

To Incorporate Or Not To Incorporate!

Incorporation is a complex decision that many family farm operations have to consider through their farming careers. Remember, a corporation is a separate and legal entity and is not simply an extension of your own personal affairs. This leads to considerable complexity but also provides significant opportunities to manage your operation more effectively. This begs the question, "Should I then incorporate my cattle and cattle feeding operations?"

To answer this question, I have provided a number of questions and answers that may assist you in that decision.

1. What is the income tax advantage of a corporation?

The combined provincial and federal income tax rate for 2009 is 14% up to \$400,000 of taxable income. The combined top tax rate in Alberta on a personal basis is 39%. This is a taxation spread of 25 points which is indeed very significant.

2. My accountant says I have to buy cattle personally to offset last years' deferral. Can I then incorporate the 2008 calf purchases into a company to access these lower tax rates?

Under the income tax act, a rollover "of inventory including cattle" can be transferred to a corporation on a tax free basis. Once the cattle are sold in 2009, that income will then be corporate income and not personal. By choosing a different fiscal year end, this further allows more effective tax planning by not having to purchase all of your inventory by December 31 of each calendar year.

3. What happens when I transfer the cattle to the company if I have debt attached to those cattle?

This of course, is the most common situation especially where cattle have been purchased in the "tax cattle trap" system. Although the *Income Tax Act* allows for a transfer of inventory on a tax free basis, if there is debt which is assumed by the corporation then effectively you have been paid by the company for the cattle.

For example if the cattle are worth \$200,000 at the time of incorporation and an operating loan of \$150,000 exists and that debt is transferred with the cattle into the company, \$150,000 of taxable income will have to be reported by the taxpayer. It is extremely important to understand this feature as the vast majority of producers will be in this situation when considering incorporating a cattle feeding enterprise. There are specific solutions to this concern which includes the use of a family farm partnership for 2 years prior to incorporating and/or the transfer of land or equipment to the corporation. This is beyond the scope of this article and should be discussed with your accountant in greater detail.

4. I understand that if I buy cattle to reduce my taxable income, sell those cattle but have died prior to repurchasing again, that my estate would have to pay tax on that entire cattle value even though I left everything to my spouse?

Yes, that is indeed a major concern and one of the main advantages of farming in a corporation. The shares can transfer tax free via your will to your beneficiaries and meanwhile the corporation can continue operating the business without a deemed tax liability.

5. Presently, my cattle operation results in a farming loss which then is applied to my off farm salary and I receive a tax refund. If I form a corporation, can I still utilize these losses?

No. Corporate losses cannot be utilized by the shareholder. Losses can be carried back 3 years or forward 10 but cannot be applied to a personal tax return. This is a major disadvantage for those producers who have significant off farm income and are presently expanding their cattle operation.

6. If I do incorporate only my cattle enterprise and I have significant income from my grain operation, can I then purchase cattle personally as well?

There is nothing under the *Income Tax Act* that disallows you to personally purchase cattle once a corporation has been formed. Practically however, either a separate grain enterprise should be incorporated or the entire farm should be transferred into one company in order to access the low tax rates for all income earned by the operation. It is very common however to leave the land out of the corporation and simply form an “operating company” where the cattle, machinery and all inventory is transferred into the company and the corporation either leases or joint ventures the land from the farmer personally.

7. Will incorporating the farm but not the land still allow us access to the family farm rollover provision and the \$750,000 capital gains exemption?

The *Income Tax Act* does allow for these provisions to apply both to the land owned personally and to the corporate shares under this type of structure. The only concern is that the corporation cannot have more than 10% of its assets being non-active farm assets. Non-active farm assets can include long-term investments which have not been utilized within the normal course of the business. If this 10% “of substantially all” rule is not met at the time of your death, then the corporate shares will not qualify for the family farm rollover or the family farm exemption.

In conclusion, the creation of a well crafted operating company, I believe will offer a significant after tax financial benefit and over the long term, significant succession and estate planning options for the majority of family farms within the Province of Alberta. Please contact your accountant and professional advisors prior to incorporating as options create complexity but complexity often provides unique solutions.