Planning for farming or fishing property

If you own farming or fishing property, you may benefit from unique planning strategies to help save taxes. For example, you may qualify for lower or no taxes when you sell certain property. Or you may qualify to defer taxes on the growth if you leave certain property to specific heirs. Whether you can qualify for these tax planning strategies is the complicating part. Life insurance can also play a critical role in your farming or fishing business succession. We discuss these strategies and more below.

Farming and fishing activities

Before reviewing the planning opportunities, the first step is to understand what farming and fishing activities qualify. Will you benefit from tax incentives if you plant berries in your small backyard garden? Or does taking out your fishing boat twice in the summer qualify? Not all farming and fishing activities qualify for the tax incentives. The scope and context of the farming and fishing activities affects available planning opportunities. Further, qualifying for the opportunities usually requires active farming or fishing activities for a certain length of time. Let's look at the considerations in more detail.

Under the Income Tax Act (ITA), farming includes planting crops, raising livestock, and maintaining horses for racing, and beekeeping. Fishing includes fishing for or catching shellfish, crustaceans, and marine animals. Some activities may fall into both farming and fishing. For example, aquaculture, which is raising fish or shellfish in a controlled in environment. The more feeding, medication, and monitoring, the more the activities relate to farming. However, the ITA definition under is not exhaustive. The CRA also accepts the common, ordinary, and generally accepted meaning. Despite this, the rules specifically excludes certain activities from qualifying for the tax benefits and planning opportunities.

Renting or sharecropping vs joint venture or custom work arrangement

Some farmers may stop personally farming or fishing and rent out property or equipment or sign a sharecropping arrangement. You may consider this option as you age and have no successor or buyer for the business or property. From a tax perspective, renting property is normally a passive activity because you're receiving passive rental income. A sharecropping arrangement is also generally passive. Sharecropping is when you take a share of the crops instead of cash for rent. As we will see below, passive activities may disqualify you from many of the tax benefits available.

Instead, you may agree to work with another farmer or fisher or hire someone to farm or fish using your property. This could be through a joint venture or custom work arrangement which may qualify as active farming or fishing. Whether the CRA views the activities as passive or active comes down to the facts. In general, to be active you must share in the risks associated with the activities. Active involvement may include sharing expenses, making managerial decisions, and retaining control over activities. Sharing in the risks involved in farming or fishing also indicate active rather than passive.

If your activities include renting or sharecropping, we recommend you speak with your external tax professionals. They can help determine the nature of your agreement and ensure you keep the tax incentives, where possible.

Business or hobby

You may partake in farming and/or fishing activities, but are the activities for business purposes, or just a hobby? Distinguishing between business and hobby is important because only property involved in business qualify for the tax incentives. The government wants to give incentive to farmers and fishers who spend significant time and resources running their business.

The Canada Revenue Agency (CRA) publishes guides on which activities they consider indicate a business rather than a hobby. For farming, you need to actively engage in either managing the day-to-day activities or earning income from the business. For fishing, several different activities may indicate you're operating a fishing business. This includes participating in making a catch or owning or leasing a boat used to make a catch. It may also include owning licenses to make a catch or other activities. You also need to have a reasonable expectation of profit for either farming or fishing. On the other hand, hobby activities include farming or fishing for personal reasons. Whether the CRA considers any activity a business instead of a hobby depends on your specific situation. Review with your tax and legal advisors whether your activities meet the definition for active farming or fishing activities.

Owner or Operator

When planning for the tax incentives, two terms often arise: "owner" and "operator" of the farm or fishing property. You may be the current owner and operator. However, in many farm or fishing businesses, the operator can be different from the owner. Further, many family farm and fishing businesses may change ownership or operator over the years. The ITA recognizes this and expands the normal definitions used to qualify for the tax benefits.

- Although you're the current owner, to meet ownership time related requirements an owner can be you or others. This includes your spouse or common-law partner, parent, child, or a family farm or fishing partnership interest owned by you or your spouse or common-law partner. The ITA also expands child to include your child, grandchild, great-grandchild, and their spouse or common-law partner. An owner can own their interest directly or as beneficial owner through a personal trust. We define these as "**eligible owner**".
- An operator can be any of the same people as an eligible owner (an **"eligible individual operator**"). In some cases, an operator includes a family farm or fishing corporation of these persons (together, an "**eligible operator**").

