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COMMENT

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PART-TIME FARMERS

Governments use the tax system to give benefits and/or support to certain sectors of the economy. For example, Canadian farmers receive many unique tax benefits. Issues often arise, however, when an individual has more than farming in his or her mix of business activities. Consider, for example, an individual who was raised on a farm but ventures out, creating a successful career in law, all the while continuing to farm. Should this individual continue to benefit from the full suite of tax incentives for farmers or should he be restricted in his access to these benefits?

The Income Tax Act contains a provision that restricts an individual's ability to claim farm losses if the taxpayer's chief source of income is not farming or a combination of farming and something else. The amount of the farm loss that can be written off against other income of the taxpayer is reduced to an amount determined by formula. The deductible amount is the lesser of the actual farm loss and $2,500, plus the lesser of one-half of the loss in excess of $2,500 and $6,250, plus any deductions taken for scientific research and experimental development.

Three examples illustrate the application of this formula:

		Example 1	Example 2	Example 3
Actual farm loss	A	$2,500	$15,000	$50,000
1/2 of (A – 2,500)	B	Zero	$6,250	$23,750
Lesser of B and $6,250	C	Zero	$6,250	$6,250
C plus $2,500 The deductible portion	D	$2,500	$8,750	$8,750

Any amounts that are non-deductible because of the application of the formula become restricted farm losses, which can be carried back three years or carried forward twenty years and deducted against farm income realized in any of those years.

This restriction on the deduction of losses will not apply where the farming activity, alone or in combination with other activity, is the taxpayer's chief source of income. Until recently, a landmark Supreme Court decision (*Moldowan v. the Queen*) set out three criteria that were used to determine whether a taxpayer's farming business was a chief source of income;

- measuring the time devoted to farming,
- the amount of capital committed to farming, and
- the actual or potential profit that could be derived from farming.

The *Moldowan* case, however, essentially went on to conclude that if farming income was subordinate to other types of income earned by the taxpayer, then the taxpayer's chief source of income could not be said to be a combination of farming and some other source of income. As a result, unless the taxpayer earned only farming income, the farm loss rules would always apply, to restrict the deductibility of the losses from other sources of income.

Over the years, many tax professionals commented that the conclusions in *Moldowan* around the combination of farming and some other source of income seemed overly restrictive, and in fact some lower courts made decisions inconsistent with the precedents set by the Supreme Court in that earlier decision.

A recent Supreme Court of Canada case, *The Queen v. Craig*, reconsidered the prior decision in *Moldowan* and overruled that decision, bringing some additional clarity to the interpretation of the restricted farm loss rules. The Court found that farming could be a chief source of income by itself or in combination with another source of income. Farming need not be the only source of income in order for the taxpayer to claim the farm losses fully against other income.

The facts of the recent case are as follows:

1. John Craig operated a successful law practice.
2. He had investment income.
3. He operated a race horse business (buying, selling and training horses for racing).

4. The horse racing activities constituted a business — they were neither personal nor a hobby.

5. Mr. Craig sought to deduct the full amount of farm losses realized in 2000 and 2001.

The Canada Revenue Agency reassessed Mr. Craig on the basis that his farm losses were limited to $8,750 in each of 2000 and 2001 because the horse racing business was a subordinate or sideline business and not his chief source of income. Mr. Craig appealed and won at the Tax Court of Canada. The Crown appealed to the Federal Court of Appeal and lost. The Crown subsequently appealed to the Supreme Court of Canada, which heard the appeal and decided in favour of the taxpayer. The Supreme Court noted that the provision in the Income Tax Act had two distinct elements; to avoid the restriction on farm losses, farming had to be the taxpayer's chief source of income, or the taxpayer's chief source of income had to be a combination of farming and something else.

This is good news for taxpayers who invest a significant amount of time, capital and energy into a farming business while at the same time continuing a separate career. The opportunity to report farm losses without limit will allow faster recovery of the tax shield available from farm losses.

I/R 2121.00; 7501.02

SUPPORT OBLIGATIONS

Estate planning should involve a thorough review of an individual's financial, moral and legal obligations to ensure they are entrenched and reflected in the individual's will and estate plan. The most obvious of these obligations is the provision for the ongoing support of a spouse, minor children and children with special needs.

Less obvious obligations can often be uncovered in a wide-ranging conversation with the individual. This will help uncover previously unspoken information about obligations, whether moral, legal or financial, regarding those the individual interacts with or assists financially.

Where a testator has not made adequate provisions for the proper support of a dependent, provincial laws allow the courts to order the estate of the deceased to be responsible for such support obligations. A court order of this nature can reduce the overall value of the estate available for other beneficiaries and/or defer the settlement of the estate until the support obligations are fulfilled.

In determining the amount and duration of a support obligation on the estate, the courts will consider all of the circumstances of the situation. The type of circumstances will include some or all of the following:

- The claimant's needs as well as the standard of living to which the claimant has become accustomed
- The contributions (both financial and non-financial) the claimant made to the deceased's welfare
- The length of time the claimant and the deceased co-habited
- The claimant's assets, liabilities and income at the time of the claim for support
- The claimant's capacity to earn income
- The claimant's likely future assets/liabilities and income
- The measures that could be taken to enable the claimant to earn more income (i.e., schooling or training programs)
- The claimant's age and health, both physical and mental

The combination of a wide-ranging set of factors, as outlined above, will influence the courts in arriving at decisions. The financial award that recognizes an individual's claim for financial support can be satisfied through a lump-sum settlement and/or an income stream, both of which must be financed through the deceased's estate.

