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Supplementary Guide

# Farming Income Tax Guide

1991

# Your Guide



## In this Guide

What's New for 1991?

Contents

Forms

CCA Rates

Index

## PLUS

Examples

Charts

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## What's new for 1991?

The major changes to this guide are outlined below. For more details on all changes for 1991, see the areas highlighted in yellow in this guide.

### Goods and services tax (GST)

The GST came into effect January 1, 1991 and can affect the amount of income you report, or the capital cost allowance you claim. You may have received an input tax credit, a transitional credit, or a federal sales tax inventory rebate because of the GST. See chapters 2 and 5 for details.

If you are a member of a partnership, you may be eligible for a rebate of the GST paid on certain expenses. See chapter 10 for details.

### Proposed changes

This guide includes changes to the *Income Tax Act* introduced by the Minister of Finance on May 30, 1991. These had not yet become law at the time of printing. However, we are preparing to apply the proposed changes.

**Changing your return** — The time limit for requesting an adjustment to your income tax return may be extended in certain cases. See chapter 12 for details.

**Elections** — The time limit for making, amending, or revoking elections may be extended in certain cases. See chapter 12 for details.

**Notice of Objection** — The method for filing a Notice of Objection will be made simpler. See chapter 12 for details.

Besides the above changes, there are two new items you should be aware of.

**The self-employment report** — A new Schedule 8 has been added to the *General Tax Guide*. Use this schedule to complete the calculation for Canada Pension Plan contributions for self-employment earnings and the self-employment report.

**Net income stabilization account (NISA)** — In their January 11, 1991 news release, the Department of Agriculture announced a farm safety net program called NISA. Further information on this program and application forms may be obtained by calling, ~~1-800-665-NISA~~, or you can write to the following address:

NISA Administration  
P.O. Box 6100  
Winnipeg, Manitoba  
R3C 3A4

If you receive income from this program in 1991, contact your district taxation office for information on how to report it.

### Dates to remember

**February 29, 1992** — File your 1991 T4 and T4A returns (Form T4 and T4A Summaries and Supplementary forms) and give your employees their copies of the Supplementary slips.

**March 31, 1992** — Most farming partnerships file a Partnership Information Return by March 31, 1992. However, there are exceptions as explained in Information Circular 89-5, *Partnership Information Return*.

**April 30, 1992** — File your 1991 income tax return and pay the amount due on income tax and Canada Pension Plan contributions. Also, if you would like to average your income, file Form T2011, *Election to Average Income, with your income tax return*.

**April 30, 1992** — File Form T581, *Forward Averaging Tax Credits*, if you would like to bring all or some of your accumulated averaging amount into income.

**December 31, 1992** — Pay your instalment of income tax and Canada Pension Plan contributions.

This guide uses plain language to explain the most common income tax situations. If you need more help, please contact your district taxation office.

# Contents

	Page		Page
<b>Chapter 1 — Introduction</b> .....	4	<b>Chapter 8 — Capital gains and farming</b> .....	25
Who should read this guide? .....	4	What is a capital gain? .....	25
Do you need any other forms or publications? .....	4	Principal residence .....	26
What is farming income? .....	4	Restricted farm losses .....	27
Fiscal period .....	4	Qualified farm property and the lifetime capital gains deduction .....	27
Keeping records .....	4	Special registered retirement savings plan rule for farmers .....	27
How do you report farming income? .....	5	Transfer of farm property to a child .....	27
Cash method .....	5	Transfer of farm property to a spouse .....	28
Accrual method .....	5	Other special situations .....	28
Changing your method of reporting income .....	5	<b>Chapter 9 — Investment tax credit</b> .....	29
Paying tax by instalment .....	5	General information .....	29
Forms .....	6	How to calculate your investment tax credit .....	29
<b>Chapter 2 — Income</b> .....	7	When to claim your investment tax credit .....	29
<b>Chapter 3 — Expenses</b> .....	9	Refundable investment tax credit .....	30
Net income (loss) before adjustments .....	13	Other adjustments .....	30
<b>Chapter 4 — Adjustments to the income and     expenses statement</b> .....	13	<b>Chapter 10 — Partnerships</b> .....	30
<b>Chapter 5 — Capital Cost Allowance Schedule     Form T2041</b> .....	18	What is a partnership? .....	30
What is capital cost allowance? .....	18	Partnership income .....	30
Definitions .....	18	Capital cost allowance on depreciable property of partnership .....	30
General comments .....	18	Eligible capital expenditures .....	31
How to complete Form T2041, capital cost allowance schedule .....	18	Goods and services tax rebate .....	31
Special points about capital cost allowance .....	22	Partnership information return .....	31
<b>Chapter 6 — Eligible capital expenditures</b> .....	22	Partnership losses .....	31
Definitions .....	22	Income averaging .....	31
Cumulative eligible capital account .....	22	<b>Chapter 11 — Averaging of income</b> .....	31
Annual allowance .....	23	Forward averaging .....	31
Proceeds of disposition .....	23	Five-year block averaging .....	31
Replacement property .....	23	How to complete Form T2011, Election to average income .....	32
<b>Chapter 7 — Farm losses</b> .....	24	<b>Chapter 12 — General information</b> .....	35
Farm losses — fully deductible .....	24	What happens after you file your return? .....	35
Restricted farm losses — partially deductible .....	24	Further review or audit — Inspection of records .....	35
Farm losses — non-deductible .....	25	Appeal process .....	35
		Non-resident withholding tax .....	35
		<b>Rates of capital cost allowance</b> .....	36
		<b>Index</b> .....	37
		<b>Calculating the mandatory inventory adjustment</b> ...	39

# Chapter 1

## Introduction

### Who should read this guide?

Read this guide if you are a self-employed farmer or you are a member of a farming partnership. It will help you calculate your farming income for 1991. The *General Tax Guide* will help you complete your 1991 return.

### Do you need any other forms or publications?

This guide refers to forms that you attach to your return, and to publications that cover topics in greater detail. As you read this guide, list the forms and publications you need on the order form found at the back. You can then take or mail the order form to your district taxation office. You can also call the "Request for Forms" telephone number listed in your *General Tax Guide*.

### What is farming income?

**Farming income** includes income earned from:

- tilling the soil
- raising or exhibiting livestock
- maintaining horses for racing
- raising fish
- raising poultry
- dairy farming
- fur farming
- tree farming
- fruit growing
- beekeeping
- market gardening
- growing Christmas trees
- operating a feedlot
- operating a wild-game reserve
- operating nurseries or greenhouses
- operating a chicken hatchery

If you are not sure you are earning income from a farming business, get Interpretation Bulletin IT-433, *Farming — Use of Cash Method*.

Farming income **does not include** income earned from *trapping or your pay as an employee of someone else who operates a farming business*. It also does not include any other salaries or wages, interest and other investment income, Old Age Security pension, Canada or Québec Pension Plan benefits, Unemployment Insurance benefits, etc. You should report these types of income on the appropriate lines on page 1 of your return.

### Fiscal period

The taxation year or period for an individual filing an income tax return is the calendar year. However, you do not

have to report your farming income using the calendar year as your business year.

You can choose the dates of your business year. You do this when you file your first return to report income from your business. The period your business year covers is your fiscal period.

You report farming income in the taxation year your fiscal period ends. For example, you report income for the fiscal period July 1, 1990 to June 30, 1991 on your 1991 return because the fiscal period ends in the 1991 taxation year.

A fiscal period cannot be more than twelve months. A fiscal period can be less than twelve months in certain situations such as when a business begins, when a business ends, or when you change your fiscal period.

To change your fiscal period you have to get permission from the director of your district taxation office. The request should be made in writing and will only be approved if the change is for sound business reasons. A change will not be approved if the main reason is to minimize taxes. If you would like more information, refer to 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 to show any assets purchased, bank statements, duplicate bank deposit slips, and cancelled cheques.

Be sure your record book is at least a daily record of your income and expenses. A columnar book with separate pages for income and expenses is convenient. The examples on page 6 show this type of book.

Always obtain receipts or other documents for every income and expense item. Examples of such documents are 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. Show the name and address of the supplier, the date you made the payment, the amount you paid, and details of the transaction.

Be sure you have a system to file your receipts, cancelled cheques, and other documents to support the amounts shown in your books. If you do not keep this information and there is no other evidence to support your expenses, we may reduce the expenses you claim.

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

We do not provide record books and do not recommend any type of book or sets of books. There are many record books and bookkeeping systems. 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. For example, business records and documents for the 1986 taxation year must be kept until December 31, 1992. If you file your return late, keep your records and supporting documents for six years from the date you filed that return.

The general ledger and any special contracts or agreements that relate to the general ledger must be kept for six years after the end of the taxation year in which the business ceases.

Also, you must keep records and supporting documents necessary for dealing with a Notice of Objection or appeal until we settle the issue and the time for filing any further appeal has expired. More information on this subject can be found on page 35 under "Appeal process."

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

## How do you report farming income?

You can use either the **cash** method or the **accrual** method to report your farming income. Once you have chosen a method, use it in future years. If you want to change your method, see the instructions under "Changing your method of reporting income" on this page.

### Cash method

When using this method, you:

- report income in the fiscal period you receive it; and
- deduct expenses in the fiscal period you pay them.

If you accept a post-dated cheque as payment of a debt, you include the amount in income at the time you receive the cheque. If the cheque is not honoured, you may adjust your income at that time.

If you accept a post-dated cheque as security for a debt you include the amount in income when the cheque is payable.

If you accept a post-dated cheque that is payable before the debt is due, include the amount in income on the earlier of:

- the date the debt is payable; or
- the date you cash or deposit the cheque.

When using the cash method, do not include inventory when you calculate your income. However, there are two exceptions to this rule. We explain these exceptions in chapter 4 on page 14 under "Code 635 — Mandatory inventory adjustment" and on page 17 under "Code 651 — Optional inventory adjustment."

A partnership may only use the cash method if all partners choose to use this method.

If you would like more information on the cash method of reporting farming income, read Interpretation Bulletin IT-433, *Farming — Use of Cash Method*.

### Accrual method

When using this method, you:

- report income in the fiscal period you earned it, no matter when you receive it; 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.

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 inventory at its fair market value.
- Value individual items at cost or fair market value, whichever value is lower. You can value classes of items if individual items cannot be distinguished from each other.
- Value livestock according to the unit price base. For this method, you need to complete Form T2034, *Election to Establish Inventory Unit Prices for Animals*.

**If this is your first year of farming** you may choose any of these methods to value your inventory. In the first year, you will not have an opening inventory at the beginning of your fiscal period.

**If this is not your first year of farming**, use the same method you used in past years. The value of your inventory at the beginning of your 1991 fiscal period is the same as the value at the end of your 1990 fiscal period.

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

### Changing 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 adjustments to income and expenses caused by the change in methods.

Before you change from the **cash method to the accrual method**, you first have to get permission from the director of your district taxation office. Make the request in writing and include the reasons for the change. Also make the request before the date you have to file your income tax return for the year you want to make the change.

Once the director approves the change and you file a return for the first time using the accrual method, your income and expenses statement has to show each adjustment caused by the change.

We will not approve retroactive changes.

### Paying tax by instalment

If your chief source of income is from farming, you may have to make one instalment of income tax. For 1992, the instalment is due on or before December 31, 1992.

## INCOME ITEMS (Farm)

DATE	PARTICULARS	WHEAT	OATS	BARLEY	RYE	OTHER CROPS	CDN WHEAT BOARD	FORAGE CROPS	CATTLE	OTHER LIVESTOCK	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 LICEN-SES	FRE & CROP INS.	BLDG. & FENCE REPAIRS	MACHY. REPAIRS	MOTOR VEHICLE EX-PENSES	GAS-OIL EXCEPT MOTOR VEHICLE	CATTLE	OTHER LIVESTOCK	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.														TRAC-TOR 10,600.00	

### Forms

All forms are available at your district taxation office. This guide has two copies of each form listed below for your convenience. For any form you complete, attach one copy to your return and keep the other for your records.

- **Form T1A — Request for Loss Carry-Back**  
Use this form when requesting a loss carry-back. Losses are explained in chapter 7.
- **Form T2011 — Election to Average Income by Farmers and Fishermen**  
Use this form if you decide to average your income under the five-year block averaging provisions available to people who farm. Chapter 11 will explain how to complete this form. Send the completed form with your return.
- **Form T2038 — Investment Tax Credit (Individuals)**  
Use this form if in 1991 you purchased property that is eligible for the investment tax credit. Send it with your 1991 return whether or not you decide to claim this credit for 1991. Also, use this form if you are claiming a credit carried forward from an earlier year. See chapter 9 for information on this credit.
- **Form T2041 — Capital Cost Allowance Schedule for Farmers and Fishermen**  
Use this form to help you calculate your capital cost allowance. If you prefer, you can prepare your own

schedule. Chapter 5 provides more details on this subject.

- **Form T2042 — Statement of Farming Income and Expenses**  
Prepare a farming income and expenses statement each year to determine the amount of income or loss you are to report on your return. Use this form if you report your income using the cash method.  
Form T2042 is divided into six sections. It is important to complete each section **in the order it appears on the form**. The order is as follows:
  - 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 are a member of a partnership, there are two ways your share of the partnership income can be reported. They are explained in chapter 10. Read chapter 10 before completing the partnership's income and expenses statement. If you have another business, in addition to farming, prepare a separate statement for that business. The *Business and Professional Income Tax Guide* will help you calculate your income from that business. It also has the necessary forms for you to use.

## Chapter 2 Income

This chapter explains the more common types of income. They are explained under the same code numbers as those shown on Form T2042. If you have other types of income not shown on Form T2042, put them on the blank spaces or use 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

If you sell grain directly or through various agencies, include all the amounts you receive from these sales in income. For example, include any Wheat Board payments you receive from the sale of wheat, oats, barley, rye, flaxseed, or canola.

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 that time.

