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FARMING FOR OUR FUTURE: CANADA'S 150TH

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FARM MANAGEMENT CANADA
GESTION AGRICOLE DU CANADA
1992 - 2017 25 YEARS-ANS

Tax Considerations for Farmers

That Was Then, This is Now

Anne Van Delst, CPA, CA, LPA

What’s going on?

- July 18, 2017: Department of Finance announces their proposal for tax reform for private corporations

- Finance followed this up with a string of announcements through October with more definitive details of the changes

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The proposed changes – version 1

- Income sprinkling - dividends taxed at highest marginal rates

- Lifetime capital gains exemption limitations

- Increased taxation on passive investments in a company

- Surplus stripping

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Proposed changes as currently known

- Income sprinkling
  - draft legislation to be released this fall
  - Effective Jan 1, 2018
- Lifetime capital gains exemption limitations - removed
- Passive investments in a company
  - first $50K of income same rules as today, remainder unknown at this time
  - More details to be provided in 2018 federal budget in March
- No clarification on treatment of intercorporate dividends

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Income Sprinkling

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Income sprinkling: The proposed changes

- Purpose test for all dividend payments for labour and capital contributions, and previous returns/remuneration
  - Stricter rules for 18-24 age group

- Much more restrictive dividend payments/income splitting
  - Is your family actually involved in business? Documentation?

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Reasonableness Criteria: 18 – 24 Years (July 18)

- ***Labour***
  - only recognize labour if individual actively engaged on a "**regular, continuous, and substantial basis in the activities of the source business**";
    - What if child is attending post-secondary education?
- ***Capital***
  - Basically don't recognize capital contributions
    - What if grandparent still owns land?
- ***Loans & Guarantees (for all individuals)***
  - From family members to buy capital **not recognized as capital contributed to the farm**

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Income sprinkling: Clarifications received

Under the proposed changes, adult family members will be asked to demonstrate their contribution to the business based on four basis principals:

1. Labour contributions;
2. Capital or equity contributions to the business;
3. Sharing the financial risks of the business, such as co-signing a loan or other debt; and/or
4. Past contributions in respect to previous labour, capital, or risks.

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Income sprinkling: Clarifications received

- “Reasonable” payments of dividends to family members will be evaluated using these principals. Payments not meeting the reasonable test will be taxed at the highest personal tax rates, thus reducing the benefit of income splitting.

- A modified version of the draft legislation will be released this fall and proposals will be effective January 1, 2018. The Department of Finance has commented that they agree changes are required to the draft legislation on this matter; however, they have yet to provide details.

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Passive Investments in a Company

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Passive investments in a company

- Trying to match the investment base at the corporate level to unincorporated employee i.e., after tax personal dollars
- Separate rules for corporate level capital taxed at corporate rates
- No draft legislation has been released on this to date.

Passive income: The impact

- Limited benefit to corporate beneficiary of trust going forward
- Holdco/trust income splitting is limited
- Current passive capital grandfathered
- Pure investment Holdco still ok (refundable taxes, capital dividends)
- Finance intends to have high dividend tax rate when withdrawing funds to make up difference
  - May be advantageous to pay dividend when at lower tax bracket (i.e., retirement)

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Possible concerns with proposed changes

The proposed changes overlook:

- Risk of operating a small business
- Lack of pension
- Lack of job security
- Lack of health insurance or any other group benefits
- Lack of paid vacation
- Lack of severance, maternity leave, etc.

The impact on businesses and their employees will be profound.

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What’s to come

- Even with these announcements, uncertainty remains as we await more announcements to come, including a modified version of the draft legislation, which will be released later this fall. While a lot of information has been presented, note that all the announcements made are still proposed changes, and are not yet law

- It should be noted that the information discussed is current to October 20, 2017

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What’s next?

- If the new tax laws are put into place, everyone’s action plan should include a meeting with their professional advisors about how the proposed changes may impact their business and corporate structure

- Current compensation and estate planning strategies may also need to be adjusted

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Possible planning for 2017

- Payment of large dividends
- Pay salary to justify future dividends
- Planning for less active related shareholders
- And more…

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Current structures

- What is/was the purposes of the structure?
  - Income sprinkling;
  - Wealth transfer;
  - Creditor protection;
  - Estate planning; and
  - Many more.

- What is the involvement of family members?

- What are the future plans for the farm operations?

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Questions?

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