Farming

1988

Farming Income Tax Guide

T4003

Your Guide

In this Guide

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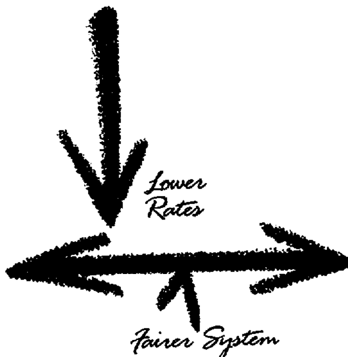

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NEW FOR 1988

As you complete your statement of farming income and expenses and your income tax return, you will notice there are a number of changes this year. These changes are a result of tax reform, which comes into effect for the 1988 taxation year.

To help you identify the major changes, they are shaded in yellow under the heading "New for 1988" throughout this Guide.

DATES TO REMEMBER

December 31, 1988 — Calculate the amount of your 1988 instalment payment on form T7B, *Farmers and Fishermen – 1988* and make your instalment payment of tax and Canada Pension Plan contributions.

February 28, 1989 — File your 1988 T4-T4A Return (form T4-T4A Summary and related forms T4 and T4-A Supplementary) and deliver the Supplementary slips to employees.

April 30, 1989 — File your 1988 income tax return and pay your balance of tax and Canada Pension Plan contributions due.

April 30, 1989 — File form T2011, *Election to Average Income* if you elect to average your income with your income tax return.

The material in this Guide is condensed from the Income Tax Act, Regulations and Income Tax Application Rules, 1971, the Canada Pension Plan and Regulations and the Unemployment Insurance Act and Regulations which contain the terms of the law on which your tax, Canada Pension Plan contributions and Unemployment Insurance premiums are determined. **This Guide is not a legal document;** it is intended as a Guide only and not a substitute for the above-mentioned Acts and Regulations.

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CHAPTER 1
INTRODUCTION

This Guide contains information for a self-employed individual who is carrying on a farming business. The information provided will assist you in calculating the farming income to report on your 1988 return. The *1988 General Tax Guide* contains the information for the completion of your 1988 return. If you are completing a return for a deceased taxpayer, obtain the *1988 Deceased Persons' Income Tax Guide*.

This Guide refers to additional forms that you have to attach to your return and to departmental publications that cover topics in greater detail. As you read through this Guide, list the forms and publications you require on the order form located on the inside back cover.

Farming income includes income from activities such as

- tilling the soil,
- raising or exhibiting livestock,
- maintaining horses for racing,
- raising poultry,
- fur farming,
- dairy farming,
- fruit growing, and
- bee keeping,

but **does not include** employment income received from a person engaged in the business of farming.

Note:
To ensure your farming operation qualifies as a business refer to the explanation of "Non-Deductible Losses" in Chapter 5 of this Guide.

METHODS OF COMPUTING INCOME

You may use either the **cash** or **accrual** method to calculate your farming income. Once you have chosen one of these methods you should continue to use that method in subsequent years.

Cash Method

Under the cash method, you

- report income in the year received, and
- deduct expenses in the year paid.

If you report your income on the cash basis and accept a post-dated cheque in payment of a debt, the amount of the cheque is normally considered income at the time you receive the cheque. If the cheque is not honoured at the time you present it for payment, you may make an adjustment to income. On the other hand, if you accept a post-dated cheque as security for a debt, the amount of the cheque is brought into income at either the date the cheque is payable, or the date it is negotiated, whichever is earlier. If the debt is not payable at the time the post-dated cheque is payable, the amount of the cheque is brought into income at the date the debt becomes payable or the date the cheque is negotiated, whichever is earlier.

When calculating your income using the **cash** method, inventories are normally not taken into account. However, you may include livestock inventories at your option. Refer to the comments under Code 510, "Optional Inclusion of Value of Livestock on Hand" in Chapter 2 for details.

A **partnership** carrying on a farming business may use the cash method only if **all** partners elect to use this method.

For more details on the **cash** method, obtain Interpretation Bulletin IT-433, *Farming – Use of Cash Method.*

Accrual Method

Under the accrual method, you

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

You must include complete inventories of livestock, crops, feed, fertilizer, etc., when calculating income using the accrual method.

The value you place on the items in your year-end inventory is important in determining your income. There are three methods of valuing an inventory that are acceptable for income tax purposes:

- valuation of the entire inventory at its fair market value,
- valuation of individual items (or classes of items if specific items are not readily distinguishable) in the inventory at the lower of their cost or fair market value, and
- unit price basis (for livestock only). An election form, T2034 is available at your district taxation office.

If this is the first year you are reporting farming business income, you may choose the method of valuation that is most suitable for your type of business. However, if this is not your first year of reporting farming business income, you must continue to use the same method used in the previous year. An exception to this is where in the previous year you valued your entire inventory at cost. In this case, you must change your method of inventory valuation to one of the above methods.

You will not have an opening inventory if this is the first year of your farming business. If this is not your first year of business, the value of the inventory at the beginning of the period must be the same as the value of the inventory at the close of the previous period.

A physical stock-taking should be carried out at the end of each year.

For more details, obtain Interpretation Bulletin IT-473 and Special Releases, *Inventory Valuation*.

Changing Your Method

You may change from the accrual method to the cash method by filing a return using the cash method and including a statement that properly reflects the changeover adjustments to both income and expenses.

To change from the cash method to the accrual method you must obtain permission from the Department. Send your request, along with the reasons for the change, to the Director of your district taxation office. This request must be made before the date you are required to file your income tax return for the year in which the change will occur. For the first taxation year in which you report your farming income using the accrual method, your statement of income and

expenses must show separately the adjustments to income and expenses resulting from the change.

Note:
The Department will not approve retroactive changes.

FISCAL PERIOD

For individuals, the taxation year or period for which income tax returns are filed is the calendar year. However, you do not have to report income from a farming business on a calendar year basis.

As a self-employed individual you may choose the date that your normal business year ends. You do this when you file your first return reporting income from the farming business. The time-span covered by your statements is your **fiscal period** and may not be more than 12 months.

A fiscal period that is less than 12 months may occur in certain circumstances. For example, this can occur when a new business begins or when a business ceases to exist.

Income from a farming business is reported in the taxation year in which the fiscal period ends. For example, you report income for the fiscal period April 1, 1987 to March 31, 1988 on your 1988 return because the fiscal period ends in the **1988** taxation year.

Once you choose a fiscal period for a farming business, you can only change it if you first obtain approval from the Director of your district taxation office. A request to change your fiscal period will be approved if it is made for sound business reasons. A change will not be permitted if the main reason is to minimize taxes. For additional information, obtain Interpretation Bulletin IT-179 and Special Release, *Change of Fiscal Period*.

KEEPING RECORDS

To determine your profit or loss at the end of each year, you must keep a record of all your business transactions. The minimum requirement is a day-to-day record of your receipts and expenses. A columnar book with separate pages for income and expenses is most convenient. Keep this record together with your duplicate deposit slips, bank statements and cancelled cheques. The examples that follow show this type of book.

Keep a separate permanent record of assets on which you may claim capital cost allowance. The record should show from whom the asset was acquired as well as the cost and date of acquisition. When you sell or trade an asset, show the date you disposed of it and the amount you received or were allowed on trade-in.

The Department does not issue record books, nor does it recommend any particular book, or set of books. There are many adequate record books and bookkeeping systems that you may obtain for a reasonable cost. As well, some provincial Departments of Agriculture issue bookkeeping records you can use.

Always obtain receipts or other vouchers when you make business expenditures. File these receipts systematically along with cancelled cheques and other documentation to support the amounts you show in your record books. If you do not keep receipts or other vouchers to support your expenses and there is no other evidence available, we may reduce the expenses claimed. For further information, obtain Information Circular 76-4R2, *Unvouchered Expenditures*.

INCOME ITEMS (Farm)

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

EXPENSE ITEMS (Farm)

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

You must keep business records and supporting documents for at least six years from the end of the last taxation year to which they relate. If you filed your return late, keep your records and supporting documents for six years from the date you filed that return. Also, you must keep every book and supporting record necessary for dealing with a notice of objection or appeal until the notice of objection or appeal is resolved and the time for filing any further appeal has expired.

If you wish to destroy your books or records before the six-year period is up, you must apply in writing to the Director of the district taxation office in your area. For further details, obtain Information Circular 78-10R, *Books and Records Retention/Destruction*.

FORMS

This Guide includes two copies of each of the following forms:

- Form T1A – Request for Loss Carry-Back
  You **must** use this form when requesting a loss carry-back.
- Form T2011 – Election to Average Income (Five-year block averaging)
  You must use this form to elect to average your income under the five-year block averaging provisions available to farmers and fishermen. Chapter 10 in this Guide contains instructions for completing this form. Attach the completed form to your return and mail them to your taxation centre by April 30, 1989.
- Form T2038 – Investment Tax Credit (Individuals)
  If you acquired property in 1988 that is eligible for the investment tax credit, complete this form and submit it with your 1988 return. You must do this whether or not you are claiming an investment tax credit for 1988. You should also complete this form if you are claiming an investment tax credit carried forward from a previous year. For details on this credit, refer to Chapter 7 in this Guide.
- Form T2041 – Capital Cost Allowance Schedule for Farmers and Fishermen.
- Form T2042 – Statement of Farming Income and Expenses.

Forms T2041 and T2042 were developed to help taxpayers prepare the statements necessary for income tax purposes. Their use is optional. Additional copies are available at your district taxation office.

CHAPTER 2
INCOME AND EXPENSES

STATEMENT OF FARMING INCOME AND EXPENSES

Form T2042, *Statement of Farming Income and Expenses* is an example of the type of statement you must prepare to report the income and expenses from your farming business. This chapter discusses some of the income and expense items shown on form T2042. For your convenience, this Guide contains two copies of this form. You may use them if you report your income using the cash method.

Attach one copy of your *Statement of Farming Income and Expenses* to page 3 of your return. Keep a copy for your records.

On the statement, show only your income and expenses from farming. If you are a partner in a farming business, include the total income and expenses of the partnership and complete a partnership schedule. The reverse of form T2042 provides a sample schedule for this purpose. For more information on partnerships, refer to Chapter 8 of this Guide.

If you have another business in addition to farming, you must prepare separate statements for that business. You may use form T2124, *Statement of Income and Expenses from a Business*, which you may obtain at your district taxation office along with the *1988 Business and Professional Income Tax Guide*.