If you receive a **cash purchase ticket**, a sale has taken place. We consider you to have received payment at the time you received the ticket and, therefore, you have to include the amount in income.

If you receive a **deferred cash purchase ticket**, you may be able 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 that you delivered the grain.

Deferral of income is only available in certain cases. Details are provided in Interpretation Bulletin IT-184, *Deferred Cash Purchase Tickets Issued for Grain*.

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

#### Other produce

If you sell any other produce directly or through an agency, include all the amounts you receive from these sales in income.

#### Code 430

##### Western grain stabilization payments

Include stabilization payments or refunds, under the *Western Grain Stabilization Act*, in income in the fiscal period you received them.

#### Codes 440 to 444

##### Livestock

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

#### Gifts of livestock or other items

Include the fair market value of livestock or other items (that you would normally sell) that you give to your spouse or children in income. Fair market value is the price you would buy or sell a property for in a normal business transaction.

You cannot deduct any future costs for raising or maintaining these gifts.

#### Income deferral from the destruction of livestock

Include payments you receive under the *Animal Contagious Diseases Act* for destroying animals in income. You can deduct all or part of the amount included in income as an expense in the same year.

If you choose to claim a deduction, include the amount you deducted as income in the following year.

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

Amounts you receive in your 1991 fiscal period from the sale of breeding animals may not have to be included in income until a future year. This can happen if your farm business is in a **prescribed drought region** and the **breeding animals** in your **breeding herd** are reduced by a certain number.

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 taxation office.

**Breeding animals** are cattle, bison, goats and, sheep you keep for breeding. Also included are horses you keep for breeding in the commercial production of pregnant mare's urine. These animals must be over 12 months of age.

To find out your **breeding herd** for your 1991 fiscal period, complete Part I and Part II of the following chart.

Part I	
How many breeding animals do you have?	_____ (1)
How many cattle have given birth?	_____ (2)
How many female cattle have not given birth?	_____ (3)
What is one-half (1/2) of the answer to question (2)?	_____ (4)
Compare the answers in questions (3) and (4). Which is the smaller number?	_____ (5)

**Part II**

Enter your answer to question (1)	_____ (A)
Enter your answer to question (3)	_____ (B)
Enter your answer to question (5)	_____ (C)
Subtract (C) from (B) and enter the total	_____ (D)
Subtract (D) from (A) and enter the total	_____ (E)
<b>The total in (E) is your breeding herd for 1991.</b>	

The following paragraphs explain the rules for the income you can postpone.

If your farming business is in a prescribed drought region at any time in your 1991 fiscal period and you have postponed including amounts in income from earlier years, you do not have to include these amounts in income for 1991.

Income you received for breeding animals you sell and receive payment for in 1991 can be postponed. You calculate the amount you can postpone as follows:

- If your breeding herd is reduced between 15% and 30%, you can postpone up to 30% of the amount you received.
- If your breeding herd is reduced by 30% or more, you can postpone up to 90% of the amount you received.

The amount you can postpone is the amount over the cost of the breeding animals you bought in the same year.

**Note**

Although you can postpone the income amounts mentioned, you can also include any part of these amounts in your 1991 income.

If your farming business is **not in a prescribed drought region during your 1991 fiscal period**, you cannot postpone the amounts you received from the sale of breeding animals.

Also, all amounts not included in income in earlier years must be included in income for 1991.

**Code 470****Wood**

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

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

However, we consider the amounts you receive for occasionally allowing other persons to remove standing timber from your woodlot a capital receipt. A taxable capital gain or an allowable capital loss may result. For information on capital gains and losses, read the *Capital Gains Tax Guide*.

If you would like more information on the sale of wood, read Interpretation Bulletin IT-373, *Farm Woodlots and Tree Farms*.

**Code 480****Patronage dividends**

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

**Codes 485, 486, and 487**

Rebates — Gasoline tax  
— Property tax  
— Other

You may receive federal or provincial rebates on gasoline tax, property tax, or interest that apply to your farming business. You can either include the amount of the rebates in income or reduce your expenses by that amount.

**Codes 455 and 495****Government grants and subsidies****Government assistance**

You may receive a grant, subsidy, or another type of assistance payment from a government or government agency. Generally, you either include it in income or use it to reduce the related expense by the amount of the income.

Milk or dairy subsidies and Special Canadian Grains Program payments have to be included in income.

If you receive government assistance to buy depreciable property, deduct it from the cost of the property. This reduction is for capital cost allowance (see page 20 in chapter 5) and investment tax credit (see chapter 9) purposes.

You may also receive an inducement, reimbursement, contribution, or allowance from a non-government source. Include these amounts in income. However, if you use the amount to buy property, you can either reduce the cost or capital cost of the property, or include the amount in your income.

**Goods and services tax (GST)**

Starting on January 1, 1991, some of the expenses or property purchases you made for your farming business will have included the GST. If this is your situation, you may have also claimed the related **input tax credit** from Revenue Canada, Customs and Excise for the expense or property purchase.

If you receive an input tax credit for your farming expenses, you either include the amount in income or reduce your related expenses.

If you receive an input tax credit for the purchase of depreciable property used in your farming business, we consider the amount you receive to be government assistance. Therefore, you must deduct the amount of the input tax credit from the cost of the property. This reduction is for capital cost allowance (see chapter 5) and investment tax credit (see chapter 9) purposes. See the comments on page 20 under "Grant, subsidy, or other incentive or inducement" for more information on how the input tax credit affects your capital cost allowance claim.



**Transitional credit**

If you receive a GST transitional credit of up to \$1,000 from Revenue Canada, Customs and Excise, include it in income.

**Federal sales tax inventory rebate**

If you receive a GST federal sales tax inventory rebate from Revenue Canada, Customs and Excise, include it in income.

**Code 500****Other farming income**

If you have other types of farming income not shown on Form T2042, enter them in the spaces under this code. If there is not enough space, use 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**

Payment in kind is the value of grain, livestock, or other produce you give to another person as payment for a debt, or as part of the purchase price of property you are buying. If you make this type of transaction, include the value in income.

If the debt you are settling is a business expense, you can also deduct the value as a business expense.

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

If you lease your farmland for petroleum or natural gas exploration, the amounts you receive will be either income or a capital receipt.

Include the annual amount you receive for rental, severance, or inconvenience under a surface rental for petroleum or natural gas exploration in income.

Usually, the initial payment under the lease is larger than the subsequent annual payments. Also, the lease may not specify the part of the initial payment that is for rental, severance, or inconvenience. In this case, for the year you receive the initial payment, include the annual payment for rental, severance, or inconvenience you will receive in subsequent years in income. The balance of the initial payment may result in either a capital gain or loss.

If you would like more information, read Interpretation Bulletin IT-200, *Surface Rentals and Farming Operations*.

**Rental income**

When you rent farm property or real estate, you receive the income either in cash or on a sharecrop basis. In most cases, you do not include these amounts in your farming income. However, you do include rental income received on a sharecrop basis as farming income for the purpose of five-year block averaging (see chapter 11).

Include rental income from farm property or real estate on line 126 on page 1 of your return. To calculate your rental income, you can use Form T776, *Statement of Real Estate Rentals*. You can get this form along with the *Rental Income Tax Guide* from your district taxation office.

**Capital cost allowance recapture**

If you sell depreciable property and the sale results in a recapture of capital cost allowance, include the amount of recapture in income. For more information on recapture refer to page 21 in chapter 5.

Also, the sale of depreciable property may result in a capital gain. For information on capital gains read the *Capital Gains Tax Guide*.

**Miscellaneous**

Examples of miscellaneous income are amounts you receive from the sale of soil, sod, sand, gravel, or stone. For some of these items, you can deduct a depletion allowance. For information on depletion allowances, read Interpretation Bulletin IT-492, *Capital Cost Allowance — Industrial Mineral Mines*.

Include fair or exhibition prizes in income. However, if your children win these prizes, they can report the income. For more information on prizes, read Interpretation Bulletin IT-213, *Prizes from Lottery Schemes, Pool Systems Betting and Giveaway Contests*.

Include in income the amount you receive from the sale of property such as small tools that you previously deducted as an expense.

## Chapter 3 Expenses

This chapter explains the more common expenses. They are explained under the same code numbers as those shown on Form T2042. If you have other types of farming expenses not shown on Form T2042, put them in the blank spaces or on a separate sheet of paper and attach it to your return.

Your deductible expenses include any GST paid on these expenses.

**Prepaid expenses**

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

**If you use the cash method** to calculate your farming income and have a binding contract with a supplier, you can deduct the full amount of prepaid expenses paid in the year.

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

**Code 195****Salaries and wages**

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

When you pay your employees, the general rule is to withhold Canada or Québec Pension Plan contributions, Unemployment Insurance premiums, and income tax on their behalf. For information about this and exceptions to the 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*. Wages you paid to non-resident employees may also be subject to these deductions.

Deduct the wages you paid **before** withholding amounts. Deduct as a separate expense the employer's portion of Canada or Québec Pension Plan contributions and Unemployment Insurance premiums, but **do not deduct** amounts you withhold on your employees' behalf.

Report on a T4 Supplementary slip the wages you paid to your employees and the amounts you withheld.

Also, complete a T4 and T4A return, including the T4 and T4A Summaries and Supplementaries. For the 1991 taxation year, complete this information and mail it to your taxation centre by February 29, 1992. For instructions on how to complete the T4 and T4A returns see the *Employers' Guide to Source Deductions*.

Deduct the wages you paid to your child if:

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

Keep documents to support the amounts you pay. If you pay by cheque, keep the cancelled cheques. If you pay in cash, have the child sign a receipt.

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 for the year in income; and
- you include the same amount in your gross sales for the year.

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

Report the wages you paid to your children and your spouse on T4 slips. You cannot deduct the value of board for dependants.

#### Code 205

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

If you rent, for example, land, buildings, or pasture, deduct the rent you pay. If you are farming on a sharecrop 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
- not including the amount in income and not deducting the same amount as an expense.

#### Codes 210 and 211

##### Interest expense

Deduct the interest you paid on money borrowed to earn farming income such as interest on money borrowed to buy farm equipment. However, there is a limit on the interest you can deduct on money borrowed to buy a passenger

vehicle used in your farming business. This is explained under "Code 225 — Motor vehicle expenses."

Do not 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

This expense is explained on page 12 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**, an **automobile** and a **passenger vehicle**.

Knowing the difference is important because there is a limit on the amount of capital cost allowance, interest, and leasing costs you can deduct in the year for passenger vehicles.

The capital cost allowance limits are explained in chapter 5. The interest and leasing cost limits are explained later in this chapter.

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

Under proposed legislation, an **automobile** is a motor vehicle that is designed or adapted primarily to carry people on streets and highways, and 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 you buy it, you use it primarily (more than 50%) to transport goods or equipment in the course of earning income; or
- a pick-up truck, van, or similar vehicle that in the year you buy it, you use it 90% or more to transport goods, equipment, or passengers while earning income.

A **passenger vehicle** is any **automobile** you bought after June 17, 1987. A passenger vehicle is also an automobile that you leased under an agreement entered into, extended or renewed after June 17, 1987.

An automobile you bought under the terms of a written agreement entered into before June 18, 1987 is not a passenger vehicle.

#### Note

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

#### Business-use of a motor vehicle

If you use your motor vehicle for business and personal-use, you can only deduct the portion of the expenses related to business-use. Business-use includes trips made to pick up parts, farm supplies, deliver grain, etc. If you have a job as an employee or 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 your farm.

To support your motor vehicle expenses, it is important to keep a record of both the total kilometres driven and the kilometres driven to earn business income.

**Example**

Jim's farming business has a December 31, 1991 year-end. He owns a pick-up truck that he used to pick up supplies and equipment. Jim recorded the following information for 1991:

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 .....	<u>100</u>
Total expenses for the truck .....	<u>\$7,000</u>

Jim calculates the motor vehicle expense he can deduct in 1991 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**

Subject to certain limitations, you can deduct interest paid on money borrowed to purchase a passenger vehicle for business-use.

The amount you can deduct depends on the date you bought your passenger vehicle. If you bought a passenger vehicle **before September 1, 1989**, you cannot deduct more than \$8.33 times the number of days for which interest was paid. If you bought a passenger vehicle **after August 31, 1989**, you cannot deduct more than \$10.00 times the number of days for which interest was paid.

If you use the cash method to calculate your income, complete chart 1 to calculate the interest you can deduct. If you use your passenger vehicle for business and personal-use, complete this chart before calculating the business-use portion you can deduct as an expense.

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

Chart 1	
Enter the total interest paid in the year	_____ (A)
the number of days	
\$ _____ * x for which	_____ (B)
interest was paid	
<b>Available interest expense:</b>	
<b>Lesser of (A) and (B)</b>	
=====	
* For passenger vehicles bought before September 1, 1989 enter \$8.33. For passenger vehicles bought after August 31, 1989 enter \$10.00.	

**Example**

Frank's farming business has a December 31, 1991 year-end. In **March 1988** he bought 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 buy the car and the interest he paid in 1991

was \$5,000. Frank recorded the following information for 1991:

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 .....	<u>60</u>
<b>Total car expenses .....</b>	<b><u>\$8,000</u></b>

\*\* Since the car Frank bought is a passenger vehicle, the interest is restricted. The available interest Frank calculates is the lesser of:

- the total interest paid in 1991 of \$5,000; or
- \$8.33 x 365 days = \$3,040.

Since Frank bought the passenger vehicle before September 1, 1989, he used the rate of \$8.33.

Frank calculates the motor vehicle expense he can deduct in 1991 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 business-use, there is a limit on the leasing costs you deduct as an expense. If you report your income using the cash method, use the chart "Eligible Leasing Costs Chart for Passenger Vehicles" in chapter 6 of the *Employment Expenses Tax Guide*. If you report your income using the accrual method, use the similar chart in chapter 3 of the *Business and Professional Income Tax Guide*.

