SaskCanola
Saskatchewan Canola Development Commission

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October 2, 2017

Honourable Bill Morneau
Minister of Finance
Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5

**Re: Tax Planning Using Private Corporations**

Dear Minister Morneau,

SaskCanola appreciates the opportunity to provide the following submission to the consultation on proposed changes to tax planning through the use of private corporations.
SaskCanola is a farmer-led organization representing some 23,000 farmers who grow and sell canola in Saskatchewan. These farmers and their farm businesses are the foundation of the Canadian canola industry which annually contributes $26.7 billion to the Canadian economy and accounts for 250,000 jobs.

Canola is a significant contributor to the strength of the agriculture industry generating over $9 billion in farm cash receipts, making it the most valuable agricultural product in Canada in 2016. Agriculture, in turn, accounts for 6.7% of Canada's GDP and one in eight Canadian jobs. The government recently identified agriculture as a growth sector and set an ambitious export target of $75 billion by 2025. Canola farmers want to play an important role in helping meet these targets. At the same time, farmers do not see how the proposed tax changes align with the government's growth targets as these goals cannot be realized without a regulatory environment that encourages investment by farm businesses.

The consultation document outlines that the purpose of these changes is to ensure high income earners are following the tax rules in the spirit in which they are intended. However, as proposed, these changes will also impact farmers who are using the Income Tax Act in the spirit in which it is intended. The proposed changes on income sprinkling and capital gains have the potential to impact all family farms in Canada whether they are incorporated, sole proprietor or a partnership. As well, the proposed changes on passive income have the potential to significantly impact farmer retirement and the ability of farm businesses to invest in their operations.

While SaskCanola appreciates your recent statements clarifying the government's intent is not to harm the family farm, canola farmers remain concerned that the proposed changes will have a significant impact on their farm businesses. Several respected accounting firms have publicly stated their concerns regarding these changes and the impact on family farms as well as the immediacy in which they may be implemented. This has caused tremendous anxiety and uncertainty amongst farmers at a time when many are still focused on harvest.

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To address the current uncertainty, more time is required to understand the complexity of these changes and how they will be applied to farming businesses.

**Recommendation:**
**Provide more time for better analysis and to understand the complexity of the changes.**

## Lack of Clarity on Application to Farms

The current ITA recognizes that farming is a very distinct business and sets out several provisions available only to Qualified Farm Property (QFP) that facilitate effective management of capital assets. While we do not believe that it is the government's intention to change the spirit of the ITA in recognizing the distinct nature of farming, without clarity on how the proposed changes will be applied to QFPs, CCGA is very concerned the proposed changes will have a significant impact on farm businesses.

Tax treatment of QFP under the current legislation has many necessary exceptions which are critical to enable and promote family farm succession planning. It is important to understand whether there are any planned exceptions in relation to farm property in the proposals, and if not, what the applicability is of the proposed changes to the following ITA sections.

**Recommendation**
**Provide clarity on the applicability of the proposed changes to the following Income Tax Act sections and ensure exemptions are provided to farm properties and farm income in the proposals as they relate to these sections:**

a. **Subsections 110.6(1) Capital Gain Exemptions Definitions and 110.6(2) Capital Gains Exemption – Qualified Farm Property;**
b. **Section 73 – Intervivos transfers of Qualified Farm Property to spouses and children**
c. **Section 75.1 – Attribution of a gain from sale of property by a minor child;**
d. **Subsection 69(11) – Attribution of a gain from the sale of gifted property during the three year hold period.**
e.

## Unique Characteristics of Farm Businesses

Farming is a highly capital-intensive business with revenue that typically fluctuates greatly year over year due to factors beyond the control of farmers such as weather, disease and pests. The significance of these unique characteristics of farm businesses cannot be understated when it comes to the importance of tax legislation and policy that enables farmers to have confidence to invest in their business and transition it to the next generation. Effective management of capital assets, including continuous productivity improvement, and access to the farmland necessary for their livelihood are currently enabled by a framework of tax laws and provisions that allow farmers to invest in their businesses.

The majority of farms in Canada are family farms, and coupled with the capital-intensive nature of farming and the inherent risks, these changes create significant challenges for succession – moving the farm ownership to a new generation without saddling that generation with

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unmanageable debt loads while still providing the retiring generation with the financial means to live comfortably. Successful farm transition takes significant time and planning but without well thought out succession plans the future viability of family farms is at risk. Reducing this risk has been the focus of much effort by the agriculture industry over the last several years in encouraging and providing resources to farmers to help them establish succession plans. As a result, the number of farms with succession plans is increasing as these farm families have made significant investments of time and money for professional advisor fees to create transition plans that are based on long-standing tax law and policy.

The proposed changes will have a direct impact on all succession plans currently in place as well as those under development as they will all need to be re-examined and resulting in many being deemed to be either no longer be valid or no longer tax efficient. This will then trigger a need for these farm families to again invest significant time and money in the development of new succession plans. The immediacy of the proposals, should they go into effect, will throw farmers and advisors into a panic in order to make adjustments in time. This is not the careful consideration of succession planning that is promoted.

