STARK & MARSH CPA LLP

HOMEGROWN SUCCESS
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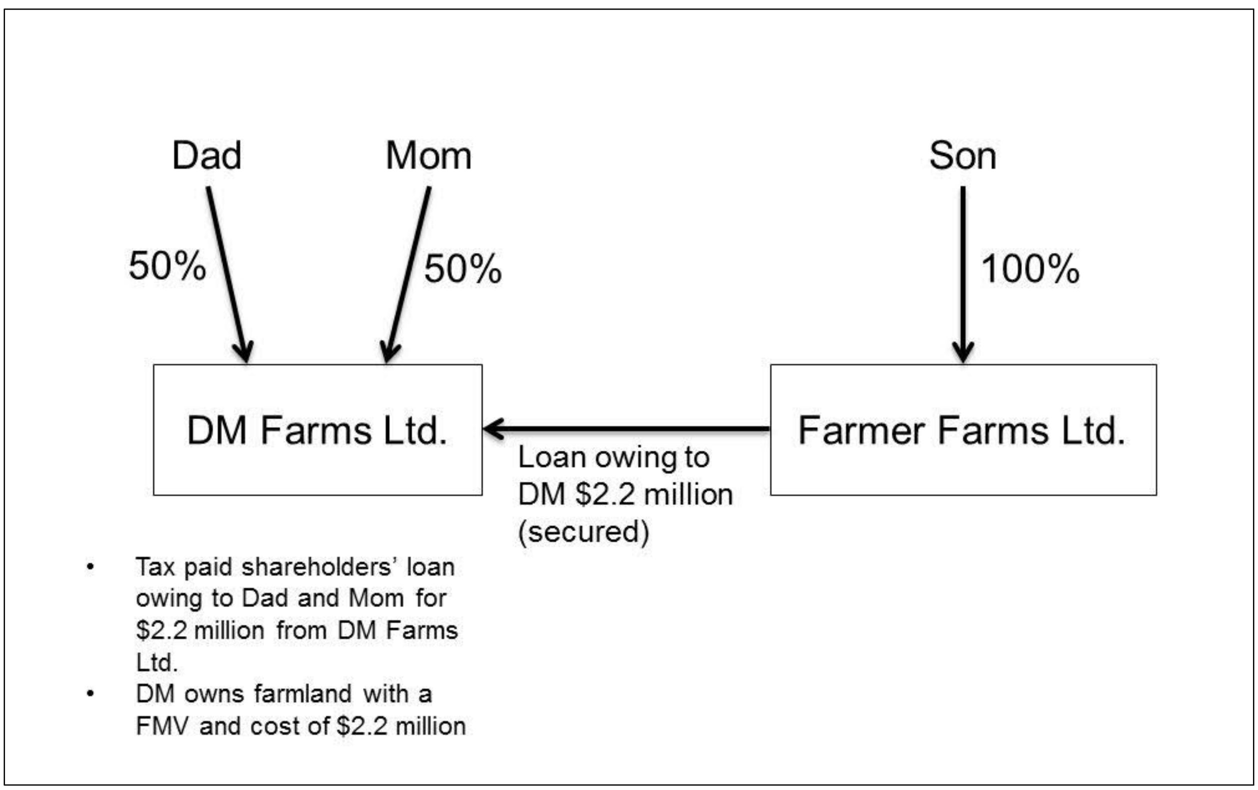
Land Companies

- Agriculture producers have been and continue to be inclined not to have land owned inside of a company and we're not sure why that is.
- From an income tax perspective, it makes the most sense to own farmland in a company.
- If you were to purchase farmland at today's prices, a company provides more after tax dollars for the land purchase or principal payments on the mortgage
    - For a Canadian-controlled private corporation, the first $500,000 of active business income will be taxed at 11%.
    - Personal income tax rates vary from 27.75% to 47.75%
- You could currently have land with significant equity owned outside of a company
    - We would recommend transferring the land to the company, utilize the capital gains deduction (CGD) and create a large shareholder's loan
    - Pay no tax on the transfer
    - You would then be able to pay tax at 11% in the company and repay the shareholder's loan without further income tax consequences
- It is becoming more common for a company to purchase the shares of another company that contains only farmland
    - The individual vendor can claim the CGD on the sale of the shares
- Should land be owned by the operating company? Likely not.
- A land company will assist with estate planning, exiting farming and situations where one no longer wants to actively farm, but would like to retain ownership of the land
- For estate planning, one may not be able to provide sufficient other assets to non-farming children. Some of the value in the land may need to be provided to non-farming children.
    - Likely best that non-farming children are not shareholders in the operating company.
    - Having a separate land company allows them to participate in the land ownership.
    - If there are concerns that non-farming children would prevent the farmland being used as security for expanding the operation, you could establish two land companies – one for the farming child and one for the non-farming children.
- Separate land companies will provide income tax benefits where there is a total exit from farming or a partial exit with sale of operating assets, but retention of land.
- On total exit, if land was contained in the operating company, other operating assets would need to be liquidated and the after tax cash removed prior to selling the shares of the operating company.
    - For example, let's say that there was $1 million left after the sale of operating assets. Immediate income taxes could be as high as $396,000.
    - If had a separate land company, would still liquidate operating assets in the operating company, but would not need to remove the after tax cash prior to selling the shares of the land company.
- Could withdraw cash from the operating company over a period of years reducing the tax rate on the dividends from 40% to 23%
- It is not possible to create a separate land company without creating income tax consequences immediately prior to the share sale.
    - It is better to have a separate land company where the creation of that company is not linked to a subsequent sale.

