FARMING MATTERS

Newsletter December 2017

Year End Tax Planning

Many farm sectors have experienced a profitable year as a result of higher commodity yields and in some instances higher prices. The timing of government assistance may also trigger higher than expected incomes. Tax planning before year-end may provide substantial tax savings. We recommend, that if you are concerned about your income level and the tax liability it may generate, you contact us for a preliminary review of your tax situation.

Some ways to lower your tax liability include:

- Prepaying in 2017 for 2018 inputs such as feed, crop inputs and livestock.
- Income sharing with children and or spouses (please review with us).
- Repairing equipment and/or farm buildings.
- Delaying receipt of commodity sales until the new year.
- For individuals purchasing RRSPs prior to March 1, 2018.
- Delaying the withdrawal of AgriInvest funds until the new year.

Income Splitting

For many farm businesses, income splitting with family members is an effective way to reduce taxes. If your spouse is not already a partner in the business or children who have contributed to your farm business, it may make sense to allocate income to them. The amounts need to be reasonable for work performed and amounts should be paid and reported on a proper payroll. Any earnings to a spouse or children would be insurable for purposes of Workers' Compensation. Despite the extra reporting there can be significant tax savings from income splitting. Any income allocations need to be paid before the year end.

HST Audits

We continue to see an increase in HST desk audits in the farm and other sectors. In particular, CRA seems to be paying specific attention to filings where there is a substantial variance from previous filings. In cases where you are building or substantially renovating a building you can almost expect to be asked for receipts to support your claim. The requests usually require you to submit a complete listing of Input tax credits for the period as well as several of the most substantial invoices. The best way to prepare for this is to ensure your filing agrees to your financial records and that you are claiming HST supported by invoices. In many instances the audit ``headache`` can be reduced substantially if Ward & Uptigrove does the final HST return for the fiscal year. This gets all the adjustments on the final return in the proper year, substantially decreasing the time required to support the filed numbers. On the downside, your HST refund may be delayed until the statement is complete.

CRA also continues to review vehicles in companies to be sure there is no personal benefit attached to them, or if they should be a personal asset in the first place. We suggest vehicles purchased in a company be invoiced in the company name, have the ownership in the company name and be included in the company insurance policy. In addition, the vehicle should also be supportable as a business asset. Please talk to us if you are unsure whether or not to acquire a vehicle using your company.

WSIB Audits

Similar to HST, WSIB is conducting more audits these days. These audits are typically desk audits where you are required to send in details of your wages and custom work accounts as well as casual wages. Although typically small dollar amounts, WSIB is looking for those businesses that should have been enrolled and charged WSIB. or are under reporting for WSIB purposes. WSIB is not optional and all wages, even if casual, must be covered. Profit shares and/or wages to children and spouses also require WSIB inclusion. We encourage compliance with WSIB as the penalties and costs of a farm injury, where you never had WSIB coverage, can be very high.

HST and Dwellings

If you have a second dwelling that is rented, while the expenses related to it are deductible, you cannot claim back the HST related to these expenses. Residential rent does not attract HST, meaning you do not charge HST on the rental income. However, the same is also true for residential rental house expenses. You cannot claim an input tax credit (ITC) on any outlay related to a residential rental house.

If your personal dwelling is in a corporation for tax purposes it is considered a "rental dwelling" and follows the rules of a rental house above.

In recent HST audits, CRA has taken an even stronger position and indicated claiming any HST on a personal dwelling or renovations is denied. The old argument that the home is the farm office does not seem to be enough anymore.

We suggest avoiding this complication and forego any HST claims on anything to do with dwellings.

Sharing of the Small Business Deduction

The small business deduction is an incentive offered to Canadian controlled private corporations on up to $500,000 of their active business income. The rate on this first $500,000 of active income is 15% for 2017 (decreasing to 12.5% by 2019) whereas income above this level is taxed at 26.5% for 2017.

