Agriculture is Everyone's Business

Agricultural Producers Association of Saskatchewan Submission to Finance Canada Tax Planning Using Private Corporations October 2, 2017

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Introduction

The Agricultural Producers Association of Saskatchewan (APAS) is the province's general farm organization. The APAS mandate is to provide a respected, unified voice that positively influences agricultural and rural communities. On behalf of its members, APAS represents thousands of agricultural producers across Saskatchewan. We strongly believe that the family farm, owned and operated by Canadian families has been a very successful model. Our farmers and ranchers have survived extreme swings in market, prices, and weather conditions for decades, and have grown a very successful industry with great potential for the future.

Saskatchewan producers were completely taken by surprise by the proposals contained in the "Tax Planning Using Private Corporations" consultation document, both by the recommendations, and by an extremely compressed consultation period conducted during our busy harvest season.

Twenty-seven percent of Saskatchewan family farms have incorporated, mainly as a vehicle for the transfer of their operating assets between generations. Decisions have been made in good faith under existing provisions to incorporate farm businesses over longer time horizons. These succession plans are designed to ensure that the farm operation is structured to allow for younger generations to take over without having to totally recapitalize the farm, and to provide a secure retirement income for retiring generations.

Current provisions under the income tax act already create a financial disincentive to transfer farm assets to family members instead of arm's length buyers, and the new proposals make this situation worse.

It is estimated that $50 billion of Canadian farm assets will be transferred over the next decade, and a large portion of those transfers will take place in Saskatchewan. APAS members are very concerned that the proposals contained in the consultation document could put that farm succession and future investment in jeopardy.

Saskatchewan producers are also very concerned about provisions that would discriminate against the use of "passive investments". Agriculture is a very capital intensive, high risk enterprise, and Canada needs to ensure that producers have tools to manage their future financial risk and to save capital for future investments. Operating in international commodity markets, Saskatchewan agricultural producers have no way to pass along increased costs to consumers.

The Government of Canada has identified agriculture and food as a target sector for future economic growth, and those ambitious goals cannot be realized without provisions that provide tools for future investment by family farm operations.

Recommendations

The Finance Canada proposals have given rise to a wide range of issues and concerns among stakeholders and tax practitioners in Saskatchewan's farm sector. APAS continues to believe that the most effective approach to addressing this uncertainty is for Finance Canada to withdraw the proposals and reconsider changes through extensive consultation with Saskatchewan farmers.

In responding to the current consultation opportunity, APAS supports the Canadian Federation of Agriculture's (CFA) proposed amendments to the proposals and draft legislation. These include:

Income Sprinkling & Limitations on the Lifetime Capital Gains Exemption

1. Exempt farming income from the reasonableness test and proposed income sprinkling rules.
2. Exempt qualified farm properties from the proposed limitations on the LCGE with regard to:
    a. gains accruing or realized before the age of 18
    b. gains accrued within a family trust; and
    c. the reasonableness test.

Passive Investment

3. Ensure that future proposals regarding treatment of passive investment income recognize and accommodate the range of legitimate business uses for passive investment income without creating additional, punitive tax liabilities.
4. AgriInvest funds and farmland rental income be considered active business income under any future proposals to reform taxation of passive investment income.

Converting Income into Capital Gains

5. The Department of Finance Canada commit to working with farm organizations and advisors to determine a test capable of differentiating real intergenerational farm transfers.
6. Establish an exemption on qualified farm properties from the proposed changes related to converting income to capital gains.

In addition to these recommendations, APAS further supports the CFA's general recommendation that Finance Canada **commit to a clear process with farm stakeholders to address the unintended consequences for the farm sector and exempt legitimate farm practices from the proposed changes before final legislation is introduced and to continue this process following the legislation's introduction.**

Discussion

Reasonableness Test & Income Sprinkling

Finance Canada has proposed the use of a “reasonableness” test to measure family members’ contributions against income received. Family members aged 18 to 24 will be subject to a more stringent test.

APAS does not believe this test can be applied fairly in the context of a family farm operation and is seeking an exemption for corporations to address a number of concerns, including:

- The proposed test will make farm corporate tax planning more complex and cumbersome. The tracking and reporting of family member contributions imposes significant administrative compliance costs.
- The proposal is vague about how the tests would be applied in specific circumstances. This is a cause of concern for farms which rely heavily on contributions from spouses and other family members.
- The business of farming is conducted at the place of residence, increasing the risk that legitimate contributions will be discounted or underreported.
- Young people attending post-secondary education or working off-farm to develop skills would be disqualified by rules that exclude labour contributions that are not “regular, continuous, and substantial”.
- The reasonableness test is inconsistent with longstanding government policy on the intergenerational farm transfers, specifically the farm rollover provisions, which are designed to exempt farm assets from taxation every time they are passed onto the next generation.