AMOUNTS TO BE INCLUDED IN INCOME

The most common amounts you must report as income are discussed below under the same code numbers as those listed on form T2042. If you have other items of farming income that do not appear on this statement

- use the spaces provided to describe them, or
- list them on a separate sheet of paper and attach it to your return.

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

Grain

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

When you deliver grain to a licensed public elevator or process elevator you may receive

- a storage ticket,
- a cash purchase ticket, or
- a deferred cash purchase ticket.

If you are given a **storage ticket,** no sale has taken place. Therefore, you are not considered to have received income at that time.

If you are given a **cash purchase ticket,** a sale has taken place. You are considered to have received payment at that time, regardless of when you present the ticket for payment.

If you are given a **deferred cash purchase ticket,** you may be eligible to report the purchase price stated on the ticket as

income in your next fiscal period if the ticket provides for payment after the end of the fiscal period in which you delivered the grain for sale.

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

Under the Advance Payments for Crops Act and the Prairie Grain Advance Payments Act, producers of various crops are eligible to receive advance payments on crops stored in their own names from their respective producers' associations. Advances you receive under these two Acts are considered **loans** and are not treated as income in the year you receive them. You must include the full amount of the sale of these crops as income in the **year** the sale actually takes place.

Other produce

You may also sell other produce through various agencies. Include the payments you received from any agency in your income, as well as all amounts you received as a result of direct sales.

Code 430
Western grain stabilization payments

You must include stabilization payments or refunds of any levy under the Western Grain Stabilization Act in your income for the year in which you receive them.

Codes 440 to 444
Livestock

Generally, you must include in income the amounts received from the sale of livestock, including those animals in a **basic herd.**

If you established a basic herd before 1972 that has not been completely phased-out, obtain Information Circular 86-6, *Basic Herds*, for details.

If you make a gift of cattle or other marketable item to your spouse or children, you must include in your income the fair market value of these items at the date you made the gift. Also, you cannot include in your expenses any future costs you incur for raising or maintaining these gifts.

If you received a payment for the destruction of animals under the Animal Contagious Diseases Act you must include it in your income in either

- the year the animals were destroyed, or
- the immediately following taxation year.

Tax tip

If as a result of drought conditions you were forced to sell 15 per cent or more of your breeding herd of grazing livestock you may be eligible to defer a portion of the sale proceeds.

This tax deferral program for farmers was announced by the Department of Finance in an information release dated June 30, 1988. You may obtain more information about this special deferral by contacting your district taxation office.

Code 470
Wood

If you operate or periodically harvest a woodlot as part of your farming operation, you must include in your income the amounts received from

- the sale of trees, lumber, logs, and poles, or
- the sale of firewood that is cut by you or for you.

You may deduct from this income an allowance for depletion. For more details, see the section "Depletion allowance" in Chapter 3.

However, an amount you receive in an isolated transaction for allowing other persons to remove standing timber from your woodlot is normally considered a capital receipt, and a taxable capital gain or allowable capital loss may result. Refer to the *1988 Capital Gains Tax Guide* for information on capital gains and losses.

For more details, obtain Interpretation Bulletin IT-373R, *Farm Woodlots and Tree Farms.*

Code 480
Patronage dividends

All patronage dividends you receive, other than those for consumer goods or services, are taxable in the taxation year in which you receive them. If you receive a patronage dividend that is a share or a certificate of indebtedness, you are considered to have received the patronage dividend at the time you received the share or certificate.

Codes 485, 486, and 487
Rebates — Gasoline tax
— Property tax
— Other

If you receive a federal or provincial rebate on gasoline tax, property tax, or interest that applies to your farming operation you must either

- add the rebate to your farming income, or
- deduct it from your expenses.

Codes 455 and 495
Government grants and subsidies

If you receive a grant from a government or a government agency that

- increases your income or reduces your expenses, or
- relates to an income deficiency, or
- relates to specific expenses,

you must **either** add the grant to income or deduct it from the specific expenses.

The following are examples of amounts you must add to your income:

- agricultural subsidies such as those for milk, or
- cash payments under the **Special Canadian Grains Program.**

If you received a government grant to assist you in purchasing depreciable property, you **must** reduce the cost of the property for capital cost allowance (depreciation) and investment tax credit purposes.

Unless the Income Tax Act specifically requires a different treatment (for example, that noted above for a government grant received in respect of a depreciable property) most **inducements, reimbursements, contributions, and allowances** received in the course of earning farming income must be included in income. However, if the amount received is related to the acquisition of a property, upon filing your return, you may **elect** to reduce the cost or the capital cost of the related property by the amount received, and that amount is not included in your income calculation.

Ontario Farm Tax Rebate Program

If you receive a Farm Tax Rebate from the province of Ontario for municipal taxes, you must include it in income in the year received to the extent that you claimed the taxes as an expense against your farm income. Under this program, 100% of the taxes levied on eligible farm land and outbuildings for 1988 may be rebated. The taxes levied on your farm residence and one acre of land are **not eligible** for this rebate.

Obtain Interpretation Bulletins IT-252, *Agricultural and Rural Development Act Grants*, and IT-273R and Special Release, *Government Assistance – General Comments* for more details.

Code 500
Other farm income

If you have other types of farming income that do not appear on the statement, use the spaces provided to describe them.

Payment made in kind

You must include as a separate income item the value of grain, livestock, or other produce given as payment to another person

- to settle a business or a personal liability, or
- as part of the purchase price of a property.

If any liability so settled was for a business expense, you also show the value as an expense item.

Surface rental for petroleum or natural gas exploration

If land you use in your farming operation is being leased from you for petroleum or natural gas exploration, you may have to include an amount in your income either as a capital receipt or as an income receipt.

An income receipt includes the annual amount you receive for rental, severance or inconvenience under a surface rental for petroleum or natural gas exploration. Usually the initial payment under the lease is larger than the subsequent annual payments, and the lease may not specify the portion of this initial payment that is for rental, severance or inconvenience. In this case, you include in your income for the year in which you receive the initial payment an amount equal to the annual rental, severance or inconvenience payments you will receive in subsequent years. The balance of the initial payment is considered a capital receipt, and may result in a capital gain or a capital loss.

For more details, obtain Interpretation Bulletin IT-200, *Surface Rentals and Farming Operations*.

Rental income

Do not include rental income, whether from farm property or real estate, with your farming income. You must report rental income separately on line 126 on page 1 of your return. To calculate your net rental income, you may use form T776, *Statement of Real Estate Rentals*. You may obtain this form at your district taxation office along with the *1988 Rental Income Tax Guide*.

You may receive rental income either in cash or on a share crop basis. Generally, income from a farming business does not include rental income received on either basis. However, there is one exception. You may include rental income received on a share crop basis as farming income for the purpose of the five-year block averaging.

Sale of property

If you sell a capital property, you may have to include certain amounts in your income such as

- recovery of capital cost allowance, commonly known as **recapture,** and
- two-thirds of any capital gains you realize.

These items are discussed in more detail later in this Guide.

If you sell property such as small tools that you have previously charged directly to expense, you must add any amounts received to your income.

Disposal of inventory on termination of farming operation

If you sell your livestock, grain or other inventory upon or after ceasing to carry on your farming operation, or part of your operation, you must include in income any amount received from the sale of inventory (excluding any capital realization from a basic herd).

The following are examples of situations where you would be considered to have ceased to carry on your farming operation, or part of your operation:

- You had dairy and beef cattle and you sold the dairy cattle.
- You had breeding stock as well as dairy cattle, and you sold the breeding stock.
- After you sold your farm or ceased to cultivate your land, you sold your stored grain.

Miscellaneous

Normally, you must include in your farming income the amounts you receive from the sale of soil, sod, sand, gravel, or stone. You may deduct an allowance for depletion for certain of these items.

The growing of Christmas trees is considéred to be a farming operation.

Fall fair prizes are income. However, if your children win these prizes, the Department will accept the reporting of the amount of these prizes as income of the children.

Amounts not to be reported as farming income

Your farming income does not include salaries, wages, municipal council fees, interest and other investment income, Old Age Security pension, Canada or Quebec Pension Plan benefits, Unemployment Insurance benefits, etc. Instead, report these types of income on page 1 of your return and, in the case of investment income, also on Schedule 4.

Do NOT include as income

- War Disability Pensions,
- money you have borrowed, or
- money you have inherited.

Refer to your *1988 General Tax Guide* for other amounts that you do not include in income.

Code 510
Optional inclusion of value of livestock on hand

If you are reporting your income on the **cash basis,** you may elect to include in your income for the year an amount for livestock on hand at the end of the year. The amount may not exceed the fair market value of livestock on hand, and you must deduct this amount in calculating your income in the

following year. This option does not include animals of a basic herd.

Example:

In 1988, your gross income from farming using the cash method is $20,000. Expenses total $22,000. This would result in a loss of $2,000. For 1988, the amount you use to calculate your non-refundable credits is $11,000 (your personal amount of $6,000 plus your married amount of $5,000). You may increase your 1988 income by up to $13,000 ($11,000 plus $2,000) without creating any income tax liability.

You have an inventory of livestock with a fair market value of $18,000. You plan to sell a large portion of this livestock in 1989 and expect to have a substantial taxable income. To even out your income over the two-year period, you could elect to add $13,000 to your 1988 income. When you file your 1989 income tax return, you must deduct this same $13,000 from your 1989 income. This would have the effect of reducing your 1989 income tax without increasing your 1988 income tax.

If you have been reporting your income using the accrual method and wish to change to the cash method to take advantage of this provision, refer to the section entitled "Changing your Method" in Chapter 1 of this Guide for further details.

If you have made this claim and wish to revise the amount included in income, you must request an adjustment to your return within 90 days of the date of your notice of assessment for the year of the claim. Refer to the section entitled, "Changing your return after you mail it" in your *1988 General Tax Guide* for details on how to request an adjustment to your return.

AMOUNTS TO BE CLAIMED AS AN EXPENSE

The most common expense items allowed as deductions for the year are outlined below under the same code numbers as those listed on form T2042. If you have other types of farming expenses that do not appear on the statement, use the spaces provided to describe them.

You may only claim amounts spent to earn income from farming as expenses.

Prepaid expenses

If you are using the cash method to calculate your farming income, and you have prepaid expenses, you may deduct the amounts paid in the year only if a binding contract exists between you and the supplier.

If you are using the accrual method to calculate your income, you must claim any expense you prepay in the year(s) in which you receive the related benefit.