**Joint ownership**

If you and someone else own or lease the same passenger vehicle, the limits on capital cost allowance, interest, and leasing costs still apply. The total amount the joint owners can deduct cannot be more than the amount only one person owning or leasing the passenger vehicle could deduct.

**More than one vehicle**

If you use more than one motor vehicle for business purposes, keep a separate record of the business kilometres driven and the total kilometres driven, and the expenses for each vehicle. Calculate each vehicle's expenses separately.

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

**Code 255**

**Veterinary fees, medicine and breeding fees**

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

**Code 260**

**Building repairs**

Deduct the amounts you paid for repairs to all buildings you use for farming (except your farmhouse). 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 5.

If you would like more information about capital expenditures, refer to Interpretation Bulletin IT-128, *Capital Cost Allowance — Depreciable Property*.

If you use your farmhouse for business purposes, read the section, "Code 660 — Business-use of home expenses" in chapter 4 for more information.

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

Deduct the full cost of a tool that was less than \$200. If a tool costs \$200 or more, add the cost to your capital cost allowance schedule (see chapter 5).

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

Deduct the amounts you paid for insuring your farm buildings, crops, and livestock.

Do not deduct the amounts you paid for insuring personal property such as your home or car. However, if you use property for personal and business purposes, you can deduct the business portion as an expense. For more information, see the sections "Code 225 — Motor vehicle expenses" in this chapter and "Code 660 — Business-use of home expenses" in chapter 4.

Generally, you cannot deduct the amounts you paid for life insurance premiums.

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

You can deduct legal fees that apply to your farming business. You can also deduct any fees you paid to have your tax return completed. Put these types of legal and accounting fees on your statement of income and expenses.

You add legal and other fees you paid to purchase property such as land, buildings, and equipment to the cost of the property. For example, the capital cost of an aircraft bought to spray your crops is the actual price plus the legal fees you paid to buy it.

You can also deduct legal and accounting fees if they are for an objection or appeal against an assessment for income tax, Canada or Québec Pension Plan contributions, or *Unemployment Insurance premiums*. (However, you should reduce your deduction by any amount you receive to cover your costs.) Put these type of fees on line 232 of your income tax return.

If you would like more information, read Interpretation Bulletin IT-99, *Legal and Accounting Fees*.

Deduct the fees you paid for memberships in organizations and subscriptions that relate to farming. Also deduct the cost of office expenses such as stationery, invoices, receipt and accounting books.

#### **Code 285** **Telephone**

You cannot deduct the basic cost of your home telephone. However, you can deduct the amounts you paid for any business long-distance telephone calls made on your home telephone. If you have a separate telephone for business-use, you can deduct the basic cost of the telephone as an expense.

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

You can only deduct a portion of these costs. To figure out this portion, separate the amounts you paid for property taxes, electricity, and heating fuel for the farmhouse and other properties.

For example, the business portion of electricity you used will depend on whether or not more electricity was used for the farmhouse or for the barns and shops. You deduct the portion used for the barns and shops. The portion for the farmhouse is personal and, therefore, you cannot deduct it unless you meet the conditions explained under "Code 660 — Business-use of home expenses" in chapter 4.

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 payment cannot be included in the property tax expense.

Do not include expenses for a house that you rent to someone in farming expenses. You put 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 *Rental Income Tax Guide* from your district taxation 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., the initial ploughing of land for farm use, and the cost of constructing an unpaved road. You can deduct these costs as an expense from your farming business if you own the land or rent it from someone.

You do not have to deduct the full amount as an expense in the year you pay it. As long as you pay it, you can deduct any part of it in the year you paid it and carry forward to another year any part you did not deduct. This also applies to the cost of installing land drainage.

If you rent land to a person who is using it for farming, you cannot deduct the cost of clearing or levelling the land as an expense. You add the cost of clearing or levelling the land to the cost of the land, or the cost of the property to be built on the land if you start construction without delay. Also, add the costs for land drainage to class 8 of your capital cost allowance schedule (see chapter 5).

If you would like more information, refer to Interpretation Bulletin IT-485, *Cost of Clearing or Levelling Land*.

##### **Improving land**

You cannot deduct the cost of a paved road as an expense. You add this cost to class 17 of your capital cost allowance schedule (see chapter 5).

You can deduct the cost of drilling or digging water wells as an expense in the year the work was done. However, add the costs for casing and cribwork to class 8. Also, add the cost of a water distribution system, which includes the pump, pump installation, piping, and trenching, to class 8.

You can deduct any payments you made to have public utilities brought to your farm as long as the installations remain the property of the public utility.

You can deduct any payments you made under *The Co-operative Associations Act* for the construction of a distribution system under a gas service contract.

#### Code 320

##### Other expenses

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

If you take a deferred cash purchase ticket as settlement, we consider the Western Grain Stabilization levy to have been paid on the date the grain is delivered for sale. You can deduct the levy as an expense for that year. However, include the total purchase price as stated on the deferred cash purchase ticket in income for the next year.

##### Leasing costs

If you lease property, deduct the lease payments you made in the year. If you are leasing a "passenger vehicle" see "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 person you are leasing from elect, the following rules apply:

- we consider you to have purchased the property rather than to have leased it; and
- we consider you 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 you make the lease agreement.

We treat the lease payments as combined payments of principal and interest on the loan. You can deduct the interest portion of the payment as an expense. Also, deduct the 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. 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.

If you have made this type of lease arrangement, contact your district taxation office if you would like more information.

#### Code 326

##### Mandatory inventory adjustment

If you included an amount for the mandatory inventory adjustment in income for 1990, deduct this amount as an expense in 1991.

#### Code 327

##### Optional inventory adjustment

If you included an amount for the optional inventory adjustment in income for 1990, deduct this amount as an expense in 1991.

#### Code 330

##### Capital cost allowance

Enter the amount you calculated as capital cost allowance from Form T2041 or from your own schedule. Capital cost allowance is defined in chapter 5.

#### Code 331

##### Allowance on eligible capital property

This deduction, and how to calculate it, is explained in chapter 6, "Eligible capital expenditures."

#### Code 335

##### Total farming expenses

Add your farming expenses for the year and enter the total on line 335. Enter the amount on line 335 at line 515.

#### Code 520

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

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 put it on the back of Form T2042.

## Chapter 4 Adjustments to the income and expenses statement

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

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

If you do not have to make any adjustments, enter the amount on line 520 at line 141 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.

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

**Code 605****Salary or wages paid to yourself, your partner or partners or both**

If you operate your farming business on your own and deduct the salary you pay to yourself as an expense, add this amount to your income.

If your farming business is operated as a partnership and salaries are paid to each partner and then are deducted as an expense, add these amounts into income. This is done because the partners' salaries are actually a distribution 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 goods you would normally sell, add the cost of producing these goods into income if you deducted the cost of producing these items as an expense. Examples of such goods are milk, cream, butter, eggs, potatoes, poultry, and meat.

**Code 620****Personal or non-business portion of expenses**

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

- charitable donations and political contributions that you deducted as a business expense. You may be able to claim these at the relevant lines on your income tax return;
- interest and penalties on income tax;
- life insurance premiums; and
- fines and penalties.

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 (MIA)**

The MIA applies if you have a cash loss and have purchased farming business inventory on hand at the end of your fiscal period. Because of the MIA, you will not be able to create or increase a farm loss by purchasing farming inventory.

You make the MIA if you:

- report your income using the cash method;
- have a net loss after adjusting the income and expenses statement on line 630; and
- purchased inventory you still have at the end of your 1991 fiscal period.

If this is your situation, reduce your net loss after adjusting the income and expenses statement (on line 630) by the MIA.

**Note**

Even if you do not have to make the MIA, read this section and count the purchased inventory you still have at the end of your 1991 fiscal period. This information is important if you have to make this adjustment in a future year.

**Definitions**

Before we can explain how you attach a value to your inventory and calculate the MIA, you need to know the meaning of the following terms.

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

Examples of inventory for a farmer 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 bought and paid for.

**Specified animal** is a horse and, if you choose, an animal registered under the *Animal Pedigree Act*. To make this choice, put a note in your return that says 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 one until you sell it.

**Cash cost** is the actual amount you paid toward the purchase of your inventory.

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

**Value of purchased inventory**

The first step in calculating the MIA is to value your purchased inventory. To do this, follow the instructions in the following paragraphs. Also, there are examples with completed charts for you to follow. On pages 39 and 40 of this guide, there are blank charts for you to use for your own calculations. Keep these charts as part of your records.

**Value purchased inventory, except specified animals, bought in or before your 1991 fiscal period** at the lower amount between the:

- cash cost; and
- fair market value.

To figure out which amount is lower, compare each item or class of items in the inventory separately.

**Value specified animals purchased in your 1991 fiscal period** at an amount that is:

- not more than the cash cost; but
- not less than 70% of the cash cost.

You can choose any amount between these two values.

**Note**

A specified animal acquired in a non-arm's length transaction is considered to have been acquired in the year the seller acquired it.

**Value specified animals purchased before your 1991 fiscal period that you still have at the end of your 1991 fiscal period** at an amount that is:

- not more than the cash cost; but
- not less than 70% of the total of their value at the end of your 1990 fiscal period, plus any amounts paid in your 1991 fiscal period towards the purchase price.

You can choose any amount between these two values.

**Example**

Jake's farming business has a December 31, 1991 year-end. Jake shows a net loss of \$55,000 after adjusting the income and expenses statement. He also has purchased inventory at the end of his 1991 fiscal period. This means he decreases his net loss by the MIA. Jake recorded the following information about

the cash cost of his purchased inventory (livestock) at the end of his 1991 fiscal period.

Year of purchase	Amount of purchase	Amount paid by the end of the 1991 fiscal period
1991	\$26,000	\$20,000
1990	22,000	22,000*
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 1990 fiscal period, Jake paid \$15,000 in 1990 and \$7,000 in 1991.

Jake's other inventory is made up of fertilizer, seed, and fuel. The cash cost and fair market value for this inventory is the same amount and is valued as follows:

purchased in his 1991 fiscal period	\$15,000
purchased in his 1990 fiscal period	6,000
purchased in his 1989 fiscal period	5,000

At the end of his 1991 fiscal period, Jake did not have any other inventory that was purchased before 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 completes chart 1 as follows:

### Chart 1 Cash Cost of Purchased Inventory

Enter the amount you paid by the end of your 1991 fiscal period for the specified animals you purchased:

● in your 1991 fiscal period	<u>\$20,000</u>	(1)
● in your 1990 fiscal period	<u>\$22,000</u>	(2)
● in your 1989 fiscal period	<u>\$20,000</u>	(3)
● before your 1989 fiscal period	<u>\$31,500</u>	(4)

To figure out the amount for line (4), for the fiscal period of purchase, multiply the amount paid by the percentage and enter the amounts in the "Cash cost" column. Then total all the years and enter this amount on line (4).

Fiscal period of purchase	Amount paid	Percentage	Cash cost
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>
<b>Total</b>			<u><u>\$31,500</u></u>

Enter the amount you paid by the end of your 1991 fiscal period for all the other inventory you purchased:

● in your 1991 fiscal period	<u>\$15,000</u>	(5)
● in your 1990 fiscal period	<u>\$ 6,000</u>	(6)
● in your 1989 fiscal period	<u>\$ 5,000</u>	(7)
● before your 1989 fiscal period	<u>0</u>	(8)

### Example

Now that Jake has calculated the cash cost of his specified animals, he uses this information to calculate the value of his purchased inventory at the end of his 1991 fiscal period. He completes charts 2 and 3 as follows:

### Chart 2 Value of Purchased Inventory for Specified Animals

#### Inventory purchased in your 1991 fiscal period

Enter an amount that is not more than the amount on line (1) but not less than 70% of the amount on line (1). <sup>(a)</sup>\$16,000 (9)

#### Inventory purchased in your 1990 fiscal period

Enter an amount that is not more than the amount on line (2) but not less than 70% of the value at the end of the 1990 fiscal period plus any amounts paid in your 1991 fiscal period towards the purchase price. <sup>(b)</sup>\$12,250 (10)

#### Inventory purchased in your 1989 fiscal period

Enter an amount that is not more than the amount on line (3) but not less than 70% of the value at the end of the 1990 fiscal period plus any amounts paid in your 1991 fiscal period towards the purchase price. <sup>(c)</sup>\$ 6,860 (11)

#### Inventory purchased before your 1989 fiscal period

Enter an amount that is not more than the amount on line (4) but not less than 70% of the value at the end of the 1990 fiscal period plus any amounts paid in your 1991 fiscal period towards the purchase price. <sup>(d)</sup>\$10,805 (12)

(a) Jake chose \$16,000, an amount that is less than the cash cost (\$20,000) but not less than 70% of the cash cost (\$14,000).

(b) Jake chose to value his inventory at the end of his 1990 fiscal period at 70% of the cash cost. Therefore, the value of his inventory at the end of his 1990 fiscal period was \$10,500 (\$15,000 x 70%). Remember, Jake paid \$15,000 for this "specified animal" in 1990 and \$7,000 in 1991.

For his 1991 fiscal period, Jake again values his inventory at 70% of the value at the end of the 1990 fiscal period plus any amounts he paid in the 1991 fiscal period towards the purchase price. The amount he enters on line 10 is \$12,250 [(\$10,500 + 7,000) x 70%]. He could have chosen any amount between the cash cost (\$22,000) and the lowest acceptable inventory value of \$12,250.

(c) Jake chose to value his inventory at the end of his 1989 fiscal period at 70% of the cash cost. Therefore, the value of his inventory at the end of his 1989 fiscal period was \$14,000 (\$20,000 x 70%).

For his 1990 fiscal period, Jake also chose to value his inventory at 70% of the value at the end of his 1989 fiscal period. Therefore, the value of his inventory at

the end of his 1990 fiscal period was \$9,800 (\$14,000 x 70%).

