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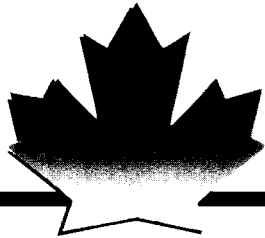
Revenu Canada  
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## Supplementary Guide

# Farming Income Tax Guide

1990

# Your Guide



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## WHAT'S NEW FOR 1990?

In a news release dated July 13, 1990, the Department of Finance issued the following proposed amendments to the *Income Tax Act*. These changes are also highlighted in yellow in the Guide. If your situation is affected by any one of these items, please pay special attention to them when calculating your income.

- For certain properties purchased after 1989, they must be **available for use** in order to be eligible for capital cost allowance and the investment tax credit.
- A new definition for "automobile" has been proposed. See the section "Code 225 — Motor vehicle expenses" in Chapter 2 for details.

## DATES TO REMEMBER

**December 31, 1990** — Calculate the amount of your 1990 instalment payment on Form T7B, Farmers and Fishermen — 1990 and make your instalment payment of tax and Canada Pension Plan contributions.

**February 28, 1991** — File your 1990 T4 and T4A Returns (Form T4 and T4A Summaries and related Forms T4 and T4A Supplementary) and give your employees their copies of the Supplementary slips.

**March 31, 1991** — Most farming partnerships file a Partnership Information Return by March 31, 1991. However, there are exceptions as explained in Information Circular 89-5, Partnership Information Return.

**April 30, 1991** — File your 1990 income tax return and pay your balance of tax and Canada Pension Plan contributions due.

**April 30, 1991** — File Form T2011, Election to Average Income, if you wish to average your income, with your income tax return.

This Guide uses plain language to explain the most common income tax situations. It does not replace the laws found in the *Income Tax Act*, the *Unemployment Insurance Act*, the *Canada Pension Plan*, and their related regulations. For more information, please refer to these laws or contact your district taxation office.

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## CHAPTER 1 INTRODUCTION

Use this Guide if you are a self-employed person who farms as a business. This Guide will help you calculate your farming income for 1990. The *1990 General Tax Guide* will help you complete your 1990 return. To complete a return for a deceased person, get the *1990 Deceased Persons Income Tax Guide*.

The Guide refers to forms that you attach to your return and to publications that cover topics in greater detail. As you read through this Guide, list the forms and publications you need. To order any of these forms or publications you may use the order form at the back of the Guide.

### What is farming?

The *Income Tax Act* defines farming as tilling the soil, raising or exhibiting livestock, maintaining horses for racing, raising poultry, fur farming, dairy farming, fruit growing, and bee keeping.

However, the definition is not restricted only to the activities described in the *Income Tax Act*. Farming also includes operating a feedlot, tree farming, the growing of Christmas trees, the operation of a wild game reserve, market gardening, the operation of nurseries and greenhouses, and the operation of a chicken hatchery. For more information on the definition of farming, get Interpretation Bulletin IT-433, Farming — Use of Cash Method.

Farming **does not include** your pay as an employee of someone else who operates a farming business.

It is important for you to determine if your farming operation is a business. If it is not a business, you may not be able to deduct your farming losses. For more information, read the section "Farm losses — non-deductible" in Chapter 5.

### Fiscal period

The taxation year or period for filing an income tax return for individuals is the calendar year. However, your **farming income** does not have to be reported on the calendar year basis. You may choose the date you want your business year to end. You do this when you file your first return as a self-employed farmer. For example, you may choose June 30th as the date you want your business year to end.

The period your financial statements cover is your fiscal period. This period may not be more than twelve months. A fiscal period that is less than twelve months may happen in certain situations. For example, this can happen when a new business begins or when a business comes to an end.

Your farming income is reported in the taxation year your fiscal period ends. For example, you report income for the fiscal period July 1, 1989 to June 30, 1990 on your 1990 return because the fiscal period ends in the 1990 taxation year.

Once you choose a fiscal period, you can only change it if you get permission from the Director of your district office. A request will be approved if it is made for sound business reasons. A change will not be allowed if the main reason is to minimize taxes. If you need more information, get Interpretation Bulletin IT-179 and Special Release, Change of Fiscal Period.

### Keeping records

To calculate your farming income or loss for each year, keep a record of all your business transactions. Your records should include a record book to show all your business transactions, receipts or other vouchers to support your income and expense items and any assets purchased, bank statements, duplicate bank deposit slips, and cancelled cheques.

Your record book should at least be a day-to-day record showing your income and expenses. A columnar book with separate pages for income and expenses is convenient. The examples in this Chapter show this type of book.

Always get and keep receipts or other documents for every income and expense item. Examples of such documents include cash purchase tickets from the sale of grain, the cheque stub portion of cheques you receive from marketing boards, and invoices for the purchase of livestock, seeds and plants, etc.

If a supplier does not give you a receipt, keep your own record showing the name of the supplier, date of payment, amount paid and details of the transaction.

You should have a system to file your receipts, cancelled cheques, and other documents to support the amounts you show in your books. If you do not keep this information and there is no other evidence to support your expenses, the Department may reduce the expenses you deduct.

Keep a separate record of assets bought and sold. Land, buildings, tractors and ploughs are examples of these types of assets. The record should show who sold you the asset, the cost, and date of purchase. With this record, keep all the documents for your purchases. When you sell or trade an asset, show the date you sold it and the amount you received or were allowed on a trade-in.

Revenue Canada does not provide record books and does not recommend any type of book or sets of books. There are many suitable books and bookkeeping systems available for a reasonable cost. Some provincial

Departments of Agriculture issue bookkeeping records that you can use.

You must keep business records and supporting documents for at least six years after the end of the taxation year to which they relate. If you file your return late, keep your records and supporting documents for six years from the date you filed that return.

Also, you must keep records and supporting documents necessary for dealing with a notice of objection or appeal until the issue is settled and the time for filing any further appeal has expired.

If you wish to destroy your business records before the six year period is up, you first must get permission from the Director of your district office. To do this, you may use Form T137, Request for Destruction of Books and Records. More information on this is in Information Circular 78-10R2, Books and Records Retention/Destruction.

## Methods of computing income

You may use either the **cash** or **accrual** method to calculate your farming income. Once you have chosen a method, you should continue to use that method in future years. However, if you want to change your method see the instructions under "Changing your method" in this chapter.

### Cash method

Under the cash method, you

- report income in the year you receive it, and
- deduct expenses in the year you pay them.

If you use the cash method and accept a post-dated cheque in payment of a debt, the amount of the cheque is included in income at the time you receive the cheque. If the cheque is not honoured, you may adjust your income.

If you accept a post-dated cheque as security for a debt, include the amount of the cheque in income on either the date the cheque is payable or the date it is cashed or deposited, whichever is earlier.

If the debt is not payable at the time the post-dated cheque is payable, include the amount of the cheque in income on the date the debt becomes payable or the date the cheque is cashed or deposited, whichever is earlier.

Under the cash method, you do not include inventory when you calculate your income. However, there are two exceptions to this rule. These exceptions are explained in Chapter 2 under "Code 635 — Mandatory inventory adjustment" and "Code 651 — Optional inventory adjustment."

A farming business which is a partnership may use the cash method if all partners choose to use this method.

If you need more information on the cash method, get Interpretation Bulletin IT-433, Farming — Use of Cash Method.

### Accrual method

Under the accrual method, you

- report income in the fiscal period it is earned, regardless of when you receive payment, and
- deduct expenses in the fiscal period they are incurred, whether or not you paid them in that period.

Include complete inventories of livestock, crops, feed, fertilizer, etc., when you calculate your income under this method.

You should count and make a list of your inventory at the end of your fiscal period. Keep this list as part of your business records.

The value you place on the items in your year-end inventory is important when you calculate your income. There are three methods to value inventory for income tax purposes:

- value all your inventory at its fair market value;
- value individual items (or classes of items if individual items cannot be distinguished from each other) at their cost or fair market value, whichever value is lower; and
- unit price base (for livestock only). For this method, you need to complete Form T2034, Election to Establish Inventory Unit Prices for Animals.

If this is the first year of your farming business you may choose any one of these methods to value your inventory. Since this is your first year of business you will not have an opening inventory.

If this is not your first year of farming, continue to use the same method used in past years. The value of your inventory at the beginning of your 1990 fiscal period is the same as the value at the end of your 1989 fiscal period.

If you need more information on inventories, get Interpretation Bulletin IT-473 and Special Releases, Inventory Valuation.

### Changing your method

You may change your method of reporting income.

To change from the accrual method to the cash method, file your return using the cash method and include a statement showing the changeover adjustments to income and expenses.

Before you change from the cash method to the accrual method, you must get permission from Revenue Canada. Send your request and the reasons for the change to the Director of your district office. Make this request before the date you are required to file your income tax return for the year the change will happen. For the first year you report your income using the accrual method, your income

and expenses statement must show each adjustment as a result of the change.

Retroactive changes will not be approved.

### Paying tax by instalment

If your chief source of income is from farming or fishing, you may be required to make one instalment of income tax. For 1990, this instalment is due by December 31, 1990. The *1990 Instalment Guide for Farmers and Fishermen* explains when you must pay tax by instalment.

### INCOME ITEMS (Farm)

DATE	PARTICULARS	WHEAT	OATS	BARLEY	RYE	OTHER CROPS	CDN WHEAT BOARD	FORAGE CROPS	CATTLE	OTHER LIVE-STOCK	DAIRY PRODUCTS	CUSTOM WORK	PETROLEUM PAYMENTS	OTHER INCOME	LIST OF CAPITAL ITEMS
Jan. 6	Canada Milling Co.	625.00													
Jan. 30	Man. Packers (4 steers)								4,000.00						
Feb. 10	Pleasant Dairy (milk)										350.75				
Mar. 18	Man. Packers (10 hogs)									2,930.00					
Apr. 1	Seed Fair (prize money)													PRIZE 25.00	
Apr. 15	Auto Wreckers (old car)														75.00

### EXPENSE ITEMS (Farm)

DATE	PARTICULARS	WAGES	TAXES LICENSES	FIRE & CROP INS.	BLDG & FENCE REPAIRS	MACH. REPAIRS	MOTOR VEHICLE EXPENSES	GAS-OIL EXCEPT MOTOR VEHICLE	CATTLE	OTHER LIVE-STOCK	SEEDS PLANTS	FEED STRAW	FERTILE SPRAYS	OTHER EXPENSES	CAPITAL ITEMS	PERSONAL EXPENSES
Jan. 30	L. Smith	120.00														
Feb. 12	Craig Hardware													SMALL TOOLS 12.60		
Feb. 12	Poulin Lumber Co.				72.75											
Feb. 28.	Fred's Service Station						14.40	22.50								
Mar. 8	Rural Telephone													PHONE 8.20		
Apr. 2	Implements Ltd.														TRACTOR 10,600.00	

### Forms

This Guide has two copies of each form listed below.

- **Form T1A — Request for Loss Carry-Back**  
You must use this form when requesting a loss carry-back.
- **Form T2011 — Election to Average Income by Farmers and Fishermen**  
You must use this form to elect to average your income under the five-year block averaging provisions available to people who farm or fish. Chapter 9 will explain how to complete this form. Send the completed form with your return and mail it to your taxation centre by April 30, 1991.
- **Form T2038 — Investment Tax Credit (Individuals)**  
If you purchased property in 1990 that is eligible for the investment tax credit complete this form and send

it with your 1990 return whether or not you decide to claim this credit for 1990. You should also complete this form if you are claiming a credit carried forward from an earlier year. See Chapter 7 for information on this credit.

- **Form T2041 — Capital Cost Allowance Schedule for Farmers and Fishermen.**
- **Form T2042 — Statement of Farming Income and Expenses.**

Forms T2041 and T2042 are available to help you prepare the statements necessary for income tax purposes. You can either use these forms or prepare your own statements.

Additional copies of all the forms listed in this Guide are available from your district office.

## CHAPTER 2 INCOME AND EXPENSES

### Statement of farming income and expenses

A farming income and expenses statement is prepared each year to determine the amount of income or loss to report on your return. You may use Form T2042, Statement of Farming Income and Expenses, if you report your income using the cash method. When completing Form T2042, it is important to complete each section **in the order it appears on the form**. There are two copies of Form T2042 with this Guide. Attach one copy to your return and keep the other copy for your records.

This chapter explains some of the income items, expense items and adjustments on Form T2042. The form is divided into the following sections:

- income and expenses statement,
- adjustments to the income and expenses statement,
- mandatory inventory adjustment,
- optional inventory adjustment,
- business-use of home expenses, and
- partnership schedule.

If you have another business in addition to farming, prepare separate statements for that business. The *1990 Business and Professional Income Tax Guide* will help you to calculate your income for that business. The Guide also has the necessary forms you may use.

If you are a member of a partnership, there are two different ways your share of the partnership income is reported. The two ways are explained in Chapter 8. You should read Chapter 8 before completing the partnership's income and expenses statement.

### Amounts to be included in income

This part of the chapter explains the more common income items. They are explained using the same code numbers as those on Form T2042. If you have other types of income not shown on Form T2042, use the blank spaces on the form to show them or list them on a separate sheet of paper and attach it to your return.

#### Codes 400 to 415, 435, 445, 450, and 460 to 465 Grain and other produce

##### Grain

You may sell grain directly or through various agencies. Include in income all amounts you receive from these agencies for the sale of grain. For example, include in income any **Wheat Board Payments** you receive from the sale of wheat, oats, or barley.

When you deliver grain to a licensed public elevator or process elevator, you will receive either a **storage ticket**, a **cash purchase ticket**, or a **deferred cash purchase ticket**.

If you receive a **storage ticket**, a sale has not taken place. Therefore, you do not include any amount in income at this time.

If you receive a **cash purchase ticket**, a sale has taken place and you are considered to receive payment at the time you receive the ticket. Include the amount of payment in income at the time you receive the cash purchase ticket.

If you receive a **deferred cash purchase ticket**, you may be eligible to defer or postpone including the purchase price (as stated on the ticket) in income until your next fiscal period. You can do this if the ticket calls for payment after the end of the fiscal period in which you delivered the grain.

This deferral of income is only available in certain circumstances. For information on these circumstances, get Interpretation Bulletin IT-184R, *Deferred Cash Purchase Tickets Issued for Grain*.

Under the Advance Payments for Crops Act and the Prairie Grain Advance Payments Act, producers of various crops may be eligible to receive advance payments on crops being stored in their own name from the producers' associations. These advances are considered **loans** and are not treated as income in the fiscal period you receive them. You include the full amount of the sale of these crops as income in the fiscal period the sale actually takes place.

##### Other produce

You may sell other produce through agencies. Include amounts you receive from these agencies in income, as well as amounts you receive through direct sales.

##### Code 430

###### Western grain stabilization payments

Include stabilization payments or refunds of any levy under the Western Grain Stabilization Act in income for the fiscal period you receive them.

##### Codes 440 to 444

###### Livestock

Generally, you include in income amounts you receive from the sale of livestock. The following comments explain certain situations and some exceptions to the general rule.

##### Gifts of livestock or other items

If you give livestock or other items you sell to your spouse or children, include in income the **fair market value** of these items on the date you made these gifts. **Fair market value** is the price you would purchase or sell a property for in a normal business transaction.

Also, you cannot deduct the expenses for any future costs for raising or maintaining these gifts.

#### **Income deferral from the destruction of livestock**

If you receive payment under the **Animal Contagious Diseases Act** for destroying animals, you include this amount in your income. **However**, if you want, you can deduct all or part of the amount you include in income as an expense for the same year. If you do this, you include the amount you deduct as an expense in your income for the next year.

#### **Income deferral for sales in a prescribed drought region**

Amounts you receive from the sale of **breeding animals** may be eligible to be postponed until a future year if

- your farm business is in a **prescribed drought region** and
- the number of **breeding animals** in your **breeding herd** is reduced by a certain amount.

**Breeding animals** are cattle, bison, goats, sheep and horses kept for breeding in the commercial production of pregnant mare's urine. These animals must be over 12 months of age and are kept for breeding in your farming business.

A **breeding herd** is the number of breeding animals as calculated by the formula

$$A - (B - C).$$

- A** is the total number of breeding animals;
- B** is the total number of female cattle that have not given birth to calves; and
- C** is the lesser of the following two amounts:
  - the amount for **B**, and
  - one-half of the total number of female cattle that have given birth to calves.

A **prescribed drought region** is a region the Minister of Agriculture has identified as suffering from drought conditions. For a list of these regions contact your local office of the Department of Agriculture or your district office.

The following paragraphs explain the rules in calculating the amount of income you may postpone.

If your farming business is in a prescribed drought region **at any time** in your 1990 fiscal period and you have postponed including amounts in income from earlier years, you do not have to include these amounts in income for 1990. In addition, breeding animals you sell in 1990 and receive payment for in the same year are eligible to be postponed. The amount you may postpone is calculated as follows:

- where your breeding herd is reduced between 15 and 30 per cent, you may postpone up to 30 per cent of the amount you receive; and
- where your breeding herd is reduced by 30 per cent or more, you may postpone up to 90 per cent of the amount you receive.

The amount eligible to be postponed is net of the cost of breeding animals purchased in the same year.

#### **Note**

Although you are eligible to postpone amounts as mentioned above, if you prefer, you can include any part of these amounts in your 1990 income.

If your farming business is **not in a prescribed drought region during your 1990 fiscal period**, you are not eligible to postpone amounts you receive from the sale of breeding animals. In addition, all amounts postponed in earlier years are included in income for 1990.

#### **Code 470**

##### **Wood**

If you operate or regularly harvest a woodlot, include in income amounts you receive from the sale of trees, lumber, logs, poles or firewood.

You may deduct from this income an allowance for depletion. This depletion allowance is explained in Interpretation Bulletin IT-481, Timber Resource Property and Timber Limits.

However, an amount you receive from the odd transaction for allowing other persons to remove standing timber from your woodlot is considered a capital receipt. A taxable capital gain or an allowable capital loss may result from this type of a transaction. For information on capital gains and losses, get the *1990 Capital Gains Tax Guide*.

If you need more information on the sale of wood, get Interpretation Bulletin IT-373R, Farm Woodlots and Tree Farms.

#### **Code 480**

##### **Patronage dividends**

Include all patronage dividends you receive (other than those for consumer goods or services) in income in the year you receive them. A patronage dividend that is a share or a certificate of indebtedness is considered to be income at the time you receive the share or certificate.

