Estate planning for farmers and fishers

When a farmer or fisher either sells their business during their lifetime or transfers it on death, the *Income Tax Act* (Canada) ("ITA") contains specific rules that may help reduce or defer their tax liability. These rules include the use of the lifetime capital gains exemption of $1,000,000 on the disposition of "qualified farm or fishing property" and a tax-deferred rollover of farm or fishing property to a spouse or children on death. Estate planning for farmers and fishers should ensure the eligibility of these special rules on the transfer of their business, along with the use of life insurance and critical illness insurance to help equalize, protect, and preserve their estate for the next generation.

Transferring the farm or fishing business on death

For tax purposes, you're deemed to dispose of all your capital property, both depreciable and non-depreciable, immediately before death.[i] The resulting capital gains or losses are realized in your terminal return. Two types of transfers that permit a tax-deferred rollover on death include, generally, those to surviving spouses and those to your children.

Exception – transfer to spouse

A primary exception to the deemed disposition on death rule occurs when capital property passes to a spouse or spousal trust.[ii] If capital property is transferred to the spouse of the deceased, or to a qualifying spousal trust, there may be a total deferral of any potential accrued capital gains and losses.[iii] The spouse or spousal trust acquires the property at the deceased's cost[iv] and any capital gains and losses are deferred until the property is disposed of by the spouse or spousal trust. The tax-deferred rollover of property to a spouse or spousal trust will only apply if the following specific requirements are met:

- The deceased is a resident of Canada immediately before death
- The spouse or spousal trust is a resident of Canada immediately before death
- The property is transferred or distributed as a consequence of the death of the deceased
- The property vests indefeasibly in the spouse or spousal trust not later than 36 months after death

For property to pass to a spousal trust on a tax-deferred basis, the surviving spouse must be entitled to all income earned by the trust during his or her lifetime and no person other than the surviving spouse may obtain the use of any of the income or capital of the trust before he or she dies. These requirements are rigid. For example, a trust would be "tainted" where its terms include a clause prohibiting or reducing the amount of income the spouse is entitled to under the trust or because of a subsequent remarriage. A tainted spousal trust is not eligible for the tax-deferred rollover of property of the deceased on his/her death.

Exception - transfer to children

A second exception to the deemed disposition on death rule is unique to farmers and fishers. There is a tax-deferred rollover available when the following types of property are transferred to a "child" on death either directly, or indirectly through a spousal trust:[v]

- land and certain depreciable property used principally[vi] in a farming or fishing business
- shares of a family farm or fishing corporation
- an interest in a family farm or fishing partnership

Specific conditions must be met for this tax-deferred rollover to apply:[vii]

- The property is located in Canada
- The deceased, their spouse, their parent(s) or any of their children was actively engaged in the business on a regular and continuous basis before his/her death
- The deceased's child to whom the property is transferred is a resident in Canada immediately before death
- The transfer takes place on or after deceased's death and as a consequence of their death
- The property vests indefeasibly in the child within 36 months of the deceased's death

Lifetime capital gains exemption

Aside from the tax-deferred rollovers described above, a farmer or fisher may be in a position to increase the cost base of their "qualified farm or fishing property" by using their lifetime capital gains exemption. This exemption is the greater of $1,000,000 and the indexed lifetime capital gains exemption, which is $848,252 (in 2018). Qualified farm or fishing property is defined to include property owned by the deceased or spousal trust that is:

- Real or immovable property, such as land and building
- A share of the capital stock of a family farm or fishing corporation, or
- An interest in a family farm or fishing partnership
- Certain intangible property, such as quotas

Even though there is tax-deferred rollover on death of farm or fishing property, an election can be made out of the rollover to utilize the deceased's lifetime capital gains exemption. The use of this exemption allows a step-up in cost base of the farm or fishing property to the spouse or child so they aren't taxed on any unrealized capital gains on the deceased's death.

Estate planning objectives and considerations

A well-designed estate plan could take advantage of the above rules to facilitate the transfer of property from one generation to the next while reducing or deferring taxes. However, as a farmer or fisher you may have other estate planning objectives which are similar to those of other business-owners, including:

- Wealth preservation and minimization of current taxes
- Estate preservation and minimization of taxes at death
- Liquidity at death sufficient to meet debts, tax liabilities and other obligations
- Provision for retirement
- Transfer of farm or fishing business to beneficiaries without dissolution of the business
- Equitable distribution of the estate for children not involved in the business
- Protection of the business against a key person's illness or death

Life insurance and critical illness insurance may provide attractive solutions for achieving these estate planning objectives to help ensure the future viability of your business.

Equalize family members not active in the farm or fishing business

As the farm or fishing business is usually the largest asset in your estate, it may be difficult to decide how to distribute it in an equitable manner between your spouse and children, who may or may not be active in the farm or fishing business. Life insurance can be used as a method of providing equality in your estate. The life insurance policy's proceeds (death benefit) on your death can be distributed to your spouse and non-active children as designated beneficiaries. If inadequate provisions are made for your spouse and dependent children, they may challenge your will. The use of life insurance in your estate can be a cost-effective measure to ensure that your inactive family members are adequately provided for without affecting your farm or fishing business.

Protect your estate for the next generation

Farmers or fishers are not immune to risk. Your personal health affects your business health. Your ability to drive business is essential not only to you, but also to your family. This risk is not completely mitigated for the next generation if the farm or fishing business has already been transferred from you to your children. The risk now lies with your children and their health to carry on the farm or fishing business. One way to help alleviate this risk is for a farm or fishing business to hold a life insurance or critical illness policy on the life of each of the family members active in the business. The policy can help manage the mortality or health risk of the farmer or fisher. Generally, proceeds from a life insurance policy are received tax-free by the business (only if the business is named as the beneficiary under the policy) and may be used to support the business until a purchaser is found. Often, a lump-sum payment from a critical illness policy is also received by the business tax-free and can be used to hire a manager to carry on the business during your illness.

Preserve your estate on death

You may have other sources of estate liabilities that require liquidity. Without liquidity, there's a risk that your farm or fishing assets could be sold to pay these debts, which may include:

- income tax from registered assets
- capital gains taxes from other non-farm or fishing assets
- probate taxes
- personal or business debt
- matrimonial and dependent obligations

You may have charitable estate planning objectives as well that require the liquidity as provided from a life insurance policy payout.

Summary

Farmers and fishers have estate planning measures at their disposal which may reduce or defer their capital gains taxes at death relating to assets used in the farm or fishing business. Farmers and fishers have other significant insurance needs relating to their business which range from estate equalization, key person coverage, debt retirement and other taxes.

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[i] Including any recapture or terminal losses on depreciable property.

[ii] All references to spouse or spousal trust will include a common-law partner and common-law partner trust.

[iii] Subsection 70(6) of the ITA.

[iv] The lesser of the cost and undepreciated capital cost.

[v] A child of the taxpayer has an extended meaning in the ITA to include grandchildren, great grandchildren, a child of the taxpayer's spouse, an adopted child, a spouse of the child of the taxpayer, and any person who, at any time before the person attained the age of 19 years, was wholly dependent on the taxpayer for support and of whom the taxpayer had, at that time, in law or in fact, custody and control.

[vi] More than 50%

[vii] Subsection 70(9) of the ITA