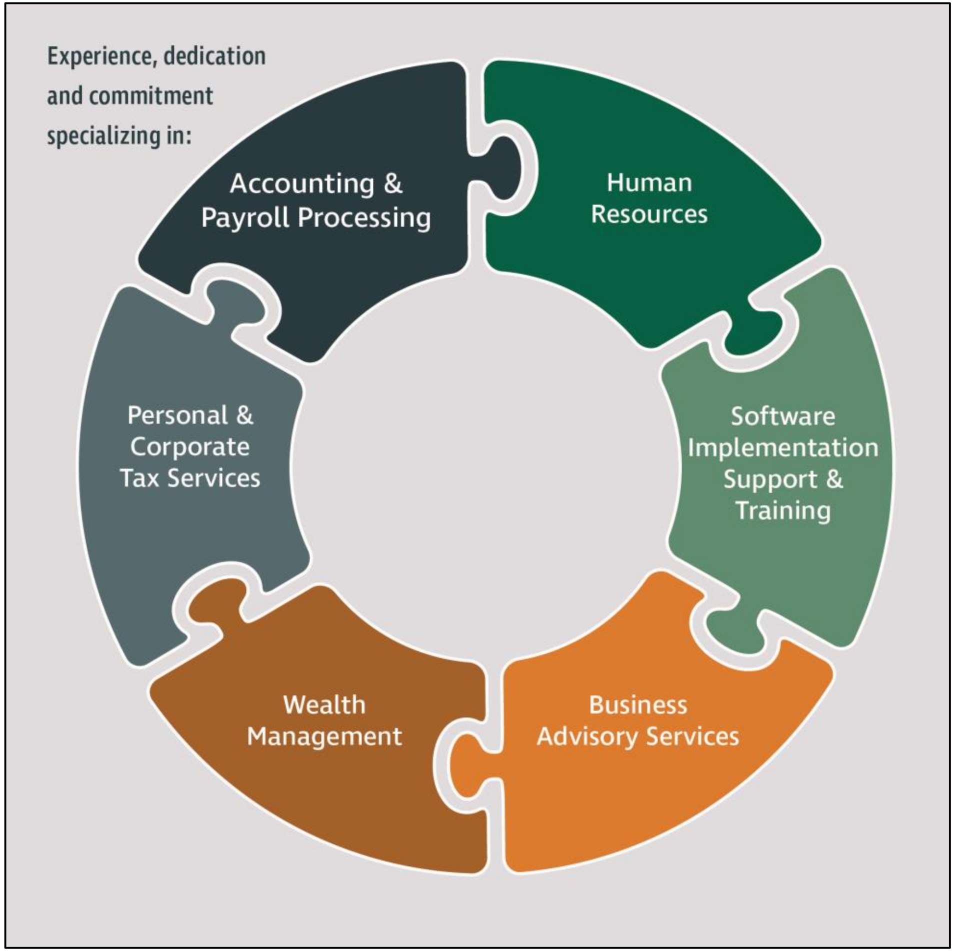
Ward & Uptigrove
Chartered Professional Accountants

Catching Up on the Farm
Tax Changes Most
Affecting Agriculture

January 19, 2019



About our firm

- Firm of 100 professionals in Listowel, Ontario
- Wide base of clients – 50% agriculture

About me

- Born and raised in Listowel area
- CPA, CA, Partner – Taxation Services
- Specialize in estate & succession planning, corporate reorganizations, purchases & sales

Agenda

- Income Tax Update
  - Tax Rates & Tax System
  - Tax on Split Income (TOSI)
  - Passive Investment Income
  - Small Business Deduction - Specified Corporate Income
  - New Capital Cost Allowance Rates - Depreciation
  - Has anything not changed recently???