#### **Codes 485, 486, and 487**

Rebates — Gasoline tax  
— Property tax  
— Other

If you receive a federal or provincial rebate on gasoline tax, property tax, or interest that applies to your farming business, you either include the rebate in income or reduce your expenses by the amount of the rebate.

#### **Codes 455 and 495**

##### **Government grants and subsidies**

##### **Government assistance**

Generally, a grant, subsidy, or any other type of assistance payment you receive from a government or a government agency is either included in income or you may reduce the related expense by the amount of the rebate. However, amounts received for Western Grain Stabilization payments, milk or dairy subsidies, or payments under the Special Canadian Grains Program must be included in income.



**If you receive government assistance to purchase depreciable property** you must deduct it from the cost of the property. This reduction is for capital cost allowance (see Chapter 3) and investment tax credit (see Chapter 7) purposes.

Unless a different treatment is required under the *Income Tax Act* (for example, a government grant to purchase depreciable property), most **inducements, reimbursements, contributions, and allowances** you receive for your farming business are included in income. However, if the amount you receive is used to purchase property, you may choose to reduce the cost or capital cost of the property. If you do this, do not include the amount in your income.

#### **Ontario farm tax rebate program**

Under the Ontario farm tax rebate program, 100 per cent of the taxes levied on eligible farm land and buildings may be rebated. The taxes levied on your farm house and one acre of land are not eligible for this rebate.

If you receive a farm tax rebate from the Province of Ontario for municipal taxes you include it in income. The amount you include in income is that part of the rebate that you deducted as an expense.

If you need more information, get Interpretation Bulletins IT-252, Agricultural and Rural Development Act Grants and IT-273R and Special Release, Government Assistance — General Comments.

#### **Code 500**

##### **Other farming income**

If you have other types of farming income not shown on Form T2042, use the spaces under this code to show them. If there is not enough space to show them, list them on a separate sheet of paper and attach it to the form.

Examples of other types of farming income are explained in the following paragraphs.

##### **Payment made in kind**

Include in income, the value of grain, livestock or other produce you give to another person as payment to settle a business or a personal loan or debt or as part of the purchase price for property you are buying.

If the debt you are settling is a business expense, you also show the value you include in income as a business expense.

##### **Surface rental for petroleum or natural gas exploration**

If your farm land is leased by you for petroleum or natural gas exploration, amounts you receive will either be an income item or a capital receipt.

Include in income the annual amount you receive for rental, severance, or inconvenience under a surface rental for petroleum or natural gas exploration. Usually the initial payment under the lease is larger than the subsequent annual payments, and the lease may not specify the part of the initial payment that is for rental, severance or

inconvenience. In this case, include in income for the year you receive the initial payment an amount equal to the annual payment for rental, severance, or inconvenience you will receive in subsequent years. The balance of the initial payment may result in either a capital gain or loss.

If you need more information, get Interpretation Bulletin IT-200, Surface Rentals and Farming Operations.

#### **Rental income**

Do not include amounts you receive for rent, whether from farm property or real estate, in your farming income. You report rental income separately, on line 126 on page 1 of your return. To calculate your rental income, you may use Form T776, Statement of Real Estate Rentals. You can get this form along with the *1990 Rental Income Tax Guide* from your district office.

You may receive rental income either in cash or on a share crop basis. Generally, this type of income is not included in farming income. However, there is one exception to this rule. Rental income you receive on a share crop basis is included as farming income for the purpose of five-year block averaging. The five-year block averaging is explained in Chapter 9.

#### **Capital cost allowance recapture**

If you sell depreciable property, this may result in a recapture of capital cost allowance. The amount of recapture is included in income for the year. For more information on recapture see Chapter 3.

In addition, the sale of depreciable property may result in a capital gain. For information on capital gains get the *1990 Capital Gains Tax Guide*.

#### **Miscellaneous**

Examples of miscellaneous income include amounts you receive from the sale of soil, sod, sand, gravel or stone. For some of these items, you may be entitled to deduct an allowance for depletion. For information on this depletion allowance, get Interpretation Bulletin IT-492, Capital Cost Allowance — Industrial Mineral Mines.

Fair or exhibition prizes are income. However, if your children win these prizes, they may report the income. For more information on prizes, get Interpretation Bulletin IT-213R, Prizes from Lottery Schemes, Pool Systems Betting and Giveaway Contests.

If you sell property such as small tools that you have deducted as an expense, include in income the amount you receive from the sale.

Amounts not to be reported as farming income  
Farming income does not include salaries, wages, council fees, interest and other investment income, Old Age Security pension, Canada or Quebec Pension Plan benefits, Unemployment Insurance benefits, etc. Instead, report these types of income on page 1 of your return. Also, include investment income on Schedule 5.

## Amounts to be deducted as expenses

The most common expenses are explained in this part of the chapter. They are explained using the same code numbers as those on Form T2042. If you have other types of farming expenses not shown on Form T2042, use the blank spaces on the form to show them or list them on a separate sheet of paper and attach it to your return.

### Prepaid expenses

A prepaid expense is for example, the cost of a service that is paid in advance. Examples of this include insurance, taxes and rent you pay in one year but do not receive the benefit until the next year.

You deduct the full amount of prepaid expenses paid in the year. You may do this, if you use the cash method to calculate your farming income and have a binding contract with the supplier.

If you use the accrual method to calculate your farming income, you deduct for the year the portion of the prepaid expenses that relates to that year. This is explained in Interpretation Bulletin IT-417R, Prepaid Expenses and Deferred Charges.

### Code 195

#### Salaries and wages

Deduct as an expense, the total wages paid to hired help plus the cost of their board. Keep a detailed record of the amounts paid to each employee along with the employee's name, address, and social insurance number.

When you pay your employees, the general rule is you withhold Canada or Quebec Pension Plan contributions, Unemployment Insurance premiums and income tax on their behalf. For information about this and exceptions to the general rule, see the employer's instructions in the *Employers Guide to Source Deductions* and the booklet *The Canada Pension Plan — Information for the Self-Employed*. Also, wages paid to non-resident employees may be subject to these deductions.

You deduct as an expense the amount of wages paid before withholding amounts. This means you do not deduct as a separate expense amounts you withhold on your employees' behalf. However, you deduct as an expense the employer's portion of Canada or Quebec Pension Plan contributions and Unemployment Insurance premiums.

Each year report on a T4 Supplementary slip the wages paid to your employee and amounts you withhold. You also complete a T4 and T4A Returns which includes T4 and T4A Summaries and the T4 and T4A Supplementaries. For your 1990 taxation year, complete this information and mail it to your taxation centre by February 28, 1991. For instructions on how to complete the T4 and T4A Returns see the *Employers Guide to Source Deductions*.

You deduct wages paid to your child if

- you actually paid the wages in cash or in kind;
- the work by the child is necessary for earning farming income and, if the work was not done by the child you would have hired some other person to do this work; and
- the wages are reasonable, considering the child's age and the amount you would have paid another person for the same work.

Keep documents to support the amount of wages paid to your child. If you pay by cheque, keep the cancelled cheque to support these amounts. If you pay in cash, get a receipt signed by the child.

If you pay wages to your child in kind (for example, you give your child livestock or grain rather than cash) and you deduct the wages as an expense,

- your child includes the value of the livestock or grain in income for the year, and
- you include the same amount in your gross sales for the year.

You can also deduct wages paid to your spouse if you follow the same rules as wages paid to your child.

You report the wages paid to your children and your spouse on T4 slips. You cannot deduct as an expense the value of board for dependent children.

### Code 205

#### Rent (land, buildings, pasture)

If you rent, for example, land, buildings or pasture, deduct the amount paid as an expense. If you are farming on a share-crop basis, treat any rent you pay in kind by either,

- adding the fair market value of the crops you give to your landlord to your income and deducting the same amount as an expense, or
- do not include the amount in income and do not deduct the expense for rent.

### Codes 210 and 211

#### Interest expense

You deduct interest paid on money borrowed for the purpose of earning farming income; for example, interest on money borrowed to buy farm equipment. However, there is a limit on the interest you deduct on money borrowed to purchase a "passenger vehicle" you use in your farming business. This is explained under "Code 225 — Motor vehicle expenses."

You cannot deduct interest on money borrowed for personal purposes, interest on overdue income taxes, or the principal portion of loan or mortgage payments.

**Code 215****Property taxes**

The amount you deduct for property taxes is explained under "Codes 290, 295 and 215 — Property taxes, electricity and heating fuel."

**Code 225****Motor vehicle expenses**

Before explaining the motor vehicle expenses you are entitled to deduct, you first need to know the difference between a **motor vehicle, automobile** and a **passenger vehicle**. This is important to know because there is a limit on the amount of capital cost allowance, interest and leasing costs you deduct in the year for **passenger vehicles**.

A **motor vehicle** is any automotive vehicle for use on highways or streets.

A **passenger vehicle** is any **automobile** purchased after June 17, 1987 unless you bought it under a written agreement entered into before June 18, 1987. A passenger vehicle also includes an automobile that is leased under an agreement entered into, extended or renewed after June 17, 1987.

An **automobile** is a motor vehicle that carries people and their luggage and seats no more than eight passengers and a driver. Most cars, station wagons, vans and some pick-up trucks are automobiles.

However, there are exceptions. An automobile does not include

- a station wagon, van or similar vehicle if it is permanently equipped to carry only a driver and no more than two passengers; or
- a pick-up truck, van or similar vehicle that carries no more than a driver and two passengers and is "used primarily" in a business to transport goods or equipment. "Used primarily" means the vehicle is being used more than 50% for business purposes.

**Note**

The vehicles described above as exceptions are motor vehicles, not passenger vehicles. Therefore, they are not subject to the interest, leasing and capital cost allowance limitations.

In a news release dated July 13, 1990, the Department of Finance issued Draft legislation that will change the definition of an **automobile**. This change is proposed to apply to taxation years and fiscal periods beginning after June 17, 1987 that end after 1987.

The proposed definition of an **automobile** is a motor vehicle that seats no more than the driver and eight passengers. However, there are exceptions to this definition. An automobile does not include:

- a pick-up truck, van or similar vehicle that seats no more than a driver and two passengers and in the year

it is purchased is "used primarily" to transport goods or equipment in the course of earning income. "Used primarily" means the vehicle is being used more than 50 per cent for business purposes; or

- a pick-up truck, van or similar vehicle that in the year of purchase is used all or substantially all (90 per cent or more) to transport goods, equipment or passengers in the course of earning income.

If you need more information about the new definition or how it may affect your 1988 and 1989 returns, contact your district office.

If you use your motor vehicle for business and personal use, you deduct the portion of the total expenses for the vehicle that is for the business-use portion. Business-use includes trips made to pick up parts, farm supplies, deliver grain, etc. If you have a job as an employee or you do not live on your farm, business-use does not include the distance travelled to and from your place of employment, or to and from the farm.

To support your motor vehicle expenses, it is important to keep a record for the business and personal use.

**Example**

Jim's farming business has a December 31, 1990 year-end. During all of 1990 he owned a pick-up truck that he uses to pick up supplies and equipment. The truck carries a driver and two passengers. For 1990, Jim recorded the following information about his truck:

Business kilometres.....	27,000 km
Total kilometres .....	30,000 km
Gasoline and oil .....	\$3,500
Repairs and maintenance .....	500
Insurance .....	1,000
Interest (on loan to purchase truck) .....	1,900
License and registration fees .....	100
Total expenses for the truck .....	<u>\$7,000</u>

The motor vehicle expense Jim deducts for the pick-up truck in 1990 is \$6,300 and is calculated as follows:

$$\frac{\text{Business kilometres}}{\text{Total kilometres}} = \frac{27,000}{30,000} \times \$7,000 = \$6,300$$

**Interest on money borrowed for a passenger vehicle**

There is a limit on the amount you deduct for money borrowed or on an amount you owe to purchase a passenger vehicle for use in your business. If you purchase a passenger vehicle **before September 1, 1989**, you cannot deduct more than 8.33 times the number of days for which interest is paid. If you purchase a passenger vehicle **after August 31, 1989**, you cannot deduct more than 10.00 times the number of days for which interest is paid.

If you pay interest on any debt for the purchase of a passenger vehicle and you use the cash method to calculate your income, complete Chart 1 to calculate the interest you deduct. If your passenger vehicle is used for business and personal use, you still do this calculation before calculating the business-use portion you deduct as an expense.

If you use the accrual method to calculate your income, get the *1990 Business and Professional Income Tax Guide* for information on the interest you can deduct.

<b>CHART 1</b>	
Enter the total interest paid in the year	\$ _____ (A)
\$ _____ * ×	the number of days for which interest was paid \$ _____ (B)
<b>Available interest expense</b> is (A) or (B), whichever amount is less \$ _____	
* for passenger vehicles purchased before September 1, 1989 enter \$8.33.	
* for passenger vehicles purchased after August 31, 1989 enter \$10.00.	

### Example

Frank's farming business has a December 31, 1990 year-end. In March 1988 he purchased a new car that he uses for both personal and business purposes. The car seats a driver and four passengers. Frank borrowed the money to purchase the car and the interest he paid in 1990 was \$5,000. For 1990, Frank recorded the following information about the car:

Business kilometres . . . . .	20,000 km
Total kilometres . . . . .	25,000 km
Gasoline and oil . . . . .	\$2,000
Repairs and maintenance . . . . .	1,000
Insurance . . . . .	1,900
Interest (on loan to purchase car) . . . . .	3,040*
License and registration . . . . .	60
Total car expenses . . . . .	<u>\$8,000</u>

\* As Frank purchased a car after June 17, 1987 that is a passenger vehicle, the interest for the car is restricted. The available interest Frank calculates is the lesser of

- the total interest paid in 1990 of \$5,000, and
- $\$8.33 \times 365 \text{ days} = \$3,040$ .

Since Frank purchased the passenger vehicle in March 1988, he uses the rate of \$8.33 which is for passenger vehicles purchased before September 1, 1989.

The motor vehicle expense Frank deducts for the car in 1990 is \$6,400 and is calculated as follows:

$$\frac{\text{Business kilometres}}{\text{Total kilometres}} = \frac{20,000}{25,000} \times \$8,000 = \$6,400$$

### Leasing costs for a passenger vehicle

If you lease a passenger vehicle for use in your farming business, there is a limit on the leasing costs you deduct as an expense. If this is your situation, get Interpretation Bulletin IT-521, *Motor Vehicle Expenses Claimed by Self-Employed Individuals*, which explains this limitation.

### Note

If you entered into or extended a lease agreement before September 1, 1989 use the amounts as shown in paragraph 10 of Interpretation Bulletin IT-521.

If you entered into or extended a lease agreement after August 31, 1989 change the amounts in paragraph 10 of Interpretation Bulletin IT-521 as follows:

- change \$600 to \$650.
- change \$20,000 to \$24,000.
- change \$23,529 to \$28,235.

### Joint ownership

If you and somebody else own or lease the same passenger vehicle, the limits on capital cost allowance, interest and leasing charges still applies. The total deduction by all the owners cannot be more than the deduction allowed if only one person owned or leased the passenger vehicle.

### More than one vehicle

If you use more than one motor vehicle for business purposes, calculate the motor vehicle expenses for each vehicle. To do this, keep a separate record of the business and total kilometres driven and the expenses for each vehicle.

If you need more information on motor vehicle expenses, get Interpretation Bulletin IT-521, *Motor Vehicle Expenses Claimed by Self-Employed Individuals*.

### Code 255

**Veterinary fees, medicine and breeding fees**  
Deduct amounts paid for veterinary fees, medicine for your animals, and breeding fees (including artificial insemination).

### Code 260

**Building repairs**  
Deduct amounts paid for repairs to all buildings (except your farm house) you use for farming. However, if the repairs improve a building beyond its original condition, these costs are capital expenditures. This means you add the cost of the repairs to the cost of the building on your capital cost allowance schedule. Capital cost allowance is explained in Chapter 3.

If you need more information about capital expenditures, get Interpretation Bulletin IT-128R, *Capital Cost Allowance — Depreciable Property*.

If you use your farm house for business purposes, see the section, "Code 660 — Business-use of home expenses" for more information.

**Code 270****Small tools**

Deduct the full cost of a tool that costs less than \$200. If a tool cost \$200 or more, you add the cost to your capital cost allowance schedule (see Chapter 3).

**Code 275****Insurance (buildings, crops, livestock)**

Deduct amounts paid for insuring your farm buildings, crops and livestock. In Quebec, the province reimburses a part of the cost of this insurance. If you receive a reimbursement, reduce your insurance expense by this amount.

You cannot deduct amounts paid for insuring any personal property such as your home or car. However, if you use property for personal and business purposes, you deduct the business portion as an expense. For more information, see the sections "Code 225 — Motor vehicle expenses" and "Code 660 — Business-use of home expenses" in this chapter.

Generally, you cannot deduct as an expense, amounts paid for life insurance premiums.

**Code 280****Accounting, legal, office, advertising, memberships and subscriptions**

Deduct legal costs paid if they are for your farming business. However, legal costs and other fees for the purchase of property such as land, buildings or equipment are added to the cost of the property.

Also, you deduct fees and expenses if they are for

- advice and assistance to prepare and file your income tax return; or
- an objection or appeal against an assessment for income tax, Canada or Quebec Pension Plan contributions or Unemployment Insurance premiums. Deduct these type of fees and expenses on line 232 in your return.

Please note that your expense is reduced by the amount of any award you receive to cover your costs.

If you need more information, get Interpretation Bulletin IT-99R3, *Legal and Accounting Fees*.

Deduct fees paid for memberships in organizations and subscriptions that relate to farming.

You can also deduct the cost of office expenses such as stationery, invoices, receipt books and accounting books.

**Code 285****Telephone**

You cannot deduct the basic cost for your home telephone. However, you deduct amounts paid for any business long distance telephone calls. If you have a separate telephone used only for business, the basic cost is deducted as an expense.

**Codes 290, 295 and 215****Property taxes, electricity and heating fuel**

You can only deduct a portion of these costs. To find out this portion, separate amounts paid for property taxes, electricity and heating fuel between the farm house and other properties.

For example, the business portion for electricity will depend on whether more electricity is used for the farm house or for the barns and shops. You deduct the portion that is for the barns and shops. The portion for the farm house is personal and cannot be deducted unless you meet the conditions to deduct an amount for the business-use of your home. This is explained under "Code 660 — Business-use of home expenses."

