm's capacity to generate revenue, with parents and children being honest about their expectations.



The biggest challenge for farming parents is often determining what is fair and what is equal when there are both farming and non-farming children and most of the fixed assets are required to keep the farm going.



This is in part because fixed assets do not provide the farming child with the money required to fund the business. In fact, those assets require ongoing work from the farming children to generate income. Also, farming children who have worked in the business for a number of years prior to inheriting the farm have helped to increase the farm's value. On the other hand, non-farming children will often receive liquid assets that are readily available for their ongoing support and needs. However, is it fair for non-farming children not to share in the future growth of the farm operation? From this arises the dilemma facing many farming families of whether a monetarily equal gift to farming and non-farming children is actually fair?





Considering all the pieces

To resolve this dilemma, a number of considerations may come into play such as family values, the importance of passing the farming operation to the next generation and the extent of that generation's ongoing involvement in the business. It is also important to bear in mind the willingness of non-farming children to hold farmland, the family dynamic and the value of fixed versus liquid assets.

Sometimes the whole estate is tied up in the farming operation, with minimal liquid assets available for non-farming children. This could lead to non-farming children receiving farmland, with provisions that they are required to lease the land to farming children. Farming children may also be granted an option to purchase the land over a period of time.

Where there are minimal liquid assets, the use of life insurance can help balance the inheritance received by farming children. Purchasing a joint last-to-die life insurance policy and naming non-farming children as equal beneficiaries can ensure they receive their share of the estate seamlessly and tax-free. This would also avoid any disruption in the farm operation being passed onto farming children. The next question is how much life insurance is needed. This may be answered a number of different ways although to a large extent is based on family values and what they feel is equal. This is just one example of how life insurance may be used. Life insurance may also be split with farming children to provide funds to continue the business. In the end, there are many ways and reasons to use life insurance in estate planning for farming families, subject to the needs and unique circumstances of each family.

The Thompson family case study

Frank and Sharon need to update their wills to confirm how their assets will be distributed in the event they were both to pass away. They want the wills to give clear direction on how their farming and non-farming assets will be allocated among their children.

Frank and Sharon's pre-tax gross estate value is estimated to be approximately $5,500,000. Their current wills divide their estate equally among their children.

Allocating assets

Given that James has taken part ownership of the farm, Frank and Sharon now want to ensure that certain farming assets are transferred to him. They also want to minimize the chance of conflict in the family. Another important consideration is to name an executor and trustee with the time, skill and expertise to deal with their estate assets and work well with the family.

Frank and Sharon's farming assets represent over half of their current net worth ($4,650,000 including farmland, an interest-free loan receivable from James, principal residence, farm buildings and equipment). They also realize that the deregistration of their RRSPs would result in a significant tax liability (estimated to be $350,000), which would further decrease the non-farming assets. Any other tax liabilities have been assumed to be inconsequential.

While they want to ensure that James has the opportunity to manage the family farm, they're not comfortable leaving all of the farming assets to him. Frank and Sharon's new wills therefore distribute their assets as follows:

James will receive the following assets with a current value totalling $2,500,000:

- The five quarter sections of farmland that Frank and Sharon acquired from Frank's parents, which they would most like to see remain in the family. This land is located next to land that James now owns.
- The farm buildings located on the land James will receive and all farm equipment with a total value of $250,000.
- The outstanding balance of the interest-free loan will be forgiven.

Matthew and Sarah will receive equal shares of the balance of the estate, which currently includes the remaining five quarter sections of farmland. These assets, net of the tax liability noted, are estimated to be worth $2,650,000 or $1,325,000 per child.

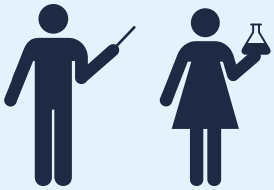
In addition, Frank and Sharon decide to purchase a joint last-to-die insurance policy with a death benefit of $2,000,000, to be split equally between Matthew and Sarah. This policy will help to equalize the children's inheritance, as well as offset the expected increase in value of the farmland in the future.



