SASKATCHEWAN FARMS – PROPRIETORSHIPS, PARTNERSHIPS AND CORPORATIONS

Law Society of Saskatchewan

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BARRISTERS AND SOLICITORS

BROAD OUTLINE

- Proprietorships
- Partnerships
- Corporations

BROAD OUTLINE

- Legal Considerations
- Income Tax Considerations
- Goods and Services Tax (“GST”) Considerations
- Succession and/or Sale – Pros and Cons under each structure

PROPRIETORSHIPS

- LEGAL
  - Business name
  - Liability exposure
  - Farmland ownership rules

PROPRIETORSHIPS

➢ LEGAL - BUSINESS NAME

- Section 2 In this Act (*The Business Names Registration Act*, RSS 1978, c B-11 (as amended)):

  (c) "business name" means:

  - (i) in the case of a sole proprietor who is an individual, a name or style, including his own family name or surname or a name or style comprising his own family name or surname with the addition of some other word or phrase indicating a plurality of persons, under which he carries on or intends to carry on business …

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PROPRIETORSHIPS

- LEGAL - BUSINESS NAME

  - *The Business Names Registration Act*, section 4(1) states:

    4(1) Subject to subsection (3), every person who carries on business under a business name shall cause the business name to be registered under this Act.

    A "person" includes an individual. [s. 2(d.2) of the said Act]

PROPRIETORSHIPS

➢ LEGAL – LIABILITY EXPOSURE

- The individual proprietor is legally responsible for all liabilities of the farming operation.

- Advise the client to consult with an insurance broker to ascertain insurance coverage (e.g. public liability; fire).

PROPRIETORSHIPS

- LEGAL – FARMLAND OWNERSHIP IN SASKATCHEWAN

  - *The Saskatchewan Farm Security Act*, S.S. 1988-89, c. S-17.1, as amended, Part VI places restrictions on who can own farmland in Saskatchewan

    - S. 76(d) - “farm land” means real property in Saskatchewan that is situated outside a city, town, village, hamlet or resort village or the Northern Saskatchewan Administration District as defined in The Northern Municipalities Act and that is used or is capable of being used for the purposes of farming …

PROPRIETORSHIPS

➢ LEGAL – FARMLAND OWNERSHIP IN SASKATCHEWAN

- Persons who may own Saskatchewan farmland:
  - Canadian citizens
  - Permanent residents of Canada
  - Corporations and membership-based organizations which are 100 per cent Canadian-owned (and are not publicly traded)
- Other than that, generally speaking, persons must apply to The Farm Land Security Board to own more than 10 acres of farm land in Saskatchewan

PROPRIETORSHIPS

- GST Considerations

  - *Excise Tax Act* (Canada) ("ETA"), section 240(1) states:

    "240 (1) Every person who makes a taxable supply in Canada in the course of a commercial activity engaged in by the person in Canada is required to be registered for the purposes of this Part, except where

    (a) the person is a small supplier;

    (b) the only commercial activity of the person is the making of supplies of real property by way of sale otherwise than in the course of a business; or

    (c) the person is a non-resident person who does not carry on any business in Canada."

PROPRIETORSHIPS

- GST Considerations

  - A “person” includes an individual, a partnership and a corporation [ETA, ss. 123(1), definition of “person”]

  - A “commercial activity” is defined at ss. 123(1) of the ETA as follows:

    commercial activity of a person means

    (a) a business carried on by the person (other than a business carried on without a reasonable expectation of profit by an individual, a personal trust or a partnership, all of the members of which are individuals), except to the extent to which the business involves the making of exempt supplies by the person …

  - Thus, “farming” is a commercial activity.

PROPRIETORSHIPS

➢ GST considerations

- A GST registrant carrying on a commercial activity:
  - Must account for GST collected or collectable on products or services sold in the course of the commercial activity
    - other than zero-rated supplies, which include supplies of livestock, and grains or seeds in their natural state for storage purposes, or hay, silage or other fodder crops where ordinarily used to produce food for human consumption or feed for livestock or poultry – see ETA, Schedule VI, Part IV.
  - May claim input tax credits in respect of purchases of products or services used in the course of the commercial activity.

PROPRIETORSHIPS

- GST Considerations
  - Farmland acquisitions - provided the individual farmer is registered for GST, when that individual acquires farmland which will be used in the farming business, special rules found at ss. 221(2) and ss. 228(4) of the ETA apply:
    - The seller does not have to collect GST on the purchase price of the farmland from the purchaser.
    - The purchaser self-assesses in their GST return covering the time period in which the farmland is purchased. A liability for GST to the federal government will be calculated on line 405 of the GST return (e.g. if the purchase price is $1,000,000, then the GST to be accounted for will be 5% of that price, namely $50,000).
    - An offsetting ITC will be claimed (in addition to any other ITCs to be claimed on any other inputs in that reporting period) on line 105 of the GST return.
    - This set-off assists in managing cash flow (no net GST needs to be remitted to the government).

PROPRIETORSHIPS

➢ INCOME TAX

- 2021 Tax Rates under the *Income Tax Act* (Canada) (“**ITA**”)
- Succession Rules:
  - Rights and Things
  - Rollovers
  - Lifetime capital gains exemption (“**LCGE**”)

PROPRIETORSHIPS

- 2021 Top Marginal Tax Rates

Ordinary income (such as farming income):	47.50%
Eligible dividends:	29.64%
Other than eligible dividends:	42.29%
Capital Gains: (or 21.75% on capital gains arising from the disposition of QSBC shares and Qualified Farm Property)	23.75%

The greater the amount of farming income earned in the year, the higher the applicable income tax rate.

PROPRIETORSHIPS

- SUCCESSION "as a consequence of death"
- Terms of Will, testamentary instrument, laws governing intestacy, disclaimers, releases, surrenders [ITA ss. 248(8)]
- Matrimonial property orders [ITA ss. 248(23.1)]
- Dependants' relief orders [ITA ss. 248(9.1)] – trusts vs. outright property transfers
- Sales under a Will do not qualify for a rollover as they are not "as a consequence of death" [*The Estate of Andrew Hrycej v. MNR* (1984), 84 DTC 1089 (TCC)]

PROPRIETORSHIPS

- SUCCESSION after death - Qualifying property
  - Rights and Things
  - Farmland and depreciable property of a prescribed class

PROPRIETORSHIPS

- Rights and things
  - Farm inventory (e.g. grain on hand; livestock)
  - Declared but unpaid dividends

PROPRIETORSHIPS

- Rights and Things – where to report the value of a right or thing on the death of a taxpayer
  - Terminal tax return
  - Rights and things tax return
  - Elect to transfer to beneficiary – ultimately their income

PROPRIETORSHIPS

- SUCCESSION after death – type of farm property

  - Farmland and depreciable property of a prescribed class

  - The eligibility requirements for rollovers of depreciable property of a prescribed class used in the business of farming in Canada are substantially the same for as for farmland

  - This presentation will focus on the rules respecting farmland

PROPRIETORSHIPS

- SUCCESSION after death – Rollovers of farmland – to whom

- To spouse or common-law partner

  - Common-law partner – person who cohabits with taxpayer in a conjugal relationship for at least 12 months, or is a parent of a child with that taxpayer [ITA ss. 248(1), definition of "common-law partner"]

PROPRIETORSHIPS

- Farmland – Succession after death – to whom
  - to spouse or common-law partner or spouse trust
    - Generally, any farmland in Canada owned by the taxpayer is eligible for a rollover to a spouse or common-law partner or spouse trust (regardless of who farmed the same) provided it is transferred or distributed as a consequence of the taxpayer's death to:
      - the taxpayer's spouse or common-law partner who was resident in Canada immediately before the taxpayer's death, or
      - a spouse trust created under the taxpayer's Will that was resident in Canada immediately after the time the property vested indefeasibly in the trust [ITA ss. 70(6)]

PROPRIETORSHIPS

- Farmland – Succession after death – to whom
  - To spouse or common-law partner or spouse trust
    - Farmland must vest indefeasibly in the spouse or common-law partner or spouse trust within 36 months after the death of the taxpayer.

