

PASSING ON THE FAMILY FARM

THE TRANSFER OF A FAMILY FARM to the next generation involves a complex mix of issues. The farm, in most cases, is not only the place of business but also the home of one or more family members. Proper planning is essential to ensure that all family members are treated fairly and those who desire to carry on the farming tradition can do so with success.

HOW TO PLAN

Successful planning requires the family to have open discussions of their goals and objectives so they can have confidence that they've made the best possible decisions. Issues to address include:

- Will the parents transfer complete ownership of the farm?
It may be the parents' wish to, at least initially, operate the farm jointly with one or more children.
- If the parents are retiring, what are their income expectations?
It's important to ensure that the parents have enough income in their retirement to support their desired lifestyle.
- Can the children afford to pay off any debt owing to the parents on the transfer?
In other words, will the farm earn enough income, after servicing this debt, to provide a reasonable living for the children managing the farm? It may be that the parents have to accept a price for the farm which is below its fair market value in order for the children to afford it.
- What will be the terms of any debt that the parents take back on the transfer?
For instance, if the parents finance the purchase by the children, will they hold a mortgage over the property, or will they accept an unsecured note payable to them?
- How will children living off the farm be treated?
Many parents want to treat all children equally. However, this may be unrealistic, particularly when the parents' main asset is the farm. It may still be possible to treat the children fairly (without necessarily treating them equally) by, for example, utilizing life insurance.
- Who will make the management decisions with respect to the farm?
This is particularly important if any of the children will be operating the farm with the parents, because the property stakeholders will be affected by management decisions. It's advisable to document this management responsibility in writing to avoid future misunderstandings.

REDUCING TAX

There are a host of favourable tax rules for the transfer of family farms. Not surprisingly, these rules are exceedingly complex. It's critical for farmers to review their plans with their tax advisor to help ensure they can avail themselves of the following advantages:

- Parents can transfer certain farm property to children for proceeds between tax cost and fair market value, depending upon the payment (if any) received by the parents. Planning can be undertaken to trigger the desired levels of income and capital gains in the parents' hands. For example, it might be advantageous to trigger capital gains to utilize any capital gains deduction of the parents (see below).
- A capital gain on the transfer of "qualified farm property" is eligible for the \$500,000 capital gains deduction. This deduction allows individuals to realize up to \$500,000 of capital gains from these assets tax-free, while increasing the tax cost of the property for the next generation. However, various issues must be considered including Minimum Tax and OAS clawback.

- If a capital gain is triggered and debt is taken back as part of the proceeds, it's possible to spread taxation of the gain out over as many as 10 years.
- Where children are to become only partial owners of the farm, there are special elective provisions which allow this to occur on a tax-deferred basis using a partnership or corporation. Again, it may make sense to trigger capital gains to the extent that any capital gains deduction of the parents can be utilized.

SUMMARY

As with building a successful farming business, succession planning involves hard work. Time spent with family and advisors can help ensure the successful transfer of the family farm to the next generation!