Grant Thornton
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Agriculture

Agricultural update

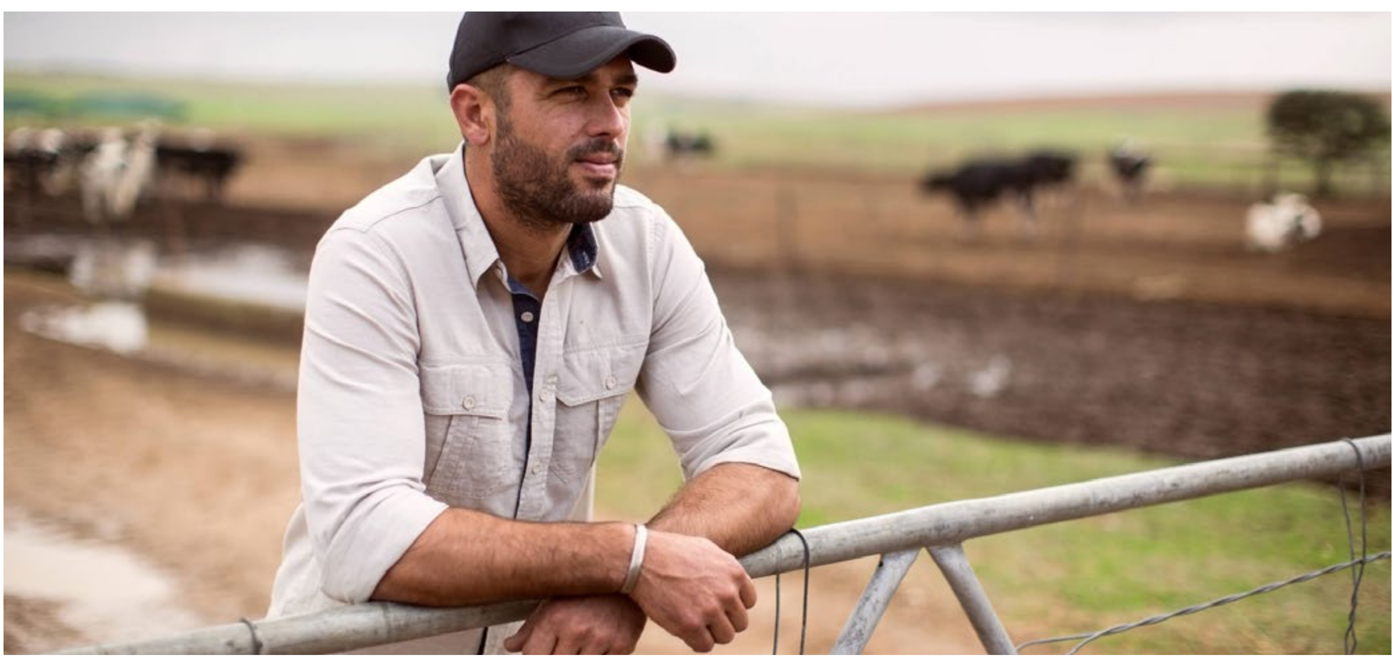
WINTER 2018

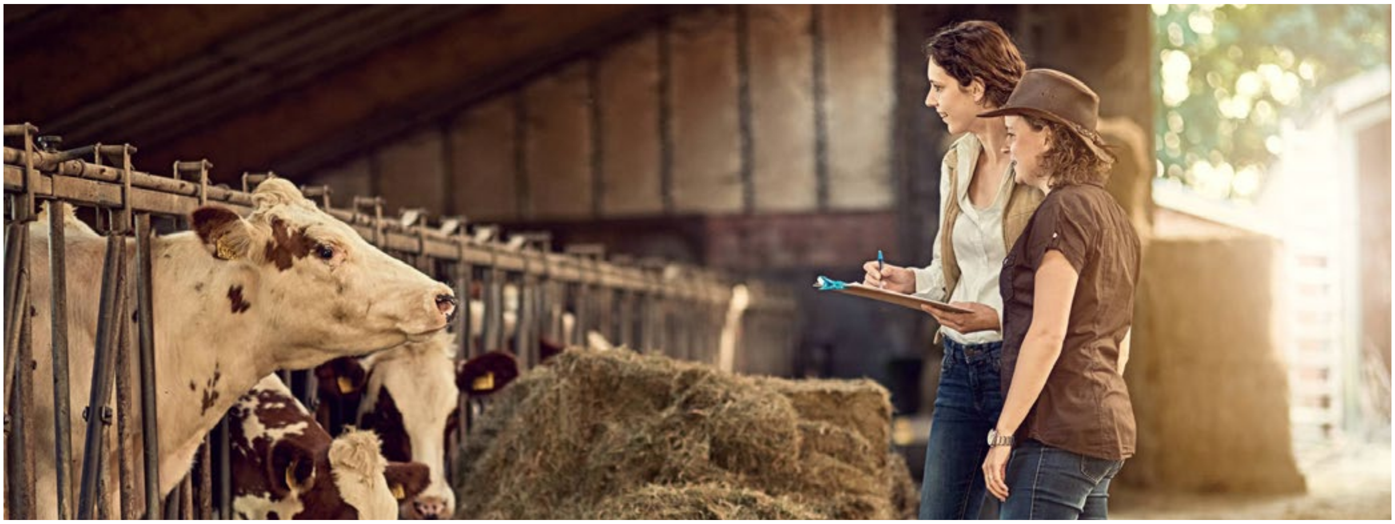
Feature story

New tax rules could impact family farm corporations

On July 18, 2017, the Department of Finance issued a consultation paper entitled *Tax Planning Using Private Corporations*, which proposed a number of changes to the taxation of private corporations and their shareholders. While some of these changes were retracted, a fair number took effect on January 1, 2018. With others still in the proposal stage awaiting confirmation, it's clear the shifting tax landscape will significantly impact the tax planning efforts of family farms, agribusinesses and the Canadian agriculture sector as a whole—particularly in the area of income splitting/sprinkling.

Original proposed tax rules	Current status
Income splitting/sprinkling	Change was effective January 1, 2018
Taxation of passive investments in a private corporation	Change is expected to be released with the 2018 or 2019 Federal budget
Converting income in capital gains	Proposed changes are currently retracted
Multiplication of the lifetime capital gains exemption	Proposed changes are mostly retracted





How the income splitting/sprinkling rules could impact your family farm corporation

The overall objective of income splitting/sprinkling is to allocate after-tax corporate profits so that instead of having one or two family members (i.e. Mom and Dad) pay 100 percent of the family's income tax, the income is split between all family members over the age of 18. This allows everyone to pay taxes using their lower marginal tax rates, and ultimately enables the family to pay less income tax overall. This has been a widely acceptable practice in Canada for decades and has been a common tax planning option to reduce the overall family tax burden.

Under the previous rules, the shareholders and directors of the company had full rights to determine how to distribute the after-tax corporate profits. If a dividend was paid to a shareholder under the age of 18, it was subject to tax at the highest marginal rate. However, with proper tax planning, dividends could be paid to any shareholder over the age of 18 and that shareholder would pay tax at their marginal tax rates based on the level of income they earned during the year. Under the new rules, if a dividend is paid to a shareholder, a long list of exceptions and exclusions must be reviewed to determine if the shareholder can use their marginal tax rates or if the new Tax on Split Income (TOSI) rules will apply. If the TOSI rules apply, the individual will be taxed at the highest marginal tax rate, regardless of their income level. In Alberta, for example, the tax rate for 2018 non-eligible dividends will be 41.64 percent.

To illustrate the potential impact of these changes, let's assume that we have a family farm corporation (FarmCo) that earns less than $500,000 of taxable income per year. Mom, Dad and the two children each own 25 percent of the issued shares of the farm corporation. Mom and Dad are both active in the farming business. Their two adult children, ages 21 and 19, are attending university in the city and, as such, are not active in the farming operation, nor have they previously worked five years at an average of 20 hours per week or more.

