# Tax Project – Summary of Items/Benefits Received by G&O Producers

## Summary points

- Grain and Oilseed (G&O) farmers in Ontario can choose between operating as a sole proprietorship or an incorporated entity, a decision that can change a tax bill significantly for producers with off-farm income.
- Sole proprietors must combine off-farm job income with farm income, which can push farm profits into marginal tax brackets exceeding 50%.
- Incorporated farms in Ontario pay a flat Small Business Tax Rate of 12.2% on the first $500,000 of farm income, creating a tax deferral advantage compared to personal rates.
- A tax deduction reduces taxable income based on the marginal tax rate (e.g., saving $1,220 on a $10,000 deduction at the small business rate), whereas a tax credit is a dollar-for-dollar reduction in tax owed regardless of income level.
- Farmers with a GST/HST number can claim Input Tax Credits (ITCs) to recover taxes paid on business expenses such as fuel, freight, repairs, and business-use-of-home expenses.
- Donating grain directly to a charity is often more tax-efficient than donating cash because it eliminates the taxable income from the grain sale while still providing a charitable tax credit for the fair market value.
- If a farm corporation earns more than $50,000 in passive investment income (like stocks or standard rent), the government claws back the Small Business tax limit at a rate of $5 for every $1 of excess passive income.
- Cash rent is classified as *passive income* and is subject to the clawback, whereas "crop share" income can be classified as active business income if the landowner shares in input costs and production risks.
- To prove a crop share is active, the landowner must pay a proportionate share of expenses (e.g., 20% of seed/fertilizer for 20% of the crop) and participate in agronomic decisions.
- Under Restricted Farm Loss rules, if the CRA designates a farm as a part-time "sideline," the farmer can only deduct a certain maximum amount against off-farm income in the current year.
- To defend against restricted losses, farmers must demonstrate commercial status through capital committed, time spent logs, and a pattern of profitability.
- The Optional Inventory Adjustment (OIA) allows farmers to voluntarily include unsold inventory in their income during low-earning years to utilize personal tax credits that would otherwise be wasted.
- Farmers have access to a $1.25 Million Lifetime Capital Gains Exemption (LCGE) on Qualified Farm Property and, unlike other businesses, can apply this exemption to the sale of individual assets like a specific field.

- The Intergenerational Property Rollover allows farmers to transfer land and depreciable equipment to their children at the adjusted cost base (tax-free at the time of transfer), deferring the tax liability until the child sells the asset.
- Farmers have other trust options available similar to bare/blind trusts:
  - A Nominee Corporation can be used to hold land titles, offering privacy (appearing as a numbered company) and liability segregation from the main farming operations.
  - A Discretionary Family Trust allows the farm's growth (Common Shares) to be held in trust, enabling the allocation of capital gains to multiple beneficiaries to multiply the use of the $1.25 Million exemption.
  - An Alter Ego Trust, available to farmers aged 65 or older, allows assets to bypass the will and probate fees (1.5% in Ontario) upon death.

## Introduction

This document provides an overview of tax benefits/strategies available to grain and oilseed (G&O) farmers in Ontario/Canada. It examines differences between tax deductions and tax credits, explores the advantages of incorporation versus sole proprietorship, and addresses issues such as passive income rules and restricted farm loss provisions. The analysis includes practical scenarios demonstrating how strategic tax planning can result in savings for a large-sized farming operation. For farmers with off-farm income, the choice between operating as a sole proprietorship versus an incorporated entity can mean the difference between a tax bill of over $200,000 and one closer to $40,000.

## Farming: Tax Deductions vs. Tax Credits

A tax deduction represents an allowable business expense that reduces taxable income. Deductions are subtracted from gross revenue before calculating the tax owed. The actual tax savings from a deduction depends on the producer's marginal tax rate.

- For example, if a producer claims a $10,000 deduction and the marginal tax rate is 43%, the producer saves $4,300 in taxes. However, if the rate is only 12.2% (the small business rate in Ontario), the same deduction saves $1,220.

- A tax credit, by contrast, is a dollar-for-dollar reduction in the actual tax owed. Unlike deductions, credits provide the same benefit regardless of income level. For instance, a $1,000 tax credit reduces the tax bill by exactly $1,000, whether a producer earns $50,000 or $500,000 annually.

## Investment (Input) Tax Credits for G&O Farmers

To claim input tax credits (ITCs), farmers must have a registered GST/HST number. This allows recovery of the GST/HST paid on business inputs, effectively reducing the cost of farming operations. Farmers can claim input tax credits on a wide range of business expenses including:

- Business-use-of-home expenses,
- delivery and freight charges
- Fuel costs
- legal and accounting fees
- maintenance and repairs
- motor vehicle expenses
- office expenses
- rent
- telephone and utilities
- travel expenses
- crop insurance payments
- and check-off fees.