Beyond succession planning, farmers have made decisions for many years based on long-standing tax law and policy that impacts how they manage their assets and liabilities and how financial resources are managed to promote the capital investment necessary to sustain the farm business. Consideration needs to be given to the fact that the significance of the proposed changes being contemplated fundamentally eliminates the structures and mechanisms that farm businesses have invested in.

**Recommendation**
**Give consideration to the transitional time required for farm business to understand and adapt to any new changes before they are implemented.**

**<u>Complexity of the Impacts</u>**
Due to the complex nature of the proposed changes, our national farm organization the Canadian Canola Growers (CCGA) contracted technical expertise to assist in understanding the impact of the proposed changes. Five case studies were provided for real, commonly-used scenarios where these changes will impact farm businesses.. Below is a summary of some of the impacts highlighted by the tax expert as they pertain to each of the three areas the government has proposed these changes.

*Income Sprinkling*
It is common practice for family members to provide labour to the family farm operations and the Canada Revenue Agency has always allowed the deduction of reasonable salaries. In a farm operation, it is common for salaries to be modified based on financial performance for the year. Often, family members will forgo drawing a salary to help sustain the farm business when poor production and/or prices are incurred. This type of salary planning is done to keep the farm

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operation viable and strong, including enabling capital to be available for investment in other farm assets when required.

The proposed changes will introduce an increased review of reasonableness of salaries that could challenge this common planning technique for both incorporated farms and non-incorporated farm business. For example, if a family member takes a $50,000 drop in salary one year, it may make it harder to justify the reasonableness of a higher salary in future years when the farm business has better financial performance.

In addition, it may be difficult for farm children to meet the criterion of 'continuous' given the seasonal nature of the farm operation. The challenge for farm businesses will be to provide reasonableness and the burden to do so, and the uncertainty of the how the reasonability test will be applied, may place additional stress on farm operations.

**Recommendation**
**Provide clarity on the 'reasonableness tests' for income sprinkling and within this test provide consideration for the seasonal nature of farm work and variable nature of farm income.**

*Life Time Capital Gains Exemption*
How the proposed changes will impact intergenerational transfer of farm businesses is an area that is causing significant anxiety and concern from the entire agriculture sector. It is critically important that tax policy not be crafted in such a way as to discourage the transfer of the family farm to the next generation by penalizing sales within families with significantly higher tax implications that if the sale were made to an arms-length third party.

**Recommendation**
**Exempt the sale of Qualified Farm Property from the proposed changes such that the use of Lifetime Capital Gains Exemption for the sale of a farm business to a family member through a corporation can continue to be used.**

*Passive Income*
The proposed changes are based on the premise that the current private corporation tax rules are being used 'for personal benefit' and 'are not contributing to growing our economy', and as such 'undermine confidence in our economy by giving tax advantages to a select few'. There does not appear to be an understanding of the significant contributions that farm businesses play in Canada's economy. In addition, the proposals seem to ignore business-owners' substantial personal and financial risks to make those contributions.
Beyond these concerns with the premise of the changes, SaskCanola encourages the government to give consideration to the following distinct characteristics of farm business in further developing rules around the management of passive income.

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1. The capital-intensive nature of farming requires high levels of capital reserves to be maintained within a farm business for the purposes of reinvestment and future capital expenditures.
2. The highly unpredictable and variable nature of farming requires that farmers maintain higher levels of cash reserves to sustain their businesses through difficult years.
3. Due to both the capital requirements of farm businesses and the variable yearly incomes, it is common practice for farmers not to draw enough income from their businesses to provide for retirement savings. Instead they will leave this income in the business so it is available for reinvestment and to cash flow their business through lean years. At the end of their farming career, farmers will then rely on these investments to fund their retirement.

**Recommendation**
**Define more precisely passive income, particularly as it relates to working capital requirements for a farm business. Also provide consideration to allow farmers to continue to use the capital in their businesses to fund their retirement.**

**Conclusion**
Through our national organization, CCGA, we would like to work with your government to meet your objectives set out in the consultation document while ensuring farmers remain competitive and able to help propel the industry toward the government’s growth targets for our sector. However, given the complexity of issues outlined here, we believe more analysis is required by both government and industry to fully understand the impact and address the unintended consequences that are identified by a more thorough analysis. Allowing for more time will also provide an opportunity for your government to provide clarity on applicability of the changes to Qualified Farm Property and put consideration toward exemptions for farms. In the absence of more time to fully understand the implications and explore options, we respectfully request that farming be exempt from the proposals.
We look forward to working with you on this issue of critical importance to Canada’s canola farmers.

Sincerely,

Doyle Wiebe,
Chair, SaskCanola Board of Directors

CC. Minister Lawrence MacAulay, Agriculture and Agri-Food Canada