For his 1991 fiscal period, Jake again values his inventory at 70% of the value at the end of his 1990 fiscal period. Therefore, the amount he enters on line 11 is \$6,860 (\$9,800 x 70%). He could have chosen any amount between the cash cost (\$20,000) and the lowest acceptable inventory value of \$6,860.

- (d) At the end of his 1989 fiscal period, Jake chose to value his inventory at 70% of the cash cost. Therefore, the value of his inventory at the end of his 1989 fiscal period was \$22,050 (\$31,500 x 70%).

For his 1990 fiscal period, Jake chose to value his inventory at 70% of the value at the end of his 1989 fiscal period. Therefore, the value of his inventory at the end of his 1990 fiscal period was \$15,435 (\$22,050 x 70%).

For his 1991 fiscal period, Jake again values his inventory at 70% of the value at the end of his 1990 fiscal period. Therefore, the amount he enters on line 12 is \$10,805 (\$15,435 x 70%). He could have chosen any amount between the cash cost (\$31,500) and the lowest acceptable inventory value of \$10,805.

**Chart 3**  
**Value of Purchased Inventory**  
**for All Other Inventory**

<b>Inventory purchased in your 1991 fiscal period</b> Enter the amount on line (5) or the fair market value, whichever is less.	<u>\$15,000</u> (13)
<b>Inventory purchased in your 1990 fiscal period</b> Enter the amount on line (6) or the fair market value, whichever is less.	<u>\$ 6,000</u> (14)
<b>Inventory purchased in your 1989 fiscal period</b> Enter the amount on line (7) or the fair market value, whichever is less.	<u>\$ 5,000</u> (15)
<b>Inventory purchased before your 1989 fiscal period</b> Enter the amount on line (8) or the fair market value, whichever is less.	<u>0</u> (16)

**How to calculate the MIA**

Now that you know how to value your inventory, you can calculate the adjustment to reduce your net loss. The MIA is used to reduce your net loss after you adjust the income and expenses statement. This loss is shown on line 630 on Form T2042.

You reduce your loss by the lesser of:

- the loss shown on line 630; and
- the value of the purchased inventory you still have at the end of your 1991 fiscal period.

If your farming business **started after 1988**, your MIA is either the net loss after adjusting your income and expenses statement (line 630) or the value of your purchased

inventory that you still have at the end of your 1991 fiscal period, whichever is less. The value of the purchased inventory you still have is the amount after adding lines 9, 10, 11, 13, 14, and 15.

If your farming business **started before 1989**, you use either the **fixed dollar method** or the **elective method** to calculate your MIA. You choose which method you would like to use. However, if you choose the elective method, you must state in your income tax return that you are using this method. If you do not do this, we will assume you are using the fixed dollar method.

Calculate the adjustment using both methods before deciding which one to use. To do this, complete chart 4 for the fixed dollar method and chart 5 for the elective method. Once you choose a method, enter your MIA on line 635 on Form T2042.

**Example**

Now that Jake has valued his inventory, he now calculates the adjustment to reduce his net loss of \$55,000 after adjusting the income and expenses statement. Since Jake started farming before 1989, he can use either the fixed dollar method or the elective method. Before choosing which method to use, Jake calculates the MIA using both methods. He completes charts 4 and 5 as follows:

**Chart 4**  
**Fixed Dollar Method**

Enter the amount of your net loss after adjusting the income and expenses statement (from line 630 on Form T2042).	<u>\$55,000</u> (17)
Enter the <b>value of inventory</b> from charts 2 and 3:	
● the amount on line (9)	<u>\$16,000</u>
● the amount on line (10)	<u>12,250</u>
● the amount on line (11)	<u>6,860</u>
● the amount on line (12)	<u>10,805</u>
● the amount on line (13)	<u>15,000</u>
● the amount on line (14)	<u>6,000</u>
● the amount on line (15)	<u>5,000</u>
● the amount on line (16)	<u>0</u>
<b>Total value of inventory</b>	<u>\$71,915</u> (18)
Enter the amount on line (17) or line (18), whichever is less.	<u>\$55,000</u> (19)
Deduct:	* <u>10,000</u>
<b>Mandatory inventory adjustment under the fixed dollar method</b> (if negative enter 0).	<u>\$45,000</u> (20)
If your fiscal period is <b>less than 51 weeks</b> , prorate as follows:	
* $10,000 \times \frac{\text{number of days in the fiscal period}}{365}$	
* If your <b>1991 fiscal period begins in 1991</b> , use <b>\$10,000</b> . If your <b>1991 fiscal period begins in 1990</b> , use <b>\$12,500</b> .	



### Chart 5 Elective Method

#### Note

If you are a member of a partnership, all partners must agree to use this method.

Enter the amount of your net loss after adjusting the income and expenses statement (from line 630 on Form T2042). \$55,000 (21)

Enter the **value of inventory** from charts 2 and 3:

● the amount on line (9)	<u>\$16,000</u>	
● the amount on line (10)	<u>12,250</u>	
● the amount on line (11)	<u>6,860</u>	
● the amount on line (13)	<u>15,000</u>	
● the amount on line (14)	<u>6,000</u>	
● the amount on line (15)	<u>5,000</u>	
<b>Total</b>	<u>\$61,110</u>	<b>\$61,110 (22)</b>

Enter the **value of inventory** from charts 2 and 3:

● the amount on line (12)	<u>\$10,805</u>	
● the amount on line (16)	<u>0</u>	
Sub-total	<u>\$10,805</u>	<b>(23)</b>
Multiply line (23) by	* .429	
<b>Total</b>		<b>\$ 4,635 (24)</b>

Add lines (22) and (24) \$65,745 (25)

Mandatory inventory adjustment under the **elective method** is the amount on line (21) or line (25), whichever is less. \$55,000 (26)

\* If your **1991 fiscal period begins in 1991**, use **.429**.  
If your **1991 fiscal period begins in 1990**, use **.286**.

#### Example

Using the **fixed dollar method**, Jake calculates his MIA as \$45,000. Using the **elective method**, his MIA is \$55,000.

Jake has to reduce his **net loss after adjusting the income and expenses statement** by at least \$45,000. However, he can reduce his net loss by \$55,000 if he chooses. The amount Jake reduces his net loss by in 1991 is deducted from his farming income in 1992.

#### Code 651

##### Optional inventory adjustment

The optional inventory adjustment lets you include an amount up to the fair market value of your inventory minus the MIA in income. The meaning of inventory and fair market value are explained under "Code 635 — Mandatory inventory adjustment."

The inventory does not have to be "purchased inventory" as it has to be for the mandatory inventory adjustment. It is all the inventory you still have at the end of your fiscal period. The optional inventory amount you choose to include in your farming income in 1991 is deducted from your farming income in 1992.

#### Code 660

##### Business-use of home expenses

Deduct expenses for the business-use of a work space in your home if **either**:

- the work space is your principal place of business; or

- you use the work space for your farming business only and it is used on a continuous and regular basis for meeting your customers.

The guidelines to use to determine your principal place of business are:

- the location of your office;
- where you keep the books and records for the business;
- where you arrange transactions with your customers and suppliers;
- where your employees report to work;
- where you keep your inventory and supplies; and
- where you keep the tools of your trade.

The type of expenses you can deduct include light, heat, water, home insurance, mortgage interest, property taxes, rent (if you rent the house you are living in), and capital cost allowance. The amount you can deduct is the portion that is used for business purposes. To determine the portion you can deduct, use a reasonable basis such as the area of the work space used for business divided by the total area.

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 deducted in the next year, subject to the same rules.

If you deduct your 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 5).

If you would like more information, read 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 (see chapter 10), you have to provide:

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

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

#### Area I

Show your share, and each partner's share, of the net income or 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 the agreement may call for the interest on capital invested in the partnership to be paid to the partners. If these amounts are not based 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 that the partnership did not pay back to you. For example, if you use your automobile for the partnership business, you can deduct the business portion of your motor vehicle expenses.

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

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

If your farming business is a proprietorship, 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 5 Capital Cost Allowance Schedule Form T2041

### What is capital cost allowance?

Capital cost allowance is a tax term for depreciation. You cannot deduct the original cost of depreciable property such as equipment and buildings for use in your farming business. However, since these types of properties wear out or become obsolete over time, you can deduct a portion of their cost or **capital cost allowance (CCA)**.

### Definitions

You will need to know the meaning of certain terms to calculate your claim for CCA.

A property, other than a building, is **available for use** at the time it is delivered to you and is in working order. For example, if you buy a tractor and it is delivered to you in 1991, but it was not in working order until 1992, you cannot claim CCA until 1992.

If, however, you buy a tractor that is delivered in working order in 1991, but you do not use it until 1992, you can still claim CCA in 1991 because it was available for use.

### Note

The "available for use" rule is based on proposed legislation.

A building that you purchased or are constructing, renovating, or altering may be subject to different rules. For information on this, contact your district taxation office.

The amount on which you first claim CCA is the **capital cost** of a property. Generally, the capital cost is how much you paid for a property, plus any sales tax, legal fees, delivery and installation charges.

**Depreciable property** is any property you can claim CCA on. Depreciable properties are usually grouped into classes. For example, diggers, drills, and tools that cost \$200 or more are grouped together in class 8. Your CCA claim is based on a rate assigned to each class of property.

See the section "Rates of capital cost allowance" on page 36 for a listing of classes and rates for 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.

**Proceeds of the sale** is usually the sale price of a property after you subtract any expenses related to its sale. When you trade in a property to buy a new one, the value of the trade-in is your proceeds of the sale.

**Undepreciated capital cost (UCC)** is the balance of the capital cost left for further depreciation. The amount of CCA you claim each year will reduce the UCC of the property.

**Fair market value (FMV)** is the price you would buy or sell a property for in a normal business transaction.

A **non-arm's length transaction** is, for example, a transaction between members of a family such as a husband and wife, or father and son.

### General comments

There are a few other things you should know about CCA:

- You do not have to claim the maximum amount of CCA in any given year. You can claim any amount you would like, from nothing right up to the maximum allowed for the year.
- The amount you deduct for CCA is not affected by the method of accounting you use. The maximum you can deduct is the same using the cash or accrual method.
- If you are using depreciable property in 1991 that you used in your farming business before January 1, 1972, information on how to claim CCA is in Information Circular, 86-5, *Part XVII — Capital Cost Allowance, Farming and Fishing*.

The rest of this chapter explains how to calculate your CCA claim for 1991 using the part XI method. You can use Form T2041, included in this guide.

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

If you have more than one business, prepare a separate CCA schedule for each business.

Print your social insurance number, name and address on the top of the form.

#### Column 1 — Class number

If you started farming in 1991, read the instructions for column 3 first, and then complete this column.

If you deducted CCA in past years, put the class numbers in column 1. Use last year's CCA schedule to obtain this information.

#### Column 2 — UCC at beginning of the year

The UCC amounts for each class at the beginning of your 1991 fiscal period are the same amounts as those at the end

of your 1990 fiscal period. If you used Form T2041 for 1990, these amounts will be in column 10.

You have to reduce your UCC at the beginning of 1991 by any investment tax credit deducted, refunded, or both in 1990. You also have to reduce your UCC by any 1990 investment tax credit you carried back to a year before 1990. The investment tax credit is explained in chapter 9.

If you started farming in 1991, put zero in this column for all classes.

### Column 3 — Cost of additions during the year

If you buy depreciable property in the year, you must first figure out the capital cost of the property and then decide which class the property belongs to. To do this, complete Area A of Form T2041. Remember that your property has to be available for use for you to put the capital cost in this column.

There are some situations where you may need to adjust the capital cost of your property. The rest of the explanations for this column will show you how to do this.

#### Change in use

If you buy a property for personal-use and then start using it in 1991 for business, you need to find out the capital cost for business purposes. In most situations, the capital cost is the FMV of the property at the time of the change in use.

However, if the actual cost of the property is less than the FMV, complete the following chart to find out the capital cost to put in column 3.

Actual cost of the property		\$ _____ (1)
FMV of the property	\$ _____ (2)	
Amount on 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)	\$ _____ x 4/3 = _____ (5)	
Line (4) minus line (5) (if negative enter zero)	\$ _____ x 3/4 = _____ (6)	\$ _____ (6)
Your capital cost is line (1) plus line (6)		\$ _____

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

### Passenger vehicles — Class 10.1

Your passenger vehicle can belong to either class 10 or class 10.1. For the definition of a passenger vehicle see "Code 225 — Motor vehicle expenses" on page 10 in chapter 3.

Include your passenger vehicle in class 10.1 if it meets **either** of the following conditions:

- Your passenger vehicle is one you bought before September 1, 1989 that cost you more than \$20,000.
- Your passenger vehicle is one you bought after August 31, 1989 that cost you more than \$24,000.

The \$20,000 and \$24,000 amounts are the capital cost limits for a passenger vehicle.

Put each passenger vehicle subject to the capital cost limits into its own class 10.1. In other words, you list each class 10.1 passenger vehicle separately.

Starting on January 1, 1991, to figure out what class your passenger vehicle belongs to, use the price of the car before you add the goods and services tax (GST) and any provincial sales tax (PST).

If your passenger vehicle cost \$24,000 or less before the GST and PST, it belongs to class 10. For example, on June 21, 1991, you bought a passenger vehicle for \$21,000. You also paid GST of \$1,470 and PST of \$1,680. Your vehicle belongs in Class 10 even though its capital cost is \$24,150 (\$21,000 + \$1,470 + \$1,680). This is because your cost before the GST and PST was \$21,000. You would include \$24,150 in column 3.

If, on the other hand, your passenger vehicle cost more than \$24,000 before the GST and PST, your vehicle belongs in class 10.1. When you calculate your capital cost, you add to the \$24,000, the GST and PST you would have paid on \$24,000.

For example, suppose that on July 24, 1991, you bought a passenger vehicle that cost \$26,000 before you include the GST and PST. Your vehicle belongs in class 10.1. Assume the GST on \$24,000 is \$1,680 and the PST is \$1,920. Your capital cost is \$27,600 (\$24,000 + \$1,680 + \$1,920). You would include \$27,600 in column 3 for a class 10.1 property.