If you are repaying a loan to a municipality through your property tax payments (for example, a loan for tile drainage) the amount of the loan repayment cannot be included in the property tax expense.

Expenses for a house that you rent out are not included in farming expenses. You show rental income and expenses on a separate statement. You may use Form T776, *Statement of Real Estate Rentals*. You can get this form and the *1990 Rental Income Tax Guide* from your district office.

**Code 310****Clearing or levelling land and improving land****Clearing or levelling land**

This includes costs for clearing the land of brush, trees, roots, stones, etc., and the initial ploughing of land for farm use.

For a farming business, whether you own or rent the land from someone, these costs are deducted as an expense. You do not have to deduct the full amount paid as an expense in the year of payment. As long as payment has been made, you can deduct any part of the payment in the year paid and carry forward any portion not deducted to another year. This also applies to the cost of installing land drainage.

If you rent land to a person who is using the land for farming you cannot deduct these costs as an expense. The cost of clearing or levelling land is added to the cost of land or the property which is on the land. Also, costs for land drainage are added to Class 8 of your capital cost allowance schedule (see Chapter 3).

You deduct the cost of constructing an unpaved road as an expense in the year.

If you need more information, get Interpretation Bulletin IT-485, *Cost of Clearing or Levelling Land*.

**Improving land**

You cannot deduct the cost of a paved road as an expense. These costs are added to Class 17 of your capital cost allowance schedule (see Chapter 3).

Deduct the cost of drilling or digging water wells as an expense in the year. However, costs for casing and cribwork are added to Class 8. You also add to Class 8, the cost of a water distribution system which includes the pump, pump installation, piping and trenching.

Deduct payments made to have public utilities brought to your farm as long as the installations remain the property of the public utility.

Any payments made under The Co-operative Associations Act for the construction of a distribution system under a gas service contract are deducted as an expense.

#### Code 320

##### Other expenses

You may pay some of your expenses (such as seed, feed, sprays, fertilizers, or the grain levy under the Western Grain Stabilization program) by having these amounts deducted from your cash grain tickets or grain stabilization payments. If you do, and also deduct them as expenses, include in your income the gross amount of the grain sale or grain stabilization payment. If you include in income the net amount of the sale or payment, then you do not deduct the expenses.

If you take a deferred cash purchase ticket as settlement, the Western Grain Stabilization levy is considered to be paid on the date the grain is delivered for sale. Deduct the levy as an expense for that year. However, include in income for the next year, the total purchase price as stated on the deferred cash purchase ticket.

##### Leasing costs

If you lease property, deduct the amount of the lease payments paid in the year. If you are leasing a "passenger vehicle" see the section "Code 225 — Motor vehicle expenses" in this chapter.

If you entered into a lease agreement after April 26, 1989, there is a different tax treatment available to you. If you and the lessor jointly elect, the following rules apply:

- you are considered not to have leased the property but to have purchased it, and
- you are considered to have borrowed an amount equal to the fair market value of the leased property.

To make this election, you must use either Form T2145, Election in Respect of the Leasing of Property, or Form T2146, Election in Respect of Assigned Leases or Subleased Property, and file it with your income tax return for the year the lease agreement is made.

The lease payments are treated as combined payments of principal and interest on the loan. You deduct the interest portion of the payment as an expense. Also, you can deduct capital cost allowance on the property.

These rules apply where the total fair market value of the property you lease is more than \$25,000. In addition, only certain types of property qualify for this treatment. A

combine is an example of the type of property that qualifies, whereas, office furniture and automobiles usually do not qualify.

If you have made this type of arrangement with the lessor, contact your district office if you need more information.

#### Code 325

##### Optional value of livestock, end of previous year

If you include an amount for optional value of livestock in income for 1989, you deduct this same amount as an expense in 1990.

#### Code 326

##### Mandatory inventory adjustment

If you were required to include in income for 1989 the mandatory inventory adjustment, you deduct this same amount as an expense in 1990.

#### Code 327

##### Optional inventory adjustment

If you include an amount for the optional inventory adjustment in 1989, you deduct this same amount as an expense in 1990.

#### Code 330

##### Capital cost allowance

Enter your capital cost allowance claim that you calculate on Form T2041 or on your own schedule. Capital cost allowance is explained in Chapter 3.

#### Code 331

##### Allowance on eligible capital property

This deduction and how you calculate it are explained in Chapter 4, "Eligible Capital Expenditures."

#### Code 335

##### Total farming expenses

Add your farming expenses for the year and enter the total on line 335. Carry the amount on line 335 over to line 515.

### **Code 520**

### **Net income (loss) before adjustments**

You subtract your total farming expenses (line 515) from your gross farming income (line 505). The difference is your net income or loss before adjustments. Enter this amount on line 520 and carry it to the reverse side of Form T2042.

It is often necessary to adjust the net income (loss) before adjustments to determine the net income (loss) to report on your return. These adjustments as shown on Form T2042 are:

- adjustments to the income and expenses statement,
- mandatory inventory adjustment,
- optional inventory adjustment,

- business-use of home expenses, and
- the partnership schedule.

If no adjustments are required, the amount on line 520 is the net income (loss) you show on page 1 of your return.

### Note

It is important to calculate each adjustment in the order shown on Form T2042. You do this even if you prepare your own statement.

## Adjustments to the income and expenses statement

The more common adjustments to the income and expenses statement are shown on Form T2042. These adjustments include salary or wages paid to yourself and/or partner(s), the cost of saleable products consumed, and personal or non-business portion of expenses claimed.

### Code 605

#### Salary or wages paid to yourself and/or partner(s)

If you operate your farming business by yourself and deduct a salary paid to yourself, add this amount back to your income.

If your farming business is operated as a partnership and salaries are paid to the members of the partnership and deducted as an expense, add these amounts back into income. You do this because salaries paid are actually an allocation of the partnership income.

### Code 615

#### Cost of saleable goods consumed

If you, your family, or your partners and their families consume any crops or other products you sell, add the cost of producing these products back into income. Examples of such products include milk, cream, butter, eggs, potatoes, poultry and meat. You do this if you deduct the cost of producing these items in your expenses.

### Code 620

#### Personal or non-business portion of expenses

If you include personal or the non-business portion of expenses in your total farming expenses, add these amounts back into income. Examples of these type of expenses include

- personal expenses,
- charitable donations (see below),
- political contributions,
- interest and penalties on income tax,
- life insurance premiums, and
- fines and penalties.

You cannot deduct charitable donations as an expense of your farming business. If you have, add this amount back

into income and claim these donations on line 340 on page 2 of your return.

After making the adjustments to the income and expenses statement, enter your **net income (loss) after adjusting the income and expenses statement** on line 630.

### Code 635

#### Mandatory inventory adjustment

You make the mandatory inventory adjustment if

- you calculate your income under the cash method,
- you have a net loss after adjusting the income and expenses statement on line 630, and
- have **inventory you purchased and paid for** which is on hand at the end of your 1990 fiscal period.

If this is your situation, your net loss after adjusting the income and expenses statement (on line 630) is reduced by the mandatory inventory adjustment.

### Note

If you do not have to make this adjustment, you should still read this section and count your purchased inventory on hand at the end of your 1990 fiscal period. This information may be important to you if you have to make this adjustment in a future year. To value your inventory, you may use the charts in this section. Keep these charts as part of your books and records.

### Definitions

Before explaining how to calculate the mandatory inventory adjustment, you need to know the meaning of the following terms.

**Inventory** is a group of items a business holds and either sells them to customers or uses them in the business operation.

Examples of inventory for a farmer reporting income under the cash method include livestock, fertilizer, chemicals, feed, seed, fuel, etc. Seeds that are planted and fertilizer or chemicals that are already applied are not part of your inventory.

**Purchased inventory** is inventory that you have bought and paid for and is still on hand at the end of your 1990 fiscal period.

**Specified animal** is a horse and, if you choose, an animal registered under the Animal Pedigree Act. To make this choice, state in your return you want these animals to be treated as specified animals. Each animal that is treated in any tax return as a specified animal continues to be treated as such until it is sold.

**Cash cost** is the amount you paid to purchase your inventory.

**Fair market value** is the price you would purchase or sell a property for in a normal business transaction.

**Value of purchased inventory** is the value of your purchased inventory on hand at the end of any fiscal period.

#### How to calculate the mandatory inventory adjustment

As previously stated, the mandatory inventory adjustment is the amount you reduce your net loss after adjusting the income and expenses statement. This loss is shown on line 630 on Form T2042.

The amount you reduce your loss by is

- the loss shown on line 630, and
- the value of your purchased inventory on hand at the end of your 1990 fiscal period, whichever is less.

#### Value of purchased inventory on hand at the end of your 1990 fiscal period

The first step in the calculation is to value your purchased inventory. To do this, follow the step-by-step instructions in the following paragraphs. Also, there are charts you can use and examples on how to complete each chart.

To value your purchased inventory on hand at the end of your 1990 fiscal period you need to know the cash cost, the fair market value, and the value of this inventory which was on hand at the end your 1989 fiscal period.

Purchased inventory, **except** specified animals, is valued at either

- **cash cost**
- or
- **fair market value,**

whichever is less.

To find out which value is less, compare each item or class of items in the inventory separately.

Specified animals purchased in your 1990 fiscal period are valued at an amount

- that is not more than the cash cost
- but not less than 70 per cent of the cash cost.

You can choose any amount between these two values.

Specified animals purchased before your 1990 fiscal period and still on hand at the end of your 1990 fiscal period are valued at an amount

- that is not more than the cash cost
- but not less than 70 per cent of the total of
  - their value at the end of your 1989 fiscal period, plus
  - any amounts paid in your 1990 fiscal period on account of the purchase price.

You can choose any amount between these two values.

To calculate the **cash cost**, complete Chart 2 with the help of the accompanying example.

<b>CHART 2</b>			
<b>Cash Cost of Purchased Inventory</b>			
Enter the amount paid by the end of your 1990 fiscal period for specified animals purchased in your 1990 fiscal period.			_____ (1)
Enter the amount paid by the end of your 1990 fiscal period for specified animals purchased in your 1989 fiscal period.			_____ (2)
Enter the amount paid by the end of your 1990 fiscal period for specified animals purchased before your 1989 fiscal period. For the fiscal period of purchase, multiply the amount paid by the percentage and enter the total for all years on line (3).			
Fiscal Period of Purchase	Amount Paid	Percentage	Cash Cost
1988	_____	100%	_____
1987	_____	50%	_____
1986	_____	50%	_____
1985 and prior years	_____	25%	_____
Total cash cost for specified animals purchased before your 1989 fiscal period.			_____ (3)
Enter the amount paid by the end of your 1990 fiscal period for all other inventory purchased in your 1990 fiscal period.			_____ (4)
Enter the amount paid by the end of your 1990 fiscal period for all other inventory purchased in your 1989 fiscal period.			_____ (5)
Enter the amount paid by the end of your 1990 fiscal period for all other inventory purchased before your 1989 fiscal period.			_____ (6)

#### Example

Jake's farming business has a December 31, 1990 year end. Jake shows a **net loss after adjusting the income and expenses statement** of \$55,000 and has **purchased** inventory on hand at the end of his 1990 fiscal period. This means he decreases his net loss by the mandatory inventory adjustment. Jake recorded the following information about the cash cost of his purchased inventory on hand at the end of his 1990 fiscal period.



## Livestock

<u>Year of purchase</u>	<u>Amount of purchase</u>	<u>Amount paid by the end of the 1990 fiscal period</u>
1990	\$22,000	\$17,000
1989	20,000	20,000*
1988	16,000	16,000
1987	14,000	14,000
1986	12,000	12,000
1985	10,000	10,000

\* For livestock purchased in his 1989 fiscal period, Jake paid \$15,000 in 1989 and \$5,000 in 1990.

The cash cost for Jake's other inventory is \$15,000 for inventory purchased in his 1990 fiscal period and \$6,000 for inventory purchased in his 1989 fiscal period.

Jake's livestock is registered under the Animal Pedigree Act and he is choosing to have these animals treated as "specified animals." Jake's other inventory is made up of fertilizer, seed, and fuel. Jake completes Chart 2 as follows:

**CHART 2****Cash Cost of Purchased Inventory**

Enter the amount paid by the end of your 1990 fiscal period for specified animals purchased in your 1990 fiscal period. \$17,000 (1)

Enter the amount paid by the end of your 1990 fiscal period for specified animals purchased in your 1989 fiscal period. \$20,000 (2)

Enter the amount paid by the end of your 1990 fiscal period for specified animals purchased before your 1989 fiscal period. For the fiscal period of purchase, multiply the amount paid by the percentage and enter the total for all years on line (3).

<u>Fiscal Period of Purchase</u>	<u>Amount Paid</u>	<u>Percentage</u>	<u>Cash Cost</u>
1988	<u>\$16,000</u>	100%	<u>\$16,000</u>
1987	<u>14,000</u>	50%	<u>7,000</u>
1986	<u>12,000</u>	50%	<u>6,000</u>
1985 and prior years	<u>10,000</u>	25%	<u>2,500</u>

Total cash cost for specified animals purchased before your 1989 fiscal period. \$31,500 (3)

Enter the amount paid by the end of your 1990 fiscal period for all other inventory purchased in your 1990 fiscal period. \$15,000 (4)

Enter the amount paid by the end of your 1990 fiscal period for all other inventory purchased in your 1989 fiscal period. \$ 6,000 (5)

Enter the amount paid by the end of your 1990 fiscal period for all other inventory purchased before your 1989 fiscal period. \$ 0 (6)

Now that you have calculated the **cash cost** of your inventory, you use this information to calculate the **value of your inventory** on hand at the end of your 1990 fiscal period.

You do this calculation in several steps starting with inventory purchased in your 1990 fiscal period, then inventory purchased in your 1989 fiscal period, and lastly, inventory purchased before your 1989 fiscal period.

**Value of purchased inventory bought in your 1990 fiscal period**

Specified animals purchased in your 1990 fiscal period and still on hand at the end of your 1990 fiscal period are valued at an amount

- that is not more than the cash cost
- but not less than 70 per cent of the cash cost.

You can choose any amount between these two values.

Other inventory purchased in your 1990 fiscal period is valued at either

- cash cost
- or
- fair market value,

whichever is less.

Complete Chart 3 to calculate the value of purchased inventory bought in your 1990 fiscal period and still on hand at the end of your 1990 fiscal period.

**CHART 3****Value of Purchased Inventory Bought in Your 1990 Fiscal Period**

Specified animals — Enter an amount that is not more than the amount on line (1) but not less than 70% of the amount on line (1). \_\_\_\_\_ (7)

Other inventory — Enter the amount on line (4) or the fair market value, whichever is less. \_\_\_\_\_ (8)

**Example**

Now that Jake has calculated the cash cost of his purchased inventory, he uses this information to calculate the value of his purchased inventory bought in his 1990 fiscal period and still on hand at the end of his 1990 fiscal period.

**CHART 3****Value of Purchased Inventory Bought in Your 1990 Fiscal Period**

Specified animals — Enter an amount that is not more than the amount on line (1) but not less than 70% of the amount on line (1). \* \$11,900 (7)

Other inventory — Enter the amount on line (4) or the fair market value, whichever is less.      \*\* \$15,000 (8)

\* Jake chose \$11,900 which is 70 per cent of the cash cost of \$17,000 as the value for “specified animals.” He could have chosen any amount between the cash cost of \$17,000 and \$11,900.

\*\* In Jake’s case, the cash cost and the fair market value of his other inventory are the same.

**Value of purchased inventory bought in your 1989 fiscal period**

Specified animals purchased in your 1989 fiscal period and still on hand at the end of your 1990 fiscal period are valued at an amount

- that is not more than the cash cost
- but not less than 70 per cent of the total of
  - their value at the end of your 1989 fiscal period, plus
  - any amounts paid in your 1990 fiscal period on account of the purchase price.

You can choose any amount between these two values.

Other inventory purchased in your 1989 fiscal period is valued at either

- cash cost
- or
- fair market value,

whichever is less.

Complete Chart 4 to calculate the value of purchased inventory bought in your 1989 fiscal period and still on hand at the end of your 1990 fiscal period.

**CHART 4**

**Value of Purchased Inventory Bought in Your 1989 Fiscal Period**

Specified animals — Enter an amount that is not more than the amount on line (2) but not less than 70% of the total of the value at the end of the 1989 fiscal period plus any amounts paid in your 1990 fiscal period on account of the purchase price.      \_\_\_\_\_ (9)

Other inventory — Enter the amount on line (5) or the fair market value, whichever is less.      \_\_\_\_\_ (10)

**Example**

Jake now calculates the value of his purchased inventory bought in his 1989 fiscal period and still on hand at the end of the 1990 fiscal period.

**CHART 4**  
**Value of Purchased Inventory Bought in Your 1989 Fiscal Period**

Specified animals — Enter an amount that is not more than the amount on line (2) but not less than 70% of the total of the value at the end of the 1989 fiscal period plus any amounts paid in your 1990 fiscal period on account of the purchase price.      \* \$10,850 (9)

Other inventory — Enter the amount on line (5) or the fair market value, whichever is less.      \*\* \$ 6,000 (10)

\* Jake chose to value his inventory of specified animals at the end of his 1989 fiscal period at 70 per cent of the cash cost. Therefore, the value of this inventory at the end of his 1989 fiscal period was \$10,500 ( $\$15,000 \times 70\%$ ).

For his 1990 fiscal period, Jake again chooses to value this inventory at 70 per cent of the total of the value at the end of the 1989 fiscal period plus any amounts paid in the 1990 fiscal period on account of the purchase price. The amount he shows on line (9) is \$10,850 ( $\$10,500 + \$5,000 = \$15,500 \times 70\%$ ). He could have chosen any amount between the cash cost of \$20,000 and the lowest acceptable inventory value of \$10,850.

\*\* In Jake’s case, the cash cost and the fair market value of his other inventory are the same.

**Value of purchased inventory bought before your 1989 fiscal period.**

Specified animals purchased before your 1989 fiscal period and still on hand at the end of your 1990 fiscal period are valued at an amount

- that is not more than the cash cost
- but not less than 70 per cent of the total of
  - their value at the end of your 1989 fiscal period, plus
  - any amounts paid in your 1990 fiscal period on account of the purchase price.

You can choose any amount between these two values.