On top of their tuition expenses of $8,000 per year, each child requires an additional $22,000 to pay for housing, books, groceries and transportation, totalling $30,000 per year for each child. Mom and Dad have chosen to compensate themselves with annual dividends of $100,000 each for $200,000 in total.

Under the previous rules, the family's total personal tax burden would be approximately $32,000. Under the new tax rules, given that the children are not active in the farming business and are under the age of 25, the family's personal tax burden would increase to approximately $56,200—an increase of $24,200 or 76 percent. These rules will also effectively apply if FarmCo is owned by a family trust and the dividends are paid to the family trust and then allocated out to beneficiaries.

These new rules, and their related exceptions and exclusions, are very complex and must be carefully reviewed to be properly applied to each respective shareholder to determine if their dividends will or will not be taxed at the highest marginal rate. These exceptions and exclusions are far too complex and detailed to list here, but they include certain criteria around the number of hours the individual has worked in the business, their age and the characteristics of the shares they own. You can learn more about the specifics surrounding the income splitting changes in our tax alert, *Revised proposals to limit income sprinkling*.

Transitional Provisions:

While the new income splitting/sprinkling rules took effect on January 1, 2018, the Department of Finance has allowed for a "transitional period", where corporations have the opportunity to restructure their share capital to conform with one of the exceptions or exclusions to the new TOSI rules. If changes are needed, they must be completed during 2018 to ensure that a dividend paid in 2018 is not taxed at the highest marginal rates.

This is a basic summary of how these changes could affect your farm corporation, however, due to the complexity of the rules, we recommend reaching out to a tax advisor to discuss how your family farm corporation could be impacted and what can be done to mitigate the effects.

Forward grain contracts: Pros and cons

In the past, Canadian agribusinesses used a rather straightforward method to market grain: harvest the crop, deliver it at the elevator and take the grain price offered. However, today a growing number of farm operators are taking a more active role in managing their risks by using "forward grain contracts". A forward grain contract is a cash contract that allows the farmer to sell a specific quantity and quality of grain for an agreed-upon cash price on a future delivery date. Although these contracts come with their fair share of pros—including helping reduce risk and increasing average returns over the long run—they also come with a list of cons which are worth considering.

PROS:

- The timing of commodity pricing decisions can be independent of the timing of physical operations. Forward grain contracts can be made at any time–before planting, during the growing season, at harvest or after harvest. This provides incredible flexibility for producers to fix returns at the most opportune time. Most elevators will allow contracts up to one year before harvest. Portions of the crop can also be sold at different times to protect farmers against price increases.

- Downside commodity price risk is eliminated for the quantity contracted. The price can be locked in after input costs are known if the price represents an acceptable profit for the agricultural operation or when prices are expected to fall. This allows farmers to devote energy to other matters without worrying about commodity price uncertainties. If the price is lower at harvest, the producer can still sell for the locked in price.

- The exact commodity price, quantity and date of delivery is known, which reduces exposure to financial risk by fixing returns and assuring an outlet for delivery.

- The size of the contract is flexible and premiums can often be negotiated for large volume contracts.

CONS:

- Forward grain contracts increase vulnerability to output risk. The farmer must fill the contract even in the case of a production shortfall. If yield is not good enough to cover the contracts, producers may need to buy grain off another farmer at a higher price to deliver and fill the contract. The complete crop should not be sold forward until the output is assured.

- Upside price potential is eliminated on the quantity contracted. If the price is higher at harvest, the grain must still sell at the locked in price stipulated in the forward grain contract. Success still rests on the ability to predict price changes.

- Delivery time flexibility is given up and this could create extra storage costs.

Did you know?