Code 195
Salaries and wages

You may claim the wages paid to hired help, plus the actual cost of their board, as an expense.

Normally, you must deduct Canada or Quebec Pension Plan contributions, Unemployment Insurance premiums, and income tax from wages you paid to your employees. For exceptions to this rule, refer to the employers' instructions in the *Canada Pension Plan Contribution and Unemployment Insurance Premium Tables*. Wages paid to non-resident employees may also be subject to these deductions. However, as you claim the total wages paid to your employees as an expense, you cannot claim the amounts withheld on their behalf as a separate expense. You may claim the employer's portion of Canada or Quebec Pension Plan contributions and Unemployment Insurance premiums as an expense.

Each year you must report the wages paid to your employees, as well as the amounts withheld, on a T4 supplementary slip. You must also complete a T4-T4A Return consisting of a T4-T4A Summary and the related T4 and T4A Supplementaries. For your 1988 taxation year, you must complete this return and mail it to your Taxation Centre by February 28, 1989. Your employees must also be given their copies of the T4 and T4A supplementaries by February 28, 1989. For instructions on how to complete the T4-T4A Return obtain, the *1988 Employer's and Trustee's Guide*.

Keep a detailed record of the amounts paid to each employee along with the employee's name, address and Social Insurance Number.

The wages you pay to your child are normally allowed as an expense if

- you actually pay the wages,
- the services provided by the child were necessary for earning farming income and would otherwise have required the employment of some other person, and
- the wages are reasonable, considering the age of the child and the amount you would pay to another person for the same work.

If you pay your child by cheque, the cancelled cheque is sufficient evidence that you actually paid the wages. If you pay in cash, you should obtain a receipt signed by the child. Keep this receipt with your records.

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

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

Wages you pay to your spouse are also deductible. The rules outlined above for wages paid to a child apply as well to wages you pay to your spouse.

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

Code 205
Rent (land, buildings, pasture)

You may claim the rent you pay in cash to earn farming income as an expense. If you are farming on a share-crop basis, you may treat any rent you pay in kind using one of two methods. You may either

- add the fair market value of the crops given to the landlord to your income and claim the same amount as rent expense, or
- do not include the amount in income and do not claim an expense for rent.

Codes 210 and 211
Interest expense

You may claim interest paid on money borrowed to earn your farming income, for example, interest on money borrowed to buy farm equipment. You cannot claim as an expense

- interest on money borrowed for personal purposes,
- interest on overdue income taxes, or
- the principal portion of loan or mortgage payments.

New for 1988

If your 1988 fiscal period begins after June 17, 1987 there is a limit on the interest you may deduct on money borrowed to purchase a "passenger vehicle" used in your farming business. For more information, refer to the section, "Motor vehicle expenses."

Code 225
Motor vehicle expenses

You may claim only that portion of your motor vehicle expenses that was spent to earn your farming income.

If you use a motor vehicle for both farming and personal purposes, you may claim only that portion of the total expenses that relate to business use. Business usage includes trips made to pick up farm supplies or to deliver grain.

If you are also employed or do not live on your farm business usage does not include the distance travelled to and from the place of employment, or to and from the farm.

To support the amount claimed, it is important to keep a record of the amount of usage for each purpose.

New for 1988

If your 1988 fiscal period starts after June 17, 1987, it is necessary to determine if your motor vehicle is a "passenger vehicle." Passenger vehicles are subject to limits on the capital cost allowance, interest, and leasing costs that you may deduct. You must calculate the deductible portion of interest and leasing costs according to the following special rules. The capital cost allowance limitation is discussed in Chapter 3 of this Guide.

For income tax purposes, a **motor vehicle** is any automotive vehicle designed or adapted for use on highways or streets other than a trolley bus or a vehicle that is operated on rails.

A **passenger vehicle** is any automobile you acquired after June 17, 1987 unless you acquired it under the terms of a written agreement entered into before June 18, 1987. Also, a passenger vehicle includes an automobile that is leased under a lease entered into, extended or renewed after June 17, 1987.

An **automobile** is a motor vehicle, designed or adapted primarily for carrying people and their luggage, that seats no more than eight passengers and a driver. Generally, pick-up trucks, station wagons, vans or similar vehicles are considered automobiles.

However, there are exceptions. An automobile does **not** include

- a station wagon, van or similar vehicle if it is permanently equipped to carry only a driver and no more than two passengers, or
- a pick-up truck, van or similar vehicle designed or adapted to carry no more than a driver and two passengers and used primarily to transport goods or equipment in the course of business.

Note:

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

Example

Jim's farming business has a December 31, 1988 fiscal year-end. Throughout 1988 he owned a pick-up truck that he uses in his business for picking up farm supplies and other farm equipment. The truck is permanently equipped to carry a driver and two passengers. During the year Jim recorded the following information concerning the truck:

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

As the truck is permanently equipped to carry only a driver and two passengers and is used primarily for transporting supplies and equipment, it is not a "passenger vehicle" and therefore the interest expense included in his total expenses for the truck is not restricted. The motor vehicle expense that Jim may claim for the pick-up truck in 1988 is $6,300 and is calculated as follows:

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

Interest on money borrowed for a passenger vehicle

There is now a limit on the interest you may deduct on money borrowed to purchase, or an amount payable for the acquisition of, a passenger vehicle used in a business. Your claim cannot be more than $8.33 multiplied by the number of days for which the interest was paid.

If you are paying interest on any debt resulting from the acquisition of your passenger vehicle and you are using the cash method to report your income, complete Chart 1 to calculate your available interest expense. If you are using the accrual method, obtain the *1988 Business and Professional Income Tax Guide.*

CHART 1	
Enter the total interest paid in the year	______ (A)
$8.33 × the number of days for which the interest was paid	______ (B)
Available interest expense is the lesser of (A) and (B)	______

Example

Frank's farming business has a December 31, 1988 fiscal year-end. In September 1987 he purchased a new car that he uses for both personal and business purposes. He borrowed money to purchase the car and the interest paid on this loan in 1988 was $5,000. Frank recorded the following information concerning the car for 1988:

Business kilometres	20,000km
Total kilometres	25,000km
Gasoline and oil	$2,000
Repairs and maintenance	1,000
Insurance	1,900
Interest (on loan to purchase car)	3,050*
License and registration fees	50
Total car expenses	$8,000

*As Frank purchased a car after June 17, 1987 that does not seat more than eight passengers, it is considered to be a passenger vehicle. As a result the interest expense he may include in his total car expenses is limited to $3,050. The available interest expense is the lesser of:

- the total car loan interest paid in 1988 of $5,000, and
- $8.33 × the number of days for which the interest was paid = $8.33 × 366 = $3,050

The motor vehicle expense that Frank may claim for his car in 1988 is $6,400 and is calculated as follows:

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

Leasing costs for a passenger vehicle

If you lease rather than purchase a passenger vehicle to use in your farming business, there is now a limit on the leasing costs you may deduct.

If you are leasing a passenger vehicle and are using the cash method to report your income, complete Chart 2 to calculate your available leasing cost. If you are using the accrual method, obtain the *1988 Business and Professional Income Tax Guide.*

CHART 2

Enter the total lease charges paid in the year for the vehicle ______(1)

Enter the total lease payments deducted in previous years for the vehicle ______(2)

Enter the total number of days the vehicle was leased in this and previous years ______(3)

Enter the manufacturer's list price plus the provincial sales tax that would have been payable on the list price of the vehicle. ______(4)

Enter the greater of $23,529 and line (4) ______ × 85% = ______(5)

*Calculate and enter the imputed interest that would have been earned **for the year** and **all previous years** on that part of the total of all refundable deposits for a vehicle that exceeds $1,000. It is calculated using the prescribed rate of interest for each year the refundable amounts are outstanding (see note below). ______(6)

*Calculate and enter the imputed interest that would have been earned **during the period** for which the lease charges were paid on that part of the total of all refundable deposits for a vehicle that exceeds $1,000. It is calculated using the prescribed rate of interest for the period during which the refundable amounts were outstanding (see note below). ______(7)

Enter the total of all reimbursements receivable by you for **this year and previous years** in respect of the leased vehicle. ______(8)

Enter the total of all reimbursements receivable by you for **this year** in respect of the leased vehicle. ______(9)

$\frac{\$600 \times \text{line 3}}{30}$ – line 2 – line 6 – line 8 = ______(10)

$\left[\frac{\$20,000}{\text{line 5}} \times \text{line 1}\right]$ – line 7 – line 9 = ______(11)

Your available leasing cost is the lesser of line (10) and line (11) ______

Note:

You must calculate imputed interest only if

- *you make a deposit to the lessor of the passenger vehicle,*
- *your deposit is refundable to you, and*
- *your deposits for the vehicle total more than $1,000.*

Example

Jiri's farming business has a December 31 fiscal year-end. On August 1, 1987 he started leasing a car that is a "passenger vehicle." The car is used for both business and personal purposes. Jiri recorded the following information concerning the car:

Business kilometres for 1988	12,000km
Total kilometres for 1988	24,000km
Gasoline and oil	$2,000
Insurance	1,192
Leasing cost	5,808*
Total car expenses for 1988	$9,000

Monthly lease payment	$550
Lease payments for 1988	$6,600
Lease payments deducted in 1987	$2,750
Manufacturer's suggested list price	$25,000
Provincial sales tax	$1,750
No. of days in 1988 the car was leased	365
No. of days in 1987 the car was leased	153

*As Jiri is leasing a "passenger vehicle," the leasing cost he may include in his total car expenses is limited to $5,808. It is calculated by completing Chart 2 as follows:

CHART 2

Enter the total lease charges paid in the year for the vehicle $6,600(1)

Enter the total lease payments deducted in previous years for the vehicle $2,750(2)

Enter the total number of days the vehicle was leased in this and previous years 518(3)

Enter the manufacturer's list price plus the provincial sales tax

that would have been payable on the list price of the vehicle.	$26,750 (4)	
Enter the greater of $23,529 and line (4)	$26,750 × 85% =	$22,738(5)
Calculate and enter the imputed interest that would have been earned **for the year** and **all previous years** on that part of the total of all refundable deposits for a vehicle that exceeds $1,000. It is calculated using the prescribed rate of interest for each year the refundable amounts are outstanding (see note below).		0 (6)
Calculate and enter the imputed interest that would have been earned **during the period** for which the lease charges were paid on that part of the total of all refundable deposits for a vehicle that exceeds $1,000. It is calculated using the prescribed rate of interest for the period during which the refundable amounts were outstanding (see note below).		0 (7)
Enter the total of all reimbursements receivable by you for **this year and previous years** in respect of the leased vehicle.		0 (8)
Enter the total of all reimbursements receivable by you for **this year** in respect of the leased vehicle.		0 (9)
$\frac{\$600 \times 518}{30} - \$2,750 - 0 - 0 =$		$7,610(10)
$\left[\frac{\$20,000}{\$22,738} \times \$6,600\right] - 0 - 0 =$		$5,808(11)
Your available leasing cost is the lesser of line (10) and line (11)		$5,808

The motor vehicle expense that Jiri may claim for the leased car in 1988 is $4,500 and is calculated as follows:

$$\frac{\text{Business kilometres}}{\text{Total kilometres}} = \frac{12,000}{24,000} \times \$9,000 = \$4,500$$

If a motor vehicle is owned jointly by two or more persons, there is a limit on the deduction of capital cost allowance, interest and leasing costs for that vehicle. The total deduction by the joint owners cannot be more than the maximum amount allowable if only one person had owned or leased the vehicle.

