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Marmer Penner Inc. Newsletter

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Gr$$n Acres

Back when Canadians were known as hewers of wood and drawers of water, farmers and fishermen made up a sizable portion of this country's population. While times have changed, we still have farmers in southern and central Ontario but the majority of fishermen may live closer to the two oceans flanking our eastern and western borders. As we are still deciding whether to open Halifax and Victoria offices, this newsletter will concentrate more on farmers than fishermen.

INCOME

What makes farmers unique? Well, to start with, they have certain income tax advantages not accorded to the rest of us. Farming is considered to be a business. Individuals engaged in a business are required to calculate their taxable income on an accrual basis. For non-accountants, "accrual accounting" requires unpaid amounts to be considered in determining income. For example, Willie the snow removal contractor plowed the Yorkdale parking lot on Boxing Day 2012 and received a $1,000 payment three weeks later in January 2013. Under accrual accounting, the $1,000 is included as 2012 revenue because it should be accrued as an account receivable on December 31, 2012.

Conversely, farmers need not use accrual accounting. Vince, who operates a vineyard, reports his income differently. Around Boxing Day 2012, Vince sold $1,000 of freshly-harvested grapes for ice wine to a local winemaker. He was paid three weeks later in January 2013. Vince is not required to use accrual accounting and may opt to use “cash accounting” which means the $1,000 need not be reported as revenue until the payment is received in 2013.

When a non-farming business purchases inventory, the amount is reflected on the company’s balance sheet and has no impact on its income until the inventory is sold. Conversely, when a cattle farmer buys several heads of cattle, the cost under cash accounting is immediately deducted from income even though the cattle is still in inventory at year end.

What we see here is that under cash accounting, a farmer can reduce income by one or both of:

a) Delaying cash receipts until after year-end; and

b) Accelerating inventory purchases immediately prior to year-end.

A clue as to whether a farmer is using cash accounting and perhaps reporting lower income than would be the case under accrual accounting is the absence of accounts receivable, inventory and accounts payable on the balance sheet.

COMPONENTS OF NET FAMILY PROPERTY

Certain types of farming businesses have rights to sell products such as dairy or eggs which are subject to quotas. The rights to sell these commodities may be very valuable and are liquid. Typically, there is an active market for the trading of these quota rights.

Where a farm property is transferred by the farmer to a child, special rules may allow the transaction to occur at cost to defer tax. Accordingly, anyone holding such a transferred farm property may be sitting on a large unrealized taxable capital gain. However, in order for such a situation to occur, the transfer must have occurred at less than fair market value. And, if a transfer occurs at below market value, there maybe a gift for family law purposes that is subject to exclusion.

Lastly, much like shares of a small business corporation, certain farm property (which may include shares of a farm corporation) may qualify for the $800,000 lifetime capital gains exemption. Accordingly, a spouse holding a large property that had been farmed but is now ripe for sale to a real estate developer may be sitting on a high-value, low-taxed asset.

CONCLUSION

If you represent a farmer or a farmer's spouse in a family law dispute, you should be aware of the following:

a) In general, there is no goodwill in a farming business;

b) The highest value may be in the real property and government quotas;

c) The value of inventory and accounts receivable may be hidden from view when reviewing a balance sheet at or near the valuation date;

d) Income may be over- or under-stated in any particular fiscal year because of cash accounting;

e) Inter-generational transfers of farm property can be made tax-free if gifted or sold at or below cost; and

f) Qualified farm property qualifies for the Lifetime Capital Gains Exemption, reducing or eliminating the tax on its disposition.

There is a plethora of income tax issues to complicate the determination of a farmer's income for support purposes and net family property. One of these days, a potato farmer is going to walk into your office and you will be happy you read this.