Agenda

- Other Tax Update
  - Estate Administration Tax (Probate)
  - Land Transfer Tax

Tax Rates & Tax System

- The past few years since the Liberal government came into power in 2015 have resulted in some of the most significant changes to the tax system since the design of the current tax system in the 1970's
  - We understand the rule changes were not *created* by the Liberals (some were designed over a decade ago) but just implemented
- Presented as top tax rate increases trying to tax the "rich" (the "1%") and provide tax relief to the "middle class"
  - Is it resulting in an increase to government revenues?
  - Are the new rules actually increasing tax on the "rich" or are they affecting the "middle class" as well
- If the Conservative Party wins the 2019 election will they eliminate these new rules???

Tax Integration Theory – 2019 Rates

	Incorporated	Not Incorporated	Difference
Taxable income > $220K	$100,000	$100,000	$Nil
Initial tax (12.5% vs. 53.5%)	12,500	53,500	(41,000)
Funds to re-invest	**87,500**	**46,500**	**41,000(B)**
Future taxes (dividend @ 47.4%) **(A)(C)**	41,475	Nil	41,475
Final total tax	53,975	53,500	475
Final after tax cash	46,025	46,500	(475)

- (A) Can be reduced by income splitting
- (B) Additional funds to invest in passive assets
- (C) Can be reduced by converting taxable dividends into capital gains

Tax Rates – Small Business Rate Decrease

- To "redeem" themselves from the outcry regarding the 2017 tax proposals, the Liberal Government introduced corporate tax rate decreases for small business income.
- These rate decreases were previously planned by the Conservative government but not implemented after the Liberal government gained power in 2015.

Tax Rates – Small Business Rate Decrease

	Old Rates (2018)	New Rates (2019)	Difference
Corporate Income	$500,000	$500,000	$Nil
Initial tax	75,000	67,500	(7,500)
Funds to re-invest	**425,000**	**432,500**	**7,500**
Future taxes on dividends	198,263	205,005	6,742
Final total tax	$273,263 – 54.65%	$272,505 – 54.50%	(758)
Final after tax cash	$226,737	$227,495	758

- Increase in tax ***deferral ($7,500) yes***, but not tax ***$7,500 tax "savings"*** – very different concepts!
- System is still targeting a final tax bill as close to 53.5% as possible (Highest marginal personal tax rate in Ontario)

Tax Rates – Small Business Rate Decrease

	Old Rates (2018)	New Rates (2019)	Difference
Corporate Income	$500,000	N/A	N/A
Initial tax	75,000	N/A	N/A
Funds to re-invest (Retained Earnings)	**425,000**	**425,000**	N/A
Future taxes on dividends	$198,263 – 46.65%	$201,450 – 47.4%	
Final total tax	273,263	276,450	3,187
Final after tax cash	226,737	223,550	(3,187)

- To maintain the integrity of the tax system to get total taxes as close to 53.5% highest marginal personal tax rate, when corporate tax rates go down, personal dividend tax rates must go up!
- Corporate income that has been taxed in the past at old corporate tax rates (retained earnings) will now attract more personal tax when paid as dividends in the future– therefore lowering small business tax rates creating increased tax deferral creates a permanent tax increase on past retained earnings! **This was not part of any government announcements that I have seen!**

Tax on Split Income (TOSI)

