Your Farm. Your Family. Your Future.

Tax and Succession Expertise for Generations

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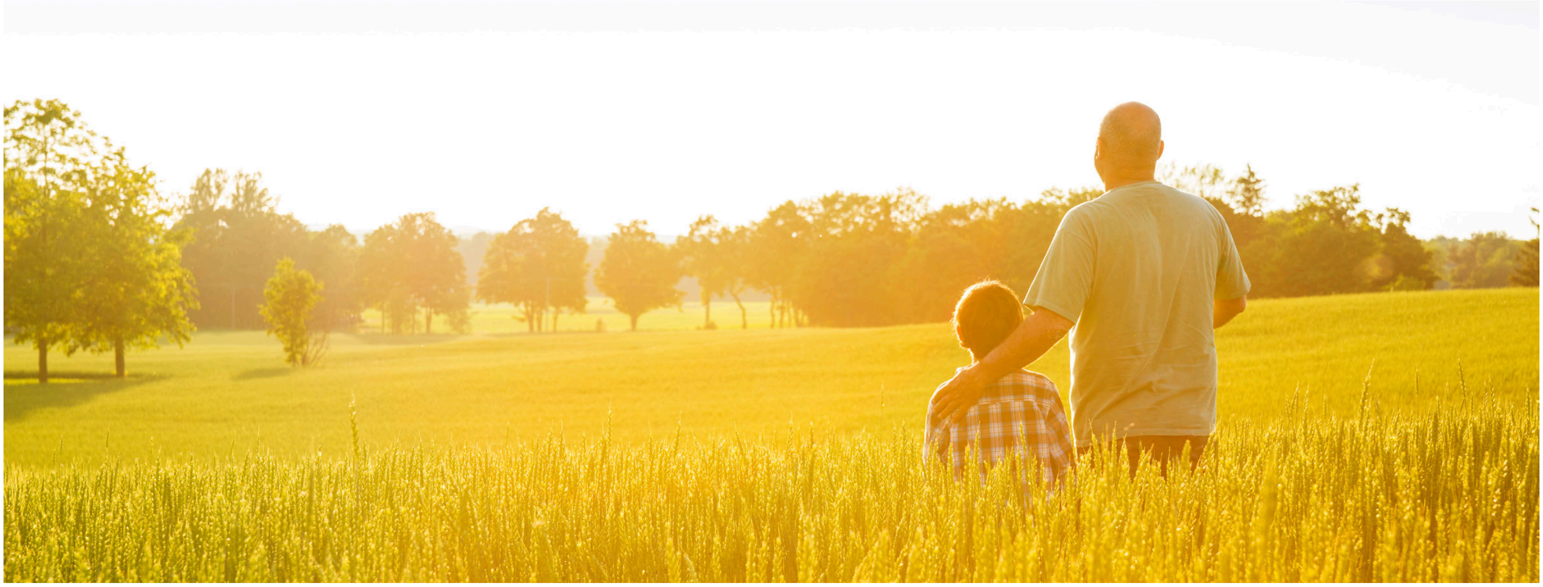

Are your heirs prepared?

Consider the emotional impact of transferring your wealth to them

– Wealth Planning Group

Through hard work and perseverance, Mark grew his modest farm into a very successful farming operation before he sold it. At his death, Mark's children were surprised to find that their father had amassed an estate worth over $6,000,000.

During his lifetime, Mark had taught his three children the value of hard work and they all had good careers: Mary was a veterinarian, Joan was an accomplished professional musician, and Peter was an accountant. Each of them reacted very differently to their new wealth.

Mary had spent the most time with Mark during his lifetime and had worked side by side with him on the family farm for many years. On learning about her large inheritance, she was stricken with an overwhelming feeling of guilt at receiving such a large amount which she felt she did not deserve. Above all, she was scared of losing even one penny of her father's hard earned wealth.

Joan was the least financially well-off of the three children. Her circle of friends included mostly struggling musicians and artists. On receiving her inheritance, Joan began to worry that her relationship with her friends would change, and was afraid they would resent her or try to find ways to help her spend her money. This fear led her to feel isolated from them and grew into anxiety and depression.

Peter had always been good with his money. However, he felt that the money he had inherited from his father was a windfall, akin to winning the lottery. Since Peter placed less value on the money he inherited, he had no difficulty spending large sums of it on extravagant purchases and travel excursions with his wife and friends. Peter also invested in a number of high risk ventures which did not succeed.

Most parents put considerable effort into planning their estate to ensure that their wealth passes to the next generation in the most financially efficient manner possible. But very few consider the effects the money may have on their children once they have passed on. It is common for beneficiaries to feel mixed emotions as they adjust to their new circumstances.

Parents can help their children in several ways:

- Helping them to be financially literate, starting at an early age
- Openly discussing financial matters with them
- Sharing their values about money and their hopes as to how their children will manage the wealth that will be passed on to them

This will enable the children to plan and mentally prepare for the impact of receiving their inheritance.

Giving children the extra time to plan is often as valuable as the financial gift itself. ■

Equalizing the estate

– Thomas Holmes, CPA, CA
Regional Vice-President, Wealth Planning

One challenge that many farmers face when planning for succession is trying to balance the division of assets between farming and non-farming children. A few strategies can be implemented to try and keep things fair – but as many farmers will tell you – what's fair is not necessarily equal!

Let's take a typical example – Jack and Marie ("J&M") have been actively farming for years and currently operate a successful incorporated farm ("J&M Inc.") and all of the farming property is qualified farm property. Although the farm operations are incorporated, they hold several sections of land personally. They have two kids – Patrick and Jennifer. Patrick is 25 years old and has been working on the farm for years and hopes to one day take over the family farm. Jennifer on the other hand has no interest in farming and plans to stay in the city once she finishes university.