Effective April 1, 2018, producers will need to have an Environmental Farm Plan (EFP) completion letter dated within the last **10 years** to be considered current and eligible for cost-share funding with the Environmental Sustainability and Climate Change programs of the Canadian Agriculture Partnership (CAP). This is the program that replaces the Growing Forward Program. If you don't have an EFP, or it is older than 10 years, you will need to register online to be assigned a technician and start the EFP approval process. Visit **http://www.albertaefp.com/start-an-efp** to register and be assigned a technician in your area.

In the community

From November 21 to 23, we were proud sponsors of the Alberta Milk Dairy Conference and AGM in Edmonton. At the conference, booth visitors had a chance to win a Gallagher SmartReader HR3. The draw took place at the banquet and we would like to congratulate our winner, Paul Walte of Sunshine Colony. During the conference, our team also gave a presentation on tax changes for private corporations.

January 26 and 27, our team was at the Canadian Bull Congress and Taste of Beef Banquet. Once again, we drew for a Gallagher SmartReader HR3 and we'd like to send out a big congratulations to our winner, Dave Vikse of Vikse Family Farm.

Our next event is a half-day seminar about the business of farming on March at the Lakedell Agricultural Society Hall. See below for full details and instructions on how to register. We hope to see you there!

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Your farm, your future

Gain new insights into the business of farming

Join us for a special half day seminar

Wednesday, March 7, 2018 | 9:30 a.m. - 2:00 p.m.

Learn how to:

- Structure the family farm to increase income and decrease taxes
- Protect your farm when it's time for transition
- Put money back in your pocket with agriculture funding programs
- **Plus, get the latest tax tips to help your bottom line.**

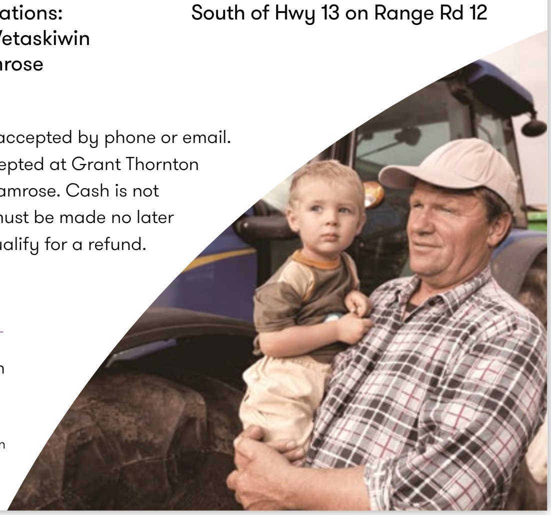
Tickets $15

Three ways to purchase tickets:

- email **Anna.Zimmerman@ca.gt.com**
- call +1 780 352 1679
- in person at these locations:
  - > 5108 51st Avenue, Wetaskiwin
  - > 4870 51 Street, Camrose

Location:
Lakedell Agricultural Society,
Main Hall
South of Hwy 13 on Range Rd 12

Visa and MasterCard are accepted by phone or email. Debit and cheque are accepted at Grant Thornton offices in Wetaskiwin or Camrose. Cash is not accepted. Cancellations must be made no later than Friday, March 2 to qualify for a refund.



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Upcoming deadlines

Deadline for contributing to an RRSP for the 2017 tax year	March 1, 2018
T5013 Partnership information return	March 31, 2018
2017 AgriStability interim payment application deadline	April 2, 2018
2018 AgriStability enrollment and fee deadline (without penalty)	April 30, 2018
Annual crop insurance AFSC deadline for applying or making changes (including cancelling)	April 30, 2018
2017 Personal tax return filing deadline if not self-employed	April 30, 2018
2017 Personal tax return payment deadline	April 30, 2018
2017 Personal tax return filing deadline if self-employed	June 15, 2018
Growing Forward 2—deadlines vary based on the applications received and programs available. Visit the Growing Forward 2 website for specific deadlines.[1]	

1 Growing Forward 2 website: http://www.agr.gc.ca/eng/about-us/key-departmental-initiatives/growing-forward-2/?id=1294780620963

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