James

- 5 quarter sections of farmland
- Buildings and equipment
- Loan balance forgiven

$2,500,000



Matthew and Sarah

- 5 quarter sections of farmland
- Principal residence
- RRSPs (each)
- Cash and non-registered accounts
- Farm buildings
- TFSAs (each)
- Life insurance policy
- Term loan

$2,325,000 (each)

Including a buy-out option

Frank and Sharon are comfortable with the fact that James's farming operation may be smaller than the one they are currently operating. They believe that 12 quarter sections are enough for James at this stage (one quarter section of purchased farmland, five inherited quarter sections, and six quarter sections of third party rental land). However, they want James to have the option to buy Matthew and Sarah's farmland if they decide to sell.

Their estate planning lawyer incorporates this option to purchase into their planning, including the timeline the option will be in place and the price James would pay for the land, if exercised. Frank and Sharon feel this is fair to all three children, as it provides the option for James to acquire the land, while allowing Matthew and Sarah to liquidate their farming assets.

Frank and Sharon will revisit their plan if any of their children's personal circumstances or involvement in the farming operation change. As their retirement approaches or if the value of their assets significantly change, they will also reconsider the plan.



In the next part of this series, we explore the potential tax benefits of the lifetime capital gains exemption.



Lifetime capital gains exemption

Whether a farm succession plan involves transferring farm assets to the next generation or a sale to a third party, comprehensive tax planning can help minimize tax liabilities. In this section of the guide, we examine one of the significant tax benefits that may be available to farming families: the lifetime capital gains exemption ("LCGE").

Taxpayers are generally required to pay capital gains tax when they dispose of capital assets that have increased in value. A disposition may come about from an asset sale, as the result of a capital asset gift made during the individual's lifetime, or from the deemed disposition of capital assets that occurs on death (an exception exists for property transferred to a spouse).



The LCGE

A way to limit your tax bill

When the property in question is qualified farm or fishing property (“QFFP”), it may be possible for the capital gain to occur on a tax-free basis up to the individual’s LCGE limit. This limit is $971,190 plus an additional $28,810 specifically for QFFP in 2023, which makes a total of $1,000,000.

For those people in the top tax bracket in Alberta, this can provide savings of up to $240,000 at current tax rates. If both spouses are eligible for the exemption, these tax savings may be doubled.

Understanding the LCGE criteria

For farmland to be considered QFFP, it generally needs to meet the following conditions:

For land acquired before June 18, 1987:

- In the year of disposal, the property must have been used principally in a farming business by the individual, their spouse, child or parent; or
- For at least five years, the property must have been used principally in a farming business by the individual, their spouse, child or parent.

For land acquired on or after June 18, 1987:

- The property must have been owned for a 24-month period by the individual, their spouse, child or parent; and
- Either:
  - In at least two years during the ownership period, the gross revenue from farming must have been greater than all other sources of income for the individual, their spouse, child or parent; and
  - In at least two years during the ownership period, the property must have been used principally in a farming business in which the individual, their spouse, child or parent was actively engaged on a regular and continuous basis;
- Or:
  - The property has been used for at least 24 months during the ownership period in a farming business of a family farm corporation or family farm partnership in which the individual, their spouse, child or parent was actively engaged on a regular and continuous basis.

"Principally used in farming" is generally considered to mean that more than 50% of the use was for farming. Rental use is not usually considered to be farming. While this guide focuses on farmland, note that other farming assets such as buildings, quotas, shares of a family farm corporation or an interest in a family farm partnership may also qualify for the LCGE.