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

For more details, obtain the new Interpretation Bulletin, *Motor Vehicle Expenses Claimed By Self-Employed Individuals.*

Code 255
Veterinary fees, medicine and breeding fees

Claim the total amount paid for veterinary fees, medicine for your animals, and breeding fees, including artificial insemination.

Code 260
Building repairs

You may claim the amount paid for repairs to all buildings (other than your farm house) that you use in your farming operation. If you use your farm home for business purposes, refer to the section, "Business use of home" in this chapter for more information.

Code 270
Small tools

If the cost of a tool is less than $200, you may claim the full cost as capital cost allowance in the year of purchase. For details on the deductibility of the costs for metric conversion, obtain Interpretation Bulletin IT-348R, *Cost Incurred in Conversion to Metric Measurement.*

Code 280
Accounting and legal expenses

Generally, you may deduct legal costs paid as an expense if you incurred them to earn income. Legal and other fees you incurred to acquire capital property are not deductible. You must include these fees as part of the cost of the property rather than as a direct expense of the year.

Also, you may deduct fees and expenses if you incurred them to

- obtain advice and assistance in preparing and filing your return, or
- prepare, institute or make an informal representation, objection, or appeal against an assessment of income tax, Unemployment Insurance premiums or Canada Pension Plan contributions.

However, you must include in your income any costs awarded to you by a court for expenses that you deducted. You must add the amount awarded to your income in the year you receive it.

For more details, obtain Interpretation Bulletin IT-99R3, *Legal and Accounting Fees.*

Code 285
Telephone

The basic cost for a home telephone is not a deductible expense. However, you may claim the amount paid for long distance telephone calls that relate to your farming business. If you have a separate business telephone that you use strictly for business purposes, the basic cost is a deductible expense.

Codes 290, 295 and 215
Electricity, heating fuel and property taxes

You must allocate the amounts paid for electricity, heating fuel and property taxes between your farm house and your other farm properties. For example, the business portion of electric power will depend on whether more electricity is used to light the farm house, or to light outbuildings or a shop. You may claim the portion applicable to your other farm properties as an expense. The farm house portion of these expenses are not deductible unless you are claiming a deduction for the business use of your home. For more details, see the section entitled, "Business use of home" later in this chapter.

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

If a house is used entirely for the lodging of hired help, you may claim the total amount of the expenses relating to the house, unless the expenses were paid by the hired help.

Do not include in your farming expenses any expenses relating to a house that you rent out. You must report rental income and expenses on a separate statement. You may use form T776, *Statement of Real Estate Rentals*. You may obtain this form at your district taxation office along with the *1988 Rental Income Tax Guide*.

Code 310
Clearing or levelling land; Improving land

Clearing or levelling land
This includes clearing the land of brush, trees, roots, stones, etc., and the initial ploughing to put the land into productive use.

Normally, the cost of clearing or levelling land is not deductible as an expense. You add these costs to the capital cost of either the land or the depreciable property built on the land. Also, the cost of laying tile drainage is usually not deductible in the year but should be capitalized and included in Class 8. However, if you are carrying on a farming business, either as an owner or as a tenant of a farm, you may deduct these costs in the year.

If you are renting land to another person who is using the land for farming, you **cannot** claim this direct deduction, since you are not carrying on a farming business.

New for 1988

Beginning in 1988, you do not have to claim the full amount paid for these costs in the year of payment. As long as payment has been made you may

- deduct any part of the payment in the year paid, and
- carry forward any undeducted balance to a future year.

Also, you may deduct any portion of the payments made for the installation of a land drainage system composed of a material other than tile.

The cost of constructing an unpaved road may also be claimed as an expense in the year. For more details, obtain Interpretation Bulletin IT-485, *Cost of Clearing or Levelling Land*.

Improving land
The cost of a paved road is not deductible in the year. You must capitalize such costs and include them in Class 17. For property included in this class you may claim capital cost allowance at the rate of 8%.

You may claim the cost of drilling or digging water wells as an expense in the year. However, you must capitalize the casing and cribwork costs and include them in Class 8. For property included in this class, you may claim capital cost allowance at the rate of 20%. Also, the cost of a water distribution system, including the pump and its installation, the piping and the trenching, must be capitalized and included in Class 8.

You may claim the payments made to have public utilities brought to your farm if the installations remain the property of the public utility. Also, you may claim a payment to a co-op under the **The Co-operative Associations Act** for the construction of a distribution system under a gas service contract as an expense.

You may normally claim as an expense the cost of replacing trees that are income producing property.

Code 320
Other expenses
Fees for membership in organizations relating to your farming activities are allowable expenses.

If you pay some of your expenses (such as seed, feed, sprays, fertilizers, or the grain levy under the Western Grain Stabilization program) by having the amount deducted from your cash grain tickets or the grain stabilization payments, and if you include these amounts in your expenses, you must report the gross amount of the grain sale or grain stabilization payments in your income. If you report only the net amount of the sale or payment in income, then you cannot claim the expenses.

If a deferred cash purchase ticket is taken as a settlement, the Western Grain Stabilization levy is considered to have been paid on the date that the grain is delivered for sale, and should be deducted in that fiscal period. However, the total purchase price, as stated on the deferred cash purchase ticket, must be reported as income in the immediately following fiscal period.

Code 325
Optional value of livestock, end of previous year
As stated in the section, "Code 510, Optional inclusion of value of livestock on hand" in this chapter, any amount that you included in your income in a year **must be deducted** in computing income in the following year. Therefore, if you included such an amount in your income for 1987, you must claim the same amount as an expense when you calculate your 1988 farming income.

Code 330
Capital cost allowance
Enter your capital cost allowance claim as calculated on form T2041. See Chapter 3 for information on claiming capital cost allowance.

Code 331
Allowance on eligible capital property
This allowance is explained in Chapter 4, "Eligible Capital Expenditures."

ADJUSTMENTS TO INCOME

To determine the net income or loss to report on your income tax return, it is often necessary to adjust the net income or loss as calculated on your income and expense statement. The lower portion of form T2042 is designed to provide for the more common adjustments required such as

- salary or wages paid to self and/or partner(s),
- cost of saleable products consumed, and
- personal or non-business portion of expenses claimed.

Note:
Any item you reported correctly for income tax purposes in the income and expense area of form T2042 will not require further adjustment in this section.

Beginning in 1988, if you are a sole proprietor and are using your farm house for business purposes, you may calculate the

allowable portion of your home expenses and deduct them in this area. See the section entitled, "Business use of home" below for details.

Code 605
Salary or wages paid to self and/or partners

If you are a sole proprietor and included a salary you paid to yourself in your farming statement of income and expenses, you must add it back to determine your net income for tax purposes. A partnership agreement may provide for the payment of **salaries** to the members of the partnership. If the partnership statement of income and expense includes salaries paid to yourself or to another partner, you must add them back to income as they are actually an allocation of partnership income.

Code 615
Cost of saleable goods consumed

You may have to adjust the income or loss from your farming business if you, your family, or your partners and their families, consume any crops or other products you would normally sell. Examples of such products include milk, cream, butter, eggs, potatoes, poultry and meat. If you included the costs of producing these items in your expenses, you must add these costs back to income on this line.

Code 620
Personal or non-business portion of expenses

You must also adjust the income or loss from your business if you claimed certain items that are not deductible. These include adjustments for

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

You cannot deduct charitable donations as expenses when you are calculating your income from a farming business. If you included any charitable donations in your statement of expenses you must

- add them back to income, and
- enter them on line 340 on page 2 of your return.

Code 630
Business use of home

New for 1988

For all fiscal periods starting after 1987, you may only claim 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 only use the work space to earn income from your farming business and you use it on a continuous and regular basis for meeting your customers.

Also, the expenses you may deduct for the business use of your home cannot exceed the income from the farming business for which you use the work space. This means that you must not use these expenses to create or increase your farming loss. You may carry forward any expenses that are not deductible in the year and deduct them, subject to the same limitation, from the income of this farming business in the following year.

Note:

If your fiscal period began in 1987 and ends in 1988, the new limitation on the expenses you may deduct for the business use of your home does not apply.

If you own or rent the farm house that you live in and use it for business purposes, you may deduct a reasonable portion of your home expenses. These expenses may include expenses such as light, heat, water, home insurance, and property taxes. The expenses should be apportioned between business and non-business use on a reasonable basis, for example, square metres of floor space used.

If you rent the house that you live in, you may deduct the portion of your rent attributable to business use.

Also, if you operate your farming business out of a house that you own, you may claim capital cost allowance (see Chapter 3) and mortgage interest on your home. If you choose to claim capital cost allowance and later dispose of this property, a taxable capital gain could arise on the portion of the property you used for business purposes. You could also be subject to recapture of capital cost allowance previously claimed (see Chapter 3).

ADJUSTMENTS TO NET INCOME (LOSS) FROM A FARMING BUSINESS

The amount calculated above as your net income or loss from a farming business may require additional adjustments if you are reporting partnership income.

Partnership income — adjustments required

If the farming business is a partnership, you must provide

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

The reverse of form T2042 contains a *Partnership Schedule* that you may use. This schedule consists of the following areas:

Area I

Enter in this area each partner's share of the net income of the partnership, including your own, determined according to the terms of the partnership agreement. Some agreements provide for the allocation of an amount as **salary** to particular partners before the partnership income is divided on a percentage basis, or for the payment of **interest** to particular partners on their capital invested in the partnership. If the allocation is not a straight percentage of the net income of the partnership, attach an explanation of how you arrived at the amounts you entered.