PROPRIESTORSHIPS

- SUCCESSION after death – Rollovers – to whom

- Parent to child

  - Child of the taxpayer must be resident in Canada immediately before the day on which the taxpayer died [ss. 70(9)(b)].
  - Farmland must be transferred to and become vested indefeasibly in the child within 36 months after the death of the taxpayer.

PROPRIETORSHIPS

- SUCCESSION after death – Rollovers – to whom

- Child

  - Who is a child? [ss. 70(10) definition of "child"; and ss. 252(1)]

    - Child (a person of whom the taxpayer is the legal parent)
    - Grandchild
    - Great-grandchild
    - Child of the taxpayer's spouse or common-law spouse (and a person who is a child of the taxpayer immediately before the death of the person's spouse or common-law partner)
    - Person who is wholly dependent on the taxpayer for support, and of whom the taxpayer has (or did have before the person attained the age of 19), in law or in fact, custody and control
    - Spouse or common-law partner of a child of the taxpayer;

PROPRIETORSHIPS

- SUCCESSION after death – Rollovers
  - Vesting indefeasibly
    - For property to be vested indefeasibly in the hands of a beneficiary:
      - The beneficiary must be identifiable; and
      - The property must be received by the beneficiary without being subject to conditions (i.e. the beneficiary must have an unassailable right to own the property).
  - Challenges using trusts (trade off – safeguarding the property in a trust vs. obtaining a rollover)

PROPRIETORSHIPS

- Farmland – Succession after death – farmland

  - From parent to child (direct transfer)

  - Pursuant to ITA ss. 70(9) and (9.01), for farmland transferred as a consequence of the taxpayer's death directly to that person's child, to qualify for a rollover the property must have been, before the taxpayer's death, <u>used principally in a farming business carried on in Canada</u> in which:

    - the taxpayer; or

    - the taxpayer's:

      - Spouse
      - Common-law partner;
      - Child; or
      - Parent

    (any person mentioned above is referred to as a member of the "**Rollover eligible group**")

    <u>was actively engaged on a regular and continuous basis</u>.

PROPRIETORSHIPS

- Farmland – Succession after death - used principally in a farming business carried on in Canada
  - Principal use – A property is considered to be used "principally" if more than 50% of the property is used more than 50% of the time in active farming operations of a member of the Rollover eligible group.
  - In terms of time, there must be more years when the property was used in the active business of farming by members of the Rollover eligible group than not.
  - The time period to consider is the use of the property over the entire period of ownership amongst **ALL** members of the Rollover eligible group.
    - See, CRA Views in Focus 2010-0381321E5 – Capital Gains and Farm Property; CRA View 2007-0240321E5 – 70(9), 73(3): Transfer farm Property to Child; CRA View, Technical Interpretation 9919895 – Rollover of Property Farmed but not Owned

PROPRIETORSHIPS

- Farmland – Succession after death - actively engaged on a regular and continuous basis
  - CRA's view is that a person:
    - Must be actively involved in the management and/or day-to-day activities carried on by the farming business; and
    - Would ordinarily be expected to contribute time, labour and attention to the business to a sufficient extent that such contributions would be determinant in the successful operation of the business. [IT-268R4 (dated April 15, 1996), para. 27]
  - CRA has also commented that "custom farming" (where the services of another person are retained for cash compensation) for all or part of the work associated with the farm activity would not disqualify a taxpayer from rolling farm property to a child. See IT-268R4 (dated April 15, 1996), para. 24.

PROPRIETORSHIPS

- Farmland – Succession after death
  - Separate and apart from a member of the Rollover eligible group using the farmland in the business of farming, pursuant to ITA ss. 70(9.8) an individual's farmland is deemed to be used by the individual in a farming business carried on in Canada if it is being used principally in the course of carrying on a farming business in Canada by:
    - A corporation a share of which is a "share of the capital stock of a family farm or fishing corporation"; or
    - A partnership an interest in which is an "interest in a family farm or fishing partnership"

PROPRIETORSHIPS

- SUCCESSION after death – Rollovers – to whom
- Spouse or common-law partner
  - outright gift
  - "spouse trust"

PROPRIETORSHIPS

- Succession – to whom
  - to spouse trust and from there to a child – an interesting planning opportunity
    - Spouse trust
      - Created by taxpayer’s Will
      - Must be resident in Canada
      - Spouse (or common-law partner) is entitled to ALL income of the trust that arises before his/her death
      - No person other than the spouse (or common-law partner) before his/her death may receive the use of any income or capital of the trust

PROPRIETORSHIPS

- Succession – to spouse trust and from there to a child – an interesting planning opportunity

  - Spouse trust to a child

    - Pursuant to ss. 70(9.1) and (9.11) of the ITA, following the death of the spouse (or common-law partner), depreciable property of a prescribed class and/or farmland owned by a spouse trust can be rolled out of that trust to the settlor's (deceased person's) child who is resident in Canada as long as the property is used in the business of farming in Canada.

    - <u>Where the property is owned by a spouse trust, there is no requirement that the property be used by the taxpayer or anyone related to the taxpayer in the farming business. Anyone can use the property in the Canadian farm business</u>.

PROPRIETORSHIPS

- Succession after death – to Spouse trust and from there to a child – an interesting planning opportunity

  - Interpretation Bulletin IT-349R3 (November 7, 1996) Intergenerational Transfers of Farm Property on Death (archived):

    - 5. Subsection 70(9.1) does **not** require that the trust, the taxpayer's spouse, or the child must be using the property in a farming business immediately before the death of the taxpayer's spouse. Therefore, a rollover under subsection 70(9.1) would be allowed where, during the period between the settlement of the spouse trust and the death of the spouse, the farm property was rented or leased to anyone who used it in a farming business. In addition, there is no requirement that the child continue to use the farm property in the business of farming after its transfer or distribution in order to qualify for the rollover under subsections 70(9) or (9.1).

PROPRIETORSHIPS

- SUCCESSION after death – Rollovers – challenges of “vesting indefeasibly” when young children are involved

  - Challenges using trusts (trade off – safeguarding the property in a trust vs. obtaining a rollover)

  - Example: A farmer dies and leaves farmland in a trust for a child. The child is 13 years old. The terms of the trust provide that the farmland is not to be transferred out of the trust to the child until the child is 25 years of age. If the child dies before age 25, the terms of the trust provide for a gift over to another person (e.g. a grandchild, whether in existence now or born or adopted in the future) or trust for the benefit of another person.

PROPRIETORSHIPS

- SUCCESSION after death – Rollovers
  - Advantage of the trust for the child – safeguards the property until the child is of a mature age.
    - Advantage – the trust terms, which provide for a "gift over" if the child passes away before turning 25 years of age, prevent the child from "breaking the trust" at age 18 under the rule in *Saunders v. Vautier*, which rule was summarized by the Supreme Court of Canada in *Buschau v. Rogers Communications Inc.*, 2006 SCC 28:
      - 21 The common law rule in *Saunders v. Vautier* can be concisely stated as allowing beneficiaries of a trust to depart from the settlor's original intentions provided that they are of full legal capacity and are together entitled to all the rights of beneficial ownership in the trust property. More formally, the rule is stated as follows in *Underhill and Hayton Law Relating to Trusts and Trustees* (14th ed. 1987), at p. 628:

        "If there is only one beneficiary, or if there are several (whether entitled concurrently or successively) and they are all of one mind, and he or they are not under any disability, the specific performance of the trust may be arrested, and the trust modified or extinguished by him or them without reference to the wishes of the settlor or the trustees."