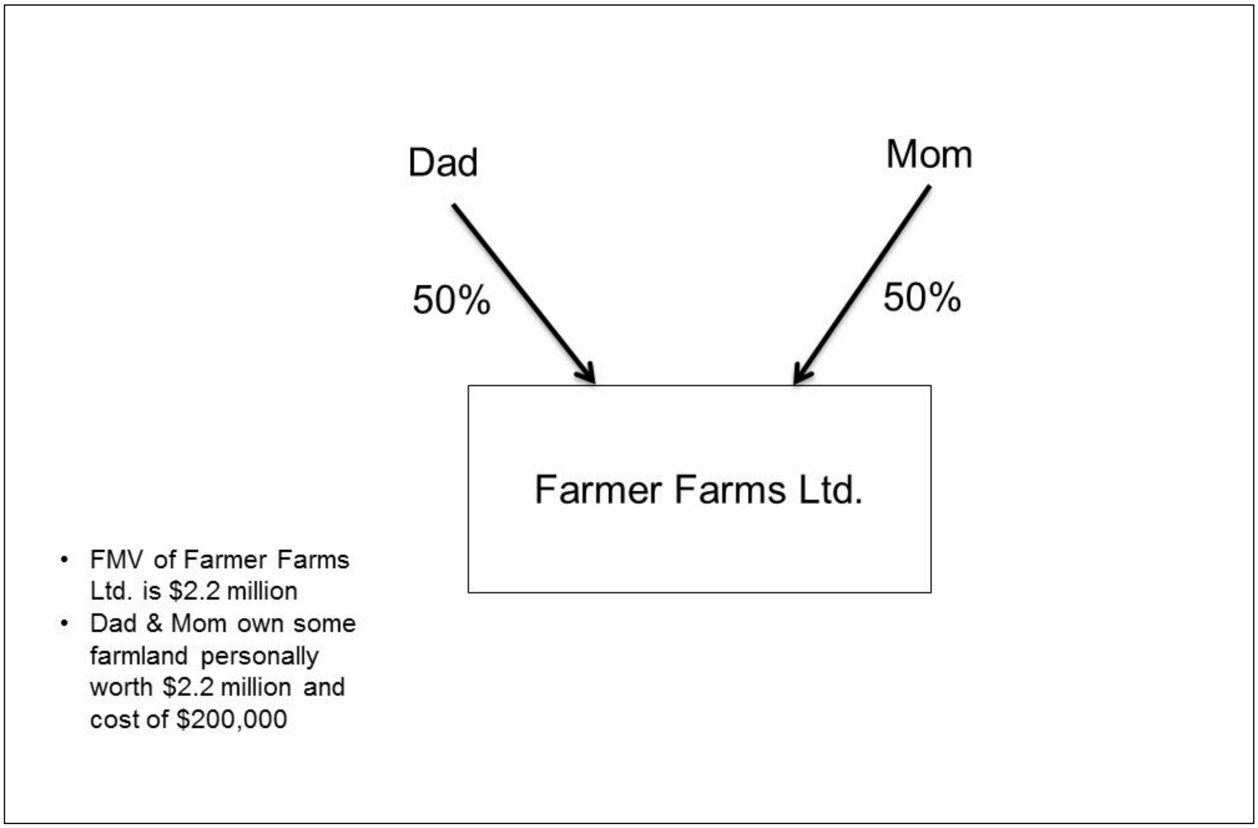
- On partial exit, where land was contained in the operating company, the company shares would no longer qualify for the capital gains deduction or tax free intergenerational rollover.
- More than 10% of the fair market value of the assets will consist of inactive assets, i.e., cash and investments received on liquidation of the operating assets.

- With a separate land company, the shares of that company can continue to qualify for the CGD and tax free intergenerational rollover.
- One could reorganize and create a separate land company after partial exit where the land was contained in the operating company.
- Let's look at an example of creating a land company where land is currently owned personally
  - This example is for retiring parents. Goal in retirement to have non-taxable cash flows.
  - However, the structure could be used well before retirement to create non-taxable cash flows.

Example #1:



Example #2:


Dad
Mom
50%
50%
Farmer Farms Ltd.
• FMV of Farmer Farms Ltd. is $2.2 million
• Dad & Mom own some farmland personally worth $2.2 million and cost of $200,000