Area II

Enter in the space provided, your share of the partnership income as shown in **Area I.** Claim any allowable expenses you made to earn that partnership income, but for which you have not been reimbursed by the partnership. For example, if you used your own automobile in carrying out your partnership duties, you may claim the business portion of your motor vehicle expenses.

If the 1988 fiscal period of the partnership starts after 1987, you may use this area to claim the expenses for the business use of your home. Please see the section entitled "Business use of home" above for details.

NET FARMING INCOME (LOSS)

Enter your gross and net farming income or loss on the appropriate lines on page 1 of your return.

The **Gross** amount is the amount of **Gross Farming Income** before the deduction of **Total Farming Expenses** on form T2042, *Statement of Farming Income and Expenses*.

If your farming operation is a proprietorship, the **Net** amount is the **Net Farming Income (Loss)** shown in the **Adjustments to Partnership or Proprietorship Income** section of the same form.

If you are operating as a partnership, the **Net** amount is the **Net Farming Income (Loss)** as calculated on the **Partnership Schedule** on the reverse of form T2042.

If you have income from another business, enter the gross and net income from that other business on the **Business income** line.

CHAPTER 3
CAPITAL COST ALLOWANCE SCHEDULE FORM T2041

The original cost of equipment and buildings used to earn income cannot be claimed as an operating expense. However, to recognize that over a number of years such properties will wear out or become obsolete, you may claim a portion of their cost each year as a deduction. The deduction allowed each year is called capital cost allowance (CCA), and is explained below.

Note:
Your claim for capital cost allowance (CCA) is not affected by the accounting method chosen, i.e., cash or accrual. Your maximum claim is the same under either method.

TYPES OF CAPITAL COST ALLOWANCE

Capital cost allowance is governed by Parts XI and XVII of the Income Tax Regulations. Part XVII applies to depreciable property you used in farming prior to January 1, 1972 and that you are still using in your farming operation in 1988. If you have property upon which you have been claiming capital cost allowance under Part XVII and require more details, obtain Information Circular 86-5R, *Part XVII – Capital Cost Allowance, Farming and Fishing*.

You may use form T2041 to calculate your claim for capital cost allowance under either Part XI or Part XVII. For your convenience, this Guide contains two copies of this form.

The following comments apply to capital cost allowance claims under Part XI.

SPECIAL POINTS CONCERNING CAPITAL COST ALLOWANCE

You cannot claim capital cost allowance on land, or on living things such as trees, shrubs or animals.

You must group depreciable property you own into classes according to the Income Tax Regulations. These regulations specify a rate of capital cost allowance for each class of property. At the end of this Guide there is a schedule setting out the rate of allowance for the various classes.

The allowance you may claim is generally based on the undepreciated capital cost (UCC) of the class at the end of your fiscal year. Generally, the UCC is the total **capital cost** of all property included in the class, less proceeds from property disposed of, and less the total capital cost allowance you claimed in previous years.

Usually the capital cost allowance you claim in a year is calculated on the declining balance basis. However, for certain types of property such as leasehold interests and wind-energy equipment, the allowance is generally based on a percentage of the original capital cost of the property (straight-line basis).

New for 1988

If your 1988 fiscal period begins after June 17, 1987 the following rules apply to all motor vehicles that you use in your farming business.

- You must include each motor vehicle you own at the end of your 1988 fiscal period in a separate class of new class 10.1. The maximum rate of allowance applicable to this class is 30%.
- The capital cost of a "passenger vehicle" for purposes of calculating your capital cost allowance claim cannot be more than $20,000.
- The recapture and terminal loss provisions will only apply to a motor vehicle if all or substantially all (90% or more) of the distance travelled by the vehicle while you owned it was for business purposes.
- In the year you dispose of a motor vehicle that was **included in class 10.1** you may claim 50% of the capital cost allowance that would have otherwise been allowable for that year.

Also, there are changes to the maximum rate of allowance that may be claimed for certain buildings acquired in 1988. These changes are discussed in more detail at the end of this chapter.

Note:
Throughout this chapter we refer to a "motor vehicle" and a "passenger vehicle." These terms are fully discussed in the section "Motor vehicle expenses" in Chapter 2 of this Guide.

HOW TO COMPLETE FORM T2041, CAPITAL COST ALLOWANCE SCHEDULE

Print your name, address and Social Insurance Number and complete each column if applicable.

Column (1) — Class No.
Column (2) — UCC at Beginning of 1988 or Amount Transferred from Class 10

If you started your business in 1988

- group the property acquired into classes, as explained below in the instructions for completing Column 3, and
- enter the class numbers in Column 1.

If you have made a claim for capital cost allowance in any prior year

- enter the class numbers in Column 1, and
- in Column 2 enter the **Undepreciated Capital Cost** of each class at the end of last year.

New for 1988

If your 1988 fiscal period starts after June 17, 1987 you must adjust the undepreciated capital cost of Class 10 at the beginning of your 1988 fiscal year if:

- you acquired a "passenger vehicle" that cost more than $20,000 in your 1987 fiscal year, and
- you owned the passenger vehicle at the end of your 1988 fiscal period.

In such cases, the new rules provide that the capital cost of a "passenger vehicle" cannot be more than $20,000. If its cost is more than $20,000, you must reduce the undepreciated capital cost of Class 10 by the amount of the excess. This reduction must be done before the calculations described below for transfers to Class 10.1.

Also, if your 1988 fiscal period starts after June 17, 1987, all motor vehicles that were included in Class 10 at the end of your 1987 fiscal period and which you still own at the end of your 1988 fiscal period, must be transferred to new Class 10.1.

You enter the amount transferred from Class 10 in Column (2) calculated as follows:

Enter the capital cost of the vehicle being transferred	$_____ (1) *	
Enter the undepreciated capital cost of class 10 immediately before the transfer	_____ (2)	
Line (1) minus line (2) (if negative, enter nil)	$_____ (3)	
Enter the total capital cost allowance deducted for the vehicle in previous years.	$_____ (4)	
Enter the amount from line (1)		$_____ (5)
Enter the **greater** of line (3) and line (4)		_____ (6)
Amount transferred from Class 10 equals line (5) minus line (6).		$_____

Note:
If the vehicle you are transferring from class 10 to new class 10.1 is a passenger vehicle that cost more than $20,000 its capital cost is deemed to be $20,000. You must enter this amount at line (1) in the above calculation.

You must also reduce the undepreciated capital cost of the former class (Class 10) by the amount that is transferred to Class 10.1.

Column (3) — Cost of Additions During 1988

If you acquired depreciable property in the year, enter the total **capital cost** for all properties of each class on the appropriate line in this column. Completing area A of form T2041 will assist you in calculating the amount to enter.

Capital cost usually means the total cost of the property including

- any legal fees incurred to acquire the property,
- charges for delivering the property to your place of business, and
- the cost of installing the property for use.

Once you have determined the capital cost of the property, you must establish the class in which to include it.

The class number and capital cost allowance rate for the more common types of property are listed at the end of this Guide. A complete list is included in Schedule II of the Income Tax Regulations.

The **Capital Cost** of property may require adjustment in the following circumstances:

Change in use

If you acquired a property for personal use and began using it in 1988 for business purposes, your capital cost for business purposes is normally equal to the fair market value (FMV) of the property at the time the change in use occurs.

However, when the actual cost of the property is less than the fair market value, the capital cost is calculated as follows:

Enter the actual cost of the property		$_____ (1)
Enter the FMV of the property	$_____ (2)	
Enter the amount from line (1) above	_____ (3)	
Line (2) minus line (3) (if negative, enter nil)	$_____ (4)	
Enter any capital gains deduction claimed for the amount at line (4) $_____ × 3/2 =	_____ (5)	
Line (4) minus line (5) (if negative, enter nil) $_____ × 2/3 =		$_____ (6)
Deemed capital cost is line (1) plus line (6)		$_____

Construction costs and/or cost of improvements

If you constructed a depreciable property for use in your

farming business, its capital cost includes the cost of materials, labour and other costs actually incurred. However, you may not include the value of your own labour.

You must add the cost of improvements or additions to a depreciable property to its capital cost.

Survey or valuation costs

The costs of surveying or valuing a property may be added to the cost of the property if you incurred them to acquire the property. You cannot claim them as expenses.

Personal use of a property

If you acquire a property for both farming and personal use, and the portion that relates to business use will remain constant in future years, enter in Column 3 only that portion of the capital cost of the property that relates to its use in the farming operation.

In cases where the business usage varies from year to year, you may add the entire cost of the property to the class. If you do this you must add the personal portion of the capital cost allowance taken back to income as an adjustment.

Grant, subsidy, or other incentive or inducement

When you receive a subsidy or grant from a government or government agency that is related to the acquisition of a capital property, you **must** reduce the cost of the related capital property. You must deduct the amount received from the total cost **before** you calculate your claim for capital cost allowance. For information on the treatment of government grants, obtain Interpretation Bulletin IT-273R and Special Release, *Government Assistance – General Comments*. For information concerning the treatment of incentives or inducements other than those received from a government or government agency, refer to the comments under this heading in Chapter 2.

Non-arm's length transaction

There are specific rules you must follow when you purchase property in a transaction that is not at **arm's length.**

Transactions between members of a family, such as husband and wife, or between a shareholder and a corporation controlled by the shareholder or the shareholder's family, are usually **not** considered to be at **arm's length.** For further details, refer to Interpretation Bulletins IT-405, *Inadequate Considerations – Acquisitions and Dispositions* and IT-419, *Meaning of Arm's Length.*

When a person (or a partnership) acquires a depreciable property from a person or a partnership with whom they did not deal at arm's length, the following special rules apply for calculating the capital cost of the property.