PROPRIETORSHIPS

- SUCCESSION after death – Rollovers

  - Disadvantage of the trust for the child – no rollover if the parent dies more than 3 years before the child turns 25 years of age.
    - The income tax rollover requires that the property must vest indefeasibly in the hands of the child within 36 months of the taxpayer's death.
    - The trust prevents indefeasible vesting, at least until the child is 25 years of age.
  - When doing their estate planning, parents of younger children have to decide which is more important: safeguard the farm property until the child is of a more mature age, or put in place a plan that ensures a tax rollover.

PROPRIETORSHIPS

- SUCCESSION after death – Rollovers

- Electing out of the rollover [ITA para. 70(9.01)(b)]

  - The legal representative can elect out of the rollover otherwise available on farmland anywhere between the adjusted cost base (“**ACB**”) and fair market value (“**FMV**”) of the land.

  - A similar election is also available with respect to depreciable property of a prescribed class.

PROPRIETORSHIPS

- SUCCESSION – an interesting difference between inter vivos and testamentary transfers of farmland
  - If farmland is transferred on an <u>inter vivos</u> basis to a child on a tax rollover basis, and if that child disposes of the farmland within 36 month in order to make use of the LCGE, then the original rollover will be denied. [See ITA ss. 69(11).]
  - If farmland is transferred on a <u>testamentary</u> basis to a child on a tax rollover basis, and if the child disposes of the farmland within 36 months in order to make use of the LCGE, then the original rollover will be allowed. [See ITA para. 70(9.01)(a) which states that s. 69 does not apply.]

PROPRIETORSHIPS

- SUCCESSION – Lifetime Capital Gains Exemption (“**LCGE**”)
- QUALIFIED FARM OR FISHING PROPERTY (“**QFP**”) –$1,000,000 LCGE – focus will be on farmland

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PROPRIETORSHIPS

- SUCCESSION – Lifetime Capital Gains Exemption
- "Qualified farm or fishing property" [ITA ss. 110.6(1)] of an individual farmer includes:
  - Real or immovable property used in the course of carrying on a farming business in Canada by:
    - The individual;
    - A personal trust, a beneficiary of which is entitled to receive any income or capital thereof;
    - A spouse, common-law partner, child or parent of any of the individuals referred to above;

    [any individual referenced in the 3 preceding subparagraphs is a member of the "**LCGE eligible group**"]
    - A corporation, a share of which is a share of a family farm or fishing corporation of an individual who is a member of the LCGE eligible group; or
    - A partnership, an interest in which is an interest in a family farm or fishing partnership of an individual who is a member of the LCGE eligible group

PROPRIETORSHIPS

- SUCCESSION – Lifetime Capital Gains Exemption

- Farmland that has been farmed by an individual and that would have qualified for the LCGE in that individual's hands can, if it is passed from one generation to the next, continue to qualify for the LCGE in the hands of that individual's child, grandchild, and great-grandchild resident in Canada, even if no person other than the aforesaid individual had actively farmed the land.

PROPRIETORSHIPS

- SUCCESSION – Lifetime Capital Gains Exemption

- Different eligibility rules apply to farmland depending on when it was acquired:

  - Farmland acquired before June 18, 1987; and

  - Farmland acquired after June 17, 1987.

PROPRIETORSHIPS

- SUCCESSION – Lifetime Capital Gains Exemption
- Farmland acquired before June 18, 1987
- One of the following tests must be satisfied:
  - In the year the property was disposed of by the individual, it was used principally in the course of carrying on the business of farming in Canada by the taxpayer, or the taxpayer's spouse, common-law partner, child, or parent, a family farm corporation, a family farm partnership, or a personal trust from which the individual acquired the property, or certain beneficiaries of certain trust; OR
  - In at least five years during which the property was owned by any of the persons described above, it was used principally in the course of carrying the business of farming in Canada by a qualified user (essentially the same group of persons as described above).

PROPRIETORSHIPS

- SUCCESSION – Lifetime Capital Gains Exemption
- Farmland acquired after June 17, 1987
  - Must be owned for at least 24 months prior to its disposition by the individual, or spouse or common-law partner, child or parent thereof or other eligible owner [ITA ss. 110.6(1)(1.3)(a)(i)]; AND
  - Either satisfy the "Gross Revenue" test OR the "Corporation/Partnership" test.

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PROPRIETORSHIPS

- SUCCESSION – Lifetime Capital Gains Exemption
- Farmland acquired after June 17, 1987 – a more stringent test
  - Gross revenue test: In at least two years while the property was owned by one or more eligible owners, the gross revenue from farming of that eligible owner exceeded that person's income from all other sources, AND during those two years, the property was used principally in a farming business carried on in Canada by one or more eligible owners on a regular and continuous basis; OR
  - Corporation/Partnership test: Throughout a period of 24 months while the property was owned by an eligible owner, it was used by a family farm corporation or family farm partnership in a farming business, and during that time, a specified person (e.g. taxpayer, or that person's spouse, common-law partner, child, or parent, or certain individuals in relation to a personal trust) was actively engaged on a regular and continuous basis in the farming business.

PROPRIETORSHIPS

- SALE (to a third party or to a family member)
  - LCGE planning
  - Capital gains reserve planning
    - 5 year reserve: Can generally defer capital gains over a period of 5 years if sale proceeds are structured so that there is an amount payable to the seller after the end of each year;
    - 10 year reserve: In a sale from a parent to a child resident in Canada, the capital gains deferral can be extended to 10 years with respect to the disposition of:
      - Farmland or depreciable property in Canada of a prescribed class used by the taxpayer, spouse or common-law partner, child or parent in a farming business carried on in Canada;
      - Share of a family farm or fishing corporation of the taxpayer; or
      - An interest in a family farm or fishing partnership of the taxpayer.

PARTNERSHIPS

- Legal Considerations
- GST
- Income Tax
- Succession

PARTNERSHIPS

- LEGAL
  - What is a partnership?
  - Business Name
  - Liability exposure

PARTNERSHIPS

- LEGAL

  - What is a partnership?

  - *The Partnership Act*, R.S.S. 1978, c. P-3, ss. 3(1):

    "Partnership is the relation that subsists between persons carrying on a business in common with a view of profit."

PARTNERSHIPS

- LEGAL
  - Partnerships require:
    A. More than one person;
    B. A combination of individuals (who are 18 or older), corporations, or other entities can be partners;
    C. Carrying on a business in common;
    D. With a view of profit.

PARTNERSHIPS

➢ LEGAL - BUSINESS NAME

- *The Business Names Registration Act*

- Section 2 In this Act:

  (c) "business name" means:

  …

  (iii) in the case of two or more persons associated in a partnership, joint venture or syndicate, the name or style under which the partnership, joint venture or syndicate carries on or intends to carry on business …

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PARTNERSHIPS

- LEGAL

  - Liability exposure

  - *The Partnership Act*, R.S.S. 1978, c. P-3, s. 11:

    "Every partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while he is a partner; and after his death his estate is also severally liable in due course of administration for those debts and obligations so far as they remain unsatisfied but subject to the prior payment of his separate debts."