Other inventory purchased before your 1989 fiscal period is valued at either

- cash cost
- or
- fair market value,

whichever is less.

Complete Chart 5 to calculate the value of purchased inventory bought before your 1989 fiscal period and still on hand at the end of your 1990 fiscal period.

**CHART 5****Value of Purchased Inventory  
Bought Before Your 1989 Fiscal Period**

Specified animals — Enter an amount that is not more than the amount on line (3) but not less than 70% of the total of the value at the end of the 1989 fiscal period plus any amounts paid in your 1990 fiscal period on account of the purchase price. \_\_\_\_\_ (11)

Other inventory — Enter the amount on line (6) or the fair market value, whichever is less. \_\_\_\_\_ (12)

**Example**

Jake now calculates the value of his purchased inventory bought before his 1989 fiscal period and still on hand at the end of the 1990 fiscal period.

**CHART 5****Value of Purchased Inventory  
Bought Before  
Your 1989 Fiscal Period**

Specified animals — Enter an amount that is not more than the amount on line (3) but not less than 70% of the total of the value at the end of the 1989 fiscal period plus any amounts paid in your 1990 fiscal period on account of the purchase price. \* \$15,435 (11)

Other inventory — Enter the amount on line (6) or the fair market value, whichever is less. \*\* \$ 0 (12)

\* At the end of his 1989 fiscal period, Jake chose to value this inventory at 70 per cent of the cash cost. Therefore, the value of this inventory at the end of his 1989 fiscal period was \$22,050 ( $\$31,500 \times 70\%$ ).

For his 1990 fiscal period, Jake again chooses to value this inventory at 70 per cent of the value at the end of the 1989 fiscal period. The amount he shows on line (11) is \$15,435 ( $\$22,050 \times 70\%$ ). He could have chosen any amount between the cash cost of \$31,500 and the lowest acceptable inventory value of \$15,435.

\*\* At the end of his 1990 fiscal period, Jake did not have any other inventory on hand that was purchased before his 1989 fiscal period.

**Calculating the mandatory inventory adjustment**  
Once you have valued your inventory you can now calculate the adjustment required to reduce your net loss.

If your farming business **started after 1988**, your mandatory inventory adjustment is either the net loss after adjusting your income and expenses statement (line 630) or the value of your purchased inventory on hand at the end of your 1990 fiscal period, whichever is less. The value of your purchased inventory on hand is the amount after adding lines (7), (8), (9) and (10).

If your farming business **started before 1989**, you use either the **fixed dollar method** or the **elective method** to calculate your mandatory inventory adjustment. It is your choice as to the method you wish to use. However, if you choose the elective method, you must state in your income tax return that you are electing to use this method. If you do not do this, it is assumed you are using the fixed dollar method.

You should calculate the adjustment under both methods and then decide which method you wish to use. To do this, complete Chart 6 for the fixed dollar method and Chart 7 for the elective method. Once you choose the method you want, enter your mandatory inventory adjustment on line 635 on Form T2042. The examples will help you complete these charts.

**CHART 6****Fixed Dollar Method**

Enter the amount of your **net loss after adjusting the income and expenses statement** (from line 630 on Form T2042). \_\_\_\_\_ (13)

Enter the **value of inventory** from Charts 3, 4, and 5.

— the amount on line (7)	_____
— the amount on line (8)	_____
— the amount on line (9)	_____
— the amount on line (10)	_____
— the amount on line (11)	_____
— the amount on line (12)	_____
<b>Total value of inventory</b>	_____ (14)

Enter the amount on line (13) or line (14), whichever is less. \_\_\_\_\_ (15)  
Deduct: \* \$12,500

**Mandatory inventory adjustment under the fixed dollar method.** \_\_\_\_\_ (16)

**\* Note** \_\_\_\_\_  
If your **1990 fiscal period begins in 1990**, use **\$12,500** as shown in Chart 6.

If your **1990 fiscal period begins in 1989**, use **\$15,000** instead of \$12,500.

**CHART 7****Elective Method**

Enter the amount of your **net loss after adjusting the income and expenses statement** (from line 630 on Form T2042). \_\_\_\_\_ (17)

Enter the **value of inventory** from Charts 3 and 4.

— the amount on line (7) \_\_\_\_\_

— the amount on line (8) \_\_\_\_\_

— the amount on line (9) \_\_\_\_\_

— the amount on line (10) \_\_\_\_\_

**Total** \_\_\_\_\_ (18)

Enter the **value of inventory** from Chart 5.

— the amount on line (11) \_\_\_\_\_

— the amount on line (12) \_\_\_\_\_

Sub-total \_\_\_\_\_ (19)

Multiply line (19) by **\*.286**

**Total** \_\_\_\_\_ (20)

Add lines (18) and (20) \_\_\_\_\_ (21)

**Mandatory inventory adjustment** under the **effective method** is the amount on line (17) or line (21), whichever is less. \_\_\_\_\_ (22)

**\* Note**

If your **1990 fiscal period begins in 1990**, use **.286** as shown in Chart 7.

If your **1990 fiscal period begins in 1989**, use **.143** instead of **.286**.

**Example**

Now that Jake has valued his inventory, he now calculates the adjustment required to reduce his net loss after adjusting the income and expenses statement of \$55,000. Since Jake started farming before 1989, he has the choice of using either the fixed dollar method or the elective method. Before choosing which method to use Jake calculates the mandatory inventory adjustment under both methods.

**CHART 6****Fixed Dollar Method**

Enter the amount of your **net loss after adjusting the income and expenses statement** (from line 630 on Form T2042). \$55,000 (13)

Enter the **value of inventory** from Charts 3, 4, and 5.

— the amount from line (7) \$11,900

— the amount from line (8) 15,000

— the amount from line (9) 10,850

— the amount from line (10) 6,000

— the amount from line (11) 15,435

— the amount from line (12) 0

**Total value of inventory** \$59,185 \$59,185 (14)

Enter the amount on line (13) or line (14), whichever is less. \$55,000 (15)

Deduct: 12,500

**Mandatory inventory adjustment under the fixed dollar method.** \$42,500 (16)

**CHART 7****Elective Method**

Enter the amount of your **net loss after adjusting the income and expenses statement** (from line 630 on Form T2042). \$55,000 (17)

Enter the **value of inventory** from Charts 3 and 4.

— the amount on line (7) \$11,900

— the amount on line (8) 15,000

— the amount on line (9) 10,850

— the amount on line (10) 6,000

**Total** \$43,750 \$43,750 (18)

Enter the **value of inventory** from Chart 5.

— the amount on line (11) \$15,435

— the amount on line (12) 0

Sub-total \$15,435 (19)

Multiply line (19) by .286

**Total** 4,415 (20)

Add lines (18) and (20) \$48,165 (21)

**Mandatory inventory adjustment** under the **elective method** is the amount on line (17) or line (21), whichever is less. \$48,165 (22)

Under the **fixed dollar method** the **mandatory inventory adjustment** is \$42,500. Under the **elective method** the **mandatory inventory adjustment** is \$48,165.

Jake must reduce his **net loss after adjusting the income and expenses statement** by at least \$42,500. However, he may reduce his net loss by \$48,165 if he chooses. The amount Jake reduces his net loss by in 1990 is deducted from income in 1991.

**Code 651****Optional inventory adjustment**

The optional inventory adjustment allows you to include in your income an amount up to the fair market value of your inventory minus the mandatory inventory adjustment. The meaning of inventory and fair market value are explained under "Code 651 — Mandatory inventory adjustment."

The inventory does not have to be "purchased inventory" as required for the mandatory inventory adjustment. It is all inventory on hand at the end of your fiscal period.

The optional inventory amount you choose to include in your income in 1990 is deducted from income in 1991.

**Code 660****Business-use of home expenses**

If you have a work space in your home and it is your principal place of business, you may deduct expenses for the business-use of this work space. This work space does not have to be strictly for business-use.

These type of expenses include light, heat, home insurance, mortgage interest, property taxes, rent (if you are renting the home you live in) and capital cost allowance. The amount you deduct is the portion that is for business-use. One way to determine this is to base the business portion on floor space used.

However, the amount you deduct for business-use of home expenses cannot be more than the net income from your farming business before deducting this expense on line 655 on Form T2042. This means these expenses cannot be used to create or increase a loss. Any expenses you cannot deduct in the year can be used in the next year, subject to the same rules.

If you deduct capital cost allowance on the business-use part of your home and later sell your home, the rules for capital cost allowance recapture and taxable capital gains apply (see Chapter 3).

If you need more information, get Interpretation Bulletin IT-514, Work Space in Home Expenses.

**Partnership schedule**

If you are a member of a partnership that does not have to file a Partnership Information Return, you must provide

- the names of all partners,
- the details of income or loss allocated, and
- a list of expenses you are deducting from your share of the partnership income or loss.

You may use the **partnership schedule** on Form T2042 to show this information. The schedule is made up of the following areas:

**Area I**

Show in this area your share and each partner's share of the net income (loss), according to the terms of the

partnership agreement. Some agreements call for a salary to be paid to the partners before the partnership income is divided on a percentage basis, or for the payment of interest to partners based on capital invested in the partnership. If these amounts are not on a straight percentage of the net income of the partnership, attach a note explaining how these amounts were calculated.

**Area II**

Show your share of the partnership income or loss from **Area I or from copy 2 of Form T5013 Supplementary**. Deduct any expenses you made to earn partnership income and were not paid back to you by the partnership. For example, if you use your automobile for the partnership business you may deduct the business portion of your motor vehicle expenses.

You may also use this area to deduct any expenses for business-use of your home. This is explained under "Code 660 — Business-use of home expenses."

**Code 665**  
**Net farming income (loss)**

Enter your gross farming income on line 168 and your net farming income or loss on line 141 on page 1 of your return.

Gross farming income is the amount before deducting total farming expenses. This amount is on line 505 on Form T2042.

If you operate your farming business by yourself, your net farming income is the amount after completing the section "Business-use of home expenses."

If your farming business is a partnership, your net farming income is the amount after completing the "Partnership schedule."

**CHAPTER 3**  
**CAPITAL COST ALLOWANCE SCHEDULE**  
**FORM T2041**

When you purchase depreciable property, such as equipment and buildings for use in your farming business, the cost cannot be deducted as an expense in the year of purchase. However, since these types of properties wear out or become obsolete over a number of years, a portion of their cost is allowed each year as a deduction against income. The deduction allowed is called **capital cost allowance (CCA)** and is explained in this Chapter.

**Note**

The amount you deduct for capital cost allowance is not affected by the accounting method you use i.e. cash or accrual. The maximum amount you deduct is the same under either method.

## General comments about capital cost allowance

Capital cost allowance applies to property that is called **depreciable property**. At the back of the Guide under "Rates of Capital Cost Allowance" is a list of the more common depreciable properties used in a farming business. Part XI of the Income Tax Regulations has a complete list of all depreciable properties.

You group depreciable property of the same class together. For example, discs, cultivators and tools costing \$200 or more are grouped together in Class 8. Each class has a certain rate for capital cost allowance. The amount you deduct for capital cost allowance is based on the balance in the class at the end of your fiscal period. This balance is called the **undepreciated capital cost (UCC)**. The list at the back of the Guide also shows the classes and rates for the depreciable properties mentioned in the previous paragraph.

If you have depreciable property you used in your farming business before January 1, 1972 and are still using these properties in 1990, the way you claim capital cost allowance is different from the way explained in this Chapter. If you need information on this, get Information Circular 86-5R, Part XVII — Capital Cost Allowance, Farming and Fishing.

The rest of this chapter explains how to calculate your capital cost allowance deduction for 1990 using the Part XI method. To do this, you may use Form T2041, Capital Cost Allowance Schedule, which is included in this Guide.

## How to complete Form T2041, capital cost allowance schedule

If you have more than one business, prepare a separate capital cost allowance schedule for each business.

On the top of the form, print your social insurance number, name and address.

### Column (1) — Class number

If you deducted capital cost allowance in past years, enter the class numbers in column (1). Use last year's CCA schedule to get this information.

If you started farming in 1990, read the instructions for column (3) first before completing this column.

### Column (2) — UCC at beginning of 1990

The undepreciated capital cost amounts for each class at the beginning of your 1990 fiscal period are the same amounts as at the end of your 1989 fiscal period. If you used Form T2041 for 1989, these amounts are shown in column (10).

However, you reduce the beginning UCC for 1990 by the amount of investment tax credit deducted or refunded in 1989, or any 1989 investment tax credit carried back to a year before 1989. You do this for the class the property belongs to for which the credit was claimed. The investment tax credit is explained in Chapter 7.

If you started farming in 1990, enter zero in this column for all your classes.

### Column (3) — Cost of additions during 1990

If you purchase depreciable property in the year, you first figure out the **capital cost** of the property and then decide to which class the property belongs. To do this, complete Area A of Form T2041.

There is proposed legislation regarding the purchase of property and when it is available for use. The rule states that although you may purchase property for use in your farming business, you **cannot** claim capital cost allowance on the property until it becomes **available for use**.

Property, other than a building, becomes **available for use** at the time it is delivered to you and is in working condition. Even if a property is purchased during the off-season and is available for use, you are still entitled to claim capital cost allowance on the property. A building that you purchased or are constructing, renovating or altering may be subject to different rules. For information on this, contact your district office.

The **available for use** rules apply to property purchased after 1989.

**Capital cost** is the total cost of the property plus

- any legal fees to purchase it,
- charges for delivering the property, and
- the cost of installing the property.

You cannot deduct these amounts as an expense, instead they are added to the capital cost of the property.

There are some situations where the capital cost of the property may require adjusting.

### Change in use

If you purchase a property for personal use and then begin using it in 1990 for business use, you need to find out the capital cost for business purposes.

In most situations, the capital cost is the fair market value of the property at the time of the change in use. Fair market value is the price that you would purchase or sell a property for in a normal business transaction.

However, if the actual cost of the property is less than the fair market value, complete the following chart to find out the capital cost to be entered in column (3).

Actual cost of the property	\$ _____ (1)
Fair market value of the property	\$ _____ (2)
Amount from line (1)	_____ (3)
Line (2) minus line (3) (if negative, enter zero)	\$ _____ (4)
Enter any * capital gains deduction claimed for the amount on line (4) \$ _____ × 4/3 =	_____ (5)
Line (4) minus line (5) (if negative, enter zero) \$ _____ × 3/4 =	_____ (6)
<b>Your capital cost is line (1) plus line (6)</b>	\$ _____

\* The capital gains deduction is explained in the *1990 Capital Gains Tax Guide*.

#### Passenger vehicles — Class 10.1

If you purchase a passenger vehicle, there is a limit on the capital cost you enter in column (3). For the definition of a passenger vehicle see "Code 225 — Motor vehicle expenses" in Chapter 2.

If you purchase a passenger vehicle **before September 1, 1989 that cost you more than \$20,000** and the vehicle is only for business-use, enter \$20,000 in column (3).

If you purchase a passenger vehicle **after August 31, 1989 that cost you more than \$24,000** and the vehicle is only for business-use, enter \$24,000 in column (3).

Each passenger vehicle subject to the \$20,000 or \$24,000 limit is set-up in its own Class 10.1. Therefore, you only have one passenger vehicle in each Class 10.1.

#### Construction costs and/or costs of improvements

If you construct depreciable property for use in your farming business, the capital cost includes the cost of materials, labour, and other costs that are for the construction. You do not include the value of your own labour.

You add the cost of improvements, additions or renovations to depreciable property to its capital cost. If you need more information on construction costs, see "Code 260 — Building repairs" in Chapter 2.

#### Survey or valuation costs

The cost to survey or value a property you are buying is added to the cost of the property. You cannot deduct these costs as an expense.

#### Personal use of property

If you purchase property for business and personal use, there are two different ways to show the business portion in your capital cost allowance schedule.

If the business-use is the same from year to year, enter in column (3), the business portion of the capital cost of the property.

If the business-use changes from year to year, add the entire cost of the property in column (3). When you claim capital cost allowance as explained in column (9) you will have to add back the portion that is for personal use.

#### Note

For passenger vehicles remember there is a limit on the capital cost as explained in the above section "Passenger vehicles — Class 10.1." This limit still applies when dividing the capital cost between personal and business use.

#### Grant, subsidy, or other incentive or inducement

When you receive a subsidy or grant from a government or government agency that is for the purchase of depreciable property, you reduce the capital cost of the property. You deduct the amount you receive from the total cost of the property before entering the capital cost in column (3). If you need more information, get Interpretation Bulletin IT-273R and Special Release, Government Assistance — General Comments.

If you receive a payment that is for an incentive or inducement from a non-government agency, you can either include this amount in income or deduct it from the capital cost of the property. This is explained under "Codes 455 and 495 — Government grants and subsidies" in Chapter 2.

#### Non-arm's length transactions

A non-arm's length transaction includes a transaction between members of a family such as husband and wife or father and son. When you purchase property in a non-arm's length transaction, there are special rules to follow in calculating the capital cost for that property. For more information about non-arm's length transactions, get Interpretation Bulletins IT-405, Inadequate Considerations — Acquisitions and Dispositions and IT-419, Meaning of Arm's Length.

When you purchase depreciable property in a non-arm's length transaction and

- the person (which does not include a corporation) you are buying the property from is a resident of Canada, and
- your capital cost for the property is more than the other person's capital cost for the same property,

the capital cost is calculated using the following chart:

Enter the other person's capital cost for the property	\$ _____	(1)
Enter your capital cost for the property	\$ _____	(2)
Enter the amount from line (1)	_____	(3)
Line (2) minus line (3) (if negative, enter zero)	\$ _____	(4)*
Enter the * capital gains deduction claimed for any person for the amount on line (4)	\$ _____ × 4/3 = _____	(5)
Line (4) minus line (5) (if negative, enter zero)	\$ _____ × 3/4 = _____	(6)
<b>Your capital cost is line (1) plus line (6)</b>	\$ _____	

\* The capital gains deduction is explained in the *1990 Capital Gains Tax Guide*.

When you purchase depreciable property in a non-arm's length transaction and the person selling the property is not a person as described above and the amount you paid to purchase the property is more than the amount paid by the other person to buy the same property, the capital cost is calculated as follows:

Enter the other person's capital cost for the property	\$ _____	(1)
Enter your capital cost for the property	\$ _____	(2)
Enter the amount from line (1)	\$ _____	(3)
Line (2) minus line (3) (if negative, enter zero)	\$ _____ × 3/4 = _____	(4)
<b>Your capital cost is line (1) plus line (4)</b>	\$ _____	

In a non-arm's length transaction where your capital cost for the depreciable property is less than the other person's capital cost for the same property, your capital cost is considered to be the same amount as the other person's capital cost. The difference between these two amounts is considered to be deducted by you as capital cost allowance for years before you purchased the property.