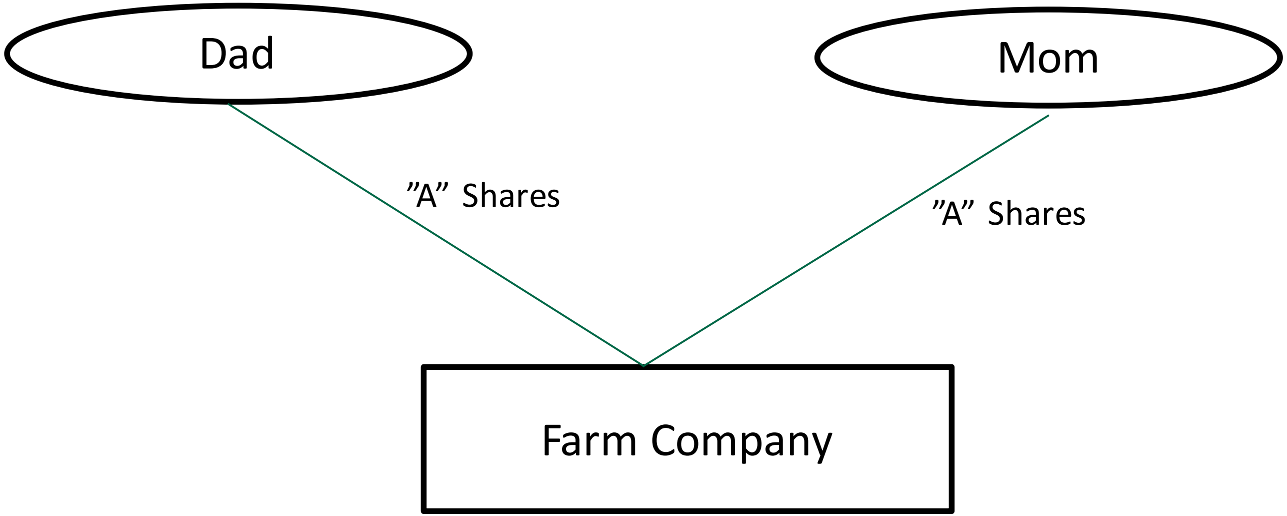
- Illustration - What is income splitting?

	"High Rate" Taxpayer	"Lower Rate" Family Member			
Taxable income (before dividend)	$220,000	$100,000	$50,000	$25,000	$Nil
$50K dividend	$50,000	$50,000	$50,000	$50,000	$50,000
Tax on $50K dividend	$22,650	$17,348	$11,799	$7,444	$2,768
Tax savings from income splitting		$5,302	$10,851	$15,206	$19,882
Tax savings %		23%	48%	67%	88%

11

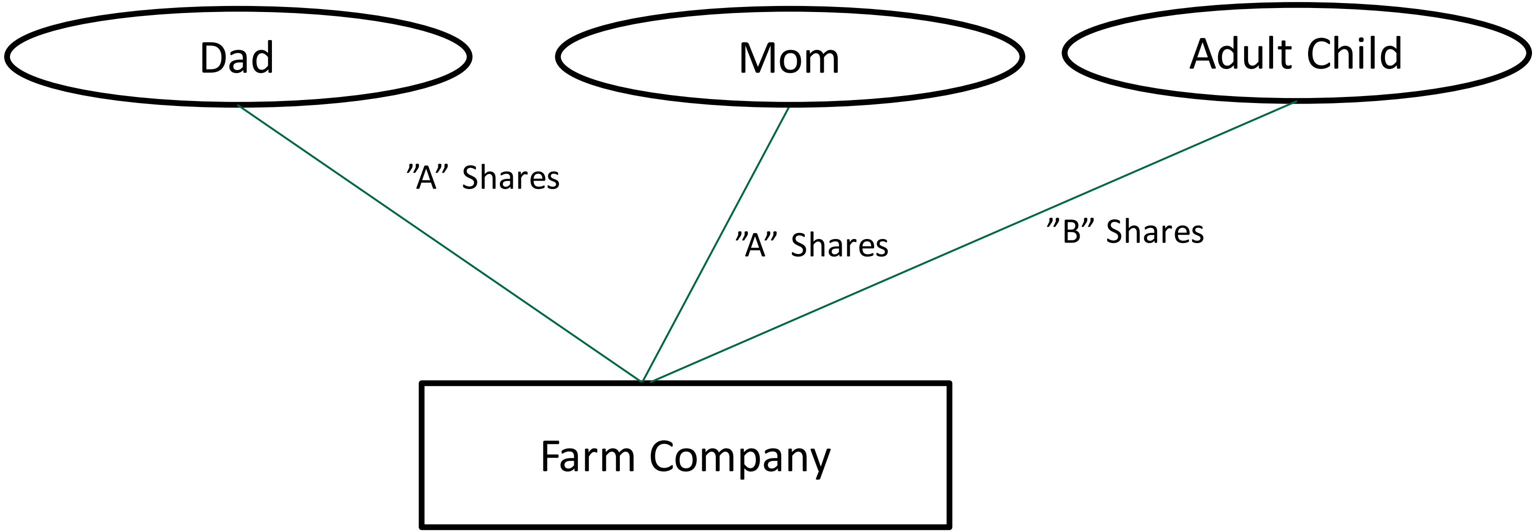
TOSI (cont'd)

