The family farm and Will planning

Addressing farm succession in your Will

RBC Royal Bank

The following article was written by RBC Wealth Management Services

The 2011 Census of Agriculture indicated that nearly half of all farmers in Canada are 55 years of age or older. As such, farm succession planning is becoming more and more important. This article discusses addressing farm succession planning in your Will.

Your farm may be your most valuable asset and may be a significant part of what you leave your family upon your passing. This article discusses ways to integrate your farm into your estate plan so that you can leave your farm assets to your loved ones in a tax-efficient manner. Specifically, there are methods available to you such that upon your passing, your loved ones may be able to receive your farm assets without any immediate tax implications to them or your estate.

This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from qualified tax and legal advisors before acting on any of the information in this article. (Note: The term "spouse" used in this article also refers to common-law partner or same-sex partner.)

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Retaining Ownership of the Farm

You may want to retain ownership of your farm property during your lifetime and gift it to your family members as part of your estate. If so, it is important to have an estate plan in place that addresses your farm assets properly, so your wishes are carried out even if unforeseen circumstances occur, such as disability or pre-mature death. Depending on whom you wish to inherit your farm, there may be tax strategies available. The first step in ensuring your farm assets pass to your intended beneficiaries is to draft your Will.

What is a Will?

A Will is a legal document that can help ensure that your assets pass according to your wishes after your death. Your Will only becomes effective on death. Until then, you can change the terms or revoke your Will as long as you are mentally competent.

Your Will should name your executor(s) (liquidators in Quebec), the individual(s) and/or institution (e.g. trust company) that will act on your behalf to carry out your wishes. Without a Will, the courts may appoint an administrator for your estate, who may not be the individual or institution you would have chosen and your estate would be distributed in accordance to the intestacy rules in your province which may differ significantly from your wishes.

An estate plan that incorporates a Will can allow you to communicate instructions and strategies to your executors so that your wishes are realized. This may include, for example, providing sufficient income for your spouse and children to maintain their lifestyle. Your legal professional can draft your Will in a way that allows your executor to implement tax savings and deferral strategies for the transfer of your farming assets. There are different tax implications and opportunities depending on who you name as beneficiary of your farm property. This article discusses the implications and strategies available in the following situations:

- Leaving farm property to your spouse;
- Leaving farm property to your child or children; or
- Leaving farm property to other individuals.

Leaving Farm Property to Your Spouse

Leaving farm property to your spouse is the easiest way to achieve a tax efficient transfer of your farm assets. Upon your passing, if your spouse inherits your farm property, he or she will receive it at your adjusted cost base (ACB), with no immediate income tax implications. The taxes payable on the unrealized gains on your farm property are deferred until your spouse sells the farm property or passes away.

Your executor, however, may have the option to file an election so that certain qualified farm property (e.g. land, depreciable property, shares in a family farm corporation, or an interest in a family farm partnership) transfer to your spouse at its fair market value (FMV). If the election is made, your spouse will inherit this property with an ACB equal to the FMV. This may make sense in a situation where your capital gains exemption is available to offset any accrued capital gains on your qualified farm property. In essence, this would allow you and your spouse to multiply the capital gains exemption and reduce the total taxes payable on the eventual disposition of the farm property. This would also make sense in a situation where you have significant capital losses available to offset any accrued capital gains on your qualified farm property.

Your executor can choose whether to make the election for each qualifying farm property. For example, the executor may choose to rollover certain assets to your spouse at its ACB and to elect to have other property transfer at FMV. This planning is not available for qualified farm property that is eligible capital property (e.g. farming quotas). There is an automatic rollover of these assets and you cannot trigger a gain to utilize the capital gains exemption.

You may also choose to have your farm assets rollover to a testamentary spousal trust. This is a trust established for the benefit of your surviving spouse through the provisions of your Will. The testamentary spousal trust can receive the farm assets at your ACB without any immediate tax implications. You must meet certain requirements in order for the rollover to take place at your ACB, as follows:

- The transfer of property occurs as a consequence of a your death, to a trust created in your Will;
- Your surviving spouse is entitled to receive all income from the testamentary spousal trust during the spouse's lifetime. In addition, no other person may obtain the use of any of the income or capital of the trust during the surviving spouse's life;
- The trust must be resident in Canada immediately after the time the property is vested indefeasibly in the trust;
- You (immediately prior to death) and your spouse must be residents of Canada;
- Your spouse has the right to absolute ownership of the property and no future event can deny him/her of this right; and
- The property vests indefeasibly in the trust within 36 months of your death. Generally, property vests indefeasibly when the acquirer (i.e. in this case, the trust) has absolute and unconditional legal or beneficial ownership in the property.

If you wish to have your spouse inherit the farm on your passing but then have your children inherit the farm once your spouse passes away, it may make sense to use a testamentary spousal trust.

