Succession Planning for the Family Farm

Succession planning for a farm is similar to succession planning for other businesses. In both cases, owners must consider their goals and objectives for their family and their business, then develop and execute appropriate strategies for both.

The key difference for a farm is the inherent importance of legacy – because farming is a passion that is often passed down from previous generations. In this article, we address some common questions asked by agricultural clients regarding succession planning.

What will happen to the farm?

What happens to the farm will depend on the family's goals and objectives. Sometimes a farm is sold to a third party, but very often we see one or more children taking over the farm operations. This occurs through a three-stage process:

1) Transfer of labour;
2) Transfer of management oversight; and
3) Transfer of ownership.

The **transfer of labour** stage typically begins when children are young and are assigned age-appropriate responsibilities for operating the farm. The **transfer of management** entails the selection and grooming of successors. This is a long process, often taking place over several years, with successors gradually taking on increased responsibility. As the successor(s) take on additional leadership oversight, there may be friction between generations because the transitioning generation has long-established ways of operating the farm while the younger generation will likely bring new ideas and a fresh perspective on the farm's operations. The actual **transfer of ownership** is the final step. Once the family has established who will own the farm business it is critical to consider the most tax effective way to facilitate this transfer. This will require consultation with an experienced tax practitioner. Outlined below are some tax issues for consideration.

Capital Gains Deduction on qualified farm property

Canadian resident individuals have a lifetime Capital Gains Deduction available to shelter capital gains (and offset the potential income tax liability) realized on the sale or transfer of qualified small business corporation shares and qualified farm or fishing property, which is reduced by any previous Capital Gains Deduction claimed previously. Currently, the lifetime Capital Gains Deduction available to individuals on the disposition of qualified farms (or fishing properties) is $1,000,000. Qualifying properties include land used in a Canadian farming business or an interest in a family farm business owned through a corporation or partnership. There are a number of complex rules relating to this deduction. For example, tests for qualification may include whether the owner is actively engaged in the business of farming on an active and continuous basis, and whether the farming income was greater than income from all other sources earned by the individual for at least two years. Less onerous tests may apply where the farm property was acquired prior to June 18, 1987. Several tax planning strategies are available to obtain optimal benefit from the Capital Gains Deduction.

Intergenerational Rollover

The Capital Gains Deduction discussed above is different from the Intergenerational Rollover of farm property that may prevent the realization of capital gains or a recapture of the capital cost allowance (i.e., tax depreciation) on farm property when it is transferred to a child or grandchild. The eligibility requirements are not the same for both strategies, although in many situations both options are available to decrease or defer tax on the transfer of qualifying farm property.

The Intergenerational Rollover on Canadian farm properties, including shares of a family farm corporation, allows for an additional tax benefit in the form of a tax deferral. An individual may transfer their interest in the farm to a child (or grandchild) on a tax-deferred basis either during his/her lifetime or at death, if the child or grandchild is a Canadian resident. The child inherits their parent's/grandparent's tax cost base, deferring the potential capital gain until the child or grandchild subsequently disposes of the property. In theory, farms that are transitioned from generation to generation may escape capital gains tax indefinitely.

Incorporating tax planning strategies for farm property into your succession plan

The use of the Capital Gains Deduction and Intergenerational Rollover for farm properties may be used to shelter or defer

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potential tax liabilities; however, conflicts may arise between the competing interests, desires and objectives of family members who are active in the farm as opposed to non-active family members. A strategy that benefits one family member from a tax perspective may reduce the value of another family member's inheritance. Therefore, it is important that any succession plan considers whether these tax strategies will be available and the impact they will have on all family members in the context of succession, retirement and estate planning.

For more information, please ask your BMO financial professional for our publication, *Tax Planning for the Family Farm*. Please be advised that planning for the family farm requires consultation with professional advisors as the rules are very technical and complex. In addition, each individual's situation will be unique in many respects, requiring the expertise of a professional to customize the appropriate plan or solution to fit your particular circumstances and personal objectives.

What will happen to my income in retirement?

The key to answering this question is planning early. By doing so, farm owners will have sufficient time to establish goals and objectives and execute appropriate strategies. This includes tax planning, estate planning, and personal retirement planning. Through this process, farm owners will benefit in the following ways:

- Ensure farm continuity;
- Optimize tax efficiencies;
- Establish targeted retirement date;
- Gain comfort around retirement income; and
- Manage family dynamics.

How will farm succession planning affect my legacy?

This depends on how legacy is viewed by the family. Does legacy mean having one or more children continue on the farm? Or, does it mean selling the land in exchange for financial capital that can be used to benefit the family in other ways? The underlying theme in both of these questions is considering the effect of these decisions on family dynamics. If the outcome creates tension among family members, how does that affect legacy? One of the most common challenges with farm succession planning is the idea of fair versus equal. If a family has three children and two children take over the farm while the third pursues a different career, the parents should consider the estate planning implications of gifting the farm to two children, and the inheritance received by the third child. This does not mean that the third child should receive an inheritance of the exact same value, but there must be open and honest discussion among the family members to come to an understanding. Families can also consider tools such as life insurance, which is commonly employed in these situations.

Seek professional advice

The complexity of farm succession planning must not be underestimated. The interconnectedness of the family and the farm means that, in addition to procedural change such as contracts, financing, and tax planning, there is also psychological change with which to contend. This includes willingness of the older generation to let go of ownership, selection and training of successors, and communication among family members. This makes seeking professional advice especially important when embarking on developing a succession plan for your farm.

! **For more information, speak with your BMO financial professional.**

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ID4064 (08/20)