This unique distinction provides flexibility for more farmers and fishers to qualify for the tax benefits below. It recognizes you may not adhere to typical ownership or use structures due to the family nature of the business. You'll see the use of these terms as we go through the tax benefits and planning opportunities.

Further, when discussing property and its use, the CRA views "used principally" to mean more than 50% of time. For example, an owner could use land for farming 6 years out of a total 10 years. Therefore, the owner can meet the "used principally" requirement since the farming activity represents 60% of the time.

Lifetime capital gains exemption (LCGE)

The LCGE is one of the main tax planning tools for farmers and fishers. It encourages Canadians to engage in farming and fishing activities, employ people in the business, and increases economic activity. To see how it creates this incentive, we'll look at an example. Assume you own a fishing license with fair market value (FMV) of $3,000,000 and nominal adjusted cost base (ACB). When you sell the license, you'll realize a capital gain for the difference between the sale proceeds and ACB. The inclusion rate for capital gains is 50% for the first $250,000 and 2/3 for gains above $250,000 annually. We'll assume you've already realized $250,000 of capital gain in the year. If you qualify, the LCGE currently reduces the capital gain by up to $1.25 million. Here is an example of how the LCGE saves taxes when you sell the license. Assume you lived in Ontario where the highest tax rate is 53.53%.

Proceeds of disposition	ACB	Capital gain	Taxes payable on $3 million gain (35.68%)	Taxes payable with LCGE on $1.75 million gain (35.68%)	Difference
$3,000,000	**Nil**	**$3,000,000**	**$1,070,400**	**$624,400**	**$446,000**

Across Canada, you could save roughly $400,000 or more by qualifying for the LCGE. You may realize additional tax savings with the proposed Canadian Entrepreneurs' Incentive set to implement between 2025 and 2029. But not all property relating to farming and fishing activities qualify for the LCGE. Only certain property qualifies.

Qualified farm or fishing property (QFFP)

Current tax rules include four categories of property as QFFP:

1. **Real property** or **fishing vessel** used by an eligible operator in **carrying on a farming or fishing business in Canada**
2. Share of capital stock of **family farm or fishing corporation**
3. Interest in a **family farm or fishing partnership**
4. **Intangible property** (e.g., quotas, fishing license) used by an eligible operator in **carrying on a farming or fishing business in Canada**

QFFP often requires an eligible operator use the property in a farming or fishing business in Canada. Keep in mind the discussion above regarding owner and operator which can be different persons. Whether your property qualifies as QFFP depends on the year you acquire the property.

Acquired on or after June 18, 1987:

An owner needs to meet both an ownership and property use condition.

Ownership:
one or more **eligible owners** owned the property for at least **24 months immediately before** the disposition.

Property use: Either,	
during at least **two years** while one or more **eligible owners** own the property: a) an **eligible individual operator's gross revenue** from the farming or fishing business **exceeds other income**; **and** b) an **eligible individual operator** was actively engaged on a regular or continuous basis and **principally** used the property in farming/fishing business carried on in Canada.	Or, throughout a period of at least **24 months** while one or more **eligible owners** owned the property a) a farm or fishing corporation or farm or fishing partnership used the property in a farm or fishing business in Cananda; **and** b) you or your spouse or common-law partner, child, or parent, was actively engaged on a regular or continuous basis in that business.

The ownership condition means you yourself don't need to hold onto the property for 24 months before the disposition. You could inherit the property from another eligible owner and together meet the ownership rule.

You can meet the property use test one of two ways. When the property user is someone other than a corporation, an eligible individual operator must meet a gross revenue and principal use test for two years. These two years don't need to be the 24 months preceding disposition. They can be any two years during ownership by an eligible owner. These two years also don't need to be consecutive. Remember, the eligible individual operator whose income meets this test doesn't have to be the owner disposing the property. For example, you may never farm or fish a day in your life. So long as an eligible individual operator meets the test, you may still qualify to claim the LCGE.