### Construction costs, or costs of improvements, or both

If you construct depreciable property for business-use, the capital cost includes the cost of materials, labour, and construction. Do not include the value of your own labour.

Add the cost of improvements, additions, or renovations to the capital cost of your depreciable property. If you would like more information on construction costs, see "Code 260 — Building repairs" on page 11 in chapter 3.

### Survey or valuation costs

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

### Personal-use of property

If you buy property for business and personal-use, there are two different ways to show the business portion in your CCA schedule:

- If the business-use is the same from year to year, enter the business portion of the capital cost of the property in column 3; or
- If the business-use changes from year to year, add the entire cost of the property in column 3. When you claim CCA as explained in column 9, you will have to add back into income the portion that is for personal-use.

### Note

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

**Grant, subsidy, or other incentive or inducement**

When you receive a subsidy or grant from a government or government agency to buy depreciable property, you have to reduce the capital cost of the property. Deduct the amount you receive from the cost of the property before entering the capital cost in column 3.

If you receive an input tax credit in respect of the GST on the purchase of depreciable property for use in your farming business, we also consider this amount to be government assistance. Deduct the amount of the input tax credit from the cost of the property before entering the capital cost in column 3.

**Note**

If you receive an input tax credit (see page 8 in chapter 2) for a passenger vehicle that is used exclusively (90% or more) in your farming business, the capital cost will be reduced by the amount of the input tax credit. If you receive an input tax credit for a passenger vehicle that is not used exclusively in your farming business, see the note on page 22 under column 10 in this chapter.

If you receive an incentive or inducement from a non-government agency to buy depreciable property, you can either include the 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" on page 8 in chapter 2.

**Non-arm's length transactions**

When you buy property in a non-arm's length transaction, there are special rules to follow to calculate the property's capital cost.

**Note**

Under proposed legislation, these special rules will not apply if the property was acquired as a result of someone's death, or if the property is a timber resource property.

You can buy depreciable property in a non-arm's length transaction from an individual or partnership who is a resident of Canada.

If your capital cost for the property is more than the seller's capital cost for the same property, the capital cost is calculated as follows:

Enter the seller's capital cost for the property	\$ _____	(1)
Enter the greater of the seller's proceeds of disposition or the FMV of 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 by any person for the amount on line (4)	\$ _____ x 4/3 = _____	(5)
Line (4) minus line (5) (if negative enter zero)	\$ _____ x 3/4 = _____	(6)
Your capital cost is line (1) plus line (6)	\$ _____	

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

You can also buy depreciable property in a non-arm's length transaction from an individual or partnership who is not a resident of Canada. If the amount you paid to buy the property is more than the amount the seller paid to buy the same property, the capital cost is calculated as follows:

Enter the seller's capital cost for the property	\$ _____	(1)
Enter the greater of the seller's proceeds of disposition or the FMV of the property	\$ _____	(2)
Enter the amount from line (1)	\$ _____	(3)
Line (2) minus line (3) (if negative enter zero)	\$ _____ x 3/4 = _____	(4)
Your capital cost is line (1) plus line (4)	\$ _____	

In a non-arm's length transaction where your capital cost for the depreciable property is less than the seller's capital cost for the same property, we consider your capital cost to be the same amount as the seller's. You deduct the difference between these two amounts as your CCA.

**Example**

John bought a tractor from his father Charlie in 1991 for \$4,000. Charlie originally bought the tractor in 1985 for \$10,000. Since the amount John paid for the tractor is less than the amount Charlie paid for it, we consider John's capital cost to be \$10,000 (the amount Charlie originally paid for the tractor). We consider the \$6,000 difference to be John's CCA.

When filling out Form T2041, John shows under "Area A — Additions", \$10,000 as the cost of the tractor. However, he enters in column 3, \$4,000 as the addition for 1991. When John sells the tractor, his capital cost for calculating any CCA recapture is \$10,000.

There is also a limit on the capital cost of a passenger vehicle that you buy in a non-arm's length transaction. The capital cost is the least of:

- the FMV at the time you bought it;
- \$24,000 plus the GST and PST you would have paid on \$24,000 if you bought it in 1991; and
- the seller's "cost amount" of the vehicle at the time you bought it. The cost amount can vary depending on what the seller used the vehicle for before you bought it. When the seller used the vehicle for earning income, the cost amount will be the UCC of the vehicle at the time you bought it. When the seller was not using the vehicle to earn income, the cost amount will usually be the original cost of the vehicle.

If you would like more information about non-arm's length transactions, read Interpretation Bulletins IT-405, *Inadequate Considerations — Acquisitions and Dispositions* and IT-419 and Special Release, *Meaning of Arm's Length*.

**Column 4 — Proceeds from disposals during the year**

If you sell or trade in depreciable property, enter in column 4 the lesser of:

- the proceeds of the sale; and
- the capital cost of the property.

If you sold a building, there are special rules and calculations that can apply to the amount you put in

column 4. If you need information about this, read Interpretation Bulletin IT-220, *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.

#### Recapture

If the amount in column 5 is **negative**, this amount is a recapture of CCA. Include this amount in farming income on Form T2042 or your own income and expenses statement.

A recapture can occur when you sell a property, receive a government grant or government assistance, or claim 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. Deduct the terminal loss from your farming income in 1991.

#### Note

The rules for recapture and terminal loss **do not apply** to passenger vehicles in class 10.1. For vehicles in class 10.1, you may be able to claim CCA 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 1991 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 CCA.

#### Column 6 — Adjustment for current year additions

You can only claim CCA on 50% of the capital cost of the property you bought in 1991. For example, if you purchase a class 8 property in 1991 for \$3,000, your claim for CCA is based on \$1,500 (\$3,000 X 50%). This is known as the "50% rule." The 50% rule can also affect you if you had a change in use or if you buy and sell depreciable property of the same class in 1991.

If any of these situations apply to you, enter in column 6, 50% of the amount column 3 exceeds column 4. If column 4 exceeds column 3, enter zero.

However, there are some situations when you do not make the adjustment in column 6. One situation is when you buy 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 1991 fiscal period until the day you bought it.

Also, some properties are not subject to this adjustment such as those 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 would like to deduct as CCA is based on the amount in column 7.

Subtract column 6 from column 5 and enter the amount in column 7. However, if you sell or trade in a passenger vehicle in class 10.1, you can claim one-half (1/2) of the

CCA you would have been allowed if you still owned the vehicle. You can do this if you meet the following conditions:

- The class 10.1 vehicle you sold was owned by you at the end of your 1990 fiscal period; and
- You bought another class 10.1 vehicle in your 1991 fiscal period and you still owned it at the end of the period.

If you meet these conditions, enter in column 7 one-half (1/2) of the amount in column 2.

#### Column 8 — Rate (%)

Enter in this column the rate, or percentage, for each class. You will find these rates on page 36 under "Rates of capital cost allowance."

#### Column 9 — CCA for the year

Enter in this column the CCA you would like to deduct for 1991. The maximum you can deduct cannot be more than the amount you get when you multiply column 7 by the rate in column 8. You can deduct any amount up to the maximum.

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

#### Buildings (Class 1)

Most buildings bought 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 bought this type of building before 1990, you can include it in class 3 if:

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

The maximum CCA rate for class 1 is 4%.

You do not have to transfer property previously included in class 3 to class 1. However, the cost of any additions or alterations to a class 3 building after 1987 is limited to the lesser of:

- \$500,000; and
- 25% 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. For more information, read Interpretation Bulletin IT-79, *Capital Cost Allowance — Buildings or Other Structures*.

#### 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 buy 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 bought at the time you installed the equipment.

For this equipment to qualify for the special CCA rate, it must be new and it must be accepted by the Minister of the Environment as equipment used specifically to prevent, reduce, or eliminate pollution. To apply or get more information contact:

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

For information on the special rates of CCA, read Interpretation Bulletin IT-336, *Capital Cost Allowance — Pollution Control Property*.

### Leasehold interest (Class 13)

Special CCA rules apply when you buy a leasehold interest in a property. If you have a leasehold interest, contact your district taxation office for information.

### Column 10 — UCC at the end of the year

Subtract column 9 from column 5 and put the amount in column 10. This is the UCC at the end of your 1991 fiscal period. These amounts will be your UCC for each class for the beginning of your 1992 fiscal period.

You will not have an amount in column 10 if you have a terminal loss or recapture for that class. For class 10.1, there will not be an amount in column 10 if you sold the passenger vehicle in the year.

### Note

An input tax credit for a passenger vehicle that is used less than 90% in your farming business will reduce your UCC in 1992.

## Special points about capital cost allowance

If you sell depreciable property for more than its capital cost, a capital gain will result. Report the taxable portion of a capital gain on line 127 on your return. The capital gain may be eligible for the capital gains deduction. If you had a capital gain in 1991, read the *Capital Gains Tax Guide* to help you calculate your taxable capital gain and the capital gains deduction.

Also, there are certain situations when you can postpone or defer a capital gain or a recapture of CCA. Examples of this are when you sell a property and replace it with a similar one, when property is expropriated or, when you transfer property to your child (see "Transfer of farm property to a child" on page 27 in chapter 8), a corporation, or a partnership.

If you would like more information, refer to the following Information Circular (IC) and Interpretation Bulletins (IT):

- IC 76-19, *Transfer of Property to a Corporation under Section 85*
- IT-259 and Special Release, *Exchanges of Property*
- IT-271, *Expropriations — Time and Proceeds of Disposition*
- IT-291, *Transfer of Property to a Corporation under Subsection 85(1)*
- IT-378, *Winding-up of a Partnership*
- IT-413, *Election by Members of a Partnership under Subsection 97(2)*.
- IT-491, *Former Business Property*

## Chapter 6 Eligible Capital Expenditures

You cannot deduct the original cost of an expenditure such as a milk quota. However, since this expenditure is capital in nature and provides a lasting benefit, you can deduct a portion of its cost. The amount you can deduct is called your **annual allowance**.

### Definitions

You will need to know the meaning of certain terms to calculate your annual allowance.

An **intangible capital property** is capital property that has no physical existence and yet provides a lasting economic benefit to the owner. Milk quotas, tobacco quotas, or other government rights for an unlimited period are examples of intangible capital property.

An **eligible capital expenditure** is the price you pay to buy an intangible capital property for use in your farming business. For more information on eligible capital expenditures read Interpretation Bulletin IT-143, *Meaning of Eligible Capital Expenditure*.

A **cumulative eligible capital (CEC) account** is the account you set up to calculate your annual allowance. This account is similar to a CCA schedule. The portion you deduct is based on the balance in your account at the end of

your fiscal period. Keep a separate account for each business.

**Eligible capital property** is any property in your CEC account.

### Cumulative eligible capital account

You calculate the balance in your CEC account at the end of your 1991 fiscal period as follows:

- Enter the balance in the account at the beginning of your 1991 fiscal period. This balance is the same amount as at the end of your 1990 fiscal period.
- Add three-quarters (3/4) of your eligible capital expenditures made in your 1991 fiscal period.
- Subtract three-quarters (3/4) of:
  - all amounts received or amounts you are entitled to receive, from the sale of eligible capital properties in your 1991 fiscal period; and
  - all amounts that became receivable in your 1991 fiscal period for the sale of eligible capital properties before June 18, 1987.

Use the balance to figure out the annual allowance you can deduct against farming income for your 1991 fiscal period.

The rest of this chapter explains each part of the CEC account.

#### Annual allowance

As long as there is a positive balance in your CEC account at the end of your 1991 fiscal period, you can deduct an annual allowance of up to 7%. You do not have to claim the full 7%. You can deduct any amount you wish, from nothing right up to 7%.

The following example shows how to figure out your annual allowance.

#### Example A

Bert started his farming business in 1985. The business has a December 31 fiscal year-end. In 1985, he bought a milk quota for \$10,000. Each year he deducted the maximum allowance. In 1991, Bert purchased another milk quota for \$16,000. The maximum annual allowance he deducts for his 1991 fiscal period is calculated as follows:

CEC account	
Balance at the beginning of the 1991 fiscal period.....	\$4,398
<b>Eligible capital expenditure</b>	
cost of milk quota \$16,000 x 3/4.....	<u>12,000</u>
Balance.....	\$16,398
<b>Maximum annual allowance</b>	
\$16,398 x 7% .....	<u>1,148</u>
Balance.....	<u>\$15,250</u>

Bert deducts any amount up to \$1,148 from his farming income for his 1991 fiscal period.

#### Proceeds of disposition

You will have proceeds of disposition if you sell an eligible capital property in your 1991 fiscal period, or if you are entitled to receive an amount for eligible capital property that you sold before June 18, 1987. If this happens, subtract three-quarters (3/4) of the proceeds (minus all expenses) from the balance in your CEC account. This amount is called the eligible capital amount.

Subtract the eligible capital amount if any of the following apply to you:

- You receive all of the proceeds from the sale in your 1991 fiscal period.
- You receive part of the proceeds in your 1991 fiscal period and are entitled to receive the other part in the future.
- You do not receive any amount in your 1991 fiscal period but are entitled to receive the proceeds in the future.
- You sold eligible capital property before June 18, 1987 and you are entitled to receive an amount in your 1991 fiscal period.

If there is a negative amount in your CEC account after you subtract the eligible capital amount, you will have an amount that you include in your farming income. You may also have an amount that is a taxable capital gain.

The amount you include in farming income is the lesser of:

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

Any part of the negative amount that is not included in farming income is used to calculate your taxable capital

gain. To calculate your taxable capital gain, subtract from the negative amount that is not included in farming income, 50% 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 1991*. This schedule is in your *General Tax Guide*. The taxable capital gain is eligible for the lifetime capital gains deduction. For information on the lifetime capital gains deduction, read the *Capital Gains Tax Guide*.