PARTNERSHIPS

- GST
  - Same considerations as outlined above when looking at the GST rules for proprietors

PARTNERSHIPS

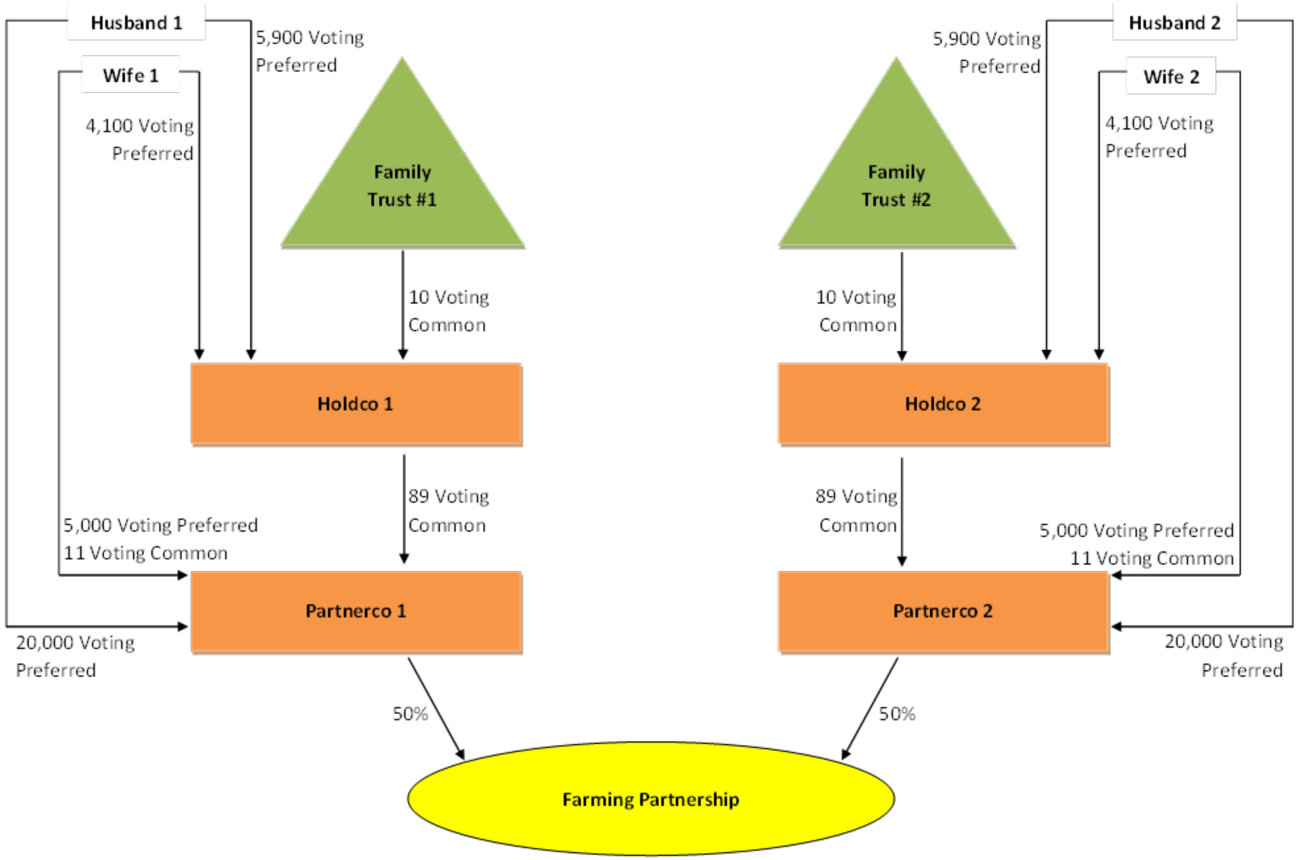
- INCOME TAX

- A partnership is not, in and of itself, a taxable person for Canadian income tax purposes. The partnership does not pay income tax. Rather, the income of the partnership is taxed in the hands of the partners.

PARTNERSHIPS

- If 2 individuals carry on a farming business in partnership, then the profit (loss) is allocated to those partners and taxed in their hands.
- Similarly, if 2 corporations carry on a farming business in partnership, then the profit (loss) is allocated to those partners and taxed in their hands.

PARTNERSHIPS



PARTNERSHIPS

- INCOME TAX - Corporate partnership example – assume
  - 2 brothers (Husband 1 and Husband 2) are active (work more than 20 hours per week on average) in their respective corporations (Partnerco 1 and Partnerco 2) which operate in a farming partnership
  - Each brother is married. Their wives are not active in the farming business.
  - Shareholdings of each Partnerco:
    - There is a holding company (Holdco 1 and Holdco 2) which owns shares in each of the partner companies, respectively.
    - Furthermore, each wife owns 10% or more of the "votes and value" of the Partnerco in which her spouse is actively engaged.

PARTNERSHIPS

- INCOME TAX - From an income tax perspective, there are a few tax rules to be aware of in connection with this structure

  - Small business deduction entitlement; and

  - The ability of each Partner company to pay dividends to the wife on her shares without being subject to the “tax on split income” (“**TOSI**”) rules.

PARTNERSHIPS

- INCOME TAX - Small business deduction entitlement

  - Where corporations are members of a partnership, their share of the partnership income is only eligible for access to the $500,000 small business deduction (thereby permitting them access to a low tax rate) to the extent of their pro rata share of partnership income.

  - At its simplest, if a corporate partner is entitled to 10% of partnership profits, on that share of income it is only entitled to $50,000 of small business deduction (10% of the small business deduction).

PARTNERSHIPS

➢ INCOME TAX - Small business deduction entitlement

- For tax years beginning on or prior to March 21, 2016, arrangements where an associated Canadian-controlled private corporation ("**CCPC**") provided services to a partner corporation could, in some circumstances, have the effect of avoiding these small business deduction limitations that otherwise applied in respect of partnership income. The corporate group would have been entitled to use the entire $500,000 small business deduction with respect to income "linked" to the partnership income.
- For tax years beginning after March 21, 2016, this potential income tax advantage has been eliminated. Any such CCPC providing services to the partner corporation is deemed to be a partner for the purposes of the small business deduction entitlement, and effectively that CCPC's service income is treated as being partnership income.

PARTNERSHIPS

- INCOME TAX - TOSI rules

  - Pre-TOSI Rules (before 2018)

    - Dividends could have been paid by a Partnerco or a Holdco to the Family Trust.

    - The Family Trust could have paid the dividends out to any of Husband or Wife (as beneficiaries of such trust) in whose hands the dividend income would have been taxed at <u>graduated</u> income tax rates.

PARTNERSHIPS

➢ INCOME TAX – TOSI rules

- TOSI (2018 and subsequent years)

  - If the TOSI rules apply to a taxpayer, then all of the dividends received by that taxpayer are taxed at the highest marginal income tax rate applicable to an individual resident in that particular province.
  - Dividends paid by a Partnerco through the Family Trust to the Wife will be caught by TOSI unless the Wife qualifies for an exclusion. The most common exclusion that is likely to be applicable to a beneficiary of a trust is the “excluded business” exception (i.e. which usually requires the beneficiary, who must be 18 years of age or older, to have worked in the business an average of 20 hours or more per week during the year or any previous 5 years). However, in this case, the Wife does not satisfy this “activity test”.

PARTNERSHIPS

- INCOME TAX – TOSI rules
  - However, there is another way out of the TOSI rules, and that is known as the “excluded share” test.
  - Provided that:
    - The Wife owns 10% or more of the “votes and value” shares of Partnerco;
    - Less than 90% of Partnerco’s income was from providing services (or, to put this another way, more than 10% of Partnerco’s revenues comes from the sale of goods such as farming products). [Note that Partnerco is considered, for income tax purposes, to carry on the business of the Farming Partnership, so you need to consider the revenues of the Farming Partnership.]; and
    - The Wife is 25 years of age or more in the current year;

  then the TOSI rules are avoided on the dividend income paid directly by Partnerco to the Wife on her shares.