It should be noted that either party can appeal the decision to a higher court. The higher court may decide to confirm the lower court's finding, reverse the decision or modify the outcome. The emotional turmoil can take a substantial toll on the individuals involved, thus making an already stressful time even more stressful. Not only is there a potential impact financially from the decision, but the cost of mounting a defence by the estate is an unanticipated financial burden.

Even simple facts often make for interesting outcomes, as seen in a June 4, 2012, ruling by the Ontario Superior Court of Justice in the case of *Sorkos v. Sorkos Estate*:

- Gus, the deceased, married Rena, then age 59; it was a second marriage for both.
- Rena, who had known Gus from childhood, moved overseas to marry Gus, who had suffered a debilitating stroke and required Rena's daily assistance.
- Gus's net worth was ascertained to be about $2,300,000.

- Gus's estate plan provided a bequest of $250,000 to Rena and named Rena as beneficiary of his $287,185 RRIF account.
- After a few other bequests, the remaining assets were to be distributed to Gus' siblings.
- Rena demonstrated that she had monthly expenses of $6,400 and had an income of $1,200 from the RRIF, $1,100 from her own pension leading to a monthly shortfall of $4,100.
- Rena made a claim against the estate for financial support.

After considering all of the factors, Justice Tausendfreund amended the bequest to Rena. He lowered the $250,000 bequest to $150,000 but, in addition, ordered the estate to purchase an annuity on Rena's life that would pay Rena $3,000 per month. In addition, she retained her position as named beneficiary of the RRIF. In his commentary, the judge noted that Gus's estate had an obligation to support Rena in her role as Gus's spouse, and that this obligation trumped Gus's right to name his siblings as the beneficiaries of the residue of his estate.

It is interesting to note that the estate was not fully responsible for Rena's income shortfall, but there was a substantial realignment of the resulting testamentary dispositions. Gus's testamentary wishes were not fulfilled as he had originally anticipated because the court recognized a support obligation that he did not view as necessary or obvious in setting out his testamentary wishes.

Estate planning must contemplate and provide for as many contingencies as possible. This requires a thorough discussion about the individual's obligations to dependents and what reasonable/adequate provision should be made in the overall estate plan.

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TAX SAVINGS FOR THE DISABLED

Severe and prolonged health impairment, whether mental or physical, can be debilitating and can seriously affect the individual's activities of daily living. Canada's income tax system has a specifically designed non-refundable tax credit that provides financial support to severely disabled individuals. In 2011, the federal government's cost of providing this credit was projected to be $665 million, with the provincial governments spending approximately an additional 50%.

The determination of whether an individual's medical impairment meets the qualifying criteria for the tax credit involves the completion of a form by the individual (or his or her legal representative) and the individual's medical practitioner, who is obligated to disclose information about the individual's condition. The objective is to enable the Canada Revenue Agency (CRA) to determine whether the impacted individual has a severe and prolonged impairment that meets specific conditions.

To qualify, the individual's impairment must be "prolonged", which generally means the impairment is expected to last for a continuous period of at least 12 months.

The severity of disability is measured in terms of restrictions in the "activities of daily living", as defined under the Income Tax Act. In general terms, the assessment considers how markedly restricted an individual is in one of the basic activities of daily living, or whether he or she is significantly restricted in two or more of the activities. The activities of daily living typically include:

- Seeing – either blind or vision in both eyes is 20/200 or less with the use of corrective lenses or medication
- Speaking – unable or taking an inordinate amount of time to speak so as to be understood by another person in a quiet setting, even with the aid of appropriate devices
- Hearing – unable or taking an inordinate amount of time to hear so as to understand another person in a quiet setting, even with the aid of appropriate devices
- Walking – unable or taking an inordinate amount of time to walk even with the aid of appropriate devices
- Eliminating – unable or taking an inordinate amount of time to eliminate
- Feeding – unable or taking an inordinate amount of time to feed
- Dressing – unable or taking an inordinate amount of time to dress
- Does not have the mental functions necessary for everyday living
- Requires life-sustaining therapy to support a vital function

It should be noted that individuals must first have availed themselves of appropriate therapy, medication and devices before being able to claim the non-refundable disability tax credit.

The disability tax credit is a non-refundable tax

credit that reduces the taxpayer's income tax liability. To the extent the disabled taxpayer cannot use all of the non-refundable disability tax credit to reduce his or her income tax liability to zero, the individual may be eligible to transfer the credit to a spouse, common-law partner or supporting individual based on specific criteria.

The completed application form for the tax credit can be submitted to the CRA at any time. If the form is approved with an effective date prior to the immediate tax year, an automatic reassessment is processed and historical returns are generally updated to reflect new information.

If an application is declined, the CRA will send a notice of determination that explains why the application was denied. The CRA may reconsider if new information becomes available that was not considered in the initial assessment. The taxpayer has the right to appeal the CRA's denial by filing a formal objection to the decision. It is important to keep in mind that there is a 90-day time limit to object after the CRA mails the notice of determination.

Approval of the application results in a disability tax credit certificate that allows the individual to claim the non-refundable tax credit in subsequent years without the need for an annual application. However, the taxpayer is obligated to inform the CRA if his or her condition improves, and the CRA has the right to request that the taxpayer reapply for the disability tax credit certificate.

Qualification for the non-refundable disability tax credit can occur suddenly. It is important to be aware of the credit and be vigilant about ensuring the certificate is in place as soon as possible.

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