

CANADIAN TAX *focus*

Multi-Level Farming Structures and the Capital Gains Exemption

Taxpayers selling a farming (or fishing) business will want to have the assets that are being sold qualify as “qualified farm or fishing property” (QFFP) so that the sale will be eligible for the capital gains exemption of \$1 million in 2016 under subsections 110.6(2) and (2.2) (the farming exemption). Some multi-level structures will not be eligible for the farming exemption; in that case, the taxpayer can either (1) restructure to qualify and delay the sale by 24 months, or (2) claim the more limited QSBC shares capital gains exemption under subsection 110.6(2.1) (\$824,176 for the 2016 taxation year).

For shares to qualify as QFFP, the farming business must be carried on actively and continuously by the individual, his or her spouse, or his or her child; and the farming property must be used by any of those individuals, the corporation (whose shares are being disposed of), a related corporation, or a partnership in which the individual has an interest for 24 months. In addition, at the time of sale, all or substantially all of the fair market value of the properties must be attributable to the properties used in the farming business.

One problematic ownership structure is that in which the farming business is carried on by a partnership owned 50 percent by Holdco and 50 percent by D Co, as illustrated in figure 1. Holdco is also owned by another holding company (C Co), which is owned by individual C. D Co is owned by individual D; individual C and individual D are arm’s-length parties.

Figure 1

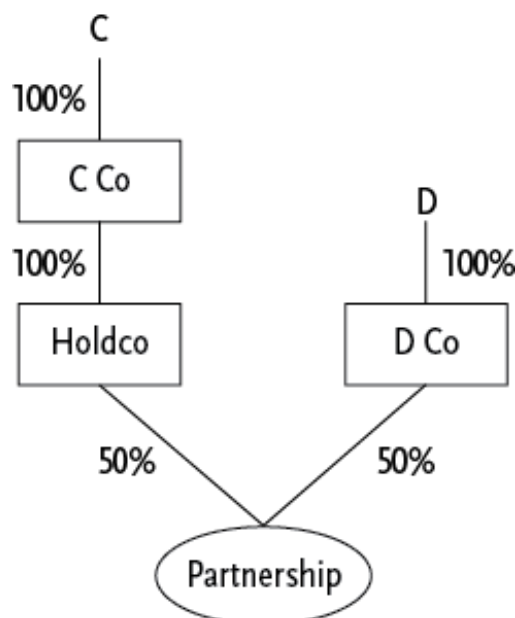


 Figure 1

In order to qualify as QFFP, the D Co shares must be shares of the capital stock of a family farm or fishing corporation as defined in subsection 110.6(1). However, element (a)(i)(F) of the definition requires that individual D hold an interest in the partnership that is carrying on the farming business, which he or she does not. Nevertheless, the CRA has stated that when a partnership carrying on a farming business has only one level of corporate partners, the corporate partner will be considered to carry on the business of the farm partnership (CRA document no. 2008-029974117, March 16, 2009). This statement qualifies the shares as QFFP under element (a)(i)(A) of the definition. Thus, by virtue of this administrative relief, the D Co shares are QFFP.

The C Co shares do not seem to be able to benefit from this relief because they are two levels above the partnership and therefore are not QFFP. Thus, there is a choice between claiming the \$824,176 exemption for QSBC shares and claiming the \$1 million farming exemption provided to QFFP by restructuring and waiting 24 months before selling. The restructuring would require individual C to have at least a nominal direct interest in the partnership. This strategy might have an adverse effect on individual D, who, as a commercial matter, would probably also have to wait 24 months before being able to sell.

Authors' note: In an earlier version of this article, we addressed the situation in which the farming business is carried on in Opco, which is owned 50 percent by Holdco (100 percent owned by taxpayer A) and 50 percent by taxpayer B (an arm's-length party). We suggested that in this ownership structure taxpayer A's shares in Holdco would not qualify as QFFP. Our view has now changed. When one is making this determination in the situation where Holdco relies on the shares of Opco to qualify (using subparagraph (a)(ii)), subparagraph (a)(i) is applied from Opco's perspective. Thus, if farming assets are held in Opco, Opco will be "the corporation" in clause (a)(i)(A), and taxpayer A's shares in Holdco are QFFP. We thank an alert reader for suggesting this line of reasoning.

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