Since a testamentary spousal trust is treated as a separate taxpayer and its income is taxed at graduated rates, the surviving spouse can take advantage of a second set of lower tax brackets (personally and through the testamentary spousal trust). Please note however that the graduated rate taxation of testamentary trusts will be eliminated in 2016 and that all income retained in the trust will be taxed at the highest marginal tax rate.

For qualified farm property that is depreciable property you can choose to transfer this to your child at any value between its undepreciated capital cost (UCC) and its FMV.

If you wish to have your spouse inherit the farm on your passing but then have your children inherit the farm once your spouse passes away, it may make sense to use a testamentary spousal trust. This can be achieved by having the farm property transferred to this trust on a rollover basis upon your death, with no immediate tax implication to the estate or your spouse. Your spouse can then receive income from the farm during his/her lifetime. When your spouse passes away, the trust may be able to distribute the farm property to your children (based on directions in your Will) at a value between the ACB and the FMV on the date of death of the surviving spouse, as elected by the trustee, if certain conditions are met.

Please ask your RBC advisor for the article titled "The Testamentary Spousal Trust" for additional details regarding this structure. It is important to consult with a qualified legal advisor to assist you in drafting your Will as well as obtain advice as to how the trust should be administered if you decide to employ this strategy.

Leaving Your Farm Property to a Child or Children

You can also transfer farm property to a child or children on a tax-deferred basis on death if you meet the following conditions:

- The child is or children are residing in Canada just before your death;
- The farm property, before your death, was used principally in a farming business in which you, your spouse or any of your children, or parents were actively engaged on a regular and continuous basis; and
- The farm property is transferred to your child as a consequence of your death and becomes vested indefeasibly in your child within 36 months after your death (a longer vesting period may be granted under special circumstances).

For the purposes of this discussion, a child, or children includes children, stepchildren, adopted children, grandchildren, great grandchildren and children-in-law. In addition, despite the wording above, Canada Revenue Agency (CRA) has commented that the farm property does not have to be used principally in farming immediately prior to the death of the individual. The conditions for "used principally" and "actively engaged on a regular and continuous basis" are similar to those discussed in the article titled "Selling the Farm". Please ask your RBC advisor for this article.

Even if the assets are qualified for a rollover, your executors may instead choose to transfer all or part of the qualified farm property to your child or children at any value between its ACB and FMV. This strategy may make sense in the case where you want to trigger a gain and use your capital gains exemption. Using this strategy may allow your estate to transfer your farm property with little capital gains taxes payable and allow your child to receive the farm property at a higher ACB resulting in fewer taxes payable when your child disposes of the property. You may also wish to choose to trigger a gain if you have unused capital losses that can be used to offset your gains and reduce your taxes payable. As discussed later in this article, this planning is not available for qualified farm property that is eligible capital property, such as farming quotas.

For qualified farm property that is depreciable property you can choose to transfer this to your child at any value between its undepreciated capital cost (UCC) and its FMV. Please note though, that if you transfer at a value higher than the UCC, it will result in additional taxable income known as recapture which cannot be sheltered by the capital gains exemption or reduced with capital losses.

Family Farm Corporation

Note that each share of a family farm corporation is considered a single property. As a result, transferring shares of a family farm corporation at death to either your spouse or children provides additional flexibility for tax planning. For example, an executor can choose to rollover some shares of your family farm corporation at ACB and transfer the remaining shares at a value between ACB and FMV in order to trigger sufficient capital gains to use your capital gains exemption and/or your remaining net capital losses.

The farm's success will depend on the knowledge and ability of your beneficiaries, and therefore it may make more sense to transfer farm property only to those children who have farming knowledge.

Alternative Minimum Tax (AMT)

One of the drawbacks of triggering capital gains on the transfer of farm assets during your lifetime and using the capital gains exemption is the potential of triggering AMT. AMT does not, however, apply in the year of death. So for situations where the capital gains exemption is available, or a deceased individual has significant capital losses, it may make sense to trigger a gain when transferring the farm assets to the child or children inheriting the property. This can allow your child or children to receive the property with a higher ACB, while having little or even no tax impact on the estate.

Minor Children Considerations

As part of your estate plan, you may wish to leave farm assets to your minor children. However, one of the criteria that you must meet in order to be able to rollover farm property to your children at death, is that the property must vest indefeasibly in the child within 36 months after your death. This may cause an issue if you prefer to leave your farm assets to your children via a testamentary trust until they reach the age of majority or at an age where you feel they will be mature enough to own the farm property directly.

CRA has indicated that property held in a trust for a minor child can still be considered to have vested indefeasibly in the beneficiary if, among other things, the absolute ownership of the property is gifted and the trust does not allow for a future event to change the individual's ownership.