Other tax considerations

If you qualify to use the LCGE, it's important to understand the impact of any alternative minimum tax ("AMT"). AMT is an alternate way to calculate tax, which may apply when benefiting from certain deductions such as the LCGE. AMT does not apply in the year of death and the amount of any AMT paid can be used to reduce taxes in the seven subsequent years. Similarly, you should consider the impact on any income-tested benefits, such as Old Age Security ("OAS").

Where an individual has already fully utilized their LCGE or the farming assets are not considered QFFP, an intergenerational rollover may allow for a transfer of farming assets to a child or children on a tax-deferred basis. We discuss intergenerational transfers further later in this guide.

This differs from a farm succession plan involving a sale to a third party. If the current accrued gains on your farming assets will use up your own LCGE, you may wish to consider planning to make use of your children's exemptions.

While the tax rules are complex, they rarely cause farm succession planning to come to a standstill. It's more likely to get bogged down in the emotional decisions rather than the technical ones. Discussing farm succession plans with your tax advisor will help you make the best use of available tax savings.

The Thompson family case study

The tax consequences of disposing of farming assets

During a meeting with their accountant, Frank and Sharon discussed their annual personal tax returns, including the farmland sale to their youngest son, James. The meeting prompted Frank and Sharon to consider the tax liabilities of future dispositions of their remaining farmland.

The tax consequences resulting from the farmland sale to James

The farmland and building were sold for a total fair market value of $475,000 (with the value attributable to the land and residence being $375,000 and $100,000 respectively). James made a $100,000 down payment and will be making subsequent annual payments of $25,000 per year. Based on a valuation of the property, the value was $450,000 when it was bought from Frank's mother.

The $25,000 increase in value during the year leading up to James's ownership was determined to be attributable to farmland only. Their accountant advised them that the LCGE is available for this transaction and, as such, the $25,000 capital gain can be realized on a tax-free basis.

This determination was based on the criteria for land acquired on or after June 18, 1987:

- Although Frank and Sharon owned the property for less than 24 months, the property was owned by them and Frank's mother for the 24-month period before they sold it to James.
- Frank and Sharon's gross revenue from farming has exceeded their income from other sources in all 30-plus years of their farming operation.
- The farmland that was sold to James has been used exclusively in the farming operation of Frank and Sharon and Frank's parents for all of the 50-plus years the land has been in the family.

Frank and Sharon's remaining 10 quarter sections are estimated to be worth approximately $375,000 each (excluding buildings). Five of these quarter sections were acquired in an arm's length purchase in 1986 for a cost of $80,000 each. The remaining five quarter sections were purchased in 2008 from Frank's parents for the estimated fair market value at that time of $100,000 each.

The farmland's current accrued capital gain is estimated to be $2,850,000 (or $1,425,000 for each of Frank and Sharon).

Similar to the analysis prepared for the land sold to James, the farmland bought from Frank's parents in 2008 currently meets all the QFFP criteria for farmland acquired on or after June 18, 1987. For the original land purchased by Frank and Sharon in 1986, the determination is based on the criteria for land acquired before June 18, 1987. Given that Frank and Sharon have used this land exclusively in their farming operation for well in excess of the required five years, this land is considered QFFP as well.

Benefitting from the LCGE

If Frank and Sharon were to dispose of more farmland at this time, a significant portion of the current accrued gains could be realized on a tax-free basis. The LCGE would be available for $1,975,000 of the $2,850,000 total gain (based on the $1,000,000 LCGE limit per individual, minus the $25,000 utilized on the sale to James).

For Frank and Sharon, it's comforting to know that, should something unexpected happen to them, the LCGE could significantly reduce the tax burden on their estate.

They have specified in their wills that the LCGE should first be applied to the land transferred to Matthew and Sarah, because James is currently entitled to a larger share of their estate.



In the next part of this series, we explore the available credit options.



Credit options

During the farm succession process, the farm's value often has to be shared among siblings and/or the retiring owners. If the family is determined to keep the farm intact, the best solution is generally to use the farm as collateral for a loan.

