Revised August 2015

Agdex 400/837-1

Understanding the Federal Tax Deferral

What is the Federal Tax Deferral?

In 1987, the federal Department of Finance introduced the Income Deferral from Sales in a Prescribed Drought Region Provision into the *Income Tax Act*. This arrangement is unique as it is written in the *Income Tax Act* (Section 80(3)(4)).

Essentially, if a municipality is identified as a drought area, a portion of the income from the sale of breeding animals can be deferred at least until the next taxation year. This deferral can continue as long as the municipality continues to be identified as a drought region.

Income deferral depends on the percentage reduction in year end breeding herd numbers

To qualify for the deferral, the taxpayer must meet two conditions:

1. The farming business was located in a Prescribed Drought Region (PDR) at some time during the current fiscal period.
2. The breeding herd was reduced, by at least 15 per cent.

Breeding animals include: bovine cattle, bison, goats, sheep, deer, elk and other similar ungulates that are kept for breeding as well as horses that are kept for breeding. All breeding animals must be older than 12 months.

The income deferral allowed depends on the percentage reduction in the year-end breeding herd numbers compared to the opening inventory numbers.

Specifically:

- if the herd is reduced by at least 15 per cent but less than 30 per cent, the producer can defer up to 30 per cent of the net sales amount;
- if the herd is reduced by more than 30 per cent, the producer can defer up to 90 per cent of the net sales amount. Producers do not have to defer all of this income. They can include any part of it in their current income taxation year and defer the balance.

Frequently asked questions

The following frequently asked questions and answers help explain the Tax Deferral Program.

1. *Where I live was not declared a Prescribed Drought Region (PDR), but I pasture my cows in a municipality that was declared. Can I still qualify for the deferral?*

   To qualify, you must be "carrying on a farming business" in a drought-affected area. That means if you traditionally pasture your herd in a drought area or if you move your herd from a drought area to a non-drought area, you will still likely fit the criteria.

2. *What does net sales mean?*

   In arriving at the dollar amount of sales available for deferral, you must deduct any purchase of breeding animals that were made in the year.

3. *What qualifies as a "breeding animal"?*

   "Breeding animals" refer to cattle, sheep, bison, elk, deer and other "grazing ungulates" as well as horses that are more than 12 months old and kept for breeding purposes. For most people, this means cows, bulls and replacement stock. Horses kept for PMU (pregnant mares' urine) may also qualify. Remember, the sale of calves does not qualify as they do not constitute a "breeding animal" over 12 months of age.

4. *How do I calculate the deferral?*

   Two calculations are involved.

   Firstly, you must determine how much your breeding herd decreased. Take the size of your breeding herd at the end of the current fiscal period and divide it by the size at the beginning of the current fiscal period. As long as this figure is at least a 15 per cent reduction, you can defer part of your income received.

   Secondly, you must determine your net sales amount. This figure is your proceeds from the sale of breeding animals less the cost of breeding animals you purchased in the current fiscal period.

   Now you can determine the amount of your deferral:

   Assume the following:

Mr. A.	Jan 01/15 Opening inventory	Purchases	Dec 31/15 Closing inventory
Bred cows	100		60
Bred replacement heifers	20	5	18
Heifer calves	18		0
Steer calves	40		0

Breeding herd	Opening	Closing	% Drop	Deferral allowed
Net sales	120	78	65%	90%
Sales	42 @ 2,800	=$117,600		$107,600
Purchases	5 @ 2,000	= (10,000)		
Net sales		$107,600		$96,840
Deferral			90%	
Sales of calves	Not eligible	–	–	–

   The bottom line here is that a 15 per cent to 29 per cent reduction in breeding herd numbers qualifies you for a 30 per cent deduction while a 30 per cent or more reduction in numbers allows you to deduct a full 90 per cent of the net income created by the sale. In this example, the allowable deferral is $96,840 (90 per cent of $107,600).

5. *When do I have to pay tax on this deferral?*

   The deferral allows eligible producers in Alberta to defer income tax on the sale of breeding livestock for one year. In the case of consecutive years of drought designation, producers may defer sales income to the first year in which:

   (a) the area is no longer designated, or

   (b) the year when a farmer dies or

   (c) the first year when the farmer is a non-resident.

Conclusion

By itself, a tax deduction is seldom an adequate reason to make an important management decision, but an obvious strategy here is to make sure you are aware of these threshold numbers if you have to reduce your breeding stock. At tax time next April, you would not want to discover that you missed a deduction by two or three animals. For more detailed analysis of this income tax deferral strategy, please see the *Understanding the Federal Tax Deferral - Advisors guide* - www1.agric.gov.ab.ca/$department/deptdocs.nsf/all/bmi8823

This is a good news–bad news story. Drought is obviously bad news, but if you can find a few strategies to help ride it out, that has to be positive. Remember, these are complicated legal and accounting issues, so you should always consult with accredited professional advisors.

For more information,

Alberta Ag-Info Centre at 310-FARM (3276)

Website: www.agriculture.alberta.ca

RV08/15