Limited Access to Capital Gains

Finance Canada is proposing several changes to the capital gains exemption. The proposals include the elimination of eligibility for individuals under 18 years of age and family trusts.

APAS is seeking an exemption for qualified farm properties from the proposed changes to capital gains treatment. The farm and ranch members have raised some of the following concerns with the proposal:

- Increased taxes on capital gains reduces the resources available to support a very significant transfer of assets that will occur in the near term. It is estimated that $50 Billion in farm assets will be transferred over the next 10 years.
- The proposed changes are disruptive to financial management and succession plans that have been developed for the long-term. In order to avoid tax liabilities, succession plans will need to be adapted to these changes in a time sensitive manner. There is an increased risk for unintended consequences, and/or unexpected tax burdens upon retirement.

- Individuals seeking to access their gains exemption will need to do so over the next year, requiring an unreasonable amount of planning and foresight for minors.
- Succession plans that include the use of a family trust will be disrupted.
- Anyone using their gains exemption though the special election could face significant tax liabilities (Alternative Minimum Tax) during a time of limited income.
- The proposed changes to capital gains introduces a level of complexity that inconsistent with prudent financial management and succession planning.

Passive Investment

Finance Canada has proposed several conceptual tax options, each designed to discourage the use of private corporate income for passive investment.

APAS recommends that Finance Canada ensure that future proposals regarding treatment of passive investment income recognize and accommodate the range of legitimate business uses for passive investment income.

APAS further recommends that AgriInvest funds and farmland rental income be considered active business income under any future proposals to reform taxation of passive investment income.

The farming and ranch members of APAS have raised the following concerns related to the Finance Canada's proposals on private investment inside a private corporation:

- A pool of funds is often maintained and invested to manage the risks associated with weather and market risks that are outside the control of producers.
- A pool of funds is often held in anticipation of future investment including land purchases.
- Increased taxation of private investment income inside a corporation will unduly influence business decisions and increase risks. The decision to rent out land within the corporation, for instance, may be part of a broader succession plan or temporary arrangement within the corporation's operating plans.
- AgriInvest is a government sponsored risk management program designed to help producers build a fund to manage small income declines. Increased taxation on AgriInvest withdrawals will undermine the integrity and spirit of this risk management program.
- As small business owners, agricultural producers lack the same safety nets that are available to wage and salaried workers, including sick leave, employment insurance, parental benefits, and pensions.

Converting Income into Capital Gains

Finance Canada is proposing new rules that extend section 84.1 of the Income Tax Act to a range of transactions that were previously exempt from the anti-avoidance measures.

APAS recommends that Finance Canada commit to working with farm organizations and advisors to determine a test capable of differentiating real intergenerational farm transfers.

APAS further recommends that Finance Canada establish an exemption on qualified farm properties from the proposed changes related to converting income to capital gains.

Under Section 84.1, the transfer of business assets between related corporations (non arm's length) are treated as dividends while arm's length transactions are considered capital gains and eligible for the exemption. APAS and other farm organizations have long held that section 84.1 discriminates against the intergenerational transfer of family businesses because it provides preferential tax treatment to transactions occurring between arm's length entities.

Although Finance Canada has expressed an interest in examining options to address this inequity, we understand that the measures contained in the July 18th proposal will reinforce the preferential tax treatment that arm's length transactions receive. It is essential the government grant qualified properties interim relief from the proposed measures, while a test is developed to validate real business transfers in order to provide these transfers access to the capital gains exemption.

Conclusion

Given the wide range of issues noted by tax practitioners and stakeholders from across the broader small business community, APAS continues to believe that the most effective approach to addressing these potential consequences would be to reconsider the current proposals following an extensive consultation with Canada's small business community.

In the absence of a new approach, APAS believes that Finance Canada, at minimum, needs to conduct further analysis and consultation with the farm sector to address any unintended consequences while exempting legitimate farm practices from the proposed changes.

APAS supports the CFA's recommendation that Finance Canada **commit to a clear process with farm stakeholders to address the unintended consequences for the farm sector and exempt legitimate farm practices from the proposed changes before final legislation is introduced and to continue this process following the legislation's introduction.**