Certain expenditures cannot be claimed as input tax credits, including certain capital property, taxable supplies purchased to make exempt supplies, membership fees for

clubs providing recreation or dining facilities unless acquired for resale, and property or services for personal consumption. See form T2042 for the full list.

## Charitable Tax Credits

When an individual farmer operating as a sole proprietor makes a personal charitable donation, the tax credit is calculated as follows:

- The first $200 receives Federal (15%) plus Ontario (5.05%) for a total of $40.10, and the remaining amount receives Federal (29%) plus Ontario (11.15%). For a $1,000 donation, this results in a total tax credit of $365.30.
- If goods or services are received in exchange that exceed 10% of the charitable contribution value, this amount must be subtracted to determine the eligible donation amount for tax credit purposes.

For incorporated farms, the dynamics change. Corporate donations become *tax deductions* rather than tax credits. Since most farms qualify for the small business tax rate of 12.2% in Ontario (combining federal and provincial rates), a $1,000 corporate donation only saves $122 in taxes—considerably less than the $365.30 benefit from a personal donation.

A more advantageous approach involves donating grain directly to qualified charities, such as the Canadian Foodgrains Bank, rather than selling the grain and donating cash. This strategy provides a double benefit: the producer receives a charitable tax receipt for the fair market value of the donated grain and does not have to report the sale of that grain as income. This effectively creates a situation where the producer eliminates the taxable income from the grain sale while simultaneously claiming the charitable tax credit, resulting in tax savings that can exceed the value of a cash donation.

## Scenario Analysis: Sole Proprietor vs. Incorporated Farm

Consider a 1,000-acre grain and oilseed operation with 500 acres of corn generating $550,000 in revenue, 500 acres of soybeans generating $337,500 in revenue, an equipment purchase of $200,000 in the tax year, participation in AgriStability and AgriInvest programs ($7,000 government contribution withdrawn from Fund 2), and off-farm income of $120,000 per year.

Here's the simulated farm expense data for this exercise:

| *Deduction Category* | *Est. Cost* | *Explanation* |
|---|---|---|
| *Seed* | $105,000 | Corn is expensive (~$120/ac); Soybeans cheaper (~$90/ac). |
| *Fertilizer* | $115,000 | High N-P-K requirement for corn; minimal for beans. |

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|---|---|---|
| *Pesticides* | $55,000 | Pre/Post-emerge herbicides + fungicides (e.g., VT fungicide for corn). |
| *Fuel (Diesel/Gas)* | $45,000 | Planting, spraying, combining, and tillage passes. |
| *Grain Drying* | $40,000 | Drying 500 acres of corn (wet harvest assumed). |
| *Machinery Repair* | $35,000 | Maintenance on combine, planter, and tillage tools. |
| *Trucking* | $25,000 | Haulage fees to the elevator ($0.30-$0.40/bu). |
| *Insurance* | $17,500 | Crop insurance (Agricorp) + Farm liability/fire. |
| *Property Tax* | $10,000 | Farm rate property tax on 1,000 owned acres. |
| ***Total Operating Expenses*** | **$447,500** | **100% Deductible** |

From our scenario, the total revenue is $894,500, with total deductible expenses of $459,827 (including check-offs and donations), capital cost allowance of $90,000, and net taxable income from the farm of $344,673. Because the net farm income is under $500,000, the operation qualifies for the Small Business Tax Rate of 12.2% (Federal 9.0% plus Ontario 3.2%) on every dollar of profit. The corporate tax payable would be $42,050.

**Sole proprietor:**

When operating as a sole proprietor, the Canada Revenue Agency (CRA) views the farmer as one single entity, combining job income and farm income for tax purposes.

- The first $120,000 from the off-farm job is taxed at an average rate of approximately 25%.
- However, because this income already pushes the farmer into higher tax brackets, the farm income immediately begins being taxed at 43%, with the majority taxed at the top marginal rate of 53.53%.
- Because the $120,000 job salary exceeds the maximum pensionable earnings, the employer has already deducted the maximum CPP contributions through payroll, meaning $0 CPP is owed on farm income.

The combined tax on job and farm income totals approximately **$205,000**, with the employer likely withholding approximately $30,000 for the job through payroll deductions, leaving the farmer with a $175,000 payment due in April.

**Incorporation:**

Under incorporation, the farmer and the farm are treated as separate legal entities.