#### Example B

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

1987 —	\$ 500
1988 —	473
1989 —	440
1990 —	409
Total	<u>\$1,822</u>

At the beginning of his 1991 fiscal period the balance in Charlie's CEC account is \$5,428. In 1991, Charlie sold his milk quota for \$14,000. Charlie's CEC account for 1991 is as follows:

CEC account	
Balance at the beginning of the 1991 fiscal period.....	\$ 5,428
1991 — Subtract eligible capital amount sale of milk quota \$14,000 X 3/4.....	<u>10,500</u>
Balance.....	<u>\$(5,072)</u>
Charlie deducted \$1,822 in annual allowances from income in past years. Since this amount is less than the negative amount in his account, he includes \$1,822 in his farming income.	
Charlie also has a taxable capital gain of \$3,000 that is calculated as follows:	
Negative balance in the account.....	\$5,072
Subtract: Amount included in farming income.....	<u>1,822</u>
Negative balance that is not farming income ..	\$3,250
Subtract: 50% of the annual allowances deducted for fiscal periods that started before 1988 (\$500 x 50%).....	<u>250</u>
Taxable capital gain.....	<u>\$3,000</u>

#### Replacement property

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

## Chapter 7

# Farm Losses

When the expenses for your farm business are more than the income for the year, the result is a net operating loss. As explained in chapter 4, this loss may be increased or decreased by certain adjustments, such as an optional inventory adjustment, to arrive at your net farm loss for the year.

If you show a net farm loss for the year, read this chapter carefully to find out how to treat your loss. If you would like more information, read Interpretation Bulletin IT-322, *Farm Losses*.

The amount of the net farm loss you can deduct on your return depends on the nature and extent of your business. A farm loss can be treated as either:

- fully deductible;
- partially deductible;
- non-deductible.

### Farm losses — fully deductible

We consider farming your chief source of income if you make your living from farming. If farming is your chief source of income, you can deduct the full amount of your net farm loss from other income. Other income could come from investments or part-time employment.

To determine whether or not 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.

#### Note

If you are a partner in a farming business, you must determine whether farming is your chief source of income on an individual basis.

Farming can still be your chief source of income even though your farming business does not show a profit.

Once you have decided that farming is your chief source of income and you show a net farm loss in 1991, reduce the loss by the amount of your other income (including any forward averaging income) for the year. Any remaining loss is your farm loss for 1991.

If in 1991 your farming expenses are \$80,000 and your farming income is \$30,000, you have a net operating loss of \$50,000. You choose to reduce this loss by the optional inventory adjustment of \$15,000. Your net farm loss is now \$35,000 (\$50,000 minus \$15,000). Also in 1991, your other income is \$2,000. Since your net farm loss of \$35,000 is

more than your other income (\$2,000) your farm loss for the year is \$33,000.

#### Carry-back — 1991 farm loss

You can carry your 1991 farm loss back three years and forward up to ten years and apply it against your income from all sources in those years.

If you choose to carry back your 1991 farm loss to your 1988, 1989, or 1990 returns, complete Form T1A, *Request for Loss Carry-Back*. File one copy of the form with your 1991 return. Do not file an amended return for the year you would like the loss applied to.

#### Applying your farm losses from years before 1991

You can apply farm losses that you had in 1983, 1984, 1985, 1986, 1987, 1988, 1989, or 1990 if they have not already been deducted. You might do this if you have income for 1991 as opposed to a farm loss.

You have to apply the loss from the earliest year first before you apply the losses from other years.

#### Non-capital loss

You may have a farm loss in 1991 in addition to a loss from another business (which is not farming or fishing). If these losses are more than your other income for the year, you calculate both your 1991 farm loss and your 1991 non-capital loss.

You can carry back your 1991 non-capital loss three years and forward up to seven years.

If you choose to carry back your 1991 non-capital loss to your 1988, 1989, or 1990 returns, complete Form T1A, *Request for Loss Carry-Back*. File one copy of the form with your 1991 return. Do not file an amended return for the year you would like the loss applied to.

For more information about non-capital losses, read Interpretation Bulletin IT-232, *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 11).

First, any farm loss or non-capital loss in the averaging period that has not been deducted can 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 can only deduct it in the ten years following the year of the loss or in an earlier year that is not included in the averaging period.

### Restricted farm losses — partially deductible

If farming is not your chief source of income, you can still deduct a portion of your farm loss. In other words, you do not rely only on farming to make your living, but do



operate it as a business. 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 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 1991, you are only entitled to deduct a portion of your farm loss, the portion you deduct from other sources of income for the year is the lesser of:

- your net farm loss for the year; and
- \$2,500 plus the lesser of:
  - $1/2 \times$  (your net farm loss minus \$2,500); and
  - \$6,250.

This gives you the portion of your farm loss you can deduct in 1991. The other portion is your restricted farm loss.

#### Note

If your farm loss is \$15,000 or more you do not have to complete this calculation. The portion of the farm loss you can deduct is \$8,750 and 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 1991, you have a farm loss of \$9,200 and also receive wages from employment. The portion of your net farm loss that you can deduct is calculated as the lesser of:

- \$9,200; and
- \$2,500 plus the lesser of:
  - $1/2 \times$  ( $\$9,200 - \$2,500$ ) = \$3,350, and
  - \$6,250.

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

You deduct the lesser of the two amounts, therefore, the portion of your farm loss you deduct in 1991 is \$5,850. The restricted farm loss is the portion you cannot deduct, which is \$3,350 ( $\$9,200 - \$5,850$ ).

#### Applying your 1991 restricted farm loss

You can carry your 1991 restricted farm loss back three years and forward 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 1991

In 1991, you have the choice of applying restricted farm losses you had in 1983, 1984, 1985, 1986, 1987, 1988, 1989, or 1990 that have not already been deducted. To do this, you have to have a net farming income in 1991. You have to apply the restricted farm loss from the earliest year before you can apply the restricted farm losses from other years.

If you sell farmland and have unused restricted farm losses, you can reduce the amount of a capital gain from the sale. For more information, see "Restricted farm losses" on page 27 in chapter 8.

#### Farm losses — non-deductible

If you do not operate your farm as a business, you cannot deduct any portion of your net farm loss. For your farm to be a business, it must be capable of making a profit or you can show that it will 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 makes it impossible either now, or in the near future, to make a profit. We consider your farm activity as for your own personal enjoyment and, therefore, any farm expenses are personal expenses.

#### Note

While we may accept the way you show your farm loss on the initial assessment of your return, it could be reviewed later on. For information on audits or reviews, see chapter 12.

## Chapter 8 Capital Gains and Farming

This chapter explains the capital gains rules for people who farm. The general rules are covered in the *Capital Gains Tax Guide*.

### What is a capital gain?

A capital gain is a profit. When you sell capital property that is depreciable or undepreciable, the sale could result in a capital gain.

A capital loss may also occur, but only on undepreciable capital property. An example of undepreciable property is land. A loss on depreciable property may result in a terminal loss. Terminal losses are explained in chapter 5.

A capital gain or loss is calculated as follows:

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

The **proceeds of disposition** is the price you sell your property for.

The **adjusted cost base** is the original cost of the property plus any other costs such as renovations or improvements.

**Selling expenses** include such things as commissions, surveyors' fees, transfer taxes, and advertising costs.

Report on your return the amount of any taxable capital gain or allowable capital loss. For 1991, the taxable capital gain is three-quarters (3/4) of your capital gain and the allowable capital loss is three-quarters (3/4) of your capital loss.

For more information, read the *Capital Gains Tax Guide*.

### Principal residence

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

If in 1991 you sold farmland 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. You should complete both calculations before choosing a method.

#### Method 1

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 (1/2) hectare (approximately one acre) unless you can prove that more land is necessary for the use and enjoyment of your home.

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

- the fair market value of one-half (1/2) 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.

**Fair market value (FMV)** is the price you would buy or sell a property for in a normal business transaction.

#### Example

Ernie sold his 16 hectare farm, which included his principal residence. One-half (1/2) hectare of land is part of his principal residence. Ernie recorded the following information:

Land values at the time of sale:	
FMV of comparable farm land per hectare ..	\$12,000
FMV of a typical residential building site in the area .....	\$25,000
Land values at the time of purchase:	
FMV of comparable farm land per hectare ..	\$7,500
FMV of a typical residential building site in the area .....	\$15,000

	<u>Principal Residence</u>	<u>Farm Land</u>	<u>Total</u>
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
<b>Capital gain</b>	<u>NIL</u>	<u>\$ 75,000</u>	<u>\$ 75,000</u>
<b>Taxable capital gain</b> (3/4 x \$75,000)			<u>\$ 56,250</u>

Since the FMV of a typical residential building site in the area is greater than the FMV of one-half (1/2) hectare of farmland, Ernie used the value of a typical residential building site for the land that is part of his principal residence.

#### Method 2

Using this method, you calculate the capital gain on your land and your 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:

- indicate that 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 bought the farm if this occurred after 1971) the property was your principal residence and you were a resident of Canada.

If you use method 2 to calculate your capital gain, 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, keep documents that show 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 farmland in 1991 and have unused restricted farm losses from previous years, you can deduct a portion of these unused losses from the capital gain. The portion you deduct is the property taxes and interest on money borrowed, or on an amount owing to buy the land, that makes up part of the unused restricted farm losses.

In this case, you can only reduce the capital gain by the restricted farm loss. You cannot use the loss to create or increase a capital loss on the sale of your farmland.

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

If you have a taxable capital gain on the sale of **qualified farm property**, you can claim a capital gains deduction. This deduction offsets all or part of any taxable capital gain. To calculate your capital gains deduction, read the *Capital Gains Tax Guide*.

#### What is qualified farm property?

Qualified farm property is property you or your spouse own, or a family farm partnership in which you or your spouse hold an interest, and includes property that is:

- a share of the capital stock of a family farm corporation that you or your spouse own;
- an interest in a family farm partnership that you or your spouse own; or
- real property (land or buildings) or eligible capital property (see page 22 in chapter 6).

Qualified farm property may also include property owned by an individual and used by a personal trust if the property had been acquired from the personal trust by that individual.

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.

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

#### Real property or eligible capital property

You may have bought or entered into a written agreement to buy real or eligible capital property before June 18, 1987. We consider this property to be used in carrying on a farming business in Canada 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 and was owned by either an individual or a partnership.

We will consider real property or eligible capital property bought **at any time** to be used in carrying on a farming business in Canada if, throughout the 24 months before the sale it is owned by you, your spouse, any of your children, parents, or a family farm partnership in which any of these individuals owned an interest, and:

- the property or a replacement property was used by an individual referred to above, in a farming business in Canada, and for at least two years, the individual's gross income from the business is larger than the individual's income from all other sources in the year; or
- it was used by a family farm partnership or family farm corporation carrying on a farming business in Canada for at least 24 months and during this time any individual referred to above was actively engaged in the farming business.

### Special registered retirement savings plan (RRSP) rule for farmers

Since the lifetime capital gains deduction was introduced in 1985, the special RRSP contribution is only available for qualified farm property sold in 1984.

If you sold qualified farm property in 1984, and are adding the taxable capital gain in income over a number of years by reserves, you are still eligible to claim the special RRSP contribution.

The contribution is available for each year that 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 can transfer your farm to your child **without any tax on a capital gain** if, just prior to the transfer, your child is a resident of Canada. Also the property must have been used for farming immediately before the transfer by you, your spouse, or any of your children. This is also true if your farm is transferred when you die.

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 the age of 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 can be postponed until the property is sold by the child.

#### Transfer of farm property if death occurs in 1991

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 just prior to 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.

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

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

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

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

If you need information on these transfers and choices available, get Interpretation Bulletins IT-349 and Special Release, *Intergenerational Transfers of Farm Property on Death*, and IT-449, *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:

- farmland
- depreciable property, including buildings
- eligible capital property
- a share in a family farm corporation
- an interest in a family farm partnership

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

#### Example

Stan wishes to transfer the following farm properties to his 19 year old 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 its fair market value (\$100,000); and
- the **combine** at any amount between the undepreciated capital cost (\$7,840) and its 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. We consider the son to have acquired the land at \$85,000 and the combine at \$7,840. When the son sells these properties, he includes in income any taxable capital gain or recapture of capital cost allowance postponed by Stan.

For more information, read Interpretation Bulletin IT-268 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.

As with the transfer of property to a child, any tax from a taxable capital gain or recapture of capital cost allowance due to this transfer is postponed until a future time.

If the spouse later sells the property, any capital gain is reported by the farmer, not the spouse. This rule applies to transfers after 1971 where the farmer is living at the time the property is sold. However, there are exceptions to this rule. For more information, read Interpretation Bulletin, IT-511, *Interspousal Transfers and Loans of Property made after May 22, 1985*.

#### Other special situations

There are other rules that allow you to postpone paying tax on capital gains.

If you sold capital property **before November 13, 1981**, you can 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 November 13, 1981.

If you sold capital property **after November 12, 1981**, you can 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 in 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 (1/10) 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 (1/5) 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 that is replaced with a similar property, and when property is expropriated. For these types of situations, get Interpretation Bulletins IT-259 and Special Release, *Exchanges of Property*, IT-271, *Expropriations — Time and Proceeds of Disposition*, and IT-491, *Former Business Property*.

## Chapter 9 Investment tax credit

### General information

The investment tax credit allows you to deduct a percentage of the cost of your property from the amount of taxes you owe. You may be entitled to this tax credit if the property you bought in 1991 qualifies or you have unused investment tax credits from years before 1991.

#### Property bought in 1991

If you buy property and it is available for use (see page 18 in chapter 5), it may be eligible for the investment tax credit. 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.

**Qualified property** includes certain new buildings, machinery, and equipment. Due to the number of properties that qualify, it is not possible to list them all in this guide. To find out if property you purchased in 1991 qualifies for the investment tax credit you can either check section 4600 of the *Income Tax Regulations* or contact your district taxation 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 buy 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. Also, the property has to be used in a farming business.