### Example

John purchased a tractor from his father Charlie in 1990 for \$4,000. Charlie originally bought the tractor

in 1985 for \$10,000. Since the amount John paid to buy the tractor is less than the amount Charlie paid to buy it, John's capital cost is considered to be \$10,000 (the amount Charlie originally paid to buy it). The \$6,000 difference (\$10,000 minus \$4,000) is considered to be capital cost allowance deducted by John.

When doing Form T2041, John shows under "Area A — Additions", \$10,000 as the cost for the tractor. However, he enters in column (3), \$4,000 as the addition for 1990. When John sells the tractor, his capital cost for calculating any capital cost allowance recapture is \$10,000.

There is also a limit on the capital cost of a passenger vehicle for use in your business that is purchased in a non-arm's length transaction. The capital cost is the least of

- the fair market value at the time of purchase,
- the undepreciated capital cost of the vehicle at the time of purchase, and
- \$20,000, if purchased before September 1, 1989 or \$24,000, if purchased after August 31, 1989.

Column (4) — Proceeds from disposals during 1990  
For depreciable property you sell or trade-in, enter in column (4) the lesser of

- the proceeds you receive from the sale minus any expenses for selling the property, and
- the capital cost of the property.

In most cases, the amount you enter in this column is the proceeds you receive from the sale minus any expenses for selling the property.

If you sold a building, there are special rules and calculations that may apply to the amount you enter in column (4). If you need information about this, get Interpretation Bulletin IT-220R2, Capital Cost Allowance — Proceeds of Disposition of Depreciable Property.

Column (5) — UCC after additions and disposals  
Enter in column (5), the amount after adding column (2) to column (3) and subtracting column (4).

Except for Class 10.1, you cannot claim capital cost allowance if the amount in column (5) is **negative** or the amount in column (5) is **positive but no property is in the class** at the end of your 1990 fiscal period.

If either of these situations apply to your Class 10.1 property, see the comments under "Column (7) — Base amount for capital cost allowance claim" to calculate your claim for capital cost allowance.

### Recapture

If the amount in column (5) is **negative**, this amount is a recapture of capital cost allowance. You include this amount as farming income on Form T2042 or on your own income and expenses statement.



A recapture can happen when for example property is sold, a government grant or assistance is received, or from claiming the investment tax credit.

#### Terminal loss

If the amount in column (5) is **positive, and there is no property left in the class**, this amount is a terminal loss. You deduct the terminal loss from farming income in 1990.

#### Note

The rules for recapture and terminal loss **do not apply** to passenger vehicles in Class 10.1.

**Column (6) — Adjustment for current year additions**  
For depreciable property you purchase in 1990, you may only claim capital cost allowance on 50 per cent of the capital cost of the property. For example, you purchase a Class 8 property in 1990 for \$3,000. Your claim for capital cost allowance is based on \$1,500 ( $\$3,000 \times 50\%$ ).

If you purchase and sell depreciable property of the same class in 1990, your claim for capital cost allowance is based on 50 per cent of the amount by which the cost of the property purchased exceeds the proceeds from the property sold. Column (4) explains how to calculate the proceeds of sale.

If either of these situations apply to you, enter in column (6), 50 per cent of the amount by which column (3) exceeds column (4). If column (4) exceeds column (3), enter zero in column (6).

However, there are some situations when you do not make the adjustment in column (6).

One such situation is when you purchase property in a non-arm's length transaction and the property was owned continuously by the seller from a day that was at least 364 days before the end of your 1990 fiscal period until the day you purchased it.

Also, some properties are not subject to this adjustment. Some examples of the types of properties that are not subject to this adjustment are properties in Class 12 (such as tools that cost less than \$200), 13, 14, 24, 27, 29, or 34.

**Column (7) — Base amount for capital cost allowance claim**  
The amount you wish to deduct for capital cost allowance is based on the amount in column (7).

Enter in column (7), the amount after you subtract column (6) from column (5).

However, if you sell or trade-in a passenger vehicle in Class 10.1, you may claim one-half of the capital cost allowance you would have been allowed if you owned the vehicle for the entire year. You can do this if you meet the following conditions:

- the passenger vehicle sold was owned by you at the end of your 1989 fiscal period, and

- you purchased another Class 10.1 passenger vehicle in your 1990 fiscal period and you owned it at the end of your 1990 fiscal period.

If you meet these conditions, enter in column (7) one-half of the amount in column (2).

**Column (8) — Rate (%)**  
Enter in this column, the rate or percentage for each class. The rates are listed at the back of the Guide under "Rates

**Column (9) — CCA for 1990**  
Enter in this column the capital cost allowance you wish to deduct for 1990. The maximum you can deduct cannot be more than the amount obtained when you multiply column (7) by the rate in column (8). You may deduct any amount up to the maximum.

The following are some special comments for certain types of properties.

#### Buildings (Class 1)

Most buildings purchased before 1988 were added to Class 3 or Class 6. Starting in 1988, you include most Class 3 type buildings in Class 1. However, if you purchased this type of building before 1990, you can include it in Class 3 if

- the building is purchased under the terms of a written agreement entered into before June 18, 1987; or
- the building is under construction on June 18, 1987.

The maximum rate of capital cost allowance for Class 1 is 4 per cent.

Property previously included in Class 3 is not required to be transferred to Class 1 after 1987. However, the cost of any additions or alterations to a Class 3 building after 1987 is limited to the lesser of

- \$500,000, or
- 25 per cent of the building's capital cost on December 31, 1987.

The cost of any additions or alterations over this limit are included in Class 1.

#### Fresh fruits and vegetables

##### Storage facilities (Class 8)

Buildings used to store fresh fruits or vegetables at a controlled temperature are included in Class 8 instead of Classes 1, 3 or 6.

Also included in Class 8 are buildings used to store ensilage.

#### Special rates for certain manure handling equipment (Classes 24 and 27)

If you purchase certain manure handling equipment that prevents, reduces or eliminates air or water pollution, it may qualify for a special rate of capital cost allowance. This type of equipment includes pads, liquid manure tanks,

pumps and other related equipment as well as new spreaders purchased at the time the installation was made.

In order for this equipment to qualify for the special capital cost allowance rate, it must be new equipment and accepted by the Minister of the Environment as equipment whose main purpose is to prevent, reduce or eliminate pollution. To make an application or get more information you can write to the

Manager ACCA Program  
Environment Canada  
Ottawa, Ontario  
K1A 1C8  
Telephone: (819) 997-2057

For information on the special rates of capital cost allowance, get Interpretation Bulletin IT-336R, Capital Cost Allowance — Pollution Control Property.

#### **Leasehold interest (Class 13)**

Special capital cost allowance rules apply when you purchase a leasehold interest in a property. If you have a leasehold interest, contact your district office for the information you need.

#### **Column (10) — UCC at the end of 1990**

Your undepreciated capital cost at the end of your 1990 fiscal period is the amount obtained by subtracting column (9) from column (5). Enter these amounts in column (10). These amounts will also be your undepreciated capital cost for each class for the beginning of your 1991 fiscal period.

Your balance in column (10) is **nil** if you have a terminal loss or recapture for that class. For Class 10.1, there will not be a balance in column (10) if you do not own the passenger vehicle at the end of your 1990 fiscal period.

### **Special points about capital cost allowance**

When you sell depreciable property for more than its capital cost, a capital gain will result. You report the taxable portion of a capital gain on line 127 on your return. In addition, the capital gain may be eligible for the capital gains deduction. If you had a capital gain in 1990, get the *1990 Capital Gains Tax Guide* to help you calculate your taxable capital gain and the capital gains deduction.

In addition, there are some situations when you have a capital gain or a recapture of capital cost allowance and including these amounts in income may be postponed to another year.

Examples of these situations are when you sell a property and replace it with a similar type of property or when property is expropriated. If you have this type of situation in 1990, get Interpretation Bulletins IT-259R2 and Special Release, Exchanges of Property, IT-271R, Expropriations — Time and Proceeds of Disposition, and IT-491, Former Business Property.

Another example of this type of situation is when you transfer property to either your child, a corporation or a partnership.

If you need more information on the transfer of property to your child, see "Transfer of farm property to a child" in Chapter 6.

If you transfer property to a partnership or corporation and need more information, get Information Circular 76-19R2, Transfer of Property to a Corporation under Section 85, Interpretation Bulletins IT-291R, Transfer of Property to a Corporation under Subsection 85(1), IT-378R, Winding-up of a Partnership, and IT-413R, Election by Members of a Partnership under subsection 97(2).

## **CHAPTER 4 ELIGIBLE CAPITAL EXPENDITURES**

This chapter outlines the tax treatment for eligible capital expenditures to purchase intangible capital property for use in your farming business.

An **intangible capital property** is capital property that has no physical existence and provides a lasting economic benefit to the owner. Examples of this type of property include milk quotas, tobacco quotas or other government rights for an unlimited period.

An **eligible capital expenditure** is the price you pay to purchase an intangible capital property for use in your farming business.

### **General comments about eligible capital expenditures**

The amount of an eligible capital expenditure cannot be fully deducted against farming income in the year the expenditure is made. Since these expenditures are capital in nature and provide a lasting benefit, you deduct a portion of the expenditure in each year.

To calculate the portion you deduct each year, set up your eligible capital expenditures in a cumulative eligible capital account. The property in this account is called eligible capital property. This account is similar to a capital cost allowance schedule. The portion you deduct is based on the balance in the account at the end of your fiscal period.

Keep a separate account for each business.

If you need more information on eligible capital expenditures get Interpretation Bulletin IT-143R2, Meaning of Eligible Capital Expenditure.

### Cumulative eligible capital account

The balance in your cumulative eligible capital account at the end of your 1990 fiscal period is calculated as follows:

- enter the balance in the account at the beginning of your 1990 fiscal period. This balance is the same amount as at the end of your 1989 fiscal period.
- add three-quarters of your eligible capital expenditures made in your 1990 fiscal period.
- subtract three-quarters of
  - all proceeds received or proceeds you are entitled to receive, for the sale of eligible capital properties in your 1990 fiscal period, and
  - all proceeds that become receivable in your 1990 fiscal period for the sale of eligible capital properties before June 18, 1987.

The balance after doing this is used to determine the amount you deduct against farming income for your 1990 fiscal period. The amount you deduct is called the annual allowance.

The rest of the Chapter explains each part of the cumulative eligible capital account.

#### Annual allowance

If there is a positive balance in your cumulative eligible capital account at the end of your 1990 fiscal period, you deduct up to 7 per cent of the account balance from your farming income.

The following example shows how to calculate the maximum allowance you deduct.

#### Example A

Bert started his farming business in 1985. The business has a December 31 fiscal year-end. In 1985, he purchased a milk quota for \$10,000. Each year he deducted the maximum allowance. In 1990, Bert purchased another milk quota for \$16,000. The maximum allowance he deducts for his 1990 fiscal period is calculated as follows:

<b>Cumulative Eligible Capital Account</b>	
Balance at the beginning of the 1990 fiscal period .....	\$ 4,729
<b>Eligible capital expenditure</b> cost of milk quota \$16,000 × 3/4 .....	<u>12,000</u>
Balance .....	\$16,729
<b>Maximum annual allowance</b> \$16,729 × 7% .....	<u>1,171</u>
Balance .....	<u><u>\$15,558</u></u>

Bert deducts any amount up to \$1,171 against farming income for his 1990 fiscal period.

#### Proceeds of disposition

If you sell an **eligible capital property** in your 1990 fiscal period or for the sale of eligible capital property before June 18, 1987 an amount becomes receivable to you in your 1990 fiscal period, you subtract three quarters of the proceeds (net of all outlays and expenses) from the balance of your eligible capital account. The amount you subtract is called an **eligible capital amount**.

You subtract the eligible capital amount if

- you receive all of the proceeds from the sale in your 1990 fiscal period,
- you receive part of the proceeds in your 1990 fiscal and are entitled to receive the other part in the future,
- you do not receive any amount in your 1990 fiscal period but are entitled to receive the proceeds in the future, and
- you sold eligible capital property before June 18, 1987 and the proceeds become receivable in your 1990 fiscal period.

If any one of the above situations apply, you subtract the full amount of the eligible capital amount from your account.

If the balance in your account is negative after subtracting the eligible capital amount, you will have an amount that is included in your farming income and you may have an amount that is a taxable capital gain.

The amount you include as farming income is the lesser of

- the negative balance in your account, and
- the total of all annual allowances deducted from farming income in past years.

Any part of the negative balance that is not farming income is used to calculate your **taxable capital gain**. To calculate your taxable capital gain, you subtract from the negative balance that is not farming income, 50 per cent of the annual allowances you deducted for fiscal periods that started before 1988.

#### Note

The calculation of the taxable capital gain is based on proposed legislation.

Show the taxable capital gain on line 543 of Schedule 3, Summary of Dispositions of Capital Property in 1990. This schedule is with your General Tax Guide and Return. The taxable capital gain is eligible for the lifetime capital gains deduction. For information on the lifetime capital gains deduction get the *1990 Capital Gains Tax Guide*.

The following example shows a sale of an eligible capital property.

**Example B**

Charlie started his farming business in 1987. The business has a December 31 fiscal year-end. In 1987 he purchased a milk quota for \$10,000. He deducted the maximum allowance each year as follows:

1987	—	\$500
1988	—	473
1989	—	440
Total		<u>\$1,413</u>

At the beginning of his 1990 fiscal period, the balance in Charlie's cumulative eligible capital account is \$5,837. In 1990 Charlie sold his milk quota for \$14,000. Charlie's cumulative eligible capital account for 1990 is as follows:

**Cumulative Eligible Capital Account**

Balance at the beginning of the 1990 fiscal period	\$ 5,837
1990 — Subtract eligible capital amount sale of milk quota \$14,000 × 3/4	<u>10,500</u>
Balance	<u>\$(4,663)</u>

Charlie's annual allowances deducted from income in past years is \$1,413. Since this amount is less than the negative balance in the account, he includes in his farming income \$1,413.

Charlie also has a taxable capital gain of \$3,000 that is calculated as follows:

Negative balance in the account	\$ 4,663
Subtract: Amount included in farming income	<u>1,413</u>
Negative balance that is not farming income	\$ 3,250
Subtract: 50 per cent of the annual allowances deducted for fiscal periods that started before 1988 (\$500 × 50%)	<u>250</u>
Taxable capital gain	<u>\$ 3,000</u>

**Replacement property**

When you sell eligible capital property and replace it with another one, you may choose to postpone all or a part of the gain on the sale. To do this, you must replace the property that was sold within one year after the end of the taxation year you sold the property. The replacement property must be for the same or similar use and for the same or a similar business. If you need more information about this, get Interpretation Bulletin IT-259R2 and Special Release, Exchanges of Property.

**CHAPTER 5 FARM LOSSES**

When the expenses of your farm business are more than the income for the year, this results in a net operating loss for the year. As explained in Chapter 2, this loss may be increased or decreased by certain adjustments e.g. optional inventory adjustment, to arrive at your net farming loss for the year.

If you show a net farming loss for the year, read this Chapter carefully to find out how to treat your loss. If after reading this Chapter you need more information, get Interpretation Bulletin IT-322R, Farm Losses.

The amount of your net farming loss you deduct on your return depends on the nature and extent of your business. A farming loss can be treated in one of three ways:

- fully deductible,
- partially deductible, or
- non-deductible.

**Farm losses — fully deductible**

You may deduct the full amount of your net farming loss from other income if farming is your chief source of income. Farming is considered your chief source of income

if you make your living from farming. Although farming is your major concern, you may also have other types of income such as investment income or wages from part-time employment.

Farming can still be your chief source of income for any year even though your farming business does not show a profit for that year. In order to determine whether farming is your chief source of income you need to consider such factors as gross income, net income, capital invested, cash flow, personal involvement, the ability of your farm to make a profit (both actual and potential), and your plans to maintain or develop your farm and how you implement these plans.

If your chief source of income is farming, and you show a net farming loss in 1990, you first reduce this loss by the amount of any other sources of income (including any forward averaging income) for the year. Any remaining loss is your farm loss for 1990.

For example, in 1990 the expenses from your farming business total \$80,000 and farming income is \$30,000. This results in a net operating loss of \$50,000. You choose to reduce this loss by the optional inventory adjustment of \$15,000. Your net farming loss is \$35,000 (\$50,000 minus \$15,000). Also in 1990, your other sources of

income total \$2,000. Since your net farming loss of \$35,000 is more than your other sources of income of \$2,000, your farm loss for the year is \$33,000.

#### Applying your 1990 farm loss

You may carry your 1990 farm loss back three years and forward for up to ten years and apply it against income from all sources in those years.

If you choose to carry your 1990 farm loss back, you request an adjustment to your 1987, 1988 or 1989 returns by completing Form T1A, Request for Loss Carry-Back. To do this, file one completed copy of Form T1A with your 1990 return. Do not file an amended return for the year you want the loss applied.

#### Applying your farm losses from years before 1990

You have the choice of applying in 1990, farm losses you had in 1983, 1984, 1985, 1986, 1987, 1988 or 1989 and have not been deducted. You would consider doing this if you have income for the year as opposed to having a farm loss.

You must apply the loss of the earliest year first before applying the losses from other years.

#### Non-capital loss

In 1990, if you have a farming loss and a loss from another business (that is not farming or fishing) and the total of these losses is more than your other income for the year, you must calculate both

- your 1990 farming loss, and
- your 1990 non-capital loss.

You may carry your 1990 non-capital loss back three years and forward for up to seven years.

If you choose to carry your 1990 non-capital loss back, you request an adjustment to your 1987, 1988 or 1989 returns by completing Form T1A, Request for Loss Carry-Back. To do this, file one completed copy of Form T1A with your 1990 return. Do not file an amended return for the year you want the loss applied.

For more information about non-capital losses, get Interpretation Bulletin IT-232R2, Non-Capital Losses, Net Capital Losses, Restricted Farm Losses, Farm Losses and Limited Partnership Losses — Their Composition and Deductibility in Computing Taxable Income.