Effective for year ends beginning after March 22, 2016, legislation limits the access to the small business deduction for corporations that provide property or services to a related corporation. A related corporation would be a corporation owned by the following: a spouse, a parent, a grandparent, a child, a grandchild, a sibling, an aunt/uncle or a niece/nephew. If you provide property or services to a corporation owned by someone identified above, please ensure you provide the details of the transactions to us when you provide your yearend information. Failing to identify these items could result in unnecessary additional tax if the small business deduction is denied to all parties involved. For more details relating to this rule change contact us in advance of your next year end.

Quota

Cost of Quota Owned

Effective January 1, 2017, the government has implemented new tax legislation that will change the taxation of farming quotas to become the same as all other capital assets. With the complex nature of these tax changes and the transitional rules around them, it is important to determine the historical cost per unit of your quota. This historical cost per unit is impacted by many factors such as the nature of how you acquired the quota and who you acquired it from (directly from the DFO, from parents or grandparents, transfer to corporation, third-party etc.). Building the historical cost per unit will require us to go back to the original acquisition of the quota in your family's farming history and we may be contacting you to request details of this history that we do not have in our office.

If you have sold quota during 2017, or if you plan to sell quota in the near future, please let your accountant know. Gathering relevant quota history can be very time consuming, and in order to provide accurate tax planning information to you, this information is necessary.

Tax Changes for Quota in 2017

Prior to January 1, 2017, farm quota and other eligible capital property (ECP) had their own regime that was different than that of the capital cost allowance (CCA) regime. However, the 2016 Federal Budget replaced the entire ECP regime with a CCA type regime with an effective date of January 1, 2017.

What changed?

The new regime for quota and other ECP results in higher taxes payable on a sale by a corporation.
Let's look at an example:

	"Old" ECP Regime		"New" CCA Regime (Class 14.1)	
Year 1: Buy Dairy quota for $1,000	$750		$1,000	
Year 1: Tax deduction	53	*CEC*	25	*CCA*
Year 2: Tax deduction	49	*CEC*	49	*CCA*
Year 3: Tax deduction	45	*CEC*	46	*CCA*
Year 4: Sell Dairy quota for $2,000	147	*Recapture income*	120	*Recapture income*
	500	*Business income*	500	*Taxable capital gain*
	22	*Tax paid on recapture*	18	*Tax paid on recapture*
	<u>75</u>	*Tax paid on gain*	<u>250</u>[1]	*Tax paid on capital gain*
	97	*Total tax paid*	268	*Total tax paid*

A few observations from the example above:

- quota acquisitions will now be subject to what is known as the half-year rule of 50%. Therefore, in the first year there is less tax depreciation available as compared to the "old" ECP regime; and

[1] The corporation would need to pay taxable dividends of $400 to the shareholders to obtain the dividend refund, reducing the net corporate tax on the capital gain to $98.

- when quota is sold and a gain is realized, the gain will no longer be taxed as business income but instead will be taxed as a capital gain. The difference in the taxes paid is largely due to a deferral of tax as business income may be eligible for the small business deduction rate whereas a taxable capital gain is initially taxed at a much higher tax rate of 50.17%, and after dividend refunds a net rate of 19.5%.

What if the farm holds multiple types of quotas?

Let's look at another example to illustrate the negative impact of the CCA regime to the sale of farm quota where a taxpayer holds more than one type of farm quota.

	"Old" ECP Regime		"New" CCA Regime (Class 14.1)	
Year 1: Buy Dairy and Broiler quota for $500 each	$750		$1,000	
Year 1: Tax deduction	53	*CEC*	25	*CCA*
Year 2: Tax deduction	49	*CEC*	49	*CCA*
Year 3: Tax deduction	45	*CEC*	46	*CCA*
Year 4: Sell Dairy quota for $600	(450)[2]	*Proceeds*	(500)	*Lower of cost and proceeds*
	Nil[3]	*Business income*	50	*Taxable capital gain*
	Nil	*Tax paid*	25	*Tax paid before RDTOH*

Additional observation from the example above:

- When one type of quota is sold (in this example, all of the dairy quota is sold), under the "old" ECP rules, the cumulative eligible capital (CEC) pool was reduced by 75% of the proceeds received on the sale of the quota. No taxes would have been payable until the CEC pool was reduced to $Nil. However, under the "new" CCA regime income tax of $25 would be payable on the sale of the dairy quota.