There is no one-size-fits-all solution when it comes to agricultural credit. Every farm is different and its financing plan should be customized to meet the immediate and long-term needs of the operation. However, it can be difficult to know where to start.

There are many potential solutions, but the best way to approach these decisions is to balance the financing needs with what the farming operation can actually manage.

Calculating the impact of financing a succession plan

1. Complete a Farm Financial Assessment: this should include the current assets, liabilities and equity in the farm, as well as its net income. Take a five-year average and break it down to a “per productive unit” basis, that is, per acre, per head, etc. This will provide the basis for evaluating your options.

2. Look at how the plan alters the productive capacity of the operation. Will the land base change in any way? Will the number of acres/cattle/quota units remain the same?

3. Examine the projected performance after the change. What will the liquidity, solvency and profitability of the farm operation look like after the plan is executed? How will net income compare before and after the plan? Take the historical “per unit” calculation from Step 1 and use that to project production figures, post-change. What is the leverage ratio and is there enough available security to carry out the plan?

4. What is your vision for the future? Will leveraging farm assets to carry out the plan have an impact on the farm’s ability to make future investments? There is only so much leverage that a farm’s cash flow can support. Tying up cash flow to repay succession planning debt can limit the farm’s future growth. Having an understanding of the leverage ratio and managing it well are critical for the farm’s long-term chances of success. Consider where the operation will be in five to 10 years and what its credit requirements will be then. What kind of impact will leveraging for the succession plan now have on that future vision?

When insurance plays a part in the plan

When considering financing, either to buy out or expand the business, it's wise to consider life insurance. If the insurance holder dies unexpectedly, the loan will be paid out.

Similarly, when a farming child takes out financing to buy farming assets, disability and critical illness insurance are highly recommended. If sickness or injury mean they can no longer work, the insurance will ensure that financial obligations are still met.

We all know that in this industry, the best laid plans can go astray, but laying out a long-term plan can help avoid potentially costly mistakes when implementing a farm succession.

The Thompson family case study

Unplanned expansion of farmland ownership

In addition to the farmland they own, Frank and Sharon also rent six quarter sections of land for use in their farming operation. The owner of two of these quarter sections has just contacted them to offer them the first option to buy the land. They have one month to decide before he lists the land for sale.

Frank and Sharon had no plans to buy further farmland, in fact, their thoughts had been moving in the opposite direction. They intend to dispose of more of their land when they retire. This unexpected news, however, makes them reconsider their short- and long-term plans for the family farm.



Buying land to maintain the farm's capacity

Frank and Sharon do not feel that the 15 quarter sections of farmland (the land they own, James's section and the four rental sections) are sufficient to provide full-time work for three people in the short-term, (though it is enough for Frank and Sharon alone).

If Frank and Sharon don't buy the neighbour's land, they would effectively reduce the size of their own farming operation for the foreseeable future. They don't know of any other farmland available for rent in the immediate area and have no guarantee that the new owner would be willing to rent the land to them.

In considering the purchase of the additional land, Frank and Sharon want to maintain the following aspects of their farm succession plan:

- To allow Frank and Sharon to work approximately 10 more years before retirement
- To provide full-time work for James during this period and to prepare him to take over management of the farming operation

Frank and Sharon don't feel ready to retire at this time or reduce their involvement in the farming operation. They don't want to ask James to look for employment elsewhere either, as this may decrease his interest and ability to take over the farm in the future. They therefore decide to buy the additional farmland, recognizing that they may sell the land when they retire.

Financing the land purchase

Frank and Sharon decide to use their cash and non-registered investments of $250,000 towards the purchase of one quarter section of land. Ideally, they want James to buy the other section with bank financing but if not, they are willing to buy both quarters themselves using bank financing.

When they discuss the situation with James, he tells them that he is not prepared to make the purchase, especially given the short time frame. Along with the significant debt he has from his recent land purchase, he feels that this would be too much for him to take on at this time.