#### Applying losses — exceptions to the rules

There are two exceptions to the general rules for applying farm losses or non-capital losses. These exceptions apply only when your income is block-averaged (see Chapter 9).

First, any farm loss or non-capital loss in the averaging period that has not been deducted may be used as noted under line 4 of Form T2011, Election to Average Income.

Second, a farm loss in the first three years after the averaging period cannot be used in the averaging period.

You may only deduct it in the ten years following the year of loss or in an earlier year that is not included in the averaging period.

### Restricted farm losses — partially deductible

You may deduct a portion of your farm loss if farming is not your chief source of income. In other words, you do not rely only on farming to make your living but do operate it as a business. In order for your farm to be a business it must be capable of making a profit or you expect it to make a profit in the near future.

This may be the situation when the size and scope of your farm is such that it is capable of producing a profit but you operate it as a sideline business.

Each year you have a farm loss, examine your situation using the guidelines explained for chief source of income. This is important because a loss that is restricted in one year may not necessarily be restricted in another year.

#### Calculating your restricted farm loss

If in 1990, you are only entitled to deduct a portion of your farm loss, the portion you deduct against other sources of income for the year is **the lesser of**

- (a) your net farming loss for the year, and
- (b) \$2,500 plus the lesser of
  - $\frac{1}{2}$  (your net farming loss minus \$2,500), and
  - \$6,250.

This calculation gives you the portion of your farm loss you deduct in 1990. The other portion is your restricted farm loss.

#### Example

You operate your farm as a sideline business that is capable of producing a profit. In 1990, you have a farming loss of \$9,200 and also receive wages from employment. The portion of your net farming loss you deduct is calculated as **the lesser of**

- (a) \$9,200, and
- (b) \$2,500 plus the lesser of
  - $\frac{1}{2} \times (\$9,200 - \$2,500) = \$3,350$ , and
  - \$6,250

The amount under paragraph (b) is \$5,850 (\$2,500 + \$3,350).

The portion of your farm loss you deduct in 1990 is \$5,850 (the lesser of (a) and (b)). The restricted farm loss is the portion you cannot deduct in 1990 which is \$3,350 (\$9,200 - \$5,850).

**Applying your 1990 restricted farm loss**

You may carry your 1990 restricted farm loss back three years and forward for up to ten years. The amount you deduct in any year cannot be more than your net farming income for that year. In other words, if you have no farming income in any of those years, you cannot deduct any restricted farm loss.

**Applying your restricted farm losses from years before 1990**

You have the choice of applying in 1990, restricted farm losses you had in 1983, 1984, 1985, 1986, 1987, 1988 or 1989 and have not been deducted. In order to do this, you must have net farming income in 1990. You must apply the restricted farm loss of the earliest year before you apply restricted farm losses from other years.

If you sell farm land and have unused restricted farm losses, you may reduce the amount of any capital gain from the sale. For more information see "Restricted farm losses" in Chapter 6.

**Farm losses — non-deductible**

If you do not operate your farm as a business, you cannot deduct any portion of your net farming loss. As previously mentioned, in order for your farm to be a business it must be capable of making a profit or you expect it to make a profit in the near future.

This may be the situation if you have a farm activity but the size and scope of the operation is such that it is not capable either now, or in the future of making a profit. Your farm activity is considered for your own personal use or enjoyment and any farm expenses are personal or living expenses which you cannot deduct.

**Note**

While the Department may accept the way you show your farming loss on the initial assessment of your return, it could be reviewed at a later time. For information on audits or reviews, see Chapter 10.

## CHAPTER 6 CAPITAL GAINS AND FARMING

This chapter explains the capital gains rules of interest to farmers. The general rules are covered in the *1990 Capital Gains Tax Guide*.

For more information, get the *1990 Capital Gains Tax Guide*.

**What is a capital gain?**

When you sell capital property or depreciable property, the sale could result in either a capital gain or a capital loss. Examples of these types of property include land and buildings.

A capital gain or loss is calculated by the following formula:

- **proceeds of disposition**  
minus
- **the adjusted cost base and any selling expenses.**

The **proceeds of disposition** is the price for which you sell the property. The **adjusted cost base** is the original cost of the property plus any other costs such as renovations or improvements.

You report on your return the amount of any taxable capital gain or allowable capital loss. For 1990, the taxable capital gain is three-quarters of your capital gain and the allowable capital loss is three-quarters of your capital loss.

**Note**

If the sale of depreciable property results in a capital loss, your allowable capital loss is **nil**. Instead, you may be able to deduct a terminal loss. Terminal losses are explained in Chapter 3.

**Principal residence**

Your home is usually considered to be your principal residence. The sale of a principal residence is exempt from capital gains.

If you sold farm land in 1990 that included your principal residence only part of the sale is subject to capital gains.

To calculate this, there are two methods you can use.

**Method 1**

You calculate separately

- the tax-exempt capital gain on your principal residence, and
- the taxable capital gain on the rest of the property.

To do this, the proceeds of disposition, the adjusted cost base and any selling expenses are divided between

- your principal residence, and
- the rest of the farm property (land, buildings and equipment).

The amount of land that is part of your principal residence is usually limited to one-half hectare (approximately one acre) unless you can prove that more land is necessary for the use and enjoyment of your home.

The value of the land that is part of your principal residence is the greater of

- the fair market value of one-half hectare and any other portion necessary for the use and enjoyment of your principal residence, and
- the fair market value of a typical residential building site in the area.

### Example

Ernie sold his 16 hectare farm which included his principal residence. One-half hectare of land is part of his principal residence. Ernie recorded the following information about the land.

Land values at the time of sale:

Fair market value of comparable farm land per hectare .....	\$12,000
Fair market value of a typical residential building site in the area .....	\$25,000

Land values at the time of purchase:

Fair market value of comparable farm land per hectare .....	\$ 7,500
Fair market value of a typical residential building site in the area .....	\$15,000

	Principal Residence	Farm Land	Total
Proceeds of disposition:			
Land	\$ 25,000	\$175,000	\$200,000
House	75,000		75,000
Barn		20,000	20,000
Silo		5,000	5,000
	<u>\$100,000</u>	<u>\$200,000</u>	<u>\$300,000</u>
Deduct:			
Adjusted cost base:			
Land	\$ 15,000	\$105,000	\$120,000
House	60,000		60,000
Barn		16,000	16,000
Silo		4,000	4,000
	<u>\$ 75,000</u>	<u>\$125,000</u>	<u>\$200,000</u>
Gain on disposition	\$ 25,000	\$ 75,000	\$100,000
Less:			
Reduction of gain for principal residence exemption	25,000		25,000
Capital gain	<u>NIL</u>	<u>\$ 75,000</u>	<u>\$ 75,000</u>
<b>Taxable capital gain</b> ( $3/4 \times \$75,000$ )			<u><u>\$ 56,250</u></u>

Since the fair market value for a typical residential building site in the area is greater than the fair market value of one-half hectare of farm land, Ernie used this value for the land that is part of his principal residence.

### Method 2

Under this method, you calculate the capital gain on your land and the principal residence and then deduct

- \$1,000 plus \$1,000 for each year after 1971 the property was your principal residence and you were a resident of Canada.

If you choose this method attach a letter to your return with the following information:

- the sale of your farm is under subparagraph 40(2)(c)(ii) of the *Income Tax Act*;
- a description of the property sold; and
- the number of years after 1971 (or the date you purchased the farm if this happened after 1971) the property was your principal residence and you were a resident of Canada.

If you use this method to calculate your capital gain, you may use Form T2090, Capital Dispositions Supplementary Schedule — Election Available to Farmers Disposing of Farmland, to help you with your calculations.

### Note

To support your property values, you should have documents showing the following information:

- a description of the property, including the size of buildings and construction type;
- the cost and date of purchase;
- the cost of any additions or improvements;
- the property assessment for property tax purposes;
- insurance coverage;
- the type of land (arable, bush or scrub); and
- your type of farming operation.

### Restricted farm losses

If you sell farm land in 1990 and have unused restricted farm losses from previous years, you deduct from the capital gain a portion of these unused losses. The portion you deduct is the property taxes and interest on money borrowed or on an amount owing to purchase the land and that makes-up part of the unused restricted farm losses.

In this case, restricted farm losses can only be used to reduce the capital gain. They cannot be used to create or increase a capital loss on the sale of farm land.

### Qualified farm property and the lifetime capital gains deduction

If you have a taxable capital gain from the sale of **qualified farm property**, you are entitled to claim a capital gains deduction. This deduction offsets all or part of any taxable capital gain. To calculate your capital gains

deduction, get the *1990 Capital Gains Tax Guide*. This part of the chapter explains qualified farm property.

What is qualified farm property?

**Qualified farm property** is property owned by you or your spouse or a family farm partnership in which you or your spouse hold an interest.

**Qualified farm property** includes property that is

- a share of the capital stock of a family farm corporation that you or your spouse owns,
- an interest in a family farm partnership that you or your spouse owns, or
- real property or eligible capital property.

Real property is immovable property such as land or buildings. Eligible capital property is defined in Chapter 3 of this Guide.

Real property or eligible capital property is qualified farm property only if it is used in **carrying on a farming business in Canada** by

- individuals that are:
  - you or your spouse,
  - any of your children,\*
  - any of your parents;
- a family farm corporation where any of the above individuals own a share of the corporation; or
- a family farm partnership where any of the above individuals own an interest in the partnership.

#### \* Note

The meaning of "child" is explained under "Transfer of farm property to a child" later in this chapter.

#### Real property or eligible capital property

Real property or eligible capital property is considered to be used in carrying on a farming business in Canada if certain conditions are met.

Real property or eligible capital property purchased **before June 18, 1987** or after June 17, 1987, when a written agreement has been entered into on or before that date, will meet this requirement if either of the following conditions are met:

- in the year the property is sold, it or any replacement property is used in a farming business in Canada by either an individual, a partnership or a corporation; or
- the property was used in a farming business in Canada for at least five years during which time it was owned by either an individual or a partnership.

Real property or eligible capital property purchased **at any time** will meet this requirement if it is owned by an individual or partnership throughout the 24 months before the sale and

- if the property or a replacement property was used by an individual for at least two years in a farming

business in Canada and the individual's gross income from the business is greater than the individual's income from all other sources in the years; or

- the property was used by a family farm corporation or partnership in a farming business in Canada for at least 24 months and during this time any individual is actively engaged in the farming business.

Qualified farm property may also include property owned by a personal trust and property used by certain trust beneficiaries.

### Special registered retirement savings plan rule for farmers

With the introduction of the lifetime capital gains deduction in 1985, the special registered retirement savings plan contribution is only available for qualified farm property sold in 1984.

If you sold qualified farm property in 1984, and are bringing the taxable capital gain into income over a number of years by reserves, you are still eligible to claim the special registered retirement savings plan contribution.

The contribution is available for each year in which a portion of the 1984 capital gain is included in income up to the maximum lifetime contribution limit of \$120,000.

### Transfer of farm property to a child

You may transfer your farm to your child without any tax on a capital gain if your child is a resident of Canada and you, your spouse or any of your children use the property for farming. This is also true if your farm is transferred because of death.

Your **child** includes

- your child, adopted child or step-child;
- your grandchild or great-grand child;
- your son-in-law or daughter-in-law; and
- a person who while under 19, was in your custody and control and was wholly dependent on you for support.

To use these transfer rules, the child relationship must exist at the time of transfer.

Also, any recapture of capital cost allowance at the time of transfer may be postponed until the property is sold by the child.

#### Transfer of farm property when death happens in 1990

A tax-free transfer or rollover of Canadian farm property from a deceased taxpayer to a child is allowed if

- the child was resident in Canada at the time of death;



- just before death, the property was used in a farming business by the deceased, the deceased's spouse or any of the children; and
- the property is transferred to the child no later than 36 months after death. This period may be extended upon approval from the Department.

The types of property that qualify for the tax-free transfer include

- land, buildings and depreciable property used in a farming business;
- the shares of a family farm corporation; and
- the interest in a family farm partnership.

The amounts chosen for the transfer can be any amount between the adjusted cost base (undepreciated capital cost for depreciable property) and fair market value. The legal representative for the deceased does this by electing in the return for the year of death. The child is considered to have acquired these properties at the amount chosen.

Similar rules also apply for property that is leased by the deceased to the family farm corporation or partnership.

If a child obtains a farm from a parent and later dies, the property may be transferred to the surviving parent.

Shares of a family farm holding corporation may be transferred from a spousal trust to a child of the settlor.

If you need information on such transfers and elections available, get Interpretation Bulletins IT-349R2, Intergenerational Transfers of Farm Property on Death, and IT-449R, Meaning of "Vested Indefeasibly."

Transfer of farm property to a child during the parent's lifetime

Similar rules allow a tax-free transfer of Canadian farm property to a child, if just before the transfer

- the child is resident in Canada; and
- you, your spouse or any of your children use the property in a farming business.

The types of property that qualify for this transfer include

- farm land;
- depreciable property including buildings;
- eligible capital property;
- a share in a family farm corporation; and
- an interest in a family farm partnership.

The transfer price is considered to be any amount between the adjusted cost base (or undepreciated capital cost for depreciable property) and fair market value.

For eligible capital property, the transfer price can be any amount between 1.3333 times the cumulative eligible capital (just before the transfer) and fair market value.

### Example

Stan wishes to transfer the following farm properties to his son.

**Land** for which he paid \$85,000 in 1972 and has a fair market value at the time of transfer of \$100,000.

A **combine** with a present fair market value of \$9,000. It was purchased in 1972 for \$16,000 and the undepreciated capital cost at the time of transfer is \$7,840.

Stan can transfer the property as follows:

- the **land** at any amount between the adjusted cost base (\$85,000) and fair market value (\$100,000); and
- the **combine** at any amount between the undepreciated capital cost (\$7,840) and fair market value (\$9,000).

If Stan chooses to transfer the land at the adjusted cost base and the combine at the undepreciated capital cost, he postpones any taxable capital gain or recapture of capital cost allowance. The son is considered to acquire the land at \$85,000 and the combine at \$7,840. When the son sells these properties, any taxable capital gain or recapture of capital cost allowance postponed by Stan is included in the son's income.

For more information, get Interpretation Bulletin IT-268R3 and Special Release, Inter Vivos Transfer of Farm Property to Child.

### Transfer of farm property to a spouse

A farmer can transfer farm property to a spouse or a spousal trust

- during the farmer's lifetime, or
- because of the farmer's death.

The results are similar to those when you transfer property to a child. In other words, any tax from a taxable capital gain or recapture of capital cost allowance is postponed until a future time.

If property is transferred from a farmer to a spouse and the spouse later on sells the property, any capital gain is reported by the farmer, not the spouse. This rule applies to transfers after 1971 and the farmer is living at the time the property is sold.

### Other special situations

There are other rules that let you postpone paying tax on capital gains in certain situations.

If you sold capital property **before November 13, 1981**, you are allowed to deduct a reasonable reserve for any

proceeds not due until after the end of the year. A reserve deducted in one year is included in income as a capital gain in the next year. A new reserve is allowed in the next year if there are still proceeds not due until after the end of that year. This rule also applies to capital property sold after November 12, 1981 under the terms of an offer or agreement in writing made or entered into before that date.

If you sold capital property **after November 12, 1981**, you are allowed to deduct a reasonable reserve for any proceeds not due until after the end of the year. Depending on the situation of the sale you are entitled to deduct one of the following reserves:

- A reserve for up to **ten years** on the sale of land or depreciable property to your child for the proceeds that are not due until after the end of the year. The property must have been used for farming either by you or your family, just before the sale. This reserve

also applies to the sale of a share of a family farm corporation or an interest in a family farm partnership. In all cases, your child must be resident in Canada just before the sale. At least one-tenth of the taxable capital gain must be reported in each of the ten years.

- A reserve for up to **five years** on the sale of property to any other person for the proceeds that are not due until after the end of the year. At least one-fifth of the taxable capital gain must be reported in each of the five years.

There are also special rules for situations such as the sale of a property and it is replaced with a similar property, and when property is expropriated. For these types of situations, get Interpretation Bulletins IT-259R2 and Special Release, Exchanges of Property, IT-271R, Expropriations — Time and Proceeds of Disposition and IT-491, Former Business Property.

## CHAPTER 7 INVESTMENT TAX CREDIT

The investment tax credit allows you to deduct a percentage of the cost of property you purchase against the amount of taxes you owe. You may be entitled to this tax credit if the property you purchase in 1990 qualifies, or you have unused investment tax credits from years before 1990. This chapter explains if you are eligible to claim the investment tax credit and how to make the claim on your return.

### Property purchased in 1990

If you purchase property and it is available for use in 1990, it is eligible for the investment tax credit. However, the property must be **qualified property** for use in a farming business located in Newfoundland, Prince Edward Island, Nova Scotia, New Brunswick or in the Gaspé Peninsula.

### Note

The available for use rules are explained in Chapter 3.

**Qualified property** includes certain new buildings, machinery and equipment. Due to the number of properties that qualify, it is not possible to list them in this Guide. If you want to find out if property you purchase in 1990 qualifies for the investment tax credit you may either check section 4600 of the Income Tax Regulations or contact your district office.

### Approved project property

Another type of property that is eligible for the investment tax credit is **approved project property**. Approved project property is property you purchase that the appropriate Federal minister has certified to be new property for use in Cape Breton in an approved project. Projects will be eligible for approval if the total capital cost of the depreciable property is at least \$25,000. In addition, the property must be used for a farming business.

If you need more information on approved project property, get Information Circular 78-4R3, Investment Tax Credit Rates.

### Property purchased before 1990

If you purchase property before 1990 that is eligible for the investment tax credit and you have not used all of the credit, you may be able to apply any unused credit in 1990. The amount you may claim in 1990 is explained under the heading "When to claim your investment tax credit."

## How to calculate your investment tax credit

Use Form T2038(IND.), Investment Tax Credit — Individuals to calculate your investment tax credit claim for 1990. This Guide has two copies of this form and the instructions to complete it. Attach one copy to your return and keep a copy for your records.

As mentioned before, the investment tax credit is based on a percentage of the **investment cost** (the cost of the property). The percentage you use to calculate the investment tax credit is listed on Form T2038(IND.).

In some situations, you may have to either increase or decrease your investment cost. For example, you decrease the investment cost by the amount of any government or non-government assistance you receive for the property. If you repay any of this assistance, your repayment increases the investment cost. You calculate the investment tax credit for any repayment using the same percentage you used for the original investment cost.