If you would like more information on approved project property, read Information Circular 78-4 and Special Release, *Investment Tax Credit Rates*.

#### Property bought before 1991

If you bought property before 1991 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 1991. To do this, complete "Part A" of Form T2038(IND.), *Investment Tax Credit — Individuals*.

### How to calculate your investment tax credit

Use Form T2038(IND.) to calculate your investment tax credit claim for 1991. This guide has two copies of this form, and the instructions to complete it. Attach one copy to your return and keep the other for your records.

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 cases, you may have to either increase or decrease your investment cost. For example, you decrease your 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.

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 you earned on the property you buy in that part of the calendar year that is after your fiscal year-end. For example, your fiscal period ends on June 30, 1991. In November 1991, you buy property that is eligible for an investment tax credit claim. When filing your 1991 return, you can claim an investment tax credit for the property bought in November.

If you are block averaging in 1991, see chapter 11 for information on claiming the investment tax credit.

### When to claim your investment tax credit

You can use the investment tax credit you earn in 1991 to reduce your taxes in 1991 (the current year), in a year before 1991 (a previous year), or in a year after 1991 (a future year).

#### Current year claim

To calculate your claim for 1991, 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 your amount.

You can also use your investment tax credit to reduce your federal individual surtax for 1991. To calculate your claim, complete section II of Form T2038(IND.). Enter the amount of your credit on line 518 of Schedule 1 of your return package.

#### Previous year deduction

You can carry back the investment tax credit you earn in 1991 three years and use it to reduce your federal taxes in those years. To do this, complete "Part B" of Form T2038(IND.).

### Future year deduction

You can carry forward, for up to ten years, an investment tax credit you earned in 1991 that is not used to reduce taxes in 1991 or a previous year. Any credit not used ten years after it is earned cannot be used.

### Refundable investment tax credit

If you cannot use all of your investment tax credit to reduce your taxes in the year, a part of the credit may be refunded to you in cash. You can only claim this refundable investment tax credit in the year you make a qualifying purchase.

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

### Other adjustments

The amount of investment tax credit claimed or refunded in 1991, or any 1991 investment tax credit carried back to a previous year, reduces the capital cost of that property. You make this adjustment in 1992. This adjustment reduces the amount of a capital cost allowance you can claim for the property. It also reduces the capital cost of the property when you calculate the capital gain.

If the investment tax credit that you deducted or were refunded in 1991 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 1992 by the amount of credit deducted or refunded. If no property remains in that class, you must report this amount in income in 1992.

## Chapter 10 Partnerships

This chapter briefly explains, in general terms, some of the special features of partnerships. If you need more information, get Interpretation Bulletins IT-90, *What is a Partnership?* and IT-138, *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 help on deciding if an arrangement is a partnership, refer to the provincial law for your province.

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

- if 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, if they make a gain or loss on the sale.

These are general points to consider when figuring out 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 that the partnership prepares a statement of income and expenses. A farming partnership can use the cash method of reporting farming income if all the partners agree. It is the net partnership income that is divided among the partners. 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. When 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, read the *Employers' Guide to Source Deductions*, and Interpretation Bulletin IT-63, *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 he or she received. The partnership will deduct 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 (see chapter 5) 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 5). However, the partners are entitled to the capital gains deduction. For information on the capital gains deduction, read the *Capital Gains Tax Guide*.

Any investment tax credit allocated to the partners, reduces the partnership's capital cost of the depreciable property. We consider this allocation to be made at the end of the partnership's fiscal year. Also, the partnership reduces the capital cost by any assistance it received from a government, municipality, or other public authority such as grants, subsidies, and forgivable loans.

## Eligible capital expenditures

A partnership can own eligible capital property such as a milk quota. This means the partnership deducts the annual allowance for this type of property (see chapter 6). The partnership also reports any income from the sale of eligible capital property.

## Goods and services tax (GST) rebate

As a member of a partnership claiming expenses on your return, you may be eligible for a rebate of the GST paid on these expenses.

The GST rebate is available to an individual who is a member of a GST registered partnership. It is paid on the expenses made outside the partnership that are deducted from the individual member's income from the partnership. The rebate is based on the amount of your individual expenses subject to GST that you deducted on your return. These expenses include such things as vehicle costs, meals, entertainment, and certain business-use of home expenses. A GST rebate may also be claimed on a CCA deduction when the CCA is claimed on a vehicle you bought for the business.

If you think you may be eligible for this rebate, complete form GST-370, *Employee and Partner GST Rebate* and attach it to your return. You can get this form from your district taxation office.

## 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 "Partnership schedule" on page 17 in chapter 4.

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 would like more information, get a copy of the *Guide to the Partnership Information Return*, and Information Circular 89-5, *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 can 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.

## Partnership losses

The loss carry-over provisions apply to each partner, not to the partnership. Therefore, each partner applies the loss carry-over provisions as explained in chapter 7.

## Income averaging

Income averaging, as explained in chapter 11, applies to each partner and not to the partnership.

# Chapter 11 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 have to do so before your 1998 taxation year. For more information about a forward averaging amount withdrawal, see line 237 in the *General Tax Guide*.

## Five-year block averaging

If you choose, the block averaging provisions allow you to calculate your income tax for 1991 based on your average income over a five-year or averaging period.

### Note

In most cases, 1991 will be the last year you can block average your income. This is because the block averaging

provisions will not apply for five-year blocks that start after 1987.

Your averaging period is made up of 1991 (the year of averaging) and four of the six years before 1991. If an income tax return for a year before 1991 in which you owed federal tax was not filed on time, you cannot include that year in the averaging period.

To be included in the averaging period, certain prior year returns have to have been filed on time even if there was no federal tax payable. They are returns for years in which you:

- disposed of capital property;
- had a taxable capital gain; or
- received a child tax credit prepayment.

You can include a year before 1991 if you did not owe any federal tax and there was no other requirement to file a

return that year, if the return for that year is filed by April 30, 1992.

For example, you would like to average your income in 1991 and you have filed returns on time for 1990, 1989, 1988 and 1986. In 1987, you did not file a return because you did not owe any tax and there was no other filing requirement. If you want 1987 to be included in the averaging period, you have to file your 1987 return by April 30, 1992. If you do this, your averaging period is 1991 (the year of averaging), 1990, 1989, 1988 and 1987. If you do not file a return for 1987, your averaging period is 1991 (the year of averaging), 1990, 1989, 1988 and 1986.

You cannot 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. Also, any minimum tax assessed will not be taken into account when calculating federal tax assessed for years in the averaging period.

### Are you eligible to block average?

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

- Farming or fishing is your chief source of income in the averaging period;
- Returns were filed on time for years included in the averaging period for which you:
  - had to pay net federal tax;
  - disposed of a capital property;
  - had a taxable capital gain;
  - received a child tax credit prepayment;
- You filed on or before April 30, 1992, a return for a year you want to include in the averaging period that had no net federal tax owing and there was no other filing requirement.
- You filed Form T2011, *Election to Average Income* by April 30, 1992.
- You have not, either in 1991 or in any year included in the averaging period, chosen to forward average, or included in your taxable income any portion of your **accumulated averaging amount** for amounts previously forward averaged.

If you choose to block average in 1991 and later on change your mind, advise your district taxation 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 Form T2011, line by line.

Enter your name, address, and social insurance number at the top of the form.

#### Line 1

##### Taxable income

In the "Year of Averaging" column, enter your taxable income as shown on your 1991 return.

For other years in your averaging period, enter your taxable income that was assessed. If the total of the allowable deductions you used to calculate your taxable income exceeds your net income, enter this excess as a negative amount on this line. However, for a year before 1988, the negative amount cannot be larger than your personal exemptions.

**If for any year in the averaging period before 1988 you had a farm loss or non-capital loss that is larger than your other income for that year, enter on line 1 the amount of your personal exemptions and show it as a negative amount.** Include the farm loss or non-capital loss on line 4 to reduce income of other years in the averaging period. See chapter 7 for more information about losses.

#### Line 2

##### Add: personal exemptions

**For each year before 1988,** enter the personal exemptions you used to calculate 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 put the five-year total in the TOTAL column at the right.

#### Line 4

##### Less: all fishing, farming or non-capital losses available for application to 1991 that were not deducted in computing taxable income on line 1

If you have farm or non-capital losses available in 1991, enter them on this line and put the total in the TOTAL column at the right.

#### Line 5

##### Gross income for the period

Subtract the total on line 4 from the total on line 3 and enter the amount on line 5.

#### 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 enter the amount 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

Subtract line 7 from line 6 and enter the amount on line 8 for each year.

#### 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 1985 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
- total non-refundable tax credits (for 1988 and following years only)

#### Federal dividend tax credit

If you receive dividends from taxable Canadian corporations in any of the averaging years, divide the total of the dividend tax credits for those years by five and add the result to each year in the averaging period. You do this whether or not you used the credit in those years. The following example shows how you calculate the average dividend tax credit and use it to reduce federal tax on average net income.

#### Example

Year	Taxable Amount of Dividends	Rate	Maximum Credits Allowable
1987	\$1,000.00	16 2/3%	\$166.67
1988	500.00	13 1/3%	66.67
1989	500.00	13 1/3%	66.67
1990	500.00	13 1/3%	66.67
1991	500.00	13 1/3%	66.67
			<u>\$433.35</u>

The federal dividend tax credit **allocated to each year** in the averaging period is \$86.67 ( $\$433.35 \div 5$ ).

1991 Average net income.....	\$18,651.40
Federal income tax on average net income for 1991:	
\$18,651.40 @ 17% .....	\$ 3,170.73
Add: Tax adjustments .....	<u>NIL</u>
	\$ 3,170.73
Less: Total non-refundable tax credits ..	<u>1,067.60</u>
	\$ 2,103.13
Less: Federal dividend tax credit .....	<u>86.67</u>
	<u>\$ 2,016.46</u>

#### Refundable Québec abatement

Farmers in the province of Québec who choose to average in 1991 are entitled to a refundable Québec abatement of 16.5% of the **basic federal tax** on the **average net income** for 1991. To calculate basic federal tax, complete Schedule 1 included with your 1991 income tax package. Multiply the amount shown opposite the **basic federal tax** on the schedule by 16.5% and enter this amount on line 440 of your 1991 return.

#### Line 10

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

Enter on this line any investment tax credit you claimed in each year before 1991. Do not include any amount of **refundable investment tax credit**.

#### Note

If you were assessed a minimum tax in 1986, 1987, 1988, 1989, or 1990, 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, enter 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 may be carried forward from 1991.

For example, 1991 is the year of averaging and the investment tax credits claimed in the averaging period (i.e., 1987, 1988, 1989, and 1990) are more than the average tax for those years. The excess becomes part of your investment tax credit pool and may be carried forward for ten years. For more information on applying the investment tax credit in 1991, see line 18.

#### Line 11

##### Subtotal

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

#### Line 12

##### Add: refundable Québec abatement allowed in each of the preceding years

Enter the amount of any refundable Québec abatement **allowed** in each year before 1991.

#### Line 13

##### Subtotal

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

#### Line 14

##### Deduct: refundable Québec abatement allowable

Enter the amount of refundable Québec abatement **allowable** for each year before 1991. The abatement is calculated at 16.5% of the **basic federal tax** based on the **average net income** for those years.

#### Line 15

##### Subtotal

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

#### Line 16

##### Deduct: federal tax assessed

Enter the amount of federal tax you were assessed for each year before 1991, add these amounts, and put the total in the **TOTAL** column.

#### Note

Enter only the federal tax assessed. Do not include any individual surtax that was assessed for years before 1991. Also, the federal tax assessed does not include any minimum tax assessed for 1986, 1987, 1988, 1989, or 1990 nor any minimum tax carried over and applied in 1987, 1988, 1989, or 1990.

#### Line 17

##### Subtotal

Subtract line 16 from line 15 and enter 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 entered on line 18.

#### Line 18

##### Deduct: investment tax credit claimed for 1991

You can claim an investment tax credit for 1991 if you have a balance in your investment tax credit pool or you earned an investment tax credit in 1991. The amount you can 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, enter nil on line 18. If you would like more information on investment tax credits, see chapter 9.

#### Line 19

##### Subtotal

Subtract line 18 from line 17 and enter the subtotal on line 19.

#### 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 *General Tax Return*. The **basic federal tax** used in this calculation is the amount on line 506 of Schedule 1 that you complete to figure out the average tax for 1991 (line 9). You base any surtax on this amount.

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

- three-quarters (3/4) 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 1991 **federal tax** or **refund**.

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

#### Line 22

##### Provincial income tax

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

You calculate your provincial income tax (except in Québec) by using the appropriate net provincial tax rate to your **basic federal tax** (as calculated on 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 1991. This credit is deducted on line 23.

#### Line 23

##### Deduct: any credits claimed under the Saskatchewan tax incentives program in each year

Enter on this line, any credit you claimed under the Saskatchewan tax incentives program for each year in the averaging period before 1991.

If the total on line 23 is larger than the total on line 22, enter 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 may be carried forward for seven years.

#### Line 24

##### Subtotal

Subtract line 23 from line 22 and enter the subtotal on line 24.

#### Line 25

##### Deduct: provincial income tax assessed

Enter the provincial tax you were assessed for each year before 1991. Add these amounts and put the total in 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 enter the subtotal on line 26.

#### Line 27

##### Deduct: Saskatchewan tax credits claimed for 1991

You can claim a tax credit under the Saskatchewan tax incentives program in 1991 if you have a balance in your tax credit pool for 1991 (see line 23), or you earned a tax credit under this program in 1991. You can only subtract an amount that is not greater than the amount 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 for the next seven years. They have to be used, however, for each year that tax is due.

#### Line 28

##### Provincial income tax or refund

If the amount on line 26 is larger than the amount on line 27, the difference is the provincial tax. If the amount on line 27 is larger than the amount on line 26, the difference is a refund. In either case, transfer the amount on line 28 to line 428 on page 4 of your return with the note, **averaged**.