Frank and Sharon are disappointed but respect his decision and move forward with financing to buy the land themselves. They each take out term life insurance worth $250,000. If they die, the insurance would pay out the new debt and there would be no impact on the permanent life insurance policy intended for Matthew and Sarah.

Frank and Sharon don't need to change their wills, as this new farmland will be part of the balance of the estate to be left to Matthew and Sarah. James would have an option to buy the land, as with the other farmland left to Matthew and Sarah.



In the final part of this series, we look at the details of intergenerational transfer.



Intergenerational transfers

Farm succession plans often involve the transfer of farming assets to the next generation of both farming and non-farming children. An intergenerational rollover, either before or after the owner's death, may allow the transfer of certain farming assets to the next generation on a tax-deferred basis.

For example, farmland could be transferred at a value between cost and fair market value, which would reduce the capital gains taxes. The rollover provisions, along with the lifetime capital gains exemption ("LCGE"), discussed in a previous article, are designed to make intergenerational transfers of farming property easier.

Conditions for a tax-deferred rollover

To use this tax-deferred rollover for farmland, the following conditions must be met:



The child receiving the property must be a resident of Canada at the time of disposition; and



The property must have been used principally in a farming business in which the transferor, their spouse, child or parent was actively engaged on a regular and continuous basis.

“Principally used in farming” is generally considered to mean that more than 50% of the use was for farming. Rental use is not usually considered to be farming. While this guide focuses on farmland, other farming assets such as farm equipment, buildings, quotas, shares of a family farm corporation or an interest in a family farm partnership may also qualify for a rollover. Farming inventory, however, is excluded from the rollover provisions.

This rollover applies to transfers of property to the owner’s child. The definition of “child” can include a biological child, grandchild, great grandchild, adopted child, step-child, or child-in-law. The rollover provisions are not available if the transfer of farming property passes to another family member, such as a sibling, niece or nephew.

Maximizing the LCGE

While a rollover may allow the owner to transfer farming property to the next generation at cost and therefore defer taxes, it may be better to first maximize the use of the LCGE.

For example, let's say that an owner wants to transfer farming property to their child. The property cost $300,000 and has a current fair market value of $1,500,000 (with a gain of $1,200,000). If it qualifies for both the LCGE and a tax-deferred rollover, it may make sense for the property to be transferred at $1,300,000 (an amount between the cost and fair market value).

This would allow the taxpayer to fully use the LCGE and provide the child with a cost of $1,300,000. If the property was transferred at the cost amount of $300,000, there would be no capital gains taxes. However, the child would have a cost of only $300,000 going forward and the parent's LCGE would not have been used at all.

Accessing the children's LCGE

The rollover provisions can also be used to access the LCGE available to children. In this case, it is important to note that the transfer may be considered to have taken place at fair market value, rather than an amount between cost and fair market value, if the child sells, or make arrangements to sell, the property within a three year time period. That is, the rollover could be denied retroactively, creating unexpected tax consequences for the parents.

Continuing with the previous example, if the child sells the property for $1,600,000 after owning it for only two years, the transfer from the parent would be considered to have occurred at $1,500,000 (the fair market value at that time) rather than $1,300,000.

The parent would have to report a further capital gain of $200,000, with no LCGE available. The child would report a capital gain of $100,000 (the increase in value during the ownership period) rather than $300,000. If the LCGE were otherwise available to the child or if the child were in a lower tax bracket than the parent, it may be preferable to wait until after the three-year time period elapses.

It's advisable to discuss your farm succession plans with your tax advisor to get the best out of both the LCGE and rollover provisions and help you achieve your goals.

The Thompson family case study

Pending retirement

A number of years have now passed and Frank and Sharon's retirement is approaching. There have been some significant changes to their farm succession plan.

Three years after Frank and Sharon bought the additional farmland (see the earlier section in this guide about credit options), James took on some part-time work with a university friend, initially intending to do this in addition to his farm work. The job expanded very quickly, however, and James's work on the family farm steadily decreased.