  See CRA Views 2019-0813021E5 – TOSI and excluded shares (August 9, 2019)

PARTNERSHIPS

➢ INCOME TAX

- Establishing an “interest in a family farm or fishing partnership” may be useful in order to utilize the LCGE and/or tax rollovers.

- For LCGE purposes [ss. 110.6(1) – definition of “interest in a family farm or fishing partnership”], there are a two tests that need to be satisfied:

    - a 24 month test; and

    - a time of disposition test.

PARTNERSHIPS

- INCOME TAX – LCGE test - "interest in a family farm or fishing partnership"
  - In the 24 month period preceding a disposition of an interest in a family farm or fishing partnership:
    - More than 50% of the fair market value of the property of the partnership was attributable to:
      - (i) Property used principally in the course of carrying a farming business in Canada
        - In which the taxpayer, a beneficiary of personal trust, a spouse, a common-law partner, a child or a parent of the taxpayer or aforesaid beneficiary (the "key individuals") was actively engaged on a regular and continuous basis
        - By the partnership, any of the key individuals, a "family farm corporation" a share of which was owned by a key individual, or a partnership an interest in which was owned by a key individual
      - (ii) Shares or debts of one or more corporations of which all or substantially all of the fair market value is attributable to properties referenced in (iv) below
      - (iii) A partnership interest or debt thereof of which all or substantially all of the fair market value is attributable to properties referenced in (iv) below
      - (iv) Properties described in any of (i), (ii) or (iii) above

PARTNERSHIPS

- INCOME TAX – LCGE test - "interest in a family farm or fishing partnership"
  - At the time the interest in the family farm or fishing partnership is disposed of:
    - All or substantially all of the property of the partnership was attributable to properties described in (iv) as set out in the previous slide
      - "all or substantially" is interpreted by the CRA to mean 90% or more
      - Note that Courts have not been as rigid as the CRA in requiring "90%" and have applied a more qualitative test. For example:
        - Wood v. R 87 DTC 312 - 80% or lower might be acceptable;
        - Ruhl v. R 98 G.T.C. 2055 – 80%;
        - McDonald v. R 98 DTC 2151 – 85%
        - Ilott v. R [2003] 2 CTC 2384 – no specific quantitative figure can be used in the determination (para 88)

PARTNERSHIPS

- INCOME TAX – rollover test - "interest in a family farm or fishing partnership" [ss. 70(10)]
  - All or substantially all of the fair market value of the property of the partnership was attributable to:
    - (i) Property <u>that has been used principally</u> in the course of carrying a farming business in Canada
      - In which the taxpayer, a spouse, a common-law partner, a child or a parent of the taxpayer (the "key individuals") was actively engaged on a regular and continuous basis;
      - By the partnership, any of the key individuals, a "family farm corporation" a share of which was owned by a key individual, or a partnership an interest in which was owned by a key individual
    - (ii) Shares or debts of one or more corporations of which all or substantially all of the fair market value is attributable to properties referenced in (iv) below
    - (iii) A partnership interest or debt thereof of which all or substantially all of the fair market value is attributable to properties referenced in (iv) below
    - (iv) properties described in any of (i), (ii) or (iii) above

PARTNERSHIPS

- An interest in a family farm or fishing partnership – LCGE and intergenerational rollover – key requirements

  - Ultimately, all or substantially all (90% or more, according to the CRA) of the fair market value of the assets of the partnership must have been used principally (more than 50% of the property is used more than 50% of the time) in active farming activity in which key individuals were involved.

  - The tests look to the past use of the partnership assets, and not just their use at the time of disposition.

PARTNERSHIPS

- INCOME TAX – "an interest in a family farm or fishing partnership"
- Using the LCGE – consider the following plan:
  - Husband and Wife establish a partnership through which they will carry on the business of grain farming.
  - After the partnership is established, each of them transfers to the partnership grain inventory, grain buildings (e.g. grain bins), and farm equipment and machinery on a tax rollover basis under ss. 97(2).
  - Husband and Wife retain personal ownership of their farmland and rent the farmland to the partnership.

PARTNERSHIPS

- INCOME TAX – "an interest family farm or fishing partnership"
- Consider the following plan for using an individual's LCGE (continued):
  - The partnership carries on the business of farming for at least 24 months. At this point, the "interest" held by each of the Husband and Wife in the partnership should qualify as eligible property for the LCGE.
  - After the partnership has been in existence for at least 24 months:
    - Husband sells his partnership interest to a farming corporation in which the husband and the wife are shareholders ("**Farmco**").
    - Now Farmco and the Wife are partners in the farming partnership.
    - 3 days later, Wife sells her partnership interest to Farmco.

PARTNERSHIPS

- INCOME TAX – “an interest in a family farm or fishing partnership”

- Consider the following plan for using an individual’s LCGE (continued):

  - Result:

    - Husband and Wife can use their LCGEs – they owned their partnership interest in the “family farm or fishing partnership” for at least 24 months.

    - With the sale of Wife’s partnership interest to Farmco, the partnership winds up [Income Tax Act, ss. 98(5)].

    - Husband and Wife end up with large shareholder loan balances in Farmco, which can be withdrawn over time tax free.

PARTNERSHIPS

- SUCCESSION after death of an interest in a farming or fishing partnership

  - Taxpayer to spouse or common-law partner or spouse trust – indefeasible vesting required - ss. 70(6).

  - Taxpayer to child resident in Canada immediately before the day on which the taxpayer dies – indefeasible vesting required – ss. 70(9.2) and (9.21) – applies to a share of a "family farm or fishing corporation" or an interest in a "family farm or fishing partnership" of the taxpayer.

  - Taxpayer to spouse trust, and on the death of the spouse or common-law partner of the settlor, the property is transferred to the settlor's child provided the child is a resident of Canada immediately before the death of the spouse or common-law partner – indefeasible vesting required – ss. 70(9.3) and (9.31) - applies to a share of a "family farm or fishing corporation" or an "interest in a family farm or fishing partnership" of the taxpayer.

CORPORATIONS

- Legal Considerations
- GST
- Income Tax
- Succession

CORPORATIONS

➢ LEGAL CONSIDERATIONS

- Incorporation
- Liability exposure
- Farmland ownership rules

CORPORATIONS

- Incorporation
  - Incorporate a company under any applicable corporate statute
    - Most farming corporations that law firms and their clients will deal with in Saskatchewan will be incorporated under *The Business Corporations Act*, R.S.S. 1978, c. B-10, as amended.
    - Interestingly, for income tax purposes (as will be seen in later slides), any type of "corporation" can theoretically carry on a business of farming in Canada and have its shares qualify as "shares of the capital stock of a family farm or fishing corporation". The income tax test only requires that a "corporation" be in existence and not, for example, a Canadian corporation, a taxable Canadian corporation, or a CCPC.
      - Ss. 248(1): "corporation" includes an incorporated company.
      - In IT-348R Meaning of the term corporation (dated September 26, 1977) (archived), the CRA identifies several different foreign entities that, in its view, can be classified as "corporations" for the purposes of the Act.

CORPORATIONS

- Liability Exposure
- Generally speaking, the debts and liabilities of a corporation are considered to be those of the corporation, and are not the debts and liabilities of its shareholders, officers or directors.
    - Note, however, the potential for personal liability exposure of corporate directors for what would otherwise be a corporation's liabilities for employees' wages (up to 6 months), employer remittances to the Receiver General, and GST.
    - In Saskatchewan, also be aware of *The Saskatchewan Farm Security Act*, S.S. 1988-89, c. S-17.1, as amended, for specific rules (restrictions) respecting debt obligations given by "farmers", including certain rules governing personal guarantees.

CORPORATIONS

- Farmland ownership rules

  - Non-public corporations all shares of which are owned by permanent residents of Canada or Canadian citizens may own Saskatchewan farmland free of any acreage limitations.