If the vendor of the property was an individual resident in Canada, or a partnership any member of which is either an individual resident in Canada or another partnership, and the cost of the property is more than the vendor's cost or capital cost, the purchaser's capital cost is calculated as follows:

Enter the vendor's cost or capital cost		$______ (1)
Enter the vendor's proceeds of disposal	$______ (2)	
Enter the amount from line (1) above	______ (3)	
Line (2) minus line (3) (if negative, enter nil)	$______ (4)	
Enter the capital gains deduction claimed by any person for the amount at line (4) $______ × 3/2 =	______ (5)	
Line (4) minus line (5) (if negative, enter nil) $______ × 2/3 =		$______ (6)
Deemed capital cost is line (1) plus line (6)		$______

If the vendor is not a person or partnership as described above and the purchaser's cost of the property is more than the vendor's cost, or capital cost, then the purchaser's capital cost is calculated as follows:

Enter the vendor's cost or capital cost		$______ (1)
Enter the vendor's proceeds of disposal	$______ (2)	
Enter the amount from line (1) above	______ (3)	
Line (2) minus line (3) (if negative, enter nil) $______ × 2/3 =		$______ (4)
Deemed capital cost is line (1) plus line (4)		$______

If the purchaser's cost of the property is less than the vendor's cost or capital cost, the purchaser's capital cost is deemed to be equal to the vendor's cost or capital cost, and the purchaser is deemed to have claimed the difference as capital cost allowance.

New for 1988
Passenger vehicle

If your 1988 fiscal period begins after June 17, 1987 and you acquired a passenger vehicle, its capital cost is the lesser of:

- $20,000, or
- the purchase price of the vehicle.

For example, if you purchased a car for a total cost of $24,595, you would enter only $20,000 as the cost of addition in Column (3).

There is also a limit on the capital cost of a passenger vehicle you acquire for business use from a person with whom you do not deal at arm's length. In this case the capital cost is the least of:

- $20,000,
- the fair market value of the vehicle at the time you acquired it, and
- the cost amount to the vendor immediately before you acquired it.

Column (4) — Proceeds From Disposals During 1988

If you disposed of a property during 1988, you must deduct from the class to which it belonged, the lesser of:

- the proceeds of disposal, and

- the capital cost of the property.

In most cases, the **proceeds of disposal** for a property will be the sale price of the property, less any outlays or expenses directly related to its disposal.

Disposal of a building

If you disposed of a building in 1988 and the building disposed of was the only property in the class, its **cost amount** is the undepreciated capital cost of the class before the disposal.

If there was more than one building in the same class, the **cost amount** of each building is calculated as:

$$\frac{\text{Capital Cost of the Building}}{\text{Capital Cost of all Buildings in the Class}} \times \text{Undepreciated Capital Cost of the Class} = \text{Cost Amount of the Building}$$

When you dispose of a building for proceeds that are **less than** both

- its cost amount (as calculated above), and
- its capital cost to you,

and at any time before the disposal you (or a person with whom you were not dealing at arm's length) owned the land on which the building was located (or land next to and necessary for the use of the building), special rules apply to determine the **deemed proceeds of disposal.**

If you disposed of a building under these circumstances, obtain the *1988 Business and Professional Income Tax Guide*. This guide describes these special rules and calculations in more detail. Additional information is also contained in Interpretation Bulletin IT-220R and Special Release, *Capital Cost Allowance – Proceeds of Disposition of Depreciable Property*.

Recapture

If at the end of the year the undepreciated capital cost of a class of property is a negative amount, this amount is a **recapture of capital cost allowance** and you must include it as income in that year. For example, recapture can result from disposing of property, receiving government assistance, or claiming an investment tax credit.

Terminal loss

If at the end of the year the undepreciated capital cost of a class of property is a positive amount, and you no longer own any property of that class, this amount is a **terminal loss** and you must deduct it from income in that year. However, if the property disposed of was a building, adjustments to the amount of the terminal loss may be required.

Capital gains

When you dispose of a depreciable property for proceeds of disposition greater than its capital cost, a capital gain will normally result. Capital gains are subject to tax to the extent that the gain accrued after December 31, 1971. Gains realized in 1985 and subsequent taxation years may be eligible for inclusion in your capital gains deduction calculation. Obtain the *1988 Capital Gains Tax Guide*, for more details.

Examples

	A	B
Original capital cost of building (1969)	$20,000	$20,000
Valuation Day Value (Dec. 31, 1971)	26,000	28,000
Proceeds of Disposition in 1988	24,000	30,000
Capital Gain	NIL	$ 2,000

In example **A,** while the building is sold for more than its capital cost, there is no capital gain for tax purposes as the capital gain actually occurred before 1972. A capital gain occurs only in example **B.** However, a recapture of capital cost allowance, as previously outlined in this chapter, may result in both cases.

Such dispositions and the resultant capital gain should be recorded on Schedule 3 of your return.

You cannot have a capital loss on the disposal of depreciable property.

Election to defer gain on disposal of property

Replacement property — Involuntary dispositions

You may elect to defer all or part of what would have been your capital gain or recapture of capital cost allowance on property that was stolen, destroyed, or expropriated, if you

- received or were entitled to receive compensation;
- acquire the replacement property within two years from the end of the year in which you were entitled to receive compensation;
- elect in your return for the year you acquired the replacement property if you wish to have this deferral apply;
- acquired the replacement property for the same or similar use as the use to which you put the former property. If you had used the former property in a business, you must have acquired the replacement property for use in the same or similar business. The replacement property must generally be the same as the former property such as land for land, building for building, etc.;
- replace a depreciable property with another depreciable property.

Note:

Compensation is generally deemed to be receivable on the earliest of:

- *the day the amount of full compensation is agreed to, or is finally determined by a tribunal or court,*
- *two years after the day of the loss, if proceedings have not been taken before a tribunal or court, and*
- *the date you cease to be a resident of Canada or a taxpayer's date of death.*

If you do not acquire a replacement property in the year you dispose of the former property, you must report any recaptured capital cost allowance or taxable capital gain in the year of disposal.

If you acquire a replacement property in a taxation year that is after the year in which you disposed of the former property, but within the specified time limit, you must

- make the election to defer your capital gain or recapture in your return for the year you acquired the replacement property, and

- request an adjustment to your return for the year of disposal to delete the portion of the capital gain or recapture you are deferring. Refer to "Changing your return after you mail it" in the *1988 General Tax Guide* for instructions on how to request an adjustment to your return.

Replacement property — Voluntary dispositions

Voluntary dispositions refer to dispositions of property where the property was not stolen, destroyed or expropriated. You may elect to defer all or part of the capital gain or recapture of capital cost allowance on a voluntary disposition if:

- you received or were entitled to receive compensation,
- the property disposed of is land or buildings used in a business but not for rental purposes, and
- you acquire the replacement land or building within one year from the end of the year in which you disposed of the former land or building.

For more details on the above elections and on what constitutes replacement property, obtain Interpretation Bulletins IT-259R2 and Special Release, *Exchanges of Property* and IT-491, *Former Business Property*.

Whether you make an election for a voluntary or an involuntary disposition of property, you will realize a capital gain only to the extent that the cost of the replacement property is less than the proceeds of disposition of the former property. You may defer the realization of this gain in cases where a portion of the proceeds of disposition is not due until a subsequent year.

If you elect to defer recognition of recapture of capital cost allowance, the proceeds of disposition are reduced by the lesser of the amount that would otherwise be recaptured and the amount used to acquire the replacement property. Consequently, the recapture will not be income in the year but instead will reduce the undepreciated capital cost of the class of depreciable property containing the replacement property.

If you elect to defer the recognition of either the capital gain or recapture of capital cost allowance, you are considered to have elected to defer both.

Transfer of property to a corporation or partnership

You may also elect to defer all or part of the capital gain or recapture of capital cost allowance on certain dispositions of property, if you

- transfer property to a taxable Canadian corporation,
- transfer property to a Canadian partnership, or
- receive property from a partnership (of which you were formerly a member).

If you are considering deferring the gain or recapture on such transfers, obtain Information Circular 76-19R, *Transfer Of Property To A Corporation Under Section 85*, Interpretation Bulletins IT-291R, *Transfer of Property to a Corporation under Subsection 85(1)*, IT-378R, *Winding-up of a Partnership*, and IT-413, *Partnership as 'Person' or 'Taxpayer' for Subsection 97(2)*.

Column (6) — Adjustment for current year additions

This column enables you to adjust the cost of property acquired during the year, so that your capital cost allowance claim is calculated on only the net adjusted amount.

If you acquired a depreciable property during your 1988 fiscal period, your capital cost allowance claim, as a general rule, is limited to 50% of the amount that would otherwise be allowable.

If you acquired a property and in the same year you also disposed of a property in the same class, your capital cost allowance in respect of the addition is generally restricted to 50% of the amount by which the capital cost of the addition exceeds the lesser of the proceeds of disposition or the capital cost of the property disposed of.

An exception to the 50% rule occurs where you acquired a property from a person with whom you did not deal at arm's length, and the property was owned continuously by you and that person for at least 364 days before the end of your 1988 fiscal period. In this case, you may claim capital cost allowance on the full capital cost of the property.

Also, not all acquisitions are subject to the 50% rule. Additions to Class 12, other than computer software (but not including systems software), are eligible for a 100% capital cost allowance claim in the year they were acquired. Also, the adjustment in Column 6 does not apply to net additions during the year to any of Classes 13, 24, 27, or 34 as discussed below.

Column (7) — Base amount for capital cost allowance claim

Your capital cost allowance claim, if any, will be based on the amount arrived at in this column.

If the amount in Column 7 is **positive** and

- if any property remains in the class at the end of the year, you may claim capital cost allowance calculated on the balance remaining, or
- if no property is left in the class at the end of the year, the remaining balance, known as a **terminal loss,** must be claimed as a deduction in the year.

If the amount in Column 7 is **negative,** the full amount, commonly referred to as a capital cost allowance **recapture,** must be reported as income in the year.

Column (8) — Rate (%)

Enter in this column the rate of capital cost allowance for each class of property included on your schedule. The rates for most common classes of property are listed at the end of this Guide.

Column (9) — CCA for 1988

Enter in this column the capital cost allowance you are claiming for 1988. The maximum you may claim cannot be more than the amount obtained by multiplying the amount in Column 7 by the rate in Column 8.

You do not have to claim the maximum capital cost allowance for each class of property.

New for 1988

Buildings (Class 1)

Most buildings acquired before 1988 were included in either Class 3 or Class 6. Starting in 1988 you must include most Class 3 type buildings you acquire in Class 1. However, a building of this type, acquired before 1990, still qualifies for inclusion in Class 3 if the building was

- acquired under the terms of a written agreement entered into before June 18, 1987, or

- under construction by you, or on your behalf, on June 18, 1987.

The maximum rate of capital cost allowance applicable to property included in Class 1 is 4%.