- How to income split – basic dividend "sprinkling model"



TOSI (cont'd)

- Child turns 18 and goes to college – little income other than summer job – pay discretionary dividend to child on B Shares (no reasonability test)



TOSI (cont'd)

- **Impact if new TOSI rules apply – income taxed at highest marginal tax rate!**
  - 47.4% for dividends and 53.5% for regular income – Ontario 2019
  - Even if the income wouldn't have been taxed at the highest rate if it was included in "original" recipient's taxable income
  - Can impact middle class taxpayers heavily – can have very little effect or risk for the "rich 1%"

TOSI (cont'd)

- "Old" rules
  - "reasonability" test for deductibility purposes
    - Generally for payment of salary and management fees, there was no similar "reasonability" test for dividends
  - "attribution" rules
    - Generally applies to spousal or common-law situations
  - "old" TOSI rules or as otherwise currently known, "kiddie tax"
    - Applied only to individuals under the age of 18

TOSI (cont'd)

- New rules
  - Legislation is extremely complex
  - Extension of the "old" TOSI rules to apply to new sources of income
    - Income on Partnerships – potential big impact for farmers
    - Other income types (shareholder benefits, gains)
  - Extension of the "old" TOSI rules to apply to new individuals
    - Basically everyone now
  - But, new rules have no impact on wages or salary – old reasonability rules still apply

TOSI (cont'd)

- Initial proposals had many issues and had significant "grey areas", after significant outcry the Government created "Bright Line" rules and exceptions to the rules for certain situations where the new TOSI rules will not apply:
  - Labour contributions – 20 hrs/week (current year or 5 years in past – doesn't have to be cumulative)
  - Holding Shares with 10% of votes and value – many complications
  - Seniors exemption (Spouse 65 years or older)
  - Reasonable return on investment
  - Separation
  - Inheritance upon death

TOSI (cont'd)

- Importance of documentation to support labour contributions
  - Timesheets, schedules, logbooks, payroll records. For past years consider type of business, duties performed, education, training and experience
- Watch out on inter-vivos transfers of Family Farm Corporation Shares
  - Still tax-deferred but TOSI may apply to children unless child meets an exemption

Holding Passive Investments

- Investment Integration – Ontario

	Incorporated	Not Incorporated	Difference
Interest income	$1,000	$1,000	$Nil
Initial tax	500	535	35
Funds to re-invest	**500**	**465**	**35**
Corporate tax refund on dividend payment	(310)	N/A	N/A
Personal tax on dividend	384	N/A	N/A
Final total tax	574	535	39
Final after tax cash	**426**	**465**	**39**

- Current system results in 3.5% tax deferral, but approximately 3.9% permanent tax cost in incorporated situations

Holding Passive Investments (Cont'd)

- Small Business Deduction provides a tax-deferral (think of like an interest free loan from the government) to finance growth of company/repayment of debt
  - Current Tax Rate (Ontario 2019) – 12.5% Combined on first $500,000 of active business income
  - $0.875 of every dollar after tax to invest in company vs. $0.465 personally
  - Potential to turn deferral into permanent tax savings with tax planning
- Government was concerned corporations were not using the additional funds from the tax deferral in an "appropriate" matter – rather, it thought people were using corporations as tax–preferred savings accounts
- New rules attempt to limit access to the tax deferral if not using the funds for purposes "deemed appropriate" by the government – not actually increasing the ultimate amount of taxes paid – integration concept

Holding Passive Investments (Cont'd)