What if the farm sells only a small portion of its quota?

As the Canada Revenue Agency ("CRA") views units of particular quota to be identical properties, the cost of each unit of a particular farm quota would be averaged. As an example, if in year one 1 unit of farm quota is purchased for $1,000 and in year two another 1 unit of farm quota is purchased for $2,000, the average cost for each unit of quota is $1,500 (i.e. $1,000 plus $2,000 divided by 2 units). If 1 unit is then sold in year 3 for $2,000, a capital gain of $500 will result (i.e. $2,000 sale proceeds less average cost of $1,500). Under the "old" ECP regime there would not have been any immediate tax consequence from the sale of the 1 unit of quota.

What if the farm buys a replacement quota?

The CRA has confirmed that farm quota would not qualify for the replacement property treatment for dispositions under the new rules effective January 1, 2017.

What if the Farmer Transfers the Quota to a Corporation?

Farmers are able to transfer farm quota to a corporation on a tax-deferred basis. As recognition for the fact the farmer had acquired the farm quota with after-tax dollars, upon the transfer to the corporation the farmer was permitted to receive cash or a shareholder loan from the corporation. Furthermore, due to the fact that under the "old" ECP regime only 75% of the cost of the quota was included in the CEC pool, upon the transfer of the farm quota to a corporation the farmer was permitted to received 4/3 of the CEC balance as cash or shareholder loan.

However, under the current transitional rules for pre-2017 quota, there is no recognition for the 25% of the farm quota cost that was not added to the CEC pool. The following chart illustrates this:

	Pre-2017 Quota transferred to a corporation before 2017	Pre-2017 Quota transferred to a corporation after 2016
Capital cost	1,000	1,000
CEC balance	750	N/A
UCC balance	N/A	750
Elected amount on transfer	1,000	750

[2] This is 75% of the proceeds ($600)

[3] No business income would have been required to be reported as the CEC pool balance after the sale would have been a positive balance of $153.

A few observations:

- Had the taxpayer transferred the quota before 2017, the taxpayer could have received cash or a promissory note from the corporation in the amount of $1,000. However, if the taxpayer transfers the quota after 2016, the taxpayer can only receive cash or a promissory note of $750 (a difference of $250).
- The result is very punitive and warrants consideration before farm quota is transferred to a corporation on a rollover basis.

It is our understanding, the ruling division of the CRA has confirmed this interpretation of the rules and referred the matter to the Department to Finance. We hope this is corrected through revised legislation.

Tax on Quota Sales

Recent tax changes have increased the taxation on quota sales. If the quota is owned personally usually farmers have their capital gains exemption to offset the quota gain. However, the tax law specifies that in order to claim the exemption the quota must have been owned for at least two years. How does this impact a farmer who has been given quota but does not need it choosing to sell it immediately? Which quota did he sell – the new or existing? CRA indicates quota must be averaged. In simple terms if you had 20 units and were given 5 units which were subsequently sold, you have sold 1/5 of your total quota. Therefore 1 unit of the 5 you sold was new quota and would not have been owned 2 years, meaning it would not qualify for the capital gains exemption. The cost of the quota for purposes of calculating any gain would be your total cost of quota actually paid for divided by 25 units. Sometimes free quota is not free.

Upcoming Deadlines

Risk Management: Important deadlines

January 31, 2018 – pay second semi-annual premium instalment for livestock
January 31, 2018 – report fourth quarter livestock sales

AgriInvest: AgriInvest deposits are due 90 days after the date on your deposit notice.