You can also meet the property use test when a farm or fishing corporation or partnership uses the property. Here, you, your spouse or common-law partner, child, or parent needs to be actively engaged in the business.

Acquired before June 18, 1987:

Where an **eligible owner** last acquired property before June 18, 1987, an **eligible operator** needs to either:

principally use the property **in the year of disposal** in a farming or fishing business carried on in Canada, **or**	principally use the property **in at least five years** in which any eligible operator owns the property.

The tests for property acquired before June 18, 1987, are a lot less onerous. For example, you acquire a fishing vessel in 1985 and rent it out until 2022. You then start using it more than 50% of the time in a fishing business in the last year. The fishing vessel could qualify under this fact pattern. This rule remains relevant as many owners may have purchased or inherited the property prior to 1987. Be careful of deemed disposition rules under the ITA which may change your acquired date. For example, in 1994 the CRA allowed a special election to realize a portion of exempt gains that year. This election deems you to reacquire the property in 1994, and lose the pre-June 18, 1987, status.

Shares/interest in a farm or fishing corporation/partnership

QFFP also includes shares in a farm or fishing corporation or an interest in a farm or fishing partnership. This property must also meet an additional test to qualify for the LCGE. Although more complex than shown here, the additional tests include:

1. Throughout **any 24-month period before disposition**, a. more than 50% of the FMV of the corporation's or partnership's property is used principally in farming or fishing business by an **eligible operator,** b. and you, your spouse or common-law partner, child, or parent, is actively engaged on a regular and continuous basis.	2. **At time of disposition** a. all or substantially all the FMV of the corporation's or partnership's property is used principally in farming or fishing business by an **eligible operator** b. and you, your spouse or common-law partner, child, or parent, is actively engaged on a regular and continuous basis.

This definition is like the LCGE test for qualified small business corporation shares (QSBCs). However, the biggest difference relates to the 24-month requirement. For QSBC shares, your corporation needs to meet the 50% test for the 24 months right before disposition. For QFFP, your corporation/partnership can meet this test in **any** 24-month period before disposition. Further, the LCGE for QSBC shares only apply to shares of a corporation and not partnership interests which do qualify as QFFP.

The CRA views "all or substantially all" to mean more than 90%. For example, your farm or fishing corporation may own other assets which the CRA considers passive. Passive assets include investments, excess cash, rental properties, or life insurance policies with large cash values. If this is your situation, review options to purify your corporation or partnership with your tax and legal advisors. This may require your professional advisors to reorganize the corporate structure and separate the active and passive assets. Keep in mind you should always target 90% in qualified active assets for planning purposes.

It's important to note QFFP doesn't include machinery, equipment, or inventory you own personally. However, your professional advisors may recommend owning these assets inside a farming or fishing corporation or a partnership. Your shares/interest in the corporation/partnership could then qualify as QFFP if it meets the above tests.

LCGE Considerations

You can claim the LCGE when you dispose of QFFP. Many people believe this requires you to sell the QFFP. However, you may have opportunities to claim the LCGE during other events that qualify as a disposition. For example, the ITA deems you to dispose of all your assets at death for tax purposes. If your QFFP qualifies, you may benefit by claiming the LCGE in your final tax return to increase the ACB. This lowers the future capital gain for your child or grandchild who inherits the property and later sells it. Dispositions can also occur when you transfer to your heirs during your lifetime or during a corporate reorganization.

Succession planning and intergenerational rollover

Succession planning can be complex for farmers and fishers. You may want to pass your business or property to your heirs while minimizing taxes. However, when you transfer to a child, you usually trigger a taxable capital gain. You can defer the capital gain if the ITA allows a tax-deferred rollover. A tax-deferred rollover allows you to transfer eligible property at cost, deferring the tax to a future date. Many farming and fishing businesses have property with significant deferred gains. Without a tax-deferred rollover, you'd need to sell the property to pay taxes when transferring among the family. The liquidity need could jeopardize your farm or fishing business from continuing operations.