## Chapter 12 General Information

### What happens after you file your return?

When we first process your 1991 return, we do a limited review of the information. Your Notice of Assessment is normally based on the income you report. This does not mean, however, that we have accepted your reported income and deductions. Your return may be selected for further review or audit some time after the initial processing and assessment.

We can reassess a return or make additional assessments, or assess tax, interest, or penalties within three years from the day we mailed your original Notice of Assessment, or notice that no tax is payable for the year. You can also request an adjustment to your return within this time period. This is known as the **normal reassessment period**.

In addition, legislation has been proposed so that you can request an adjustment to 1985 and later taxation years if the normal reassessment period has expired where the request is for a refund, or to reduce taxes payable. For further details, contact your district taxation office.

We can also reassess your return within six years from the day we mailed your original Notice of Assessment, specifically to allow you to revise a carry-back of certain deductions or credits.

In certain situations, a return will not be reassessed based on an informal request unless the request is made within 90 days from the date we mailed your Notice of Assessment. These situations are explained in Information Circulars 75-7, *Reassessment of a Return of Income*, and 84-1, *Revision of Capital Cost Allowance Claims and Other Permissive Deductions*.

Under proposed legislation, you may be able to make a late or amended election, or revoke an original election for taxation years back to 1985. To do this, you must provide the details in writing. For more information, contact your district taxation office.

### Further review or audit — Inspection of records

A self-assessment tax system only works when returns are regularly inspected. 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.

If our audit shows that you have not been keeping adequate books and records, we may ask for a written agreement from you that all books and records will be properly maintained. We may follow up by letter or by visiting with you.

If you have not been keeping adequate books and records within the time allowed, we may issue a formal requirement letter describing the information you must keep and advise you of the penalties for failing to comply. If you still fail to comply, we may prosecute.

### Appeal process

If you disagree with your Notice of Assessment, you can file a Notice of Objection. The Notice of Objection must be filed within 90 days from the date we mailed the Notice of Assessment.

To file a Notice of Objection, send two copies of Form T400A, *Notice of Objection*, setting out the reason for your objection and all relevant facts. This form is available from your district taxation office, and should be sent by registered mail to the Deputy Minister of National Revenue for Taxation, Ottawa.

Under proposed legislation, you can file a Notice of Objection simply by writing to the Chief of Appeals at your local district taxation office or taxation centre.

When we receive a Notice of Objection, we reconsider the assessment. Your assessment may then be confirmed, changed, or cancelled. If the objection is not allowed, we will notify you by registered mail. You then have the choice of appealing to the Tax Court of Canada within 90 days.

While you are waiting for your appeal to be settled by us or a court, you do not have to pay the disputed taxes. However, these taxes are still subject to the normal interest charges.

### 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 would like more information, read Information Circular 77-16, *Non-Resident Income Tax*.

## Rates of capital cost allowance

This schedule shows the more common depreciable properties used in a farming business and the class for each type of property. The rates for these classes are shown at the end of the list.

Depreciable Property	Part XI Class No.	Depreciable Property	Part XI Class No.
Aircraft — acquired before May 26, 1976 .....	16	Harness .....	10
Aircraft — acquired after May 25, 1976 .....	9	Harrows .....	8
Automobiles .....	10	Hay balers and stokers	
Bee equipment .....	8	— drawn .....	8
Boats and component parts .....	7	— self-propelled .....	10
Breakwaters		Hay loaders .....	8
— cement or stone .....	3	Ice machines .....	8
— wood .....	6	Incubators .....	8
Brooders .....	8	Irrigation equipment — overhead .....	8
Buildings and component parts		Irrigation ponds .....	6
— wood, galvanized, or portable .....	6	Manure spreaders .....	8
— other:		Milking machines .....	8
— acquired after 1978 and before 1988 .....	*3	Mixers .....	8
— acquired after 1987 .....	1	Mowers .....	8
Buildings — fruit and vegetable storage		Nets .....	8
(after Feb. 19, 1973) .....	8	Office equipment .....	8
Casing, cribwork for waterwells .....	8	Outboard motors .....	10
Chain saws .....	10	Passenger vehicles (see chapter 5 for details) ..	10.1
Cleaners — grain or seed .....	8	Piping — permanent .....	2
Combines		Planters — all types .....	8
— drawn .....	8	Ploughs .....	8
— self-propelled .....	10	Pumps .....	8
Computer hardware and systems software .....	10	Rakes .....	8
Coolers — milk .....	8	Roads or other surface areas — paved or	
Cream separators .....	8	concrete .....	17
Cultivators .....	8	Silo .....	8
Dams		Silo fillers .....	8
— cement, stone, or earth .....	1	Sleighs .....	10
— wood .....	1	Sprayers .....	8
Discs .....	8	Stable cleaners .....	8
Diggers — all types .....	8	Stalk cutters .....	8
Docks		Swathers	
— cement, steel, or stone .....	3	— drawn .....	8
— wood .....	6	— self-propelled .....	10
Drills — all types .....	8	Tile drainage — acquired before 1965 .....	8
Dugouts, dikes, and lagoons .....	6	Tillers — all types .....	8
Electric generating equipment (not exceeding		Threshers .....	8
15 Kw)		Tools	
— acquired after May 25, 1976 .....	8	— under \$200 .....	12
— acquired before May 26, 1976 .....	9	— \$200 and over .....	8
Electric motors .....	8	Tractors .....	10
Elevators .....	8	Trailers .....	10
Engines — stationary .....	8	Trucks .....	10
Fences — all types .....	6	Wagons .....	10
Forage harvesters		Water towers .....	6
— drawn .....	8	Welding equipment .....	8
— self-propelled .....	10	Well equipment .....	8
Graders — fruit or vegetable .....	8	Windchargers .....	8
Grain drying equipment .....	8	Wind-energy conversion equipment .....	34
Grain loaders .....	8		
Grain separators .....	8		
Grain storage building			
— wood, galvanized steel .....	6		
— other .....	3		
Greenhouses .....	6		
Grinders .....	8		

\*The cost of additions or alterations made to a class 3 building after 1987 is limited to the lesser of \$500,000 or 25% of the building's capital cost on December 31, 1987. The cost of any additions or alterations over this limit is included in class 1.

## Rates — Part XI

Class 1 .....	4%
Class 2 .....	6%
Class 3 .....	5%
Class 6 .....	10%
Class 7 .....	15%
Class 8 .....	20%

## Rates — Part XI

Class 9 .....	25%
Class 10 .....	30%
Class 10.1 .....	30%
Class 12 .....	100%
Class 16 .....	40%
Class 17 .....	8%

## Index

	Page		Page
Adjustments to the income and expenses statement .....	13	How to complete Form T2011 .....	32
Appeal process .....	35	Forms .....	6
Capital cost allowance on depreciable property		Forward averaging .....	31
Definitions .....	18	Further review or audit — inspection of records .....	35
General comments .....	18	Goods and services tax rebate .....	31
How to complete Form T2041 .....	18	How do you report farming income?	
Partnerships .....	30	Accrual method .....	5
Rates .....	36	Cash method .....	5
Special points .....	22	Changing your method .....	5
Capital gains		Income .....	7
Principal residence .....	26	Investment tax credit	
Qualified farm property and the lifetime capital gains deduction .....	27	General information .....	29
Special registered retirement savings plan rule for farmers .....	27	How to calculate .....	29
Transfer of farm property to a child .....	27	Other adjustments .....	30
Transfer of farm property to a spouse .....	28	Refundable amount .....	30
Eligible capital expenditures		When to claim .....	29
Cumulative eligible capital account .....	22	Keeping records .....	4
Definitions .....	22	Mandatory inventory adjustment .....	14
Replacement property .....	23	Net income (loss) before adjustments .....	13
Expenses .....	9	Non-resident withholding tax .....	35
Farm losses		Partnership information return .....	31
Fully deductible .....	24	Partnership losses .....	31
Non-deductible .....	25	Partnership income .....	30
Partially deductible (restricted) .....	24	Paying tax by instalment .....	5
Fiscal period .....	4	Statement of farming income and expenses .....	6
Five-year block averaging		What happens after you file your return? .....	35
Eligibility .....	32	What is farming income? .....	4
		What is a partnership? .....	30

## Calculating the mandatory inventory adjustment

Refer to page 14 in chapter 4 for instructions on how to complete these charts.

If your farming business **started after 1988** your MIA 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 1991 fiscal period, whichever is less. The value of your purchased inventory on hand is the amount after adding lines 9, 10, 11, 13, 14 and 15.

If your farming business **started before 1989**, you use either the **fixed dollar method** or the **elective method** to calculate your MIA. 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.

**Chart 1**  
**Cash Cost of Purchased Inventory**

Enter the amount you paid by the end of your 1991 fiscal period for the specified animals you purchased:

- in your 1991 fiscal period \_\_\_\_\_ (1)
- in your 1990 fiscal period \_\_\_\_\_ (2)
- in your 1989 fiscal period \_\_\_\_\_ (3)
- before your 1989 fiscal period \_\_\_\_\_ (4)

To figure out the amount for line (4), for the fiscal period of purchase, multiply the amount paid by the percentage and enter the amounts in the "Cash cost" column. Then total all the years and enter this amount on line (4).

<u>Fiscal period of purchase</u>	<u>Amount paid</u>	<u>Percentage</u>	<u>Cash cost</u>
1988	_____	100%	_____
1987	_____	50%	_____
1986	_____	50%	_____
1985	_____		_____
and prior years	_____	25%	_____
<b>Total</b>			=====

Enter the amount you paid by the end of your 1991 fiscal period for all the other inventory you purchased:

- in your 1991 fiscal period \_\_\_\_\_ (5)
- in your 1990 fiscal period \_\_\_\_\_ (6)
- in your 1989 fiscal period \_\_\_\_\_ (7)
- before your 1989 fiscal period \_\_\_\_\_ (8)

**Chart 2**  
**Value of Purchased Inventory for Specified Animals**

**Inventory purchased in your 1991 fiscal period**

Enter an amount that is not more than the amount on line (1) but not less than 70% of the amount on line (1).

\_\_\_\_\_ (9)

**Inventory purchased in your 1990 fiscal period**

Enter an amount that is not more than the amount on line (2) but not less than 70% of the value at the end of the 1990 fiscal period plus any amounts paid in your 1991 fiscal period towards the purchase price.

\_\_\_\_\_ (10)

**Inventory purchased in your 1989 fiscal period**

Enter an amount that is not more than the amount on line (3) but not less than 70% of the value at the end of the 1990 fiscal period plus any amounts paid in your 1991 fiscal period towards the purchase price.

\_\_\_\_\_ (11)

**Inventory purchased before your 1989 fiscal period**

Enter an amount that is not more than the amount on line (4) but not less than 70% of the value at the end of the 1990 fiscal period plus any amounts paid in your 1991 fiscal period towards the purchase price.

\_\_\_\_\_ (12)

**Chart 3**  
**Value of Purchased Inventory for All Other Inventory**

**Inventory purchased in your 1991 fiscal period**

Enter the amount on line (5) or the fair market value, whichever is less.

\_\_\_\_\_ (13)

**Inventory purchased in your 1990 fiscal period**

Enter the amount on line (6) or the fair market value, whichever is less.

\_\_\_\_\_ (14)

**Inventory purchased in your 1989 fiscal period**

Enter the amount on line (7) or the fair market value, whichever is less.

\_\_\_\_\_ (15)

**Inventory purchased before your 1989 fiscal period**

Enter the amount on line (8) or the fair market value, whichever is less.

\_\_\_\_\_ (16)

CUT ALONG THE LINE.



**Chart 4  
Fixed Dollar 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 2 and 3:

- the amount on line (9) \_\_\_\_\_
- the amount on line (10) \_\_\_\_\_
- the amount on line (11) \_\_\_\_\_
- the amount on line (12) \_\_\_\_\_
- the amount on line (13) \_\_\_\_\_
- the amount on line (14) \_\_\_\_\_
- the amount on line (15) \_\_\_\_\_
- the amount on line (16) \_\_\_\_\_

**Total value of inventory** \_\_\_\_\_ (18)

Enter the amount on line (17) or line (18), whichever is less. \_\_\_\_\_ (19)

Deduct: \* 10,000

**Mandatory inventory adjustment under the fixed dollar method**  
(if negative enter 0). \_\_\_\_\_ (20)

If your fiscal period is less than 51 weeks, prorate as follows:

\*  $10,000 \times \frac{\text{number of days in the fiscal period}}{365}$

\* If your **1991 fiscal period begins in 1991**, use **\$10,000**.  
If your **1991 fiscal period begins in 1990**, use **\$12,500**.

**Chart 5  
Elective Method**

**Note**

If you are a member of a partnership, all partners must agree to use this method. \_\_\_\_\_

Enter the amount of your net loss after adjusting the income and expenses statement (from line 630 on Form T2042). \_\_\_\_\_ (21)

Enter the **value of inventory** from charts 2 and 3:

- the amount on line (9) \_\_\_\_\_
- the amount on line (10) \_\_\_\_\_
- the amount on line (11) \_\_\_\_\_
- the amount on line (13) \_\_\_\_\_
- the amount on line (14) \_\_\_\_\_
- the amount on line (15) \_\_\_\_\_

**Total** \_\_\_\_\_ (22)

Enter the **value of inventory** from charts 2 and 3:

- the amount on line (12) \_\_\_\_\_
- the amount on line (16) \_\_\_\_\_

Sub-total \_\_\_\_\_ (23)

Multiply line (23) by \* .429

**Total** \_\_\_\_\_ (24)

Add lines (22) and (24) \_\_\_\_\_ (25)

Mandatory inventory adjustment under the **elective method** is the amount on line (21) or line (25), whichever is less. \_\_\_\_\_ (26)

\* If your **1991 fiscal period begins in 1991**, use **.429**.  
If your **1991 fiscal period begins in 1990**, use **.286**.