As is the case with many farmers, the majority of J&M's capital is tied up in the farm operations. J&M want to ensure that they provide Patrick with every opportunity to take over their farm when the time is right but at the same time want to ensure that Jennifer also enjoys a fair inheritance.

So how can J&M transfer the farming assets to Patrick while still providing a 'fair' inheritance to Jennifer? There are a few options.

Land transfer to non-farming child – Share transfer to farming child

One option available to J&M is to transfer a 'fair' portion of the land when the time comes to Jennifer on a rollover ('tax-deferred') basis. The shares of J&M Inc. could then be transferred to Patrick. It is common in these situations that the transfer agreement stipulates that the land will continue to be rented to the farming child. The rent provides an income stream to Jennifer (and J&M if they choose to keep a portion of the land to rent themselves) and allows Patrick continued access to the farmland for the farming operations.

This arrangement can work well but generally there comes a point when it makes sense for the farming child to 'buy-out' the non-farming child. It is recommended that the lease arrangement contains a 'buy-out' clause to allow this to take place at a pre-arranged time and for a pre-arranged price.

Life Insurance

Life insurance can be used in a number of ways to help equalize the estate.

Option 1 would involve J&M taking out an insurance policy equal to the value of the farming assets, or a 'fair amount', and naming Jennifer as beneficiary. J&M would then transfer the shares of J&M Inc., as well as the farmland, to Patrick on a rollover basis. This strategy allows Patrick to inherit the farming operations while providing an inheritance to Jennifer. The drawback of this strategy is that Jennifer would not receive anything until death while Patrick might receive the farming assets much sooner.

Option 2 would involve dividing the farm assets equally between the two children. Once each of them has 50% of the assets, J&M would take out an insurance policy equal 50% of the value of the farm assets and name Patrick as beneficiary. This would allow Jennifer to receive 50% of the farm assets to benefit from while also providing Patrick with the funds necessary to purchase the 50% interest from Jennifer should the decision be made to do so.

It is possible to structure both these options so that the insurance is held within the corporation allowing the premiums to be paid with corporate dollars.

Funding J&M's Retirement

A full rollover of the farming operations may not be ideal for J&M as they likely want to monetize a portion of their assets in order to fund their retirement. To accomplish this goal, J&M could sell a portion of their farm assets to Patrick or undertake an estate freeze.

An estate freeze would involve 'freezing' their interest in J&M Inc. by exchanging their common shares for fixed-value preferred shares. Patrick could then subscribe for 100% of the common shares (or whatever proportion J&M choose).

This would allow Patrick to benefit from 100% of the growth in the farm going forward but would also lock in the value of the farm at the time of the freeze. The preferred shares held by J&M could then be redeemed over time to fund their retirement by way of dividends.

A combination sale and estate freeze might present a viable alternative for the family. J&M could sell their farmland directly to Patrick to utilize the $1,000,000 capital gains exemption both J&M have access to. Obviously, it is unlikely that Patrick can fund this purchase, so by introducing Patrick as a common shareholder of the corporation by way of an estate freeze, dividends can flow out of the corporation to Patrick to fund the purchase over time.

Alternatively, J&M could transfer a portion of their land at a value above cost, to a corporation set-up by Patrick and take back a note payable (and one preferred share) from the corporation. J&M should elect to transfer the land at a value that would allow them to claim their full capital gains exemption. Receiving the land inside a corporation would allow Patrick to repay the note (i.e. fund the purchase) using income earned within his corporation at a lower tax rate.

What about unincorporated farms or family farm partnerships?

Although the strategies above were tailored to J&M's corporate farm, similar strategies can be used when dealing with unincorporated farms or family farm partnerships. The planning would be very similar so long as the farm assets in each case meet the qualified farm property criteria.

Of course, the best plan for you will likely be a combination of these options and others, so should you have any questions – please don't hesitate to contact your Assante advisor. ■

Assante Ag Group

The Assante Ag Group is a national farm advisory group that assists Canadian farm families in the areas of tax planning, retirement planning, and wealth transfer. The Ag Group consists of highly experienced and trusted Wealth Advisors as well as lawyers and accountants with knowledge and experience in the tax and estate planning issues that affect farmers.

Taxation represents the single largest expense and loss of capital in the lives of many farm families, particularly in the retirement phase. Members of the Assante Ag Group work directly with the farm family to help them understand the complex tax and financial issues that need to be addressed in order to minimize loss of farm wealth when important transitions or transactions occur.

Tax, Financial and Estate Planning

The Ag Group's main focus and strengths are tax minimization, wealth planning and estate planning, including:

- Planning for the tax efficient transfer of the family farm to the next generation;
- Pre-retirement planning for the tax efficient sale of farm equipment, inventory and other assets;
- Planning tax efficient business structures for the family farm and other ventures;
- Personal tax and estate planning;
- Financial and retirement planning.

The Ag Group brings together not only tax, estate and financial planning, but also tax efficient managed wealth solutions and insurance strategies, all personalized to meet the unique needs and values of each client family.

Coordinating Professional Advice

The busy lives of farm families can seem further complicated by the necessary involvement of professionals from various disciplines, such as accountants and lawyers. The Ag Group provides a comprehensive plan that coordinates the services of these professionals. The Ag Group creates the plan, helps coordinate its implementation by the client family's accountant and lawyer, and continues to monitor the client family's tax and financial affairs thereafter and through the retirement years.

Our Commitment to Farm Families

The Assante Ag Group is committed to maintaining the high levels of proficiency and expertise required to provide professional advice throughout our long-term relationships with Canadian farm families. ■

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