CORPORATIONS

- GST
  - Same considerations as outlined above when looking at the GST rules for proprietors.

CORPORATIONS

- INCOME TAX:
  - Tax rates (2021) for CCPCs

Active business income:

First $500,000 (no Saskatchewan income tax until July 1, 2022)	9.00%
Active business income over $500,000/$600,000	15% / 27%

Investment Income:	50.67%

CORPORATIONS

- INCOME TAX – “share of the capital stock of a family farming or fishing corporation”

  - What is it?

  - To whom may the shares be transferred on a rollover basis after death?

CORPORATIONS

- INCOME TAX – rollover test - "share of the capital stock of a family farm or fishing corporation" – what is it [ss. 70(10)]
  - A share of a corporation all or substantially all of the fair market value of the property of the corporation was attributable to:
    - (i) Property that has been used principally in the course of carrying a farming business in Canada
      - In which the taxpayer, a spouse, a common-law partner, a child or a parent of the taxpayer (the "key individuals") was actively engaged on a regular and continuous basis;
      - By:
        - the corporation;
        - a "family farm or fishing corporation", a share of which was owned by a key individual;
        - a corporation controlled by any of the above-mentioned corporations;
        - a partnership, an interest in which was an interest in a family farm or fishing partnership of a key individual; or
        - any of the key individuals;
    - (ii) Shares or debts of one or more corporations of which all or substantially all of the fair market value is attributable to properties referenced in (iv) below
    - (iii) A partnership interest or debt thereof of which all or substantially all of the fair market value is attributable to properties referenced in (iv) below
    - (iv) properties described in any of (i), (ii) or (iii) above

CORPORATIONS

- SUCCESSION – shares of the capital stock of a family or fishing corporation
  - After death
    - Taxpayer to spouse or common-law partner or spouse trust
    - Taxpayer to child
    - Taxpayer to spouse trust to child
  - During lifetime – Bill C-208

CORPORATIONS

- SUCCESSION after death – shares of the capital stock of a family farm or fishing corporation - to whom may the shares be transferred

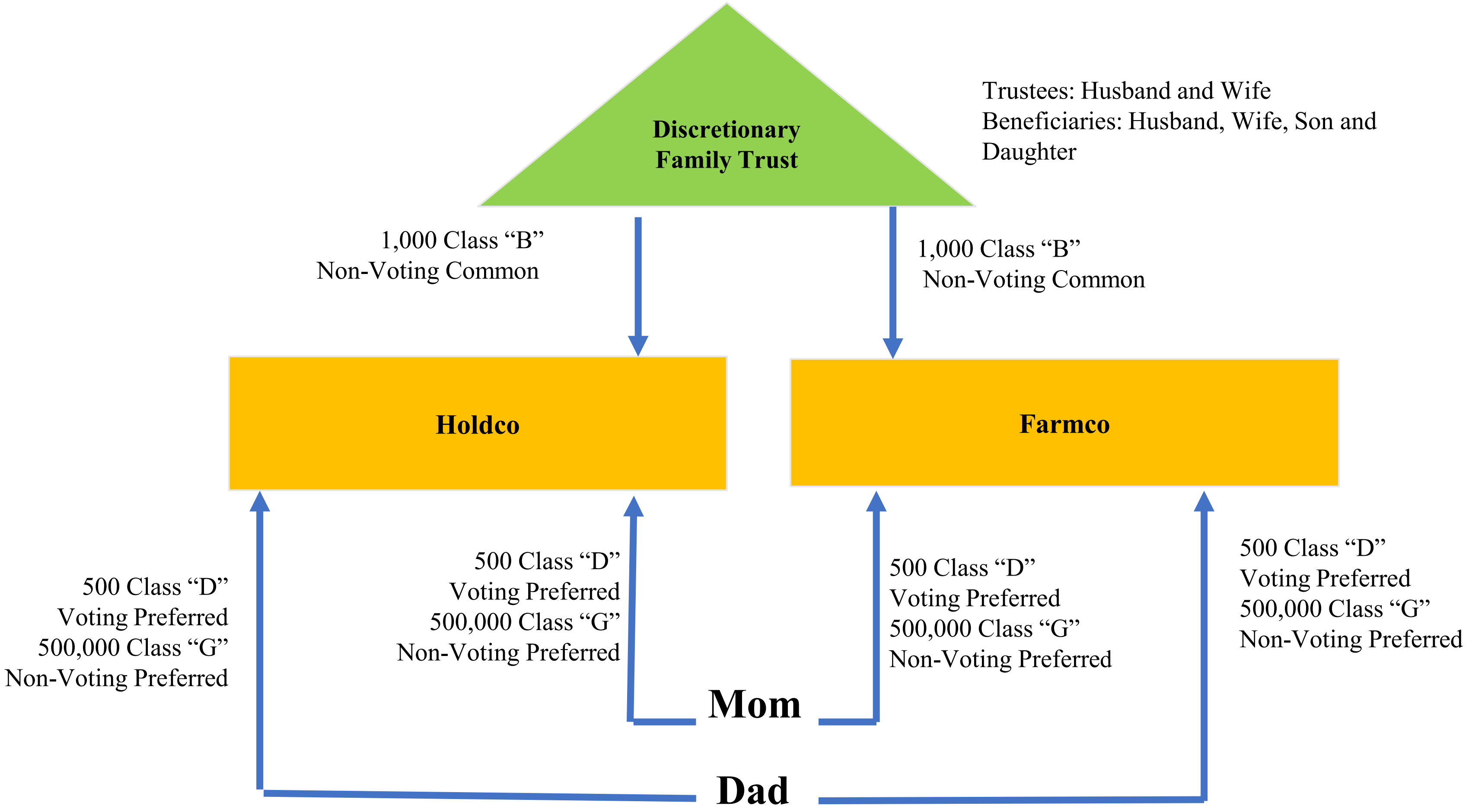
  - Taxpayer to spouse or common-law partner or spouse trust – indefeasible vesting required – ss. 70(6)

  - Taxpayer to child resident in Canada immediately before the day on which the taxpayer dies – indefeasible vesting required – ss. 70(9.2) and (9.21) – applies to a share of a "family farm or fishing corporation" or an interest in a "family farm or fishing partnership" of the taxpayer

  - Taxpayer to spouse trust, and on the death of the spouse or common-law partner of the settlor, the property is transferred to the settlor's child provided the child is a resident of Canada immediately before the death of the spouse or common-law partner – indefeasible vesting required – ss. 70(9.3) and (9.31) - applies to a share of a "family farm or fishing corporation" or an interest in a "family farm or fishing partnership" of the taxpayer

CORPORATIONS

Possible ownership structure respecting a family farm corporation



Law Society of Saskatchewan

CORPORATIONS

Notes:

1. Husband is active in Farmco's business working an average of 20 hours per week during the year.
2. Wife is not active in Farmco's business, and works as a teacher in a public school.
3. There are 2 children:
   a. Son: age 21 in full time attendance at university; and
   b. Daughter: age 28; married; up until recently, had been working as a lawyer in a law firm, but is on a maternity leave for the next year.

CORPORATIONS

➢ Pre-TOSI Rules (before 2018)

- Dividends could have been paid by Holdco or Farmco to the Family Trust.

- The Family Trust could have paid the dividends out to any of Husband, Wife, Son and Daughter in whose hands the dividend income would have been taxed at <u>graduated</u> income tax rates.