As such, if you wish to leave your farm assets to your minor child via a testamentary trust and the asset is not distributed to the minor child within 36 months after your death, you can still meet the requirement to 'vest indefeasibly' provided the minor child's ownership rights cannot be defeated by any future event (i.e. it is an irrevocable trust and your Will does not dictate, nor does the trustee have the discretion to select, to whom the property will pass).

Other Planning Considerations Regarding the Farm and Children

If you are considering bequeathing your farm assets to your children, there are a number of things to keep in mind. It is important to realize that it may not make sense to distribute your farm property equally among your children. The farm's success will depend on the knowledge and ability of your beneficiaries, and therefore it may make more sense to transfer farm property only to those children who have farming knowledge.

If you decide not to distribute your farm equally among your children, consider gifting your non-farming assets to the non-farming children such that all your children receive an equal share of your total assets. Having said that, typically, the farm may be the most significant asset in your estate. As such, it may make sense to leave the farm to the children who have an ability and interest in farming and obtain a life insurance policy, equal to the value of the farm, which names the non-farming children as beneficiaries. This solution ensures all beneficiaries are treated fairly and that each receives an equal portion of your estate, should that be your intent.

Planning with Quotas

When a quota is transferred to your children at death, it is always done at 4/3 of the cumulative eligible capital account. However, if you transfer quotas to your children during your lifetime, you can do so at any value between 4/3 of the cumulative eligible capital account and FMV. As such, if you have quotas with large gains and have not used your capital gains exemption, it may make sense to transfer them to your children during your lifetime in order to use the capital gains exemption and allow them to inherit the quotas at a higher ACB. This planning is not available when transferring quotas to a spouse.

Leaving Farm Property to Other Individuals

Leaving your farm property to anyone other than your spouse or children will result in a disposition of the assets at FMV on your terminal tax return. This may trigger capital gains or recapture. To the extent that any of the assets transferred are qualified farm property, your executor may be able to use the capital gains exemption on your terminal tax return, if available. Your beneficiary will receive the farm assets with an ACB equal to the FMV of the farm assets on the date of your death.

Other Estate Planning Considerations

Probate Tax

If your farm assets pass through your Will, they will generally be subject to probate. Probate is the process through which the court confirms the validity of the deceased's Will and the authority of the executor (liquidator) to carry out the terms of the Will. In general, when an executor or liquidator applies to court for probate, a tax must be paid to the provincial or territorial government. The probate tax rates vary among the provinces and territories. Some provinces and territories charge a flat or nominal fee, while others charge rates based on the value of the assets subject to probate. Depending on your province or territory of residence and the value of your assets, your estate may pay significant probate taxes. One way to avoid probate tax on your farm assets is to transfer your farm property to your spouse, children, or other individuals during your lifetime. This way they will not form part of your estate and will not be subject to probate tax on your death.

Power of Attorney

Estate planning involves not only the transfer of your assets on your death, but a variety of other personal considerations. A Will is not the only document you should have prepared. Powers of Attorney (Mandate in Anticipation of Incapacity in Quebec) for property and for personal care are also common elements of a comprehensive estate plan.

It may make sense to leave the farm to the children who have an ability and interest in farming and obtain a life insurance policy, equal to the value of the farm, which names the non-farming children as beneficiaries.

A POA is a legal document in which you give another person(s), referred to as the attorney/mandatary, the power and authority to act on your behalf. Having a POA in place is important in the event you become incapacitated and cannot perform your normal daily tasks yourself, for example, paying bills and managing your investments. A POA for property allows the attorney(s) you appoint to make decisions on your behalf about your financial and property matters. You can grant broad powers in this document, or restrict your attorney's power to specific defined circumstances. A different legal document may be used in some provinces and territories to make personal care decisions. In some provinces, you can execute one document authorizing your attorney to act on your behalf in relation to financial and property matters as well as personal care matters.

Give your family and yourself peace of mind by consulting a legal professional, who specializes in Will and estate planning, to prepare a thorough and up-to-date Will and POA. This can help avoid unnecessary stress and expense at the time of your death, or in the event of incapacity, and ensure that your wishes are carried out.

> Having a POA in place is important in the event you become incapacitated and cannot perform your normal daily tasks yourself.

Conclusion

With over 200,000 farms in Canada, farming is an important part of Canada's economy. As a farmer, it is important to decide how to exit your farm from a tax, retirement and business succession perspective. If you decide to retain ownership of your farm throughout your lifetime, consider planning strategies for the time when your heirs inherit your farm. If you decide to leave your farm to your spouse or your children, there are tax deferral opportunities available to avoid leaving your estate with a large tax liability. It is important to draft your Will to ensure your farm and other property is distributed according to your wishes on your death.

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