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Grandchild will inherit widow's farm

Managing taxes across the generations takes extra effort and a careful approach

By Andrew Allentuck

Celeste, as we'll call her, is 75. She lives in south central Manitoba and owns a 320-acre farm. Her husband, who we'll call Edward, passed away earlier this year. The farm, a mixed grain and grazing operation, was profitable for many years. The couple put about $382,300 into off-farm investments over the years. Celeste's problem now is to create a path for her son's four daughters to inherit family assets. The son, age 55, has a successful off-farm business. Celeste's focus is on her granddaughters and their plans.

Complicating the problem of deciding how to distribute assets is that neither her son nor three of her four granddaughters have any interest in farming. One granddaughter, however, raises prize horses. Edward wanted her to have the farm with its stables. Now Celeste wants to make a fair division of assets among the four grandchildren.

Celeste approached Don Forbes, a financial planner who heads Don Forbes Associates in Carberry, Manitoba, to work out a plan that would apportion farm assets and keep income taxes on income from the assets at or below 26 per cent each year, rather than trying to defer tax for as long as possible and then pay 50 per cent tax through the estate.

The Qualified Farm Land Capital Gains Tax Credit will avoid tax on $1 million of taxable gains. As well, Celeste can claim the $100,000 exemption for a primary residence. So $1.1 million of personally owned farmland and assets can be free of federal income tax. It would not be entirely tax-free, however, for that level of income, though exempt, would boost her nominal taxable income over the Old Age Security clawback point, currently about $74,000, and potentially increase provincial tax.

Celeste, as a farming parent, can transfer farm assets and farmland to the next generation or to grandchildren at any price between book value and today's market value. This would include all farmland, equipment and inventory, Forbes notes.

As a planning concept, the goal should be to use up all available tax credits when the land is transferred to beneficiaries while paying the least amount of income tax required by law.

It is important to structure any transfer of land or other farm assets as gifts with value embedded in consideration. The consideration value could be as little as one dollar. There is also transaction value when calculating potential capital gains. The transaction value can be anything between current book value and present market value, Forbes adds.

SPLITTING IT UP

Given that there are four grandchildren, there are several ways to apportion farm assets, Forbes explains. One path would be to have the provincial office in charge of land titles separate the 320 acres into four 80-acre parcels. The Manitoba land titles office uses a book-based registry, so no survey certificate will be needed, Forbes notes. One parcel can go immediately to the granddaughter who is fond of horses. The other parcels can be retained for a time — perhaps until Celeste passes away, to provide retirement income through rent of perhaps $4,000 per year.

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There are three ways to do the land transfers, Forbes says.

1. Transfer all land at present book value, which is really the 1972 value of about $100 per acre. There would be no capital gain and thus no income tax. There would be no OAS clawback for Celeste in the absence of income. The grandchildren would have to pay any future tax on rent or products from their parcels.
2. Transfer one 80-acre parcel to the daughter who raises horses at a value of $1,000 per acre. A $72,000 capital gain (the $80,000 2017 value less the book value of $8,000 in 1972) would be offset by the Farm Land Tax Credit. There would be no OAS clawback, but there would be a small increase, about $1,000, of

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provincial income tax. The Alternative Minimum Tax would not apply for income would be below the AMT trigger point. The inheriting daughter would be responsible for tax on any future sale over $1,000 per acre.

3. Transfer 80 acres to the daughter with horses at today's market value of $2,000 per acre. This transaction would trigger a $152,000 capital gain ($160,000 today's value less $8,000 book value). An offsetting Farm Land Capital Gain Tax Credit of $152,000 would offset the gain. But OAS would be mostly clawed back for one year. Celeste would lose her age credit and the provincial tax would rise a little.

Celeste's late husband's Farm Land Tax Credit would be used on the final return (yet to be filed) to increase the value of the farmland so that it is closer to present market value rather than the 1972 value that Canada Revenue Agency would use. The Alternative Minimum Tax would not apply to her husband's final return, as tax law recognizes that it cannot be recouped in subsequent tax years. This helps out the daughter raising horses by reducing the amount of deferred tax liability that she may inherit.

FUTURE INCOME

Celeste's income for 2017 would total $2,028 per month based on $584 monthly Old Age Security, $575 monthly Canada Pension Plan benefits, $166 per month from a Registered Retirement Income Fund, $470 from interest in Guaranteed Investment Certificates she holds, farm rent of $333 per month, less income tax payable of perhaps $100. That's $24,336 per year after tax, an amount sufficient for her to live as she does now. It is more than the $1,500 she now spends on her home and its upkeep, food, etc. Moreover, using an annuitized calculation that allows distribution of income and all assets over time, her assets would support this payout for 25 years to her age 100.

Celeste can do a lot more to raise her returns from non-farm investments, specifically the approximately $382,000 she holds in registered and non-registered investment accounts. At present, $11,220 in her Registered Retirement Income Fund, $108,120 in her and her late husband's Tax-Free Savings Accounts, and $262,994 in non-registered investment accounts is entirely in GIC. They earn an annual return of about one to 2.5 per cent, and lock in funds for one to five years. The TFSA is not taxable but other accounts are taxed. After tax and inflation, the GICs have negative returns.

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There is one kind of GIC that could help Celeste. Index-linked GICs, which tie their returns to an index like the American Standard & Poor's 500 or the Canadian TSX, offer to return not less than the amount invested no matter what happens to the chosen index. Chartered banks offer index linked GICs.

CELESTE'S MONTHLY INCOME	
OAS:	$584
CPP	$575
RRIF	$166
GICs	$470
Farm rent	$333
Less taxes	-$100
Total income:	**$2,028**

The downside is that these index-linked GICs limit their returns to 55 per cent or less of the underlying market averages and usually tie up money for several years.

Celeste would need to take advice, of course, if the idea of migrating to index-linked GICs appeals to her. An advisor could create a bond and stock portfolio with a hefty government bond weight for safety and some stock exchange traded funds for diversification. Celeste could gradually migrate to this asset mix. For now, Celeste has too much cash and almost no inflation protection. She can do a lot better. GN

Andrew Allentuck is author of When Can I Retire? Planning Your Financial Life After Work (Penguin, 2011).