September 30, 2018 – submit statement A to Agricorp

AgriStability 2017: AgriStability applications are due June 30, 2018 for the 2017 program year. If you have an off calendar year end, your applications may be filed at any time.

December 31, 2017 – apply for an interim payment
June 15, 2018 – submit your T1163 to CRA (individuals)
June 30, 2018 – submit your Statement A to Agricorp (corporations)
June 30, 2018 – submit your AgriStability application to Agricorp

AgriStability 2018: As the new CAP suite of products has not been released (please see below for our discussion on CAP) we have assumed the deadlines will remain similar to the past AgriStability deadlines.

April 30, 2018 – apply to AgriStability as a New Applicant
April 30, 2018 – pay the AgriStability fee without penalty
April 30, 2018 – cancel coverage for 2018

Self Directed Risk Management (SDRM)**:** Self directed risk management for edible horticulture deposits are due February 1, 2018. All forms should have been received from Agricorp. Please note that the matching of the deposit becomes taxable income when the deposit is made, not when it is withdrawn.

Production Insurance:

December 15, 2017 – report your yields for corn, soybeans, beans, etc.
April 1, 2018 – last day to cancel coverage
September 1, 2018 – report your yield for wheat and spelt

Canadian Agricultural Partnership ("CAP")

The government of Canada has announced that it will continue to support agriculture, agri-food and agri-based product sectors through CAP. This program will replace the Growing Forward 2 suite of options and will begin in 2018. The program will be a five-year, $3 billion investment by federal, provincial and territorial governments. There are not many specific details out on the new program but from what we have seen CAP will focus on six priority areas:

1. Science, research and innovation
2. Market and trade

3. Environmental sustainability and climate change
4. Value-added agriculture and agri-food processing
5. Public trust
6. Risk management

Many of our agricultural clients have taken advantage of the risk management programs in the past and CAP will continue to assist producers in managing the significant risks that threaten the viability of their farm and that are beyond their capacity to manage. The risk management programs will continue to include AgriStability, AgriInvest, AgriInsurance, AgriRecovery and RMP. A few changes to these programs that you will want to be aware of are as follows:

AgriStability

- A late participation mechanism has been added that provincial governments can trigger to allow producers to enter the program late in situations where there is a significant income decline and a gap in participation
- The reference margin limit will be changed to ensure a more equitable level of support for all producers.

AgriInvest

- The maximum government matching contribution will be limited to $10,000 per AgriInvest account, down from $15,000
- A minimum government matching contribution will be raised to $250, up from $75

As the government releases more specifics relating to the programs we will keep you informed.

Dairy Farmers Investment Program (DFIP)

Over 3,000 applications were submitted to Agriculture and Agri-Food Canada (“AAFC”) from across the country and as of August 29, 2017 the DFIP first application window was fully subscribed and applications were no longer being accepted. AAFC has indicated they are targeting to provide each applicant with a status update within 100 business days of receipt of the application – this timing puts that update in mid-January. The update will advise you if your application has been assigned to an officer and/or if it has been approved.

Projects applied for in the first intake window are required to be started no earlier than November 10, 2016 and no later than March 31, 2018 and must be completed before March 31, 2019 for small projects and before March 31, 2020 for large projects.

There are no details on when the second application window will open and what time period it will cover but we expect to receive further details at some point in the New Year. Once the details are released our understanding is the second window will allow for potential retroactive start dates (how far back is unknown at this time) on projects with the end date being later than the first window (likely one year).

The first window was fully subscribed within 7 days of opening and with a first-come, first serve policy, and the large dollar value available under the program ($250,000 per licensed dairy farm), timing of your application submission is very important to allow you the best opportunity to take advantage of DFIP. We will continue to keep you up to date on information we hear as it is released. We encourage you to talk to us or take a look at the program details to see what type of projects funding is available and be prepared to take advantage in the next application window.

Details on the program can be found at: http://www.agr.gc.ca/eng/programs-and-services/list-of-programs-and-services/dairy-farm-investment-program/)