James has kept ownership of the quarter section of farmland he bought from his parents and continues to live there. However, he travels a lot for work, so he is not home much and only helps around the farm occasionally.

Transitioning into retirement

As a result of James's reduced involvement in the farm, Frank and Sharon decreased the size of their operation five years ago as they transitioned towards retirement. They have continued to farm 11 quarter sections of land including the land owned by James, but have given up their previous leases.

Although they had kept the two most recently acquired quarter sections of farmland, in case James returns to farming, they are now considering selling them. Although Frank and Sharon are not yet ready to give up on the idea of James returning to farming, they won't postpone their own retirement. They plan to continue farming a single quarter section into their early retirement years and rent out the remaining land.

Minimizing tax implications

Frank and Sharon know that non-farming use of farmland can create tax challenges. They meet with their accountant to ensure they understand the implications for their situation. They bring the following information with them:



5 quarter sections @ $80,000

Five quarter sections of land were acquired in an arm's length transaction 46 years ago for $80,000 per quarter section. To date, this land has been used exclusively in their farming operation.

5 quarter sections @ $100,000

Five quarter sections of land were purchased from Frank's parents 24 years ago for $100,000 per quarter section. This land has been used in their farming operation or that of Frank's parents and grandparents for over 50 years.

2 quarter sections @ $375,000

Two quarter sections of land were acquired in an arm's length transaction nine years ago for $375,000 per quarter section. This land was used for farming for four years and has been rented for the last five years.

12 quarter sections @ 550,000

Each quarter section has an estimated fair market value of approximately $550,000 (excluding buildings).

The estimated accrued capital gain with respect to the farmland is $4,950,000. Even if all of the land qualifies for the LCGE, the current accrued gains are well in excess of the $1,000,000 LCGE limit per individual. Frank and Sharon have also already used $12,500 of their respective LCGE limits.

They want to know if a rollover could be used to transfer certain farmland to their children, if they want to hold these assets long-term. The children are Canadian residents, so the first test would be met. The second test considers each property individually and whether the farming use has exceeded the non-farming use.

Planning to reduce the tax burden

With the exception of the most recently acquired farmland, a rollover should be available during Frank and Sharon's lifetime, because the rental use should never exceed the farming use.

For the most recently acquired farmland, however, the rental use has already exceeded the farming use. If this land were transferred today, a rollover would not be available. Unless Frank and Sharon alter their retirement plans and resume actively farming this land, a rollover will not be available in the future. Fortunately, their accountant indicates that the LCGE criteria (see page 21) have been met.

By planning to utilize a combination of tax-deferred rollover and LCGE planning, Frank and Sharon can reduce their tax burden.



ATB Wealth® consists of a range of financial services provided by ATB Financial and certain of its subsidiaries. ATB Investment Management Inc. and ATB Securities Inc. are individually licensed users of ATB Wealth. ATB Securities Inc. is a member of the Canadian Investor Protection Fund and Canadian Investment Regulatory Organization.

The information contained herein has been compiled or arrived at from sources believed to be reliable, but no representation or warranty, expressed or implied, is made as to their accuracy or completeness, and ATB Wealth (this includes all the above legal entities) does not accept any liability or responsibility whatsoever for any loss arising from any use of this document or its contents. This information is subject to change and ATB Wealth does not undertake to provide updated information should a change occur. This document may not be reproduced in whole or in part, or referred to in any manner whatsoever, nor may the information, opinions and conclusions contained in it be referred to without the prior consent of the appropriate legal entity using ATB Wealth. This document is being provided for information purposes only and is not intend no ed to replace or serve as a substitute for professional advice, nor as an offer to sell or a solicitation of an offer to buy any investment. Professional legal and tax advice should always be obtained when dealing with legal and taxation issues as each individual's situation is different.