You calculate your investment tax credit at the end of the calendar year. However, the fiscal year-end of your

farming business may differ from the end of the calendar year. In this case, you include any investment tax credit earned on property you purchase in that part of the calendar year that is after your fiscal year-end. For example, your fiscal period ends on June 30, 1990. In November 1990, you purchase qualified property that is eligible for the investment tax credit. In filing your 1990 return, you may claim an investment tax credit for the property bought in November even though you bought it after the end of your fiscal period.

If you are block averaging in 1990, see Chapter 9 for information on claiming the investment tax credit and block averaging.

### When to claim your investment tax credit

You may use the investment tax credit you earn in 1990 to reduce your taxes in 1990 (the current year), in a year before 1990 (a previous year), or in a year after 1990 (a future year).

#### Current year deduction

The maximum investment tax credit you deduct in 1990 cannot exceed the least of the following three amounts:

- your **annual investment tax credit limit** for 1990,
- the balance in your **investment tax credit pool**, and
- your **federal tax**.

The **annual investment tax credit limit** is equal to \$24,000 +  $\frac{3}{4}$  (your federal tax minus \$24,000).

The balance in your **investment tax credit pool** is the total

- the investment tax credit you earn in 1990, and
- the balance of your unused credits earned before 1990.

#### Note

Unused investment tax credits for properties purchased before April 20, 1983, cannot be used in the calculation of your investment tax credit pool for 1990.

Your **federal tax** is the amount before deducting the investment tax credit, the federal forward averaging tax credit and the minimum tax carry-over. However, if you are subject to minimum tax in the year, you cannot use the investment tax credit to reduce your federal tax below the minimum amount.

To calculate your claim for 1990, complete section 1 of Form T2038(IND.). Enter the amount of your credit on line 412 on page 4 of your return. If a partnership or trust made the investments, enter only the amount allocated to you.

You may also use your investment tax credit to reduce your **federal individual surtax** for 1990. The maximum that you may deduct is the lesser of

- three-quarters of your federal individual surtax (before deducting the investment tax credit), and

- the balance in your investment tax credit pool minus the credit used to reduce your federal tax in the year.

To calculate your claim complete section 2 of Form T2038(IND.). Enter the amount of your credit on line 518 of Schedule 1 of your return package.

#### Previous year deduction

You may carry back the investment tax credit you earn in 1990 three years and use it to reduce federal taxes in those years. However, you can only carry back this credit if you first use it to reduce all of your 1990 federal taxes and your 1990 federal individual surtax.

The maximum investment tax credit you may deduct in 1987 cannot exceed the federal taxes for that year. For 1988 and 1989, the maximum investment tax credit that you may deduct is the least of your annual investment tax credit limit for the year, the balance in your investment tax credit pool and your federal tax.

#### Future year deduction

The investment tax credit you earn in 1990 and not used to reduce taxes in 1990 or a previous year, may be carried forward for up to ten years. The unused credit is included in your investment tax credit pool and may be used to reduce your taxes in a future year. Any credits not used ten years after they are earned cannot be used.

### Refundable investment tax credit

If you are unable to fully use your investment tax credit to reduce your taxes in the year, a portion of the credit may be refunded to you in cash. You may only claim this refundable investment tax credit in the year you make a qualifying purchase. You may choose the amount of the refund, however, it cannot exceed 40 per cent of the investment tax credit you earn in 1990 that was not used to reduce

- your federal tax and federal individual surtax for 1990, and
- federal taxes for 1987, 1988 or 1989.

The amount of your refundable investment tax credit refund reduces the balance in your investment tax credit pool.

To calculate the refundable portion of your investment tax credit, complete Part B of Form T2038(IND.). Enter this amount on line 454 on page 4 of your return. If a partnership or trust made the investments, enter only the amount allocated to you.

### Other adjustments

The amount of investment tax credit deducted or refunded in 1990, or any 1990 investment tax credit carried back to a year before 1990, reduces the capital cost of that property. You make this adjustment in 1991. This adjustment reduces the amount of capital cost allowance

that you may claim for the property. It also reduces the capital cost of the property when calculating any capital gain.

If the investment tax credit deducted or refunded in 1990 relates to depreciable property that was already sold, but

other property still remains in that class, you must reduce the undepreciated capital cost of the class in 1991 by the amount of credit deducted or refunded. If no property remains in that class, you must report this amount as income in 1991.

## CHAPTER 8 PARTNERSHIPS

This chapter briefly explains some of the special features of the *Income Tax Act* about partnerships. If you need more information about these features, get Interpretation Bulletins IT-90, What is a Partnership? and IT-138R, Computation and Flow-through of Partnership Income.

### What is a Partnership?

A partnership is the relationship that exists between persons carrying on a business in common to earn a profit. A valid partnership can exist with or without a written agreement. In determining whether a person is in fact a partner, it is important to know the type of partnership that exists and the person's involvement in the partnership. For guidance on whether an arrangement is a partnership, refer to the provincial law for your province.

When forming, changing or dissolving a partnership, you should consider

- whether the relationship or arrangement is a partnership;
- the special rules about capital gains or losses and capital cost allowance recapture when partners contribute property to the partnership;
- the special rules when a partnership is dissolved; and
- when partners sell their interest in a partnership, they may have a gain or loss on the sale.

These points are general, but point out the factors to consider when determining the amount of income or loss for each partner.

### Partnership income

Partnership income is calculated as if the partnership is a separate person. This means a statement of income and expenses is prepared showing the total income and expenses of the partnership. A farming partnership can use the cash method if all the partners agree to use this method. It is the net partnership income that is divided up to each partner. The partners then file their own returns reporting their share of the net partnership income.

If you use the partnership's property for your own personal use, any costs to the partnership that are deducted as an expense may be a benefit to you. This means you include

in your income the value of any benefit from the use of this property.

When the partnership makes an automobile available to either a partner or a person related to a partner, the partner includes in income a reasonable automobile standby charge. Where the partnership provides an automobile to an employee or a person related to the employee, the employee includes in income a reasonable standby charge. For information on calculating the standby charge for both these situations, get the *Employers Guide to Source Deductions* and Interpretation Bulletin IT-63R3, Benefits Including Standby Charge for an Automobile, from the Personal Use of a Motor Vehicle Supplied by an Employer.

If the partnership employs your spouse, your spouse reports the full amount of any wages received. The partnership deducts these wages as an expense if they are for the purpose of earning income and the amount paid is reasonable.

### Capital cost allowance on depreciable property of partnership

The partnership, not each partner, deducts capital cost allowance (as explained in Chapter 3) on property owned by the partnership.

If the partnership sells depreciable property, the partnership includes any taxable capital gain or capital cost allowance recapture in income (see Chapter 3). However, the partners are entitled to the capital gains deduction. For information on the capital gains deduction, get the *1990 Capital Gains Tax Guide*.

Any investment tax credit allocated to the partners, reduces the partnership's capital cost of the depreciable property. This allocation is considered to be made at the end of the partnership's fiscal year. The capital cost is also reduced by any assistance received from a government, municipality or other public authority. Grants, subsidies and forgivable loans are some examples of government assistance.

### Eligible capital expenditures

A partnership may own eligible capital property such as a milk quota. This means the partnership deducts the annual

allowance for this type of property (see Chapter 4). The partnership also reports any income from the sale of eligible capital property.

### Partnership information return

For members of a partnership, there are two different ways to report your share of the partnership income.

If you are a member of a partnership that has six or more members, the partnership is required to file a *Partnership Information Return*. If this is your situation, you should receive from the partnership, two copies of Form T5013 Supplementary, Statement of Partnership Income, and you may also receive a "memo schedule" called Form T5013S (1). Report the gross partnership income and your share of the net partnership income or loss as shown on Form T5013 on your return. Attach copy 2 of Form T5013 and a copy of Form T5013S (1) to your return.

#### Note

Your share of the net partnership income or loss as shown on Form T5013 may require adjustment for any business expenses you made and have not been paid back by the partnership. If this is your situation, see the comments in Chapter 2 under "Partnership schedule" for information.

If your partnership files a *Partnership Information Return*, do not attach the income and expenses statement for the

partnership with your return. This and other information is filed with the *Partnership Information Return*.

If you are a member of a partnership that has five members or less, the partnership does not have to file a *Partnership Information Return*. This means you include in your return a statement of income and expenses for the partnership and a schedule that shows your share of the partnership income. To do this, you may use Form T2042, *Statement of Farming Income and Expenses*, which is included with this Guide. Report on your return the gross partnership income as well as your share of the net partnership income or loss as calculated on Form T2042.

If you need more information, get a copy of the *Guide to the Partnership Information Return* and Information Circular 89-5, *Partnership Information Return*.

### Partnership losses

The loss carry-over provisions apply to each partner, not the partnership. Therefore, each partner applies the loss carry-over provisions as explained in Chapter 5, "Farm Losses."

### Income averaging

Income averaging as explained in Chapter 9 applies to each partner and not the partnership.

## CHAPTER 9 AVERAGING OF INCOME

### Forward averaging

You can no longer forward average for taxation years ending after 1987. If you wish to withdraw previously averaged amounts, you must do so before your 1998 taxation year. For more information about a forward averaging amount withdrawal, see line 237 in the *1990 General Tax Guide*.

### Five-year block averaging

#### General comments about five-year block averaging

If you choose, the block averaging provisions allow you to calculate your income tax for 1990 based on your average income over a five-year period. The five-year period is called the averaging period.

Your averaging period is made up of 1990 (the year of averaging) and four of the six years before 1990. If an income tax return for a year before 1990 in which you owed net federal tax was not filed on time, you cannot include that year in the averaging period. Also, you cannot include in the averaging period, a year in which you disposed of capital property, had a taxable capital gain, or

received a child tax credit prepayment unless the return was filed on time. A year before 1990 for which you did not owe any net federal tax and there was no other requirement to file a return may be included in the averaging period if the return for that year is filed by April 30, 1991.

For example, you wish to average your income in 1990 and have filed returns on time for 1989, 1988, 1987 and 1985. In 1986, you did not file a return since you did not owe any tax and there was no other requirement to file a return. If you want 1986 to be included in the averaging period, you must file your 1986 return by April 30, 1991. If you do this, your averaging period is 1990 (the year of averaging), 1989, 1988, 1987 and 1986. If you do not file a return for 1986, your averaging period is 1990 (the year of averaging), 1989, 1988, 1987 and 1985.

You may not include in the averaging period a year that was already in another averaging period, or a year that is earlier than the sixth year before the year of averaging.

For the purposes of block averaging, the "minimum tax" provisions do not apply when calculating average tax nor will any minimum tax assessed be taken into account when

calculating federal tax assessed for years in the averaging period.

### Note

The block averaging provisions do not apply for five-year blocks that start after 1987.

#### Am I eligible to block average?

You are eligible to block average if you meet each one of the following requirements:

- Your chief source of income in the averaging period is farming or fishing.
- You filed income tax returns for each of the five years for which you owed net federal tax, disposed of a capital property, had a taxable capital gain, or received a child tax credit prepayment. For these years, a return must have been filed by April 30th following the end of that year.
- For a year in which there was no net federal tax owing and if there was no other requirement to file a return, you must file the return for that year on or before the date that Form T2011, Election to Average Income, is due. For 1990, Form T2011 is due by April 30, 1991. You must do this if you want that year to be included in the averaging period.
- You must file a completed Form T2011, Election to Average Income. This Guide has two copies of this form. You can get additional copies from your district office.
- You must not, either in 1990 or in any year included in the averaging period, have chosen to forward average, or have chosen to include in your taxable income any portion of your **accumulated averaging amount** for amounts previously forward averaged.

If you decide to block average in 1990 and later on change your decision, you can do so if you advise your district office before your return is initially assessed or within 30 days after your return is assessed or reassessed for that year.

Do not file Form T2011 with your return unless you want to average your income.

### How to complete Form T2011, election to average income

This part of the chapter will show you how to complete, line by line, Form T2011.

Fill in the top of the form showing your name, address and social insurance number.

#### Line 1

##### Taxable income

For 1990 (the year of averaging) enter your taxable income as shown on your 1990 return.

For other years in your averaging period, enter your taxable income that has been assessed. If the total of your allowable deductions used in calculating your taxable income exceeds your net income, show this excess as a minus amount on this line. However, for a year before 1988, the minus amount cannot be greater than the amount of your personal exemptions.

**If for any year in the averaging period before 1988** you had a farming loss or non-capital loss that is greater than your other income for that year, you show on line 1 as a minus amount, the amount of your personal exemptions. You include the farming loss or non-capital loss on line 4 to reduce income of other years in the averaging period. See Chapter 5 for more information about losses.

#### Line 2

##### Add: personal exemptions

**For each year before 1988**, show your personal exemptions used in calculating taxable income. Personal exemptions do not include the disability and education deductions, charitable donations or medical expenses.

#### Line 3

##### Total

Add lines 1 and 2 for each year and extend the five year total to the TOTAL column at the right.

#### Line 4

**Less: All fishing, farming or non-capital losses available for application to 1990 that were not deducted in computing Taxable income at line 1**

If you have farming or non-capital losses available for use in 1990, show them on this line and carry the total to the TOTAL column at the right.

#### Line 5

##### Gross income for the period

The amount you show on this line is calculated by subtracting the total on line 4 from the total on line 3.

#### Line 6

**Average gross income (1/5 of TOTAL of line 5)**

Divide the **gross income for the period** (amount on line 5) by five and show the result in each of the five columns.

#### Line 7

##### Less: Personal exemptions

For each year in the averaging period before 1988, subtract the personal exemptions allowable for that year.

#### Line 8

##### Average net income

For each year, show on this line the amount after subtracting line 7 from line 6.

#### Line 9

**Average tax on average net income for each year (without any Investment Tax Credit)**

Calculate your **federal tax** on the **average net income** using Schedule 1 in your return for **each year**. The federal tax is the amount of tax after you subtract (where applicable) the

federal tax reduction, (for years before 1986 only),  
 dividend tax credit,  
 federal foreign tax credit,  
 federal political contribution tax credit,  
 employment tax credit, (for years before 1988 only),  
 scientific research tax credit, (for years before 1987 only),  
 share-purchase tax credit, (for years before 1988 only),  
 labour-sponsored funds tax credit, and  
 total non-refundable tax credits, (for 1988 and following years only).

### Example

1990 Average net income .....	\$18,651.40
Federal income tax on average net income for 1990: \$18,651.40 @ 17% .....	\$ 3,170.73
Add: Tax adjustments .....	NIL
	<u>\$ 3,170.73</u>
Less: Total non-refundable tax credits ..	1,048.73
	<u>\$ 2,122.00</u>
Less: Federal dividend tax credit* .....	102.00
	<u><u>\$ 2,020.00</u></u>

### \* Federal dividend tax credit

If you receive dividends from taxable Canadian corporations in any of the averaging years, the total of the dividend tax credits for those years (whether or not the total credit was used) is divided by five and the result is allocated to each year in the averaging period. The following shows how \$102 was calculated in the above example.

Year	Taxable Amount of Dividends	Rate	Maximum Credits Allowable
1986	\$1,000.00	22 <sup>2</sup> / <sub>3</sub> %	\$226.67
1987	500.00	16 <sup>2</sup> / <sub>3</sub> %	83.33
1988	500.00	13 <sup>1</sup> / <sub>3</sub> %	66.67
1989	500.00	13 <sup>1</sup> / <sub>3</sub> %	66.67
1990	500.00	13 <sup>1</sup> / <sub>3</sub> %	66.67
			<u>\$510.01</u>

The dividend tax credit allocated to each year in the averaging period is \$510.01 divided by 5 = \$102.

### Refundable Quebec abatement

Farmers in the province of Quebec who choose to average in 1990 are entitled to a refundable Quebec abatement of 16.5 per cent of the **basic federal tax** on the **average net income** for 1990. To calculate basic federal tax, complete Schedule 1 included with your 1990 income tax package. Multiply the amount shown opposite **basic federal tax** on the schedule by 16.5 per cent and show this amount on line 440 in your 1990 return.

### Line 10

#### Deduct: Investment tax credit claimed in each year

Show on this line any investment tax credit you claimed in each year before 1990. Do not include any amount of **refundable investment tax credit**.

### Note

If you were assessed minimum tax in 1986, 1987, 1988 or 1989, enter **NIL** on line 10 for the amount of investment tax credit claimed for each year minimum tax was assessed.

If the total of investment tax credits you **claimed** (total on line 10) is more than the total on line 9, show an amount up to, but not more than the total on line 9. Any balance remaining becomes part of your investment tax credit pool and is eligible for carry-forward from 1990. For example, 1990 is the year of averaging, and the investment tax credits claimed in the averaging period (i.e., 1986, 1987, 1988 and 1989) are more than the average tax for those years. The excess becomes part of your investment tax credit pool and is eligible for a ten year carry-forward from 1990. For more information on applying the investment tax credit in 1990, see line 18.

### Line 11

#### Subtotal

Subtract line 10 from line 9 and show the subtotal on line 11.

### Line 12

#### Add: Refundable Quebec abatement allowed in each of the preceding years

Show the amount of any refundable Quebec abatement **allowed** in each year before 1990.

### Line 13

#### Subtotal

Add lines 11 and 12 and show the subtotal on line 13.

### Line 14

#### Deduct: Refundable Quebec abatement allowable

Show the amount of refundable Quebec abatement **allowable** for each year before 1990. The abatement is calculated as 16.5 per cent of the **basic federal tax** based on the average net income for those years.

### Line 15

#### Subtotal

Subtract line 14 from line 13 and show the subtotal on line 15.

### Line 16

#### Deduct: Federal tax assessed

Show the amount of federal tax you were assessed for each year before 1990, add these amounts and extend under the **TOTAL** column.

### Note

Show only the federal tax assessed. Do not include any individual surtax that was assessed for years before 1990. Also, the federal tax assessed does not include any minimum tax assessed for 1986, 1987, 1988 or 1989 nor any minimum tax carryover applied in 1987, 1988 or 1989.

**Line 17****Subtotal**

Subtract line 16 from line 15 and show the subtotal on line 17. If the total on line 16 is more than the total on line 15, the difference is a **REFUND** and no amount is shown on line 18.

**Line 18****Deduct: Investment tax credit claimed for 1990**

You may claim an investment tax credit for 1990 if you have a balance in your investment tax credit pool or you earned an investment tax credit in 1990.