Intergenerational rollover of farming and fishing property

The ITA allows you to transfer certain farming and fishing property to a child without an immediate tax. You can transfer using an intergenerational rollover while alive, or you may still qualify at death. The ITA defines property eligible for the intergenerational rollover different from QFFP.

When the property is either **land** or prescribed **depreciable property** in Canada, the following rules apply:

- The recipient child is resident in Canada immediately before the transfer. This applies to the expanded definition of child mentioned above; and
- You, your spouse or common-law partner, child, or parent, was actively engaged on a regular and continuous basis in a farming or fishing business that principally used the property.

The rollover also applies to shares or interests in a **family farm or fishing corporations or partnerships** if the:

- recipient child is resident in Canada immediately before the transfer; and
- property is a share of a family farm or fishing corporation or interest in family farm or fishing partnership.

Unlike QFFP, meeting the definition of share/interest of a family farm or fishing corporation/partnership is easier. For the intergenerational rollover, **at the time if disposition**,

- an **eligible operator** uses all or substantially all the FMV of the corporation's or partnership's property principally in farming or fishing business,
- in which you, your spouse or common-law partner, child, or parent, is actively engaged on a regular and continuous basis.

Under the intergenerational rollover, there's no test for the 24 months right before the transfer. The test only looks at the FMV of the corporation's or partnership's property right before the transfer. You can more easily qualify for the intergenerational rollover than the LCGE for family farm corporations or partnerships. Your professional advisors may even reorganize your structure prior to the transfer to qualify without waiting two years.

Elected amount and tax deferral

The rollover allows you to elect the amount at which you transfer the property. You must elect an amount between the property's FMV and ACB (or undepreciated capital cost for depreciable property). The elected amount is your proceeds of disposition for taxes, and the new ACB for the recipient child.

For non-depreciable property, if you transfer at ACB, you'll have no immediate tax. However, you have a planning opportunity if the property qualifies for the LCGE. For example, you may choose to transfer at ACB plus your unused LCGE. Done properly, you can use your available LCGE room and create higher ACB for the future generations. Your tax advisors may also elect an amount up to the FMV for tax planning purposes. For example, if you have available capital losses to offset against capital gains. Or you have little other income for the year and are in a lower tax bracket. Choosing the appropriate amount for you to elect requires analysis with your tax advisors. This table shows the tax impact for property with a $50,000 ACB and $2,000,000 FMV when electing different amounts.

Elected amount	**ACB**	**ACB+LCGE**	**FMV**
Proceeds of disposition	$50,000	$1,300,000	$2,000,000
ACB	$50,000	$50,000	$50,000
LCGE claimed	N/A	$1,250,000	$1,250,000
Capital gain	Nil	Nil	$700,000
New ACB to the recipient child	$50,000	$1,250,000	$2,000,000
Deferred capital gain to child	$1,950,000	$750,000	Nil

As we can see from the table, if you elect at the ACB, you defer the whole capital gain. Note, this doesn't eliminate the capital gain, you've transferred it to your child. If you elect at the ACB + LCGE amount, you also defer the gain. However you increase the ACB for your child, which will reduce their future capital gains. If you elect a higher amount, for example FMV, you'll have an immediate capital gain. However, you'll increase your child's ACB, which reduces their capital gain on a future sale.

If you can transfer farm or fishing property to your children on a tax-deferred basis, why claim your LCGE? Simply put, there may be a future sale of the property. Or the property may not continue to qualify for the LCGE or intergenerational rollover. Therefore, if you or your family uses your LCGE over time, you increase the overall ACB. This results in lower taxes in the future.

There is no single correct way to transfer and elect. It depends on your situation and discussion with your advisors to choose what's best for you and your family. Additional considerations like alternative minimum tax, family dynamics and readiness, and economic conditions may apply. We encourage you to consider all available options.

