Tax Planning for Farmers in Canada

There are many tax planning opportunities available for the Canadian farmer, some of which you may still be able to take advantage of before you file your next tax return.

In this article we will be focusing on three ways of reducing the amount of tax you may have to pay. It is important to note that we will be discussing the farmer, whose primary source of income, is derived from farming. The part-time or hobby farmer may not always qualify.

Income Tax Deferral

A common method of reducing the amount of income tax that may be payable in the current year is to defer some of this year's taxable income to a future year. You will still be required to pay tax on this income, but not this year. An actual tax savings can be obtained if you are able to take advantage of lower tax rates.

Most Canadian farmers use the "cash method" of accounting. This allows the farmer to only report actual cash receipts from the sale of farm products in his taxable income. This means that you will not be taxed until you actually receive payment. As an example, if you have a $500 sale the week prior to your year end, however, you will not be receiving payment for another thirty days, under the "cash method" you will not be required to pay tax on this sale until next year, when you have actually received the cash.

In addition, farmers are allowed to deduct the cost of purchasing inventory such as seed and livestock, even if they are still on hand at the year end.

In order to maximize the income tax deferral that may be available to you under the "cash method", it is important to calculate your expected taxable income prior to your year end so that you can take advantage of the following:

Decreasing Taxable Income

Once you have calculated your expected taxable income, you may wish to decrease it by incurring additional cash expenses prior to your year end. This is a very effective income tax deferral tool. For example, you may wish to purchase additional feed or livestock which, as we just learned above, may be deducted for tax purposes in the year they are received and paid for.

Increasing Taxable Income

Some farmers may even wish to increase their taxable income in a given year. Perhaps this was not the best year financially for you, but you already know that your income for next year is going to be much higher. Taxable income can be increased by adding the fair market value of any unsold inventory on hand at the end of the year. This addition then becomes a deduction available to you the following year. This method of "smoothing" taxable income is especially useful when taking advantage of lower tax brackets.

Note: There is a mandatory increase to taxable income for the cost of any unsold inventory on hand at the end of the year if the "cash method" produces a loss for tax purposes. This increase is limited to the lesser of the value of the unsold inventory or the amount of the loss.

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Annual Income Tax Installment

Unincorporated, self-employed farmers are only required to make installments once a year, on or before December 31st. CRA bases this installment on the taxes you paid in the prior year. If you pay this amount you will not be subject to interest and penalties from CRA even if you end up owing more taxes this year. However, if you're taxable income has decreased from last year, paying this amount would result in you overpaying your income taxes for the current year and you will only get your refund when you file your tax return in the spring. By reviewing your taxable income prior to your year end, this possible overpayment can be avoided.

Income Splitting

Income splitting distributes income within the family group to take full advantage of any lower tax brackets, deductions and credits available to family members.

For farmers, this may be as simple as ensuring that all family members are paid a reasonable salary for their daily contributions to the farm. This can be as involved as the formation of corporations and family trusts.

Use All Available Tax Incentives

There are numerous tax incentives available to Canadian farmers, such as: investment tax credits for doing research on crop development and livestock hybrids or special rules relating to the deduction of tile drainage or forced livestock destruction.

As a Canadian farmer, you have many unique tax issues and it is important that you take the time to consider both the short and long-term planning issues that will help to minimize the tax that you and your family have to pay.