Property previously included in Class 3 is not transferred to Class 1 after 1987. However, the total cost of any additions or alterations made to a Class 3 building after 1987 are 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 belong in Class 1.

Fresh fruits and vegetables Storage facilities (Class 8)

Buildings acquired to store fresh fruits or vegetables at a controlled temperature must be included in Class 8 rather than in Class 1, 3 or 6.

As well, buildings acquired to store ensilage must be included in Class 8.

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

Certain manure handling equipment acquired primarily to prevent, reduce, or eliminate air and/or water pollution may qualify for an accelerated capital cost allowance (A.C.C.A.) rate. Eligible items normally include pads, liquid manure tanks, pumps and other related equipment, as well as new spreaders purchased at the time the installation was made. Such property must not have been used for any purpose whatever before you acquired it.

Before including such property in the special classes for capital cost allowance purposes, it must be accepted by the Minister of the Environment as property whose primary use is the prevention, reduction or elimination of pollution. Application forms and more details may be obtained by writing to

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

For details on the rates applicable, obtain Interpretation Bulletin IT-336R, *Capital Cost Allowance – Pollution Control Property*.

Wind-energy conversion equipment (Class 34)

Equipment that generates electrical energy from wind and that was acquired after February 25, 1986 to be used in a farming business may be eligible for full write-off in the first three years at the rates of 25%, 50%, and 25%, respectively.

To be eligible for this special write-off, wind energy equipment must be certified by the Minister of Energy, Mines and Resources. Eligible items include fixed location wind-driven turbines, related generating, control, conditioning, and transmission equipment, support structures, and a powerhouse.

Leasehold interest (Class 13)

You may usually claim capital cost allowance on a leasehold interest in a property. The maximum rate allowable depends on the nature of the leasehold interest and on the terms of the lease. If you acquired a leasehold interest in a property, you should contact your district taxation office, as special capital cost allowance rules apply.

Transfer of farm property to a child

There are special rules which affect capital cost allowance when depreciable farm property is transferred to a child, either during the parent's lifetime or after death. Refer to the section "Transfer of Property to a Child" in Chapter 6 for further details.

DEPLETION ALLOWANCE

If you receive income from a sand or gravel pit, a woodlot, or a stone quarry, you may recover the cost of the product by a claim for capital cost allowance, commonly known as a **depletion allowance.**

Sand, gravel, clay and stone are examples of industrial minerals, which are covered in more detail in Interpretation Bulletin IT-492, *Capital Cost Allowance – Industrial Mineral Mines*.

For more details on woodlots and timber limits, obtain IT-481, *Timber Resource Property and Timber Limits*.

The first year you make a claim for CCA (depletion), the maximum allowance available is calculated as follows:

$$\frac{\text{Capital Cost less Residual Value}}{\text{Units Available}} \times \text{Units Sold in the Year} = \text{Maximum Depletion Allowance}$$

The residual value is the estimated value of the property if all merchantable timber or commercially mineable material were removed.

A cost per unit is determined by dividing the estimated quantity of the product contained in the lot, pit, or quarry, into the cost less residual value. The cost per unit is multiplied by the number of units sold in the year to determine the amount of the depletion allowance for that year.

The depletion allowance per unit calculated using the above formula is to be used in all future years, unless it is determined that the amount of estimated units available or the capital cost is substantially different from the amounts used to calculate the allowance for the previous year. The revised formula would then become

$$\frac{\text{Undepreciated Capital Cost less Residual Value}}{\text{Units Available at the Beginning of the Current Year}} \times \text{Units Sold in the Year} = \text{Maximum Depletion Allowance}$$

The depletion allowance ceases when the cost has been fully recovered or the property has been disposed of.

If your operations are on a small scale, you may claim the lesser of $100 or the amount of the sales of the product in the year, instead of the amount calculated above.

CHAPTER 4
ELIGIBLE CAPITAL EXPENDITURES

In the course of carrying on your farming business you may make an expenditure to acquire an intangible capital property. Examples of this type of expenditure include the purchase of a milk quota, tobacco quota, or other Government Right.

As these expenditures are capital in nature and provide an enduring benefit you cannot deduct them in the year of the expenditure. Also, you cannot claim capital cost allowance since you did not obtain a depreciable property. These types of expenditures are **eligible capital expenditures.**

For more information on expenditures that qualify as eligible capital expenditures, obtain Interpretation Bulletin IT-143R2, *Meaning of Eligible Capital Expenditure.*

New for 1988

If your fiscal period begins after December 31, 1987:

- the additions to and deductions from your cumulative eligible capital account are based on **three-quarters** instead of **one-half** of the applicable amounts;
- your maximum annual deduction has been reduced from 10% to 7%;
- the existing balance of your cumulative eligible capital account is increased by one-half;
- a disposition of eligible capital property may result in an addition to business income and/or a deemed taxable capital gain; and
- any deemed taxable capital gain is eligible for the lifetime capital gains deduction if you were a resident of Canada throughout the year.

The comments that follow reflect the changes noted above.

CUMULATIVE ELIGIBLE CAPITAL ACCOUNT

You must create an account comparable to a capital cost allowance class for eligible capital expenditures. The property in this account is eligible capital property.

In this account, you enter three-quarters of all your eligible capital expenditures for the year.

If you have a balance in your cumulative eligible capital account at the beginning of your first fiscal period starting after December 31, 1987 increase this balance by one-half.

When you sell eligible capital property, you must deduct three-quarters of the proceeds receivable for the sale from the account balance. The amount deducted is an **eligible capital amount.**

If your cumulative eligible capital account has a negative balance at the end of the year, you must include as **farming income** the lesser of

- the negative balance of your cumulative eligible capital account, and
- all prior years' annual deductions claimed and not previously added to income.

Any portion of the negative balance that is not farming income is deemed to be a **taxable capital gain.** You report this gain on line 544 of Schedule 3, *Summary of Dispositions of Capital Property in 1988*, included with your return package.

Note:

This deemed taxable capital gain is eligible for the lifetime capital gains deduction.

For information on closing your eligible capital account when you stop operating your business, contact your district taxation office.

Annual allowance

As long as there is a positive balance in your cumulative eligible capital account at the end of your taxation year, you may deduct up to 7% of the account balance from your income for that year. Do this in the same way as you calculate your capital cost allowance claim for a particular class of property. You must subtract the allowance claimed from the balance in the account to determine your cumulative eligible capital.

The following are examples of how the cumulative eligible capital account operates. These examples include the changes that are new for 1988.

Example A

Ralph started farming on January 1, 1988. His farming business has a December 31 fiscal year-end. During the year he purchased a milk quota for $10,000. The maximum allowance he may claim on eligible capital property for 1988 is calculated as follows:

YEAR		CUMULATIVE ELIGIBLE CAPITAL
1988	**Eligible Capital Expenditure:**	
	cost of milk quota ($10,000) × **3/4**	$7,500
	Annual allowance	
	maximum: **7%** of year-end balance......	525
	Balance	$6,975

Example B

Henri started a farming business in 1986 that has a December 31 fiscal year-end. In 1986 he purchased a milk quota for $10,000. Two years later he sold the milk quota for $12,000. Each year Henri claimed the maximum allowance on eligible capital property available to him:

YEAR		CUMULATIVE ELIGIBLE CAPITAL
1986	**Eligible Capital Expenditure:**	
	cost of milk quota ($10,000) × 1/2	$5,000
	Annual allowance	
	maximum: 10% of year-end balance.....	500
	Balance	$4,500
1987	**Annual allowance**	
	maximum: 10% of year-end balance.....	$450
	Balance	$4,050
1988	**Add: 50% of existing balance ($4,050)**	2,025
		$6,075

Deduct: **Eligible capital amount**
sale of milk quota
($12,000) × **3/4**............... 9,000
Negative balance ..... (A) $(2,925)

Henri must add $950 to his 1988 farming income calculated as the lesser of $2,925 (amount A), and the total of all prior years' annual deductions of $950 ($500 + $450). He must also include in income the remaining $1,975 ($2,925 – $950) as a taxable capital gain.

Replacement property

When you dispose of eligible capital property and obtain a replacement property, you may elect to defer all or a part of any gain you realize. To qualify, you must obtain the replacement property before the end of the taxation year following the year you disposed of the former property. You must obtain the replacement property

- for the same or similar use as the former property, and
- for use in the same or a similar business (i.e. farming operation).

CHAPTER 5
FARM LOSSES

A business loss occurs when the expenses of a business exceed the income from that business in a year. If your farming operation resulted in a net loss in 1988, the amount of the loss you may deduct depends on the nature and extent of your farming operation. Before you claim a farm loss, you should read the contents of this chapter carefully. The Department does not examine the nature of a farm loss at the time you file your return but may review the loss at a later date.

If you have incurred a loss from a farming operation, it could be treated in one of three ways:

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

FARM LOSSES — FULLY DEDUCTIBLE

If your chief source of income is from farming, you may deduct the full amount of your farm loss from other income you earned in the year, or from income of other years.

A farmer, whose chief source of income is from farming, looks to farming for a livelihood. While mostly concerned with farming, the farmer may also have income from investments or other secondary sources, such as a subordinate employment or business. To determine whether a farming business constitutes your chief source of income, it is necessary to consider

- your personal involvement,
- the capital you invested, and
- the profitability, both actual and potential, of the farming operation in relation to your other sources of income.

If your chief source of income is from farming, and your farming operations resulted in a net operating loss in 1988, you must reduce the loss by subtracting it from your net income from all other sources (including any forward averaging income) in that year. If your loss is more than this income, the remaining balance of the loss is your **farm loss** for the year.

As noted above, you must fully apply the loss from your full-time farming operation in the year of loss. Only the balance that your other income in the year cannot absorb is your **farm loss** for the year.

You may carry a farm loss you incur after 1982 back three years and forward for up to ten years and apply it against income from all sources in those years.

Carry-back — 1988 farm loss

If you choose to carry your 1988 farm loss back, you may request an adjustment to your 1985, 1986 or 1987 returns by completing form T1A, *Request for Loss Carry-Back.* Do not file an amended return. Attach one completed copy of form T1A to your 1988 return.

Carry-forward of prior years losses to 1988

A farm loss incurred in 1983, 1984, 1985, 1986 or 1987 that you have not deducted may be eligible for application in 1988.

You must apply the loss of the earliest year before you apply the losses of other years.