CORPORATIONS

- Pre-TOSI Rules (before 2018)

  - If the Family Trust sold its shares in Farmco and realized a capital gain eligible for the LCGE, it could pay out the capital gain (or taxable capital gain) to each capital beneficiary of the trust who is a resident of Canada, and that beneficiary could use his or her LCGE to shield the gain from income tax. TOSI would not apply (unless the capital gain arises pursuant to a non-arm's length sale and the capital gain is distributed to a minor).

CORPORATIONS

Pre-TOSI Rules (before 2018)

- Rollover of trust property from Family Trust to Canadian resident capital beneficiaries permitted under ss. 107(2).
- For estate planning purposes, the Family Trust provided an advantage as compared to personal ownership of shares or other capital property.
- With personal ownership, parents leaving property (e.g. shares) to a child faced a FMV deemed disposition (unless a "farm rollover" of shares or other property was available).

CORPORATIONS

- TOSI regime (2018 and subsequent years)

  - Dividends paid through the Family Trust to a beneficiary will be caught by TOSI unless the beneficiary receiving the dividend qualifies for an exclusion. The most common exclusion from TOSI for dividend income that is likely to be applicable for a beneficiary of a trust is the "excluded business" exception (i.e. which usually requires the beneficiary, who must be 18 years of age or older, to have worked in the business an average of 20 hours or more per week during the year or any previous 5 years).

CORPORATIONS

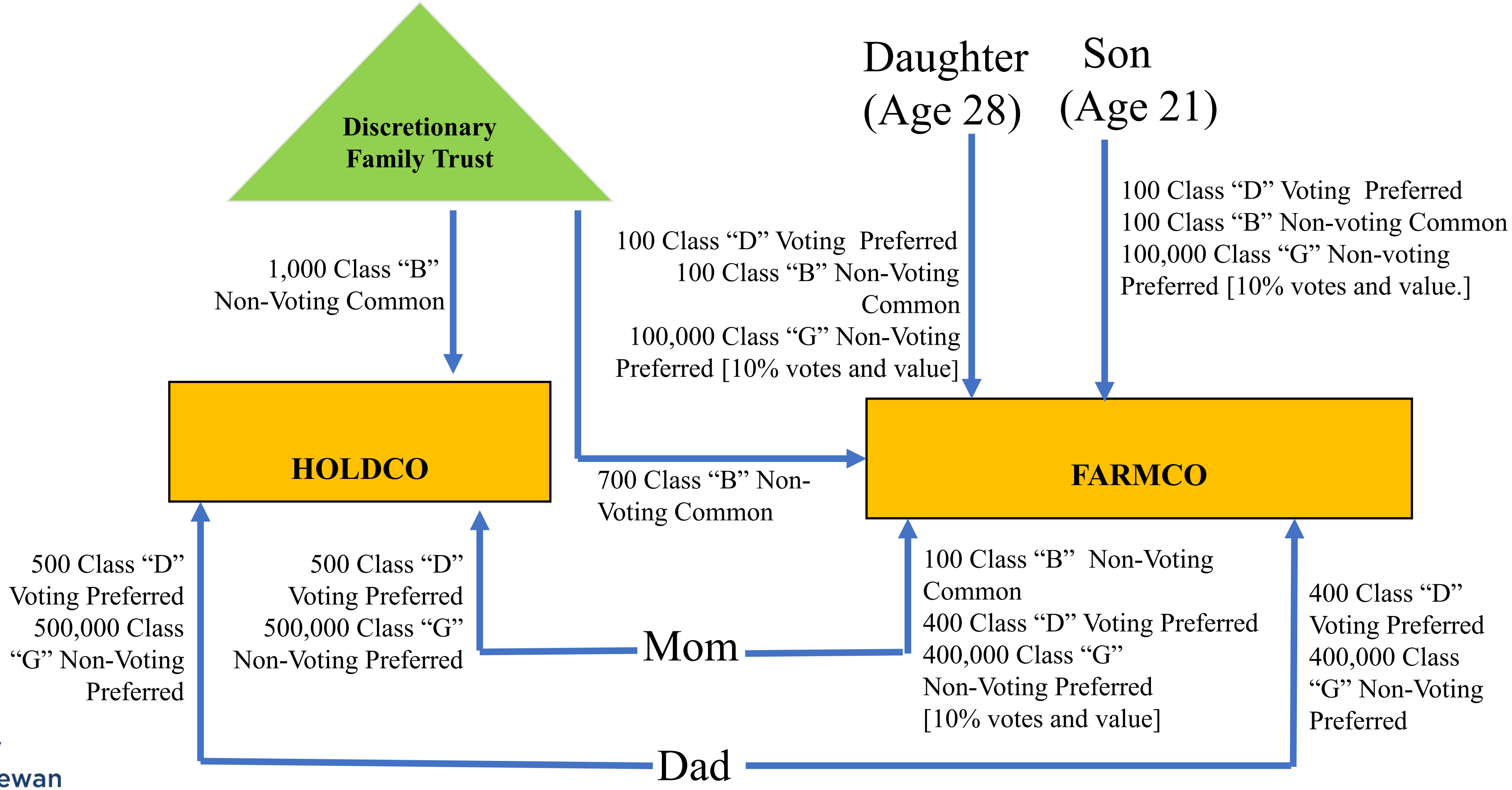
- TOSI regime (2018 and subsequent years)

  - Capital gains arising from dispositions of qualified farm or fishing property or qualified small business corporation (“**QSBC**”) shares will be exempt from TOSI, even if realized through a Family Trust (but if the capital beneficiary of the trust is under 18 years old, the capital gains must have been realized in an arm’s length disposition).

  - Rollover of trust property (such as shares of corporations) from Family Trust to Canadian resident capital beneficiaries continues to be permitted under ss. 107(2).

CORPORATIONS

Possible ownership structure of a family farm corporation (under TOSI regime)



Law Society of Saskatchewan

CORPORATIONS

- In this ownership structure, each of Mom, Daughter and Son own 10% or more of the "votes and value" shares of Farmco. TOSI will not apply provided that the particular shareholder receiving the dividend on their shares is 25 years of age or more in the current year. (The Son is 21 and will not fall outside the TOSI rules for another 4 years.)