If either or both of the above apply, you may deduct an investment tax credit in 1990. The amount you may deduct cannot be more than the least of the following amounts:

- your annual investment tax credit limit for the year,
- the balance in your investment tax credit pool, and
- your tax payable on line 17.

If no tax is payable, or a refund shows on line 17, show NIL on line 18. If you need more information on investment tax credits, see Chapter 7.

**Line 19****Subtotal**

Subtract line 18 from line 17 and show the subtotal on this line.

**Line 20****Add: Federal individual surtax**

To calculate your federal individual surtax, complete the section, **Federal individual surtax on Schedule 1 — Detailed Tax Calculation** that is with your 1990 *General Tax Return*. The **basic federal tax** used in this calculation is the amount on line 506 from Schedule 1 that you complete to arrive at the average tax for 1990 (line 9). This amount is the base on which any surtax is calculated.

You may use your investment tax credits to reduce your federal individual surtax. The amount you may use is the lesser of

- three quarters of the individual surtax (line 517 on Schedule 1), and
- the balance in your investment tax credit pool minus the amount you deducted on line 18.

Transfer the amount you calculated on line 419 of Schedule 1 to line 20.

**Note**

A federal individual surtax may apply even though the amount shown on line 19 is zero or represents a refund.

**Line 21****Federal tax or refund**

The total of lines 19 and 20 represents the 1990 **FEDERAL TAX** or **REFUND**.

Show this amount, if any, on page 4 of your return on line 420, **net federal tax** with the note, **averaged**.

**Line 22****Provincial income tax**

If you choose to average your federal income tax, you must also average your provincial income tax.

You calculate your provincial income tax (except Quebec) by using the appropriate net provincial tax rate to your **basic federal tax** (as calculated for line 9) for each year.

Do not include on this line any credit claimed under the Saskatchewan tax incentives program in each of the years in the averaging period before 1990. This credit is deducted under line 23.

**Line 23****Deduct: any credits claimed under the Saskatchewan tax incentives program in each year.**

Show on this line, any credit claimed under the Saskatchewan tax incentives program for each year in the averaging period before 1990.

If the total on line 23 is greater than the total on line 22, show an amount up to, but not more than the total on line 22. Any balance remaining becomes part of a Saskatchewan tax credit pool and is eligible for a seven year carry-forward.

**Line 24****Subtotal**

Subtract line 23 from line 22 and show the subtotal on line 24.

**Line 25****Deduct: Provincial income tax assessed**

Show the amount of provincial tax you were assessed for each year before 1990, add these amounts and extend under the **TOTAL** column. You get these amounts from your latest notice of assessment or reassessment.

**Line 26****Subtotal**

Subtract line 25 from line 24 and show the subtotal on line 26.

**Line 27****Deduct: Saskatchewan tax credits claimed for 1990**

You may claim a tax credit under the Saskatchewan tax incentives program in 1990 if you have a balance in your tax credit pool for 1990 (see line 23 for information), or you earned a tax credit under this program in 1990. You can only subtract an amount that is not greater than the amount shown on line 26.

**Note**

All unused tax credits, except the Labour-Sponsored Venture Capital Tax Credit, can be carried forward and used against net Saskatchewan tax payable during the next seven taxation years. They must be used for each year the tax becomes due.



**Line 28****Provincial income tax or refund**

The difference between the amounts shown on lines 26 and 27 is the **PROVINCIAL INCOME TAX OR REFUND** for 1990. If the amount on line 26 is more than

the amount on line 27, the difference is the net provincial tax. If the amount on line 27 is more than the amount on line 26, the difference is a refund. In either case, transfer the amount on line 28 to line 423 on page 4 of your return with the note, **averaged**.

## CHAPTER 10 GENERAL INFORMATION

### Filing an income tax return

The Canadian income tax system is based on self-assessment. You must file a return for the year if you

- still owe tax for 1990;
- already received part of your child tax credit for 1990;
- disposed of capital property or had a taxable capital gain in 1990;
- have to pay back part of your family allowance benefits, Old Age Security benefits or both;
- have to contribute to the Canada Pension Plan because you earned more than \$2,800 in self-employment income or pensionable wages, or both, in 1990;
- plan to include the income or loss for the year in five year block averaging; or
- were asked by Revenue Canada, Taxation to file a return.

You will also have to file a return to claim a

- child tax credit;
- federal sales tax credit;
- "goods and services tax credit" payment for July and October 1991 and for January and April 1992;
- refund of investment tax credit;
- provincial tax credit; or
- refund where you paid too much tax, or you contributed too much to the Canada Pension Plan or to Unemployment Insurance.

### What happens after you file your return?

When your 1990 return is first processed, only a limited review of the information is done. Your notice of assessment is normally based on the income you report. This does not mean that we have accepted your income and deductions as reported. Your return may be selected for further review or audit some time after the initial processing and assessment.

The *Income Tax Act* authorizes Revenue Canada, Taxation to reassess a return or make additional assessments, or assess tax, interest or penalties. This may occur

(1) within three years from the day we mailed either

- your original notice of assessment, or
- a notice that no tax is payable for the year, or

(2) within six years after the day we mailed your original notice of assessment to allow or revise a carry-back of certain deductions such as a loss or unused investment tax credit from some other year. The additional three years are intended to allow a reassessment for the carrying back of these deductions.

For example, if you carry back a non-capital loss that happened in 1990 to 1987, and the actual loss ends up being less than the amount you reported, the loss carried back may be changed accordingly. This can only be done within six years of the date on which we mailed your 1987 notice of assessment. However, for anything that does not relate to the carry-back, the Department as a rule is limited to three years in reassessing your 1987 return.

Most reassessments are the result of a taxpayer request. For example, after mailing your 1990 return you may find out that you forgot a deduction, or made a mistake in calculating your income. If the error is brought to our attention within the time period for reassessing a return, we will correct the error. Form T1-ADJ, T1 Adjustment Request, is available from your district office for this purpose. If you paid too much tax, the difference plus interest, will be refunded to you. On the other hand, the refund may be used to reduce other amounts you owe or are about to owe at that time. Most adjustments made to returns at the taxpayer's request are processed without the need to file a notice of objection.

In certain situations, a return will not be reassessed based on an informal request unless the request is made within the period in which a notice of objection can be filed. These situations are explained in Information Circulars 75-7R3, Reassessment of a Return of Income, and 84-1, Revision of Capital Cost Allowance Claims and Other Permissive Deductions.

If a reassessment cannot be done within the above-mentioned time frames, you may choose to waive the time limit. You do this by filing Form T2029, Waiver in Respect of the Normal Reassessment Period, with your district office before the time limit expires.

### **Further review or audit — Inspection of records**

There is a high level of public compliance with the law. However, a self-assessment tax system can be maintained only through continuous inspection of records. Obvious errors can be corrected at the time the return is initially processed and before the notice of assessment is issued. In-depth reviews, such as audits, are carried out after the notice of assessment is issued.

Certain officials of the Department are authorized to examine or audit your records. These officials will show identification cards before beginning an audit. These identification cards are for your protection against unauthorized persons claiming to be Taxation officials. For more information about the audit process, get Information Circular 71-14R3, *The Tax Audit*.

If an audit shows that you have not been keeping adequate books and records, we will request a written agreement from you that all books and records will be maintained as required. A follow-up letter or visit will happen to ensure that you have complied with the written agreement.

If you have not complied within the time allowed, we will issue a formal requirement letter describing the information you must keep and advising you of the penalties for failing to comply. If you still fail to comply, we may prosecute.

### **Appeal process**

If you disagree with an assessment, you file a notice of objection within 90 days from the date we mailed the

notice of assessment. You send two copies of the notice of objection, setting out the reasons for your objection and all relevant facts. Form T400A, *Notice of Objection*, is available from your district office, and should be sent by registered mail to the Deputy Minister of National Revenue for Taxation, Ottawa.

When the notice of objection is received, the Minister will reconsider the assessment and may either cancel, confirm or change the assessment.

If the objection is not allowed, a formal notice will be sent to you by registered mail. If you choose, you may then appeal to the Tax Court of Canada within 90 days. Currently, the law also provides for further appeal to the Federal Court of Canada.

Until an impartial review by Revenue Canada, Taxation or by a court is completed, you are not required to pay the disputed taxes. However, if tax is assessed, it will be subject to normal interest charges. Before you appeal a lower court's decision to a higher court, you must pay taxes that are in dispute or post acceptable security.

### **Non-resident withholding tax**

If you pay or credit certain amounts to a non-resident of Canada, you may be required to withhold and submit a non-resident withholding tax. If you need more information, get Information Circular 77-16R3, *Non-Resident Income Tax*.

## RATES OF CAPITAL COST ALLOWANCE

This schedule shows the more common properties used in a farming business and the class for each type of property. The rates for these classes are shown at the bottom.

Depreciable Property	Part XI Class No.	Depreciable Property	Part XI Class No.
Aircraft — acquired before May 26, 1976	16	Hay Loaders	8
Aircraft — acquired after May 25, 1976	9	Ice Machines	8
Automobiles	10	Incubators	8
Bee Equipment	8	Irrigation Equipment — Overhead	8
Boats and Component Parts	7	Irrigation Ponds	6
Breakwaters		Manure Spreaders	8
— Cement or Stone	3	Milking Machines	8
— Wood	6	Mixers	8
Brooders	8	Mowers	8
Buildings and Component Parts		Nets	8
— Wood, Galvanized or Portable	6	Office Equipment	8
— Other:		Outboard Motors	10
— acquired after 1978 and before 1988	3	Passenger Vehicles (see Chapter 3 for details)	10.1
— acquired after 1987	1	Piping — Permanent	2
Buildings — Fruit and Vegetable storage (after Feb. 19, 1973)	8	Planters — All Types	8
Casing, Cribwork for Waterwells	8	Ploughs	8
Chain Saws	10	Pumps	8
Cleaners — Grain or Seed	8	Rakes	8
Combines		Roads or other surface areas — paved or concrete	17
— Drawn	8	Silo	8
— Self-propelled	10	Silo Fillers	8
Computer hardware and systems software	10	Sleighs	10
Coolers — Milk	8	Sprayers	8
Cream Separators	8	Stable Cleaners	8
Cultivators	8	Stalk Cutters	8
Dams		Swathers	
— Cement, Stone or Earth	1	— Drawn	8
— Wood	1	— Self-propelled	10
Discs	8	Tile Drainage (acquired prior to 1965)	8
Diggers — All Types	8	Tillers — All Types	8
Docks		Threshers	8
— Cement, Steel or Stone	3	Tools	
— Wood	6	— Under \$200	12
Drills — All Types	8	— \$200 and over	8
Dugouts, Dikes, and Lagoons	6	Tractors	10
Electric Generating Equipment (Not exceeding 15 Kw)		Trailers	10
— acquired after May 25, 1976	8	Trucks	10
— acquired before May 26, 1976	9	Wagons	10
Electric Motors	8	Water Towers	6
Elevators	8	Welding Equipment	8
Engines — Stationary	8	Well Equipment	8
Fences — All Types	6	Windchargers	8
Forage Harvesters		Wind-energy Conversion Equipment	34
— Drawn	8		
— Self-propelled	10		
Graders — Fruit or Vegetable	8		
Grain Drying Equipment	8		
Grain Loaders	8		
Grain Separators	8		
Grain Storage Building			
— Wood, Galvanized Steel	6		
— Other	3		
Greenhouses	6		
Grinders	8		
Harness	10		
Harrows	8		
Balers			
— Drawn	8		
— Self-propelled	10		

Rates — Part XI	
Class 1	4%
Class 2	6%
Class 3	5%
Class 6	10%
Class 7	15%
Class 8	20%
Class 9	25%
Class 10	30%
Class 10.1	30%
Class 12	100%
Class 16	40%
Class 17	8%

## REFERENCES

The Department issues a number of forms, guides and other publications. A complete list of these publications is in Information Circular 90-1.

Listed below are publications which may help you in preparing your 1990 Statement of Farming Income and

### Interpretation Bulletins

Number	Title
IT-63R3	Benefits Including Standby Charge for an Automobile, from the Personal Use of a Motor Vehicle Supplied by an Employer
IT-90	What is a Partnership?
IT-99R3	Legal and Accounting Fees
IT-128R	Capital Cost Allowance — Depreciable Property
IT-138R	Computation and Flow-through of Partnership Income
IT-143R2	Meaning of Eligible Capital Expenditure
IT-179	Change of Fiscal Period; and Special Release dated June 13, 1986
IT-184R	Deferred Cash Purchase Tickets Issued for Grain
IT-200	Surface Rentals and Farming Operations
IT-213R	Prizes from Lottery Schemes, Pool System Betting and Giveaway Contests
IT-220R2	Capital Cost Allowance — Proceeds of Disposition of Depreciable Property
IT-232R2	Non-Capital Losses, Net Capital Losses, Restricted Farm Losses, Farm Losses and Limited Partnership Losses — Their Composition and Deductibility in Computing Taxable Income
IT-252	Agricultural and Rural Development Act Grants
IT-259R2	Exchanges of Property; and Special Release dated November 7, 1986
IT-268R3	Inter Vivos Transfer of Farm Property to Child; and Special Release dated May 30, 1988
IT-271R	Expropriations — Time and Proceeds of Disposition
IT-273R	Government Assistance — General Comments; and Special Release dated December 31, 1981
IT-291R	Transfer of Property to a Corporation under Subsection 85(1)
IT-322R	Farm Losses
IT-336R	Capital Cost Allowance — Pollution Control Property
IT-348R	Costs Incurred in Conversion to Metric Measurement
IT-349R2	Intergenerational Transfers of Farm Property on Death
IT-373R	Farm Woodlots and Tree Farms

Expenses. If you need any of these publications, you can use the order form at the back of the Guide or you may order them by telephone or in person at your district office.

IT-378R	Winding-up of a Partnership
IT-405	Inadequate Considerations — Acquisitions and Dispositions
IT-413R	Election by Members of a Partnership under subsection 97(2)
IT-417R	Prepaid Expenses and Deferred Charges
IT-419	Meaning of Arm's Length
IT-433	Farming — Use of Cash Method
IT-449R	Meaning of "Vested Indefeasibly"
IT-473	Inventory Valuation; and Special Releases dated May 25, 1984 and December 5, 1986
IT-481	Timber Resource Property and Timber Limits
IT-485	Cost of Clearing or Levelling Land
IT-491	Former Business Property
IT-492	Capital Cost Allowance — Industrial Mineral Mines
IT-514	Work Space in Home Expenses
IT-521	Motor Vehicle Expenses Claimed by Self-Employed Individuals

### Information Circulars

Number	Title
IC71-14R3	The Tax Audit
IC75-7R3	Reassessment of a Return of Income
IC76-19R2	Transfer of Property to a Corporation Under Section 85
IC77-16R3	Non-Resident Income Tax
IC78-4R3	Investment Tax Credit Rates
IC78-10R2	Books and Records Retention / Destruction
IC84-1	Revision of Capital Cost Allowance Claims and Other Permissive Deductions
IC86-5R	Part XVII — Capital Cost Allowance, Farming and Fishing
IC86-6	Basic Herds
IC89-5	Partnership Information Return
IC90-1	List of Forms and Publications Available for Use by the Public

### Guides and other publications

Employers Guide to Source Deductions
1990 Deceased Persons Income Tax Guide
1990 Capital Gains Tax Guide
1990 Business and Professional Income Tax Guide
1990 Rental Income Tax Guide

Canada Pension Plan 1990, Information for the  
Self-Employed

1990 Instalment Guide for Farmers and Fishermen (T7B)  
Guide to the Partnership Information Return

<b>Forms</b>
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<b>Number</b>	<b>Title</b>		
T1A	Request for Loss Carry-back	T657A	Calculation of Capital Gains Deduction for 1990 on Other Capital Property
T1-ADJ	T1 Adjustment Request	T776	Statement of Real Estate Rentals
T4-1990 Supp	Statement of Remuneration Paid	T936	Calculation of Cumulative Net Investment Loss to December 31, 1990
T4A-1990 Supp	Statement of Pension, Retirement, Annuity and Other Income	T2029	Waiver in Respect of the Normal Reassessment Period
T4 Summary	Summary of Remuneration Paid	T2034	Election to Establish Inventory Unit Prices for Animals
T4A Summary	Summary of Remuneration Paid	T2090	Capital Dispositions Supplementary Schedule — Election Available to Farmers Disposing of Farmland
T137	Request for Destruction of Books and Records	T2124	Statement of Income and Expenses from a Business
T400A	Notice of Objection	T2145	Election in Respect of the Leasing of Property
T657	Calculation of Capital Gains Deduction for 1990 on All Capital Property	T2146	Election in Respect of Assigned Leases or Subleased Property
		T5013 Summary	Partnership Information Return
		T5013 Supp	Statement of Partnership Income

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**AREA FOR YOUR NOTES AND CALCULATIONS**

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## Improving the Guide

This Guide is reviewed each year. If you have any comments or suggestions to improve the explanations in this Guide, we would like to hear from you.

Please send your comments to:

Tax Forms Directorate,  
875 Heron Road,  
Ottawa, Ontario  
K1A 0L8

Throughout this Guide, we refer to forms that you must attach to your return. We also mention publications that cover certain topics in more detail. If you need any of these forms or publications, complete the order form below.

You can order this material from your district taxation office by mail, by telephone, or in person. Please see the 1990 *General Tax Guide* for the address and telephone number of your district office. If you mail the order form, allow three weeks for delivery.

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### ORDER FORM

Please check (  ) the boxes below or list the titles or numbers of the publications required in the spaces provided. Print your name and address at the bottom of the form and submit it to your district office.

NAMES OF REQUESTED GUIDES OR PAMPHLETS									
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<input type="checkbox"/> Capital Gains Tax Guide					<input type="checkbox"/> Pension and RRSP Tax Guide				
<input type="checkbox"/> Child Care Expenses Tax Guide					<input type="checkbox"/> Rental Income Tax Guide				
<input type="checkbox"/> Deceased Persons Income Tax Guide					<input type="checkbox"/> Tax Guide for Emigrants				
<input type="checkbox"/> Employment Expenses Tax Guide					<input type="checkbox"/> Tax Guide for New Canadians				
<input type="checkbox"/> Farming Income Tax Guide					<input type="checkbox"/> T3 Guide and Trust Return				
<input type="checkbox"/> Fishing Income Tax Guide									
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