Intergenerational rollover and future sale

We caution when using the intergeneration rollover if there's potential for a future sale within 36 months of transfer. The CRA may deny the tax-deferred rollover and impose tax on the original transfer. Remember the expanded definition for eligible owner above means a recipient could sell the property and claim their LCGE. The government doesn't want to encourage using the rollover as a planning loophole to access more LCGEs. For example, assume you transfer property at ACB plus your LCGE and rollover the remaining gain to your child. If your child then sells the property, they could claim their LCGE on the deferred gain transferred to them. The 36-month rule is an anti-avoidance rule deeming the initial transfer to occur at FMV which denies the tax-deferral. For transfers at death, the property must transfer and vest indefeasibly in the recipient within 36 months. In other words, you cannot have future events that revoke the child from receiving the property. Complex rules apply where the recipient child dies prior to the property vesting in them.

Most importantly, there is no requirement for the child to continue the farming or fishing business. When you transfer property from parent to child, the parent must qualify. However, if your child doesn't continue farming or fishing, it may affect their ability to use the intergenerational rollover. It may also affect their ability to claim the LCGE.

Complementing your plan using life insurance

You can use life insurance for many purposes as part of protecting your farming or fishing business. For example, life insurance can replace your income or pay off debts in the event of premature death. This may be crucial if the business requires your active involvement to produce income for your family. For longer term planning, the LCGE and intergenerational rollover rules may reduce or defer tax when you transfer property. Still, tax and succession planning can benefit from using permanent life insurance as a complement to these opportunities. In some cases, you can't eliminate all tax, and you may choose to transfer the tax to your children. In other cases, you may require life insurance to protect your retirement plan. Finally, you may want to use life insurance to equalize your estate among children not active in the business. Let's look at each of these in more detail.

- **Tax on transfer**. Review and consider whether your current property qualifies for the LCGE or intergenerational transfer. Life insurance is a tax-efficient method of meeting your tax needs when the property transfers to your children. Even if your property qualifies now, consider whether it will continue to qualify in the future. Work with your financial and tax advisors to calculate the existing gain and deferred taxes.
- **Deferred tax on transfer**. Even if your property qualifies for the intergenerational rollover, consider the amount of deferred tax you transfer. You can use life insurance on your life to cover a portion of the tax transferring to your child. This then bumps up the ACB on the property you transfer to them. Or you can use life insurance on their life to provide coverage for the deferred tax transferred to them.
- **Protecting your retirement income**. You may transfer your farming or fishing property to the next generation and require them to pay you over time. If they prematurely die, your ability to continue receiving your retirement income is in jeopardy. Life insurance on the next generation can help protect this expected income.
- **Equalization**. You may have one child that wants to continue the family business and other children not interested. However, many farming and fishing families have much of their net worth in property tied to the business. Estate equalization planning ensures all your children receive a fair portion of your estate. Keep in mind "fair doesn't mean equal", and that's particularly true for business transfers. It's a common goal for many successful individuals but is often difficult to achieve. We encourage you to start succession and estate conversations with your beneficiaries well before retirement. Use life insurance to give your non-active children a legacy without requiring sale of property used in the business.

Remember reducing tax isn't the main purpose and goal for estate planning. You ultimately want to provide for your beneficiaries and ensure continued success of your family farm or fishing business. Your advisor can provide insurance solutions to help with equalization and other estate planning goals.

Permanent insurance with cash value

Many farming and fishing families have a significant portion of their property and cash flow tied to the business. Whenever you earn profit, it goes right back into the farming and fishing operation. This helps you expand and take advantage of cyclical cash flow. You may need life insurance for one or more of the above, but you're hesitant to reduce cash flow. In these cases, you may benefit from using permanent life insurance with cash surrender values. You or your business can borrow against a portion of the cash values to invest back into your business. In some cases, you can borrow back an amount equal to the entire annual premium. This helps replenish cash flow within weeks of paying the premium. Done properly, you can maintain sufficient life insurance without restricting your net cash outflow. Speak with your advisor to learn more about using permanent life insurance with cash value to meet your needs.

The bottom Line

Tax planning strategies for farmers and fishers are complex and detailed. However, if you qualify, you can reduce and defer tax on qualified farming and fishing property for many generations. Keep in mind, property not taxed for generations may also carry significant unrealized gains. When you or your family realize these gains, how will you or your heirs pay the taxes? We recommend discussing your options with your advisors to ensure you meet your estate planning goals. This includes discussing life insurance as a protection for you and your farming or fishing operation.

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