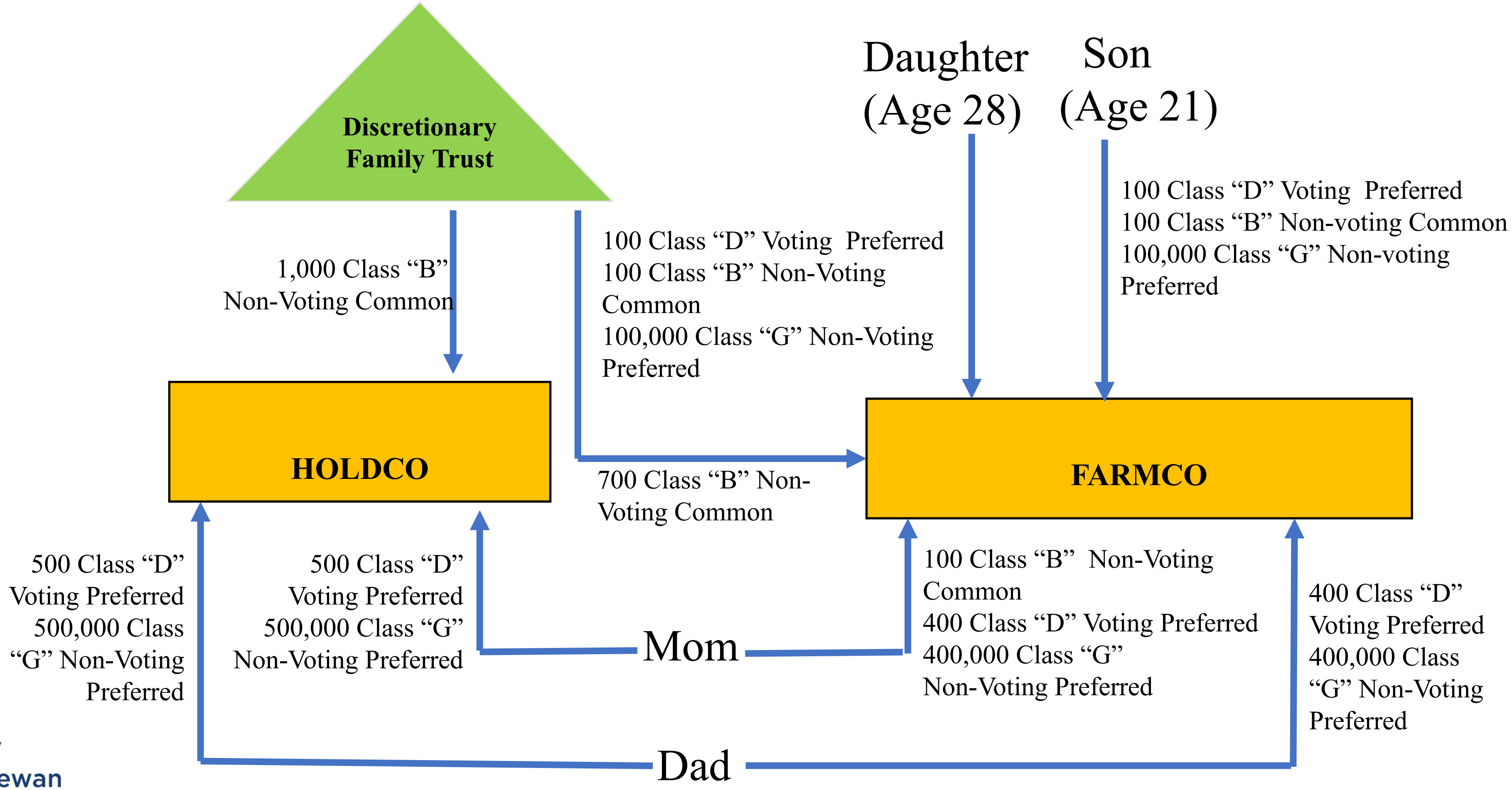
- Dad (who works more than 20 hours per week in Farmco's farming business) can receive dividends from Farmco via the Family Trust and avoid TOSI because of the "excluded business" exception.

CORPORATIONS

- Share of the capital stock of a family farm or fishing corporation – inter vivos sales between generations of a family, and new Bill C-208
  - On June 29, 2021, Bill C-208 amended section 84.1 (as well as section 55) of the *Income Tax Act* (Canada) thereby broadening the circumstances where an individual may sell QSBC shares or shares of a family farm or fishing corporation to a different corporation for cash (or other non-share consideration) and get capital gains treatment.
  - Bill C-208 is a private member bill.
  - The Department of Finance is not happy with the wording of Bill C-208 and is of the view that it creates certain loopholes that are unacceptable. On July 29, 2021, Finance announced its intention to introduce further amendments to the Act to address its concerns. These future amendments will apply as of the later of November 1, 2021 or the date of publication of the final draft legislation.

CORPORATIONS

Share ownership of a family farm corporation before intergenerational sale



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CORPORATIONS

- Share of the capital stock of a family farm or fishing corporation – inter vivos sales between generations of a family – parent sells to child's company
  - Example – using the share ownership structure outlined in the previous slide as our starting point:
    - Son incorporates a new corporation ("**Childco**"). For simplicity, assume Son is the sole shareholder of Childco (it is critical that Son controls Childco).
    - Assume Mom and Dad each want to sell 400,000 Class G shares of Farmco to Childco for a promissory note. The shares in question have an adjusted cost base and paid-up capital of $1.00 (in total) and a fair market value of $1.00 (per share).
    - On the closing of the sale, Childco will issue a promissory note in the amount of $400,000 to each of Mom and Dad.

CORPORATIONS

- Share of the capital stock of a family farm or fishing corporation – inter vivos sales between generations of a family – parent sells to child’s company
  - Prior to Bill C-208, section 84.1 (as it then read) would have given rise to a deemed dividend (rather than a capital gain) of $400,000 (approximately) in each of Mom and Dad’s hands.
  - The reason for this is that Childco dealt at non-arm’s length with Mom and Dad and paid them non-share consideration in excess of the paid-up capital of their Class G shares in Farmco.

CONCLUSION

- Share of the capital stock of a family farm or fishing corporation – inter vivos sales between generations of a family – parent sells to child’s company
  - With the amendments to section 84.1, if the requirements of that provision are satisfied, Mom and Dad will each realize a capital gain eligible for the LCGE when they sell their shares of Farmco to Childco
  - THIS IS GOOD NEWS!!

CORPORATIONS

- Share of the capital stock of a family farm or fishing corporation – inter vivos sales between generations of a family – parent sells to child's company
- In order to satisfy the new requirements of section 84.1:
  - Son must be at least 18 years of age. Interestingly, there is no requirement that Son be involved in the business of Farmco.
  - Son must control Childco at the time of purchase. However, there is no requirement that he maintain control of Childco for any period of time in the future.
  - Childco must not dispose of the shares of Farmco for at least 60 months following the acquisition of the same.
  - The shares of Farmco must meet the tests of either QSBC shares or shares of the capital stock of a family farm or fishing corporation, but its taxable capital cannot exceed $15 million.
  - There needs to be an independent assessment of the FMV of the shares sold by Mom and Dad, and an affidavit of the parent who is selling their shares and an affidavit of a third party attesting to the disposal of shares.

CORPORATIONS

- Share of the capital stock of a family farm or fishing corporation – inter vivos sales between generations of a family – parent sells to child's company
  - Areas of concern:
    - It is not entirely clear what an "independent assessment of fair market value" means.
      - Who is independent?
      - Must the report be prepared by a CPA? A CBV?
    - Why is an affidavit of the taxpayer and a third party required to "attest" to the disposition of shares?
      - Who qualifies as a "third party"?
    - When must the "independent assessment" and the "affidavits" be prepared?
    - When (how) are the independent assessment and the affidavits to be provided to the CRA?

CORPORATIONS

- Share of the capital stock of a family farm or fishing corporation – inter vivos sales between generations of a family – parent sells to child's company
  - Stay tuned. We are expecting to see the Department of Finance introduce changes to s. 84.1 that will:
    - Require the transfer of legal and factual control of the corporation carrying on the business from parent to child;
    - Clarify the level of ownership that the parent can maintain in the corporation carrying on the business for a reasonable period of time after the transfer;
    - Clarify the requirements and timeline for the parent to transition their involvement in the business to the next generation; and
    - Clarify the level of involvement of the child or grandchild after the transfer.

  [Department of Finance, Press Release dated July 19, 2021]

CONCLUSION

- There are advantages and disadvantages to carrying on the business of farming as a proprietor, a partnership and a corporation.
- It may be that the "best of all worlds" contemplates a combination of structures such as:
  - Personal ownership of farmland, which may enhance access to:
    - LCGE for the current owner (who actively farms the farmland) and successive generations (who may not actively farm).
    - Rollovers (via a spouse trust and from there to children) of farmland that might not otherwise qualify for a direct intergenerational transfer from parent to child because no person who is a member of the "Rollover eligible group" (as described on slide 27) is active in the farming business.

CONCLUSION

- A farming partnership for a period of time (minimum 24 months) amongst family members (such as spouses), and the eventual sale of partnership interests to a CCPC in consideration for shareholder loan credits to make use of the LCGE; and

- A CCPC (which would own farm buildings, farm machinery and equipment, and inventory) to make use of low corporate income tax rates on active business income earned from the farming operation.

THANK YOU

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