Note:

Before 1983, if you had a loss from a full-time farming operation that was more than your other income, it was classified as a ***non-capital loss.*** *If you incurred a non-capital loss before 1983, you could only carry it back one year, or forward five years. Accordingly, you may not deduct a farm loss you incurred before 1983 in any year after 1987.*

Non-capital loss

If you have a loss from your farming operation in 1988, as well as a loss from a business other than farming or fishing, and the total of all losses exceeds your other income, you must calculate both

- your 1988 farm loss, and
- your 1988 non-capital loss.

You may carry a non-capital loss you incur after 1982 back three years and forward seven years.

If you choose to carry your 1988 non-capital loss back, you may request an adjustment to your 1985, 1986 or 1987 returns by completing form T1A, *Request for Loss Carry-Back.* Do not file an amended return. Attach one completed copy of form T1A to your 1988 return.

Application of losses — exception 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, as explained in Chapter 10.

First, the remainder of a farm loss or a non-capital loss incurred within an averaging period which was not deducted, as outlined above, may be absorbed as noted under line 4 of form T2011, *Election to Average Income.*

Second, a farm loss incurred in the three years immediately following the period which has been averaged cannot be taken into the averaged period. You may only deduct it from income in the ten years following the year of loss or a preceding year not included in the averaging period.

RESTRICTED FARM LOSSES – PARTIALLY DEDUCTIBLE

You may claim a portion of your loss from a farming business if

- farming is not your chief source of income, and
- your farming operation is a business carried on for profit or with a reasonable expectation of profit.

The portion of the loss that you cannot claim is your **restricted farm loss.**

When you have a loss from a farming business and you also have income from other sources, such as employment or another business, the loss you may claim against these other sources of income is restricted if

- your chief source of income is neither farming nor a combination of farming and some other source of income.

Generally, this restriction will apply in instances where the size and scope of the farming operation is sufficient to provide a reasonable expectation of profit but the operation itself is a sideline business.

It is possible for farming to be your chief source of income in a particular year even though your farming operation does not yield a profit in that year. The determination of whether farming is your chief source of income is not strictly a matter of arithmetical comparison of your various sources of income for the year. Gross income, net income, capital investment, cash flow, personal involvement and other factors may be relevant considerations. You must also consider your plans for developing the operation and your activities in implementing these plans.

You must make the determination of whether farming constitutes your chief source of income each year in which you have a farm loss and some other source of income. If your farm loss is restricted in one year, it will not necessarily be restricted in another year.

For more details, obtain Interpretation Bulletin IT-322R, *Farm Losses*.

The rules for determining a restricted farm loss are somewhat different if

- farming is not your chief source of income, and
- your loss includes expenditures for **scientific research and experimental development.**

If you have made expenditures for scientific research and experimental development, you may deduct them in full when you calculate your income. In addition, you may deduct the allowable portion of your farm loss calculated according to the rules outlined below.

Restricted farm loss — calculation

If farming is not your chief source of income and you incurred a farming loss in the year, the amount of the loss you may deduct from all other sources of income in the year is **the lesser of**

(a) your farm loss for the year, and

(b) $2,500 plus the lesser of

- 1/2 (your farm loss for the year minus $2,500), and
- $2,500.

Note:

The maximum loss deductible in any one year is limited to $5,000. The balance of the loss which is not deductible in the year is your restricted farm loss.

Example

Your chief source of income in 1988 is from employment and you have a loss from farming of $7,200. You are allowed to deduct from your income from other sources a **farm loss** equal to the lesser of

(a) $7,200, or

(b) $2,500 plus the lesser of

- 1/2 × ($7,200 – $2,500) =
  1/2 × $4,700 = $2,350 and
- $2,500.
  $2,500 + $2,350 = $4,850

The lesser of (a) and (b) is the amount of the loss that you can deduct in 1988 (i.e. $4,850).

Your **restricted farm loss** (balance of the loss not deductible) is $2,350 ($7,200 minus $4,850).

Carry-back — 1988 restricted farm loss

If you incur a restricted farm loss in 1988, you may carry it back three years to 1985, 1986, or 1987 and deduct it against any farming income in those years. You may also carry any undeducted portion of your 1988 restricted farm loss forward for up to ten years and deduct it against farming income. However, the restricted farm loss that you deduct in any one of these years may not exceed your net farming income for that year.

Thus, if you had no farming income in any of those years, no deduction is available for a restricted farm loss.

You may be able to use some or all of a restricted farm loss to reduce a capital gain arising from a disposition of the farm land. This is explained in Chapter 6.

Carry-forward of prior years' restricted farm losses to 1988

You may carry restricted farm losses incurred after 1982 back three years and forward for up to ten years. You may deduct any portion of a restricted farm loss you incurred in 1983, 1984, 1985, 1986, or 1987 which you have not deducted against your net farming income in 1988.

Note:

If you incurred a restricted farm loss before 1983, you could only carry it back one year, or forward five years. Therefore, you cannot deduct from farming income a restricted farm loss you incurred before 1983 in any year after 1987.

FARM LOSSES — NON-DEDUCTIBLE

You are not entitled to claim any portion of a loss if your farming operation does not constitute a business carried on for profit or with a reasonable expectation of profit.

If you, while consistently engaged in a farming activity, are using the farm property mainly for personal benefit and you are not carrying on a farming business with a reasonable expectation of profit, the expenses you incur are usually viewed as non-deductible personal or living expenses. Therefore, you cannot claim any loss incurred under these circumstances as a farm loss.

For more information on determining whether or not a farming operation is a business, obtain Interpretation Bulletin IT-322R, *Farm Losses*.

Note:

While the Department may accept a loss on the initial assessment of your return, it could be subject to a later review of all your particular circumstances. For information concerning the audits or reviews the Department carries out, refer to Chapter 11.

CHAPTER 6
CAPITAL GAINS AND OTHER SPECIAL PROVISIONS FOR FARMERS

The basic system and general rules to be followed in the treatment of capital gains and losses are covered in more detail in the *1988 Capital Gains Tax Guide*.

Several items of particular interest to farmers are outlined below.

PRINCIPAL RESIDENCE

A home is generally exempt from tax on capital gains and need not be valued provided it is used only as the principal residence of the owner. However, the owner of a principal residence that is part of a farm would be well advised to establish its value in view of the options discussed below.

If you are a farmer and disposed of farm land in 1988 that included your principal residence, you may calculate a capital gain on the disposition under one of two methods:

Method 1

You may calculate separately

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

To do this, you must allocate the adjusted cost base and the proceeds of disposition on a reasonable basis between

- your principal residence, including up to 1/2 hectare of adjoining land, and
- the remainder of the farm property (land, buildings and equipment).

For land, the Department considers a reasonable allocation to be the greater of

- the fair market value of 1/2 hectare of comparable farm land, and
- the fair market value of a typical residential building site in the area.

Example

George is resident in Canada and disposed of his 16-hectare farm on which his principal residence was situated. One-half hectare of the land can reasonably be attributable to his principal residence.

Land values at the time of **disposition** were

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

and at the time of **acquisition** were

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

	Principal Residence	Farm Land	Total
Proceeds of Disposition:			
Land	**$ 25,000**	$175,000	$200,000
House	75,000		75,000
Barn		20,000	20,000
Silo		5,000	5,000
	$100,000	$200,000	$300,000
Deduct:			
Adjusted Cost Base:			
Land	**$ 15,000**	$105,000	$120,000
House	60,000		60,000
Barn		16,000	16,000
Silo		4,000	4,000
	$ 75,000	$125,000	$200,000
Gain on Disposition	$ 25,000	$ 75,000	$100,000
Less:			
Reduction of Gain for principal residence exemption	25,000		25,000
Capital Gain	**NIL**	**$ 75,000**	**$ 75,000**

Taxable Capital Gain (2/3 × $75,000) **$50,000**

George used the market value of a typical residential building site in the area to achieve a reasonable allocation of the proceeds and the adjusted cost base between principal residence and farm land.

The Department considers that an allocation made on this basis fairly reflects the cost of acquiring a similar site on the open market.

Method 2

You may elect to calculate the total gain you realized on the sale of both your land and residence and to deduct

- $1,000, plus $1,000 for each year ending after 1971 during which the property was your principal residence and you were resident in Canada.

The resulting gain, if any, is your capital gain and is taken into account in computing your income.

To make the election, attach a letter to your return

- stating the number of years after 1971, or the acquisition date if acquired after 1971, that you were both resident in Canada and occupying the property as a principal residence.

If you make this election, you may use form T2090, *Capital Dispositions Supplementary Schedule – Election Available to Farmers Disposing of Farmland* to help you with your calculations.

To support a property value, you should retain documents containing the following information:

- A brief description of the property, including building size 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).
- The type of farming operation carried on.

RESTRICTED FARM LOSSES

If you disposed of farm land in 1988, you may deduct restricted farm losses incurred in prior years from any capital gain on the land to the extent that they consisted of property taxes and interest on money borrowed or on an amount owing to purchase the land, and were not previously deducted.

Restricted farm losses may reduce a capital gain but may not create or increase a capital loss on disposal of farm land.

LIFETIME CAPITAL GAINS DEDUCTION

In 1985, a cumulative lifetime capital gains deduction was introduced for net taxable capital gains realized on dispositions of qualified farm property. This deduction effectively removes the tax on taxable capital gains to the extent that they do not exceed the maximum deduction for the year.

If you dispose of qualified farm property in 1988 you may claim a deduction equal to the lesser of

- your net eligible taxable capital gains for the year, and
- the unused portion of your lifetime deduction limit.

Note:

Beginning in 1988, you must include 2/3 of a capital gain in your income. Before 1988, you included only 1/2 of a capital gain in income. Therefore, for 1988 the maximum lifetime deduction limit for qualified farm property has been increased to $333,333 from $250,000. To calculate the unused portion of this deduction you must multiply the total of all capital gains deductions claimed by you before 1988 by 4/3, and deduct this result from $333,333.

New for 1988

The definition of **qualified farm property** has been revised. Beginning in 1988, qualified farm property must be owned by

- you or your spouse, or
- a partnership, an interest in which is an "interest in a family farm partnership" of you or your spouse.

Qualified farm property may include property that is

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

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

- you or your spouse,
- any of your children, grandchildren, or greatgrandchildren,
- any of your parents,
- a family farm corporation where any of the above individuals owned a share of that corporation, or
- a family farm partnership where you, your spouse or any of your children, grandchildren, great-grandchildren or parents owned an interest in that partnