

AGRI-FACTS

Practical Information for Alberta's Agriculture Industry

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Questions and Answers About Farm Debt

This factsheet addresses some of the common, and some not-so-common, questions asked by farmers about the legal implications of debt. More detailed information on the laws governing debt is available in the publications *Farm Debt: The Legal Implications Including the Personal Property Security Act*, Agdex 817-12, and *Alberta Personal Property Security Act*, Agdex 817-13.

This factsheet is not a substitute for legal advice because farm debt can have complex tax and legal implications. Readers are advised to seek professional assistance with their specific concerns about farm debt.

Foreclosure and land mortgages

What can happen if I sign a land mortgage?

If you have given land as security for a loan, and do not comply with the terms of the mortgage, the creditor can take steps to foreclose on the land.

There are two kinds of land mortgages: Land Titles Act mortgages and equitable mortgages. In a Land Titles Act mortgage, a farmer agrees to give land as security, and the mortgage is registered against the Certificate of Title for the land. In an equitable mortgage, a farmer also agrees to give land as security and the creditor registers a caveat against the Certificate of Title for the land. An equitable mortgage is just as valid and enforceable as a Land Titles Act mortgage.

A mortgage is a valid contract between a creditor and a debtor, and does not have to be registered at land titles to be valid. However, the land remains subject to the mortgage until the amount owing under the mortgage is paid in full and the mortgage is discharged.

What is foreclosure?

Foreclosure is a complex procedure that varies depending on the situation. If you have given land as security for a debt and don't pay back the debt, the creditor can foreclose on the land. The creditor can then sell the land pursuant to the foreclosure process and use the proceeds to reduce or eliminate the debt.

What is a Quit Claim and how is it used?

A quit claim is an agreement given by a creditor to quit pursuing the debtor, usually in exchange for the asset on which the debt is owing, typically land.

Farm debt can have complex tax and legal implications

Can I lose my home quarter?

Yes, if you have given a Land Titles Act mortgage or equitable mortgage on the home quarter or otherwise given the home quarter as security for a loan or credit and you have defaulted under the loan or credit arrangement.

However, if the home quarter has not been provided as security, under the Civil Enforcement Act, a creditor cannot seize the home quarter provided the home quarter is the farmer's residence and is part of the farm.

Can a creditor foreclose on land or seize assets any time it likes, even if I have made my payments on time?

No. A creditor can only foreclose on land or seize assets if the loan agreement is in default. A loan is in default if you do not comply with the terms of the loan agreement.

Typically, default occurs when you fail to make the payments, but default can also occur under other circumstances, even when payments are up to date. For example, selling a secured asset without the consent of the lender or moving the secured

assets out of the country can result in default if this doesn't comply with the terms of the loan agreement. A demand loan can be demanded by the lender at any time, but only according to the terms of the loan agreement.

How fast can a creditor foreclose on my land or seize my assets?

The time can vary from a day to over a year depending on factors that include the type of asset, what type of security has been given, how fast the creditor wishes to proceed and the involvement of the Farm Debt Mediation Service. Generally, it takes longer to foreclose on land than it does to seize and sell other assets such as machinery.

Before seizing assets, a creditor will normally send a demand letter requiring payment by a specific date or time. You have the right to ask the Farm Debt Mediation Service to review your situation, in which case the board can invoke a 30-day stay of proceedings. This stay can be extended for up to a total of 120 days while your situation is assessed. After that, how fast the creditor acts is up to the creditor's discretion within the time frames provided for by the law.

Does the creditor have any right to the improvements, such as fences, corrals or grain bins that I've build on the property since I mortgaged the land?

Structures attached to the land are generally regarded as fixtures. Fences and corrals are typical examples of fixtures. A grain bin can be a fixture or a chattel, depending on the type of bin and how it is attached to the land. Mortgage agreements generally have a clause giving the lender the right to fixtures on a foreclosure.

Chattels aren't fixed to land and can be moved from one place to another. Examples of chattels include livestock, grain, machinery and vehicles. A creditor doesn't have the right to seize chattels in a land foreclosure proceeding unless you've given the creditor valid security over the chattels for the same debt.

What can I do if I'm selling land by Agreement for Sale and the buyer doesn't make the payments?

Under an Agreement for Sale, the legal title to the property remains in the name of the seller until the property has been paid for under the terms of the agreement, which states the rights and obligations of both the buyer and seller. If the buyer defaults under the terms of the agreement, the seller would follow a procedure similar to a foreclosure under a Land Titles Act mortgage. The seller would normally first provide notice to the buyer of the buyer's right to apply to the Farm Debt Mediation Service.

Can a creditor foreclose on or seize everything I own?

A secured creditor can seize assets or foreclose on property that you have given as security for a loan. An unsecured creditor can seize most assets, subject to certain exempted property listed in the Civil Enforcement Act, after the Court has given the creditor the right to do so. A creditor entitled to a lien can hold and sometimes sell specific assets, often without going to Court.

Implication of debt for spouses

Can my spouse mortgage the farm or put other assets up for security for a loan without my knowledge?

If the property is owned by you and your spouse together, both of you must sign the lender's mortgage or security agreement to get the loan.

If the land is in the name of your spouse only, the Dower Act gives you certain rights with regard to the homestead.

One such right is the right to prevent a disposition affecting the homestead without your consent. A homestead is land (up to a quarter section) where you normally make your residence. A disposition affecting the homestead includes a transfer, agreement for sale, lease for more than three years, a mortgage or encumbrance on the land, or a transfer of land through a will or any other method that accomplishes any of these things. You have to sign a release of your dower rights before the home quarter or certain property can be put up for security.

With the exception of the homestead, unless you have your name on the titles to the land, the balance of the farm and related assets can be transferred, sold or mortgaged without your knowledge or consent subject to any rights under the *Matrimonial Property Act* and the *Dependants Relief Act*.

The lender wants me to co-sign with my spouse on a loan application. What happens if my spouse defaults on the loan, or if my spouse and I separate or become divorced, then my spouse defaults on the loan?

In general, if you co-sign a loan with your spouse, you and your spouse are each responsible to pay back the loan regardless of separation or divorce. If instead, you guaranteed a loan for your spouse, and your spouse does not pay back the debt, the creditor can recover the debt from you.

Seizure

Can an equipment dealer seize equipment sold under a sales contract with financing to be repaid over time?

Other than a receiver, only a civil enforcement bailiff employed by a civil enforcement agency can seize assets secured under the *Personal Property Security Act* by an equipment dealer.

A contract for the sale of equipment with financing to be repaid over time is a “purchase money security agreement” governed by the Alberta *Personal Property Security Act*. This *Act* specifies the procedures that creditors are to follow in establishing their rights to secured assets, including procedures for seizing, selling or retaining seized property.

Does the civil enforcement bailiff have to give me notice of seizure?

No. Under the Alberta *Personal Property Security Act*, the civil enforcement bailiff can either take physical possession of the secured assets or leave a notice of seizure either with the debtor (or a person in possession of the equipment) or post a notice in a conspicuous place.

In the case of an equipment dealer, the dealer must give you and any other party with an interest in the seized assets at least 20 days notice of the dealer’s intention to sell the seized assets. If you haven’t already done so, this period gives you or other parties with an interest in the assets time for several options:

- to file an objection as to how the assets will be sold, or
- get the assets back by redeeming the loan (by paying the entire amount owing, including arrears, interest and seizure costs), or
- reinstating the loan agreement (by paying only the arrears, interest and seizure costs) and then carrying on with the regular repayment schedule. The dealer must give you notice if the seized assets will be kept by the dealer instead of sold.

Does a lender have to wait until the best time of year to sell machinery it has seized from me?

A lender generally does not have to wait to sell assets in the seizure process. However, under the *Personal Property Security Act*, the lender has to dispose of collateral in a commercially reasonable manner. In extreme cases, it could be argued that a creditor may be acting in a commercially unreasonable manner if the creditor sells assets at the wrong time of year, perhaps by delaying the sale of seeding equipment to the fall.

Deficiency

Can a lender pursue me for the remaining amount of my loan if the proceeds received on the foreclosure of my land or seizure of my assets aren’t enough to satisfy the debt?

It depends if the assets are secured under a mortgage on land, the *Personal Property Security Act* or *Bank Act* security, and whether the loan was made to you as an individual or a farm corporation. Generally, for assets secured under the *Personal Property Security Act* or the *Bank Act*, a lender can pursue you for the amount of the deficiency.

There are exceptions. If a farmer borrowed money to purchase land that was mortgaged to the lender and the lender foreclosed on the mortgage, most lenders are prohibited from recovering any deficiencies. However, if the land was pledged as collateral security for a loan to purchase other assets, the lender can continue to pursue the farmer for a deficiency.

Under the *Personal Property Security Act*, seizure of consumer goods is deemed to extinguish the debt against the goods. Also, if a creditor retains the seized assets rather than sells them, the debt is deemed to be extinguished. In addition, if you provided a personal guarantee, a lender cannot pursue you to satisfy a deficiency for an extinguished debt.

The rules differ for corporations. For example, in most circumstances, a creditor can continue to pursue a farm corporation for deficiencies when foreclosing on land mortgages. As well, corporations do not have the same redemption periods available to them as do individuals.

Security agreements

What Is a General Security Agreement and what does it mean if I sign one?

Under the *Personal Property Security Act*, a General Security Agreement gives a lender the right to security over a broad range of assets including vehicles, machinery, equipment, receivables and inventory, such as grain or livestock, as well as after-acquired property. After-acquired property is property that you may acquire in the future, but don’t own at the time you sign the General Security Agreement. The lender normally registers a financing statement with the Personal Property Registry to establish the priority of its security over the assets with respect to other lenders.

I am selling farm machinery to my son with payments structured over the next five years. Can my son's creditors seize this machinery if he can't keep up his other loans or credit obligations?

If you did not take security over the machinery for the payments, his creditors could seize the machinery that is not exempt under the *Civil Enforcement Act*.

But, if you took a purchase-money security agreement over the machinery by registering a financing statement with the Personal Property Registry and entered into a security agreement with your son with respect to the sale of the machinery, you would have a prior claim to this machinery for the payment of the purchase price as against other creditors.

Do I have to sign a General Security Agreement if the lender asks me to?

No. But, unless the lender can secure the loan through a security agreement such as a General Security Agreement, the lender would be an unsecured creditor. The lender would therefore likely be unwilling to loan you money under these circumstances.

How long is a General Security Agreement good for before it has to be renewed?

The security agreement is effective for as long as you owe money to the creditor or for as long as the lender maintains a line of credit to you.

Should I sign a blank General Security Agreement form that the bank has sent me?

Never sign a blank form. Always understand and agree with what you are signing and always read the fine print.

What can happen if I give a section 427 Bank Act security?

Upon default of the loan agreement, the bank has the right to seize and sell the secured assets and apply the proceeds to the debt. You have the right to involve the Farm Debt Mediation Service.

Does it matter if I didn't sign the renewal forms the bank asked me to sign for the section 427 Bank Act security?

Even if you did not sign the renewal forms, the bank's security remains in place. In addition, by refusing to sign the renewals, you may jeopardize your relationship with your lender.

Bankruptcy

What are my choices if I am unable to pay my debts as they come due?

There are at least three alternatives to consider in this order:

- If the business can be saved, you might sell assets to pay down debts and/or negotiate with your creditors to restructure your debts to continue the business while making orderly payments.
- Second, if you decide to or are forced to exit the business, try to eliminate your debts and exit with as much cash or assets as possible.
- If you cannot eliminate your debt or make payments as they come due, a third choice is to declare bankruptcy.

Before choosing any of these options, obtain professional tax and legal advice, and make use of financial counseling from the Farm Debt Mediation Service.

What does bankruptcy involve and when would someone declare bankruptcy?

Secured creditors' rights to secured property are usually not affected in a bankruptcy. With respect to unsecured creditors, the legal ownership of all your assets, except those listed under the *Civil Enforcement Act*, and those secured by secured creditors is transferred to a licensed trustee, who then normally sells them and distributes the net proceeds to your unsecured creditors, who may not receive full payment for the outstanding debt. At the end of this process, the courts can order an absolute or conditional discharge from bankruptcy or no discharge at all.

A conditional discharge might require, among other things, that certain payments are made to creditors. An absolute discharge releases you from most, if not all, debts or liabilities.

Can I be forced into bankruptcy by my lender(s)?

No. Individual farmers cannot be forced or “petitioned” into bankruptcy, but a farmer can be eligible to voluntarily assign himself into bankruptcy. The *Bankruptcy and Insolvency Act* states that a farmer is eligible for voluntary bankruptcy if he/she:

- is not bankrupt,
- resides in Canada,
- owes at least \$1000.00,
- has ceased paying their obligations,
- is unable to meet his/her obligations as they become due, or
- has insufficient assets to meet his/her obligations if sold.

Farm corporations, however, are treated differently under the *Bankruptcy and Insolvency Act* and can be petitioned into bankruptcy by their creditors.

Farm Debt Mediation Service

What’s the role of the Farm Debt Mediation Service?

The *Farm Debt Mediation Act* establishes a Service whose mandate is to try to mediate a solution between farmers facing financial difficulties and their creditors. The Service can also provide financial counseling to farmers who are in financial difficulty.

When can I apply to the Farm Debt Mediation Service for help?

You can apply to the Farm Debt Mediation Service if you are in financial difficulty or if your creditors are taking legal steps against you.

Does the Farm Debt Mediation Service have any power to force a settlement between a creditor and a farmer?

No. The Service provides an independent mediator. Creditors are not obliged to agree to any arrangement suggested by the mediator. However, secured creditors must provide notice to the farmer before taking steps to realize on their security and the Service has the power to impose a stay of proceedings for up to 120 days while your situation is assessed.

Other questions

How do I recover money from someone who owes me money?

If you are a secured creditor, you have the right to seize or foreclose on assets that are provided as security. An unsecured creditor has to sue a debtor in court to obtain a judgment, and the creditor will then have the right to seize the debtor’s assets. A creditor entitled to a lien can normally hold or seize and sometimes sell a debtor’s property to satisfy a debt owing.

Does it make any difference if I just pay interest charges but not principal?

If you do not make the payments specified by the terms of the loan agreement, you are in default of the agreement. Some lenders may allow only interest payments, depending upon the terms of the loan agreement. These loans tend to be for short-term financing, with the expectation of paying off the loan at the end of a certain time period.

Business arrangements

How does a personal guarantee work?

A lender may require you to personally guarantee a loan or credit extended to another person or corporation. For example, a parent may guarantee a child’s loan. If the child defaults on the loan, the lender can sue the parent for the amount owing under the guarantee.

Is there any difference if I have a farm corporation or a partnership?

Yes. The rules regarding debts incurred by a farm corporation are generally more severe for a debtor than those governing debts of partnerships or sole proprietors. For instance, creditors often are able to sell a corporation’s seized or foreclosed assets more quickly than they can sell those of an individual farmer.

Am I liable if my partner takes out a loan in the name of the partnership or incurs trade credit in the name of the partnership?

Yes. With the exception of a partner in a limited liability partnership or a limited partner in a limited partnership, partners are each liable for debts incurred in the name of the partnership. In a limited partnership, the limited partner’s liability is limited to the extent of his/her investment in the partnership.

Tax implications of debt extinguishment or forgiveness

Are there any income tax consequences if I voluntarily give back land to my creditor or if my property is seized or foreclosed upon by a creditor?

According to section 79 of the *Income Tax Act*, when property is voluntarily given to a creditor or when a creditor seizes or forecloses on property as a result of a default in payment, the principal amount of the outstanding debt settled or extinguished is considered to be the debtor's "proceeds of disposition."

The proceeds of disposition may include capital gains, capital losses, recaptured capital cost allowance or income. When the foreclosed property is land and the outstanding debt is less than the tax cost of the land, no tax liability arises. However, when the seized assets are inventory or depreciable assets, a tax liability could arise. As this is a complex area, it is best to obtain qualified professional advice.

Is there a tax problem if I forgive debts?

An important consideration arises in the case of parents forgiving "commercial" debts to children. Section 80 of the *Income Tax Act* deems the amount forgiven must or may, in some cases, be applied to reduce the following:

- losses from previous years to be brought forward,
- capital cost amounts and the undepreciated capital cost of depreciable properties,
- adjusted cost base amounts of capital properties, including land, and
- current year capital losses.

Any remaining amount of the forgiven debt can be used to increase the parent's taxable income. Section 80 does not apply when the debt is forgiven in a will on the death of the parent.

What about GST?

When a farmer's property is seized or foreclosed upon by a creditor for an outstanding debt, the transaction is deemed to take place for no consideration and therefore does not attract GST.

For further information, contact:

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