- The personal tax return lists only the off-farm job income of $120,000, with farm income of $0 reported personally as profits remain in the corporation.
- The personal tax bill consists only of standard tax on the $120,000 salary, covered by employer payroll deductions, with no additional tax owed personally. The corporate side shows farm income of $344,673 taxed at a flat 12.2% Small Business Rate, resulting in a corporate tax bill of $42,050.
- The corporation pays tax at a flat 12.2% rate regardless of the farmer's personal income, creating a firewall between personal and corporate income.

The sole proprietor's total tax is approximately $205,000, while the incorporated farm's total tax is approximately **$42,050**, representing an annual tax savings through incorporation of approximately $163,000. This difference illustrates why incorporation is often the preferred structure for farmers with off-farm income. The ability to keep profits within the corporation and pay the small business tax rate, rather than having farm income taxed at personal marginal rates exceeding 50%, represents one of the most powerful tax planning tools available to Canadian farmers.

## Passive Income Rules and the Small Business Deduction

While incorporation offers advantages, farmers must navigate the passive income rules introduced by the federal government to protect the small business tax rate. When a farmer incorporates and retains profits (for example, $300,000 of retained cash from previous years), those funds are often invested in stocks, GICs, or other passive investments. The government has implemented a clawback mechanism: if a corporation earns more than $50,000 in passive investment income (interest, dividends from stocks, capital gains), the government begins reducing the corporation's access to the small business tax rate. For every *$1 of passive income over $50,000, the corporation loses $5* of its Small Business limit. If passive income reaches $150,000, the Small Business limit drops to $0, forcing all profits to be taxed at the higher general corporate rate.

Many farmers avoid triggering the passive income clawback by investing retained earnings in active farm assets rather than passive investments, such as purchasing additional farmland, buying farm equipment, or expanding grain storage capacity. Rental income from farmland or interest income from farm operations lending often does not count toward the passive income limit, allowing farmers to preserve their small business tax rate while generating returns on retained capital.

## Keeping Rental Income Active: The Crop Share Strategy

One of the most critical distinctions for incorporated farmers relates to land rental income. The structure of lease agreements determines whether rental income is classified as passive (subject to the clawback) or active business income (exempt from the clawback). Under a cash rent arrangement, the landowner receives a fixed payment per acre regardless of crop yield or market conditions. This is passive income because the landowner bears no agricultural risk. Under a crop share arrangement, the landowner receives a percentage of the actual crop yield. If the crop fails, the landowner

receives less or nothing. If the farmer pays a share of inputs, the CRA often accepts this as a joint venture or active farming income because the landowner is sharing in both the risks and the operational costs.

To prove that crop share income qualifies as active farming and thus avoid the passive income clawback, farmers must demonstrate that the arrangement constitutes a joint venture partnership rather than a simple landlord-tenant relationship. The CRA examines three key factors. First, the landowner cannot simply receive a share of revenue—they must pay a proportionate share of the input expenses. A passive arrangement where the farmer pays for all seed, spray, and fertilizer while the landowner takes 20% of the corn will be classified as rent. An active arrangement where the farmer and landowner both pay 20% of the seed, fertilizer, and chemical costs and both take 20% of the corn will be classified as farming. The crop share percentage should match the input cost contribution to demonstrate genuine risk-sharing.

Second, the landowner must be actively involved in agronomic and marketing decisions. If the tenant independently decides what to plant, when to spray, and when to harvest without consulting the landowner, the arrangement appears passive. Farmers should document their involvement in decisions regarding seed variety selection, input application timing, and grain marketing strategies through email trails, meeting notes, and joint marketing decisions. Third, the grain elevator should issue a separate ticket in the landowner corporation's name for their share of the bushels, with the landowner then making the independent decision to sell those bushels. Allowing the tenant to sell all the grain and write a cheque for the landowner's share creates the appearance of rent payment rather than joint agricultural production.

To meet the minimum requirements, farmers can implement a gross margin crop share structured as follows: the landowner corporation provides land and pays 25% of fertilizer, seed, and chemicals; the tenant provides machinery and labor and pays 75% of fertilizer, seed, and chemicals; and the crop is split with the landowner taking 25% and the tenant taking 75%. This structure works because if the crop fails, the landowner loses the money spent on inputs. This risk of loss is the key factor that transforms the arrangement from passive rental income into active business income.

## Restricted Farm Loss Provisions: Defending Commercial Farm Status

Farmers with off-farm income face an additional challenge when the farm operation experiences a loss. The CRA may attempt to classify the farm as a sideline activity and restrict the deductibility of farm losses against off-farm income. Consider a scenario where the 1,000-acre farm operation experiences a $30,000 loss in a given year due to weather conditions or market volatility. The CRA will examine this loss and attempt to determine whether the farmer is a legitimate commercial operation or a hobbyist.