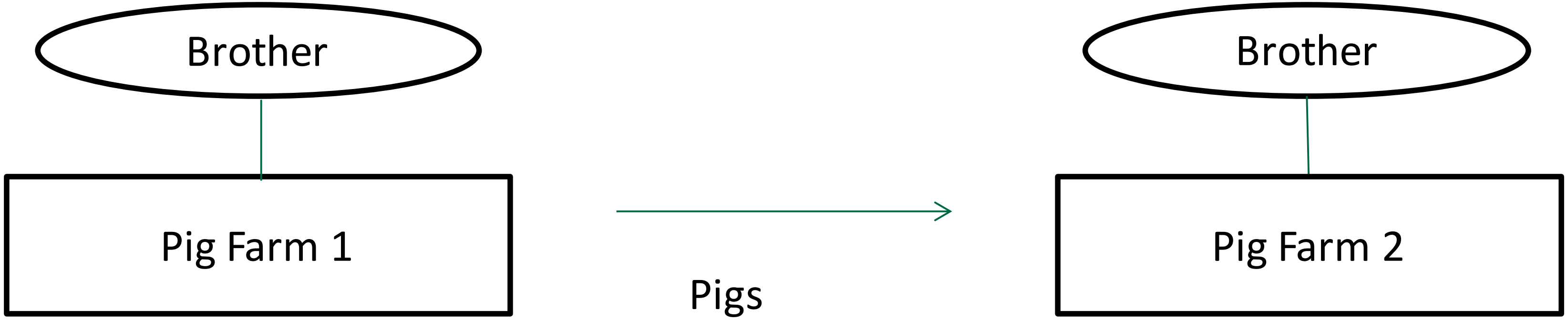
- New rules apply to corporate year ends beginning on or after January 1, 2019
  - Prior year investment income level impacts the following year's small business deductions
    - First calculations to be performed for December 31, 2018 year ends
- New rules "grind" $500,000 small business deduction limit when investment income is greater than $50,000 in a corporate group
  - $5 of limit lost for every $1 of investment income
  - $500,000 limit completely gone when investment income reaches $150,000

Holding Passive Investments (Cont'd)

- Most farmers normally don't have passive investments
  - Usually stick to buying active farm assets or have debt to pay
- But, sonsider situations where farm land may be rented or if a farmer has sold some farm assets and is slowing down without a successor to take over the farm
  - Dairy farmer who sells quota, invests proceeds in the market to fund retirement, but continues to cash crop
    - Cash crop income may not be eligible for small business deduction in the future – pay taxes at 25% on cash crop vs. 12.5%
- If rules apply and higher rate of tax to be paid, ensure accountant is claiming Ontario Manufacturing & Processing Deduction for farmers
  - 1.5% tax savings – 26.5% vs. 25% - a lot of accountants miss this

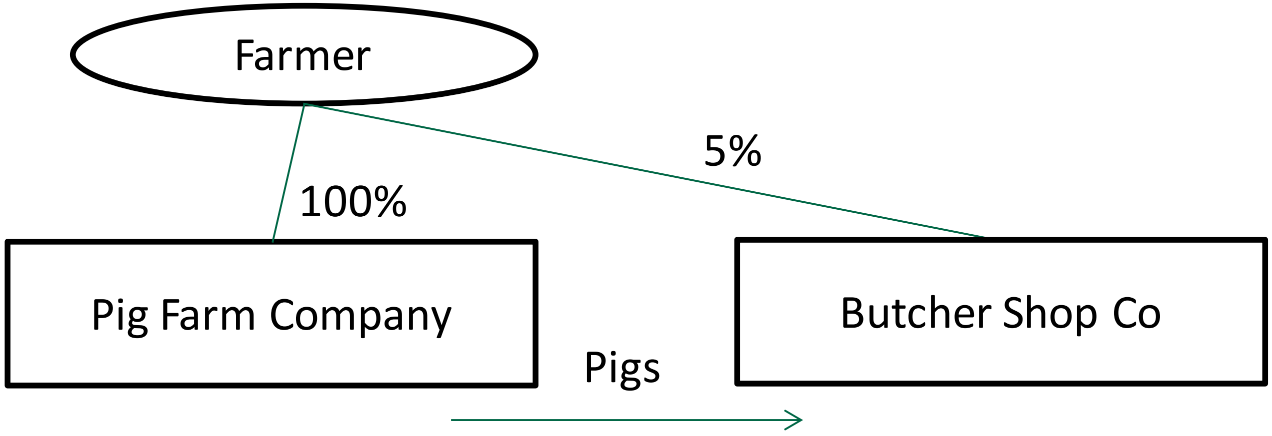
More Changes to Small Business Deduction (SBD) - Budget 2016

- Introduced new rules to limit multiplication of $500,000 small business deduction limits – "Specified Corporate Income"



- Income from Brother 1s pig sales to Brother 2 potentially not eligible for SBD

SBD (Cont'd)



- Income from sales to Butcher Shop Co potentially not eligible for SBD
- Amendments made to rules after introduction to exclude investments in agricultural co-operatives

SBD (Con't)

- Impact more widely felt in rural agricultural businesses due to connectedness, nature of business, and family connections?
- Tax rate increases from 12.5% small business rate to 25% (Ontario M&P Rate for farm corporations)
  - Loss of tax deferral, potentially more permanent taxes
- There are some exceptions to these rules
  - Less than 10% of net income from "bad" sources
  - "Associated Corporations" – common control
- Sharing of information usually required to plan properly and report – privacy issues!

Increased Capital Cost Allowance (CCA)

- In response to USA tax reform and concerns about Canada's competitiveness
- Capital assets acquired after November 20, 2018 (and before 2028) will be eligible for higher depreciation claims in year of acquisition
  - Total amount of depreciation able to be taken over life of asset not changed – timing change for higher claim in first year, then back to normal rates for remaining years
- Change made to "half year rule"
  - Previously only allowed 50% of depreciation claim in first year, now changed to 150%
  - Manufacturing & Processing Equipment and Clean Energy Equipment have separate new rules – 100% deduction in first year

Increased CCA (Cont'd)

	Old First Year Rate	New First Year Rate
Class 6 Farm Buildings – 10%	5%	15%
Class 8 Equipment – 20%	10%	30%
Class 10 Mobile Equipment – 30%	15%	45%
Class 14.1 Quota – 5%	2.5%	7.5%
Class 16 Highway Trucks – 40%	20%	60%
Class 50 Computers – 55%	27.5%	82.5%

What Hasn't Changed?

- Lifetime Capital Gains Exemptions
  - Government backed off potential rule changes affecting Capital Gains Exemption in October 2017
  - $1,000,000 lifetime exemption limit per taxpayer for qualified farm property
  - Specific tests must be met
  - Plan early – meet the tests and multiply the exemption
- Tax-deferred Rollovers for Farmers
  - No changes, but specific tests still need to be met – plan early and monitor
- Ability to compute taxable income using cash basis
  - Flexibility for farmers to potentially avoid negative impacts of new rules on small business deduction?

Ontario Estate Administration Tax (Probate)

- High farm asset values – higher amounts potentially payable
- Increasing rate scale – highest rate of 1.5% applies on estate asset value greater than $50,000
- Sometimes does not apply to "old" long held farm properties depending on other estate assets – "First Dealings"
- Many planning opportunities to decrease amount payable
  - Secondary wills
  - Trusts
  - Title
- Ensure your wills are up to date and reviewed regularly!

Ontario Land Transfer Tax

- High farm asset values – higher amounts potentially payable
- Increasing rate scale – highest rate of 2% now applies to farm properties
- Increased audit activity
- Exemptions are available on certain transfers if certain conditions are met
  - Sometime requires time to plan (i.e. change from renting to farming prior to transfer)

Ward & Uptigrove
Chartered Professional Accountants

Thank you!

Questions?

Tim Bridge, CPA, CA,

Partner – Taxation Services

(519) 291-3040 x 275

timb@w-u.on.ca