For a 1,000-acre commercial operation, farmers should contest any restricted farm loss designation. However, if the CRA applies Section 31 restrictions and designates the farmer as a part-time farmer then:

- The first $2,500 of loss is 100% deductible ($2,500), and the next $27,500 of loss is 50% deductible ($13,750), for a total deduction allowed of $16,250.

- The producer can deduct $16,250 against off-farm income in the current year. The remaining $13,750 is restricted and cannot be deducted against job income this year. Instead, it carries forward for up to 20 years and can only be used to offset future farming profits, not off-farm income.

If farming is a chief source of income (either by itself or in combination with the off-farm job), Section 31 does not apply. The producer can deduct the full $30,000 loss against the $120,000 job income, saving an additional $6,000 to $7,000 in taxes compared to the restricted scenario. To defend full loss deductibility, farmers must demonstrate three critical factors: capital committed, time spent, and profitability pattern.

Farmers should maintain documentation to support their commercial farming status, including detailed financial records showing capital investments, time logs documenting hours spent on farming activities, multi-year profit and loss statements demonstrating overall profitability, business plans and marketing strategies, and documentation of professional development such as attending farming conferences or consulting with agronomists.

## Advantages for Farmers Not Available to Other Businesses

- **Optional Inventory Adjustment (OIA**): provides farmers the ability to voluntarily create taxable income. Standard businesses must report income when it is earned and cannot choose to pay tax earlier. Farmers, however, can use the OIA to add the value of unsold corn or soybean inventory to income up to its fair market value if experiencing a low-income year that would otherwise waste personal tax credits (basic personal amount, tuition credits, etc.). The farmer pays 0% tax on that income due to credits covering it and receives a deduction in the following year when reversing it. This effectively moves income from a high-tax year to a tax-free year.

- **Lifetime Capital Gains Exemption (LCGE):** allows farmers to use the $1.25 Million lifetime capital gains on Qualified Farm Property (land and quota). Standard businesses can only use the exemption if they sell shares of the corporation and cannot sell individual assets like a building or machine and claim the exemption. Farmers can sell one 100-acre field to a neighbour, claim the exemption to pay $0 tax, and keep farming the rest of the land. A bakery cannot sell its oven tax-free; it has to sell the whole bakery.

- **Intergenerational Property Rollover:** allows farmers to hand assets to their children tax-free. For standard businesses, if a parent transfers a factory building to a child, the CRA treats it as a sale at Fair Market Value, resulting in an immediate tax bill. Farmers can transfer farmland, depreciable equipment (combines), and quota to children at Adjusted Cost Base (what was paid for it). The farmer pays $0 tax on the transfer. The tax liability is passed to the child, who only pays it if and when they sell the land. This deferral strategy is unique to farming and fishing.

However, this option is not available to extended family members. For example, a farmer’s brother cannot transfer the farm to his nephews.

## Succession – Tools Similar to Blind/Bare Trusts

- **Nominee Corporation:** is the most direct alternative to a simple bare trust. A shell company (e.g., "123456 Ontario Inc.") is incorporated to hold the title to land, with the main farming corporation (OpCo) as the beneficial owner. This provides privacy as the land registry shows a numbered company rather than a name, liability segregation as the land title is technically held by a different legal entity (though this protection is limited), and potential land transfer tax savings in some cases when selling the shares of the nominee company to a buyer rather than the land itself, though Ontario has anti-avoidance rules for this.

- **Discretionary Family Trust:** is a standard tool for passing down the farm. The farm corporation's Common Shares (the growth) are placed into a Family Trust, while Preferred Shares (the current value) and control are retained. This provides flexibility as the decision of which child gets the farm can be deferred for years, with the Trust owning the growth and the Trustee deciding later. The Trust can allocate the capital gain to multiple beneficiaries (spouse, children, grandchildren) if the farm is sold, allowing use of multiple $1.25 Million Exemptions instead of just one. Since the beneficiaries do not legally own the assets yet, it is harder for a divorcing spouse or creditor of a child to attack the farm assets.

- **The Alter Ego Trust:** is available only if the farmer is age 65 or older. Land or farm shares are transferred into this trust, with the farmer as the only beneficiary while alive. When the farmer dies, the assets in the trust do not go through the will and pass directly to heirs. In Ontario, Probate (Estate Administration Tax) is 1.5%. On a $5 Million farm, avoiding probate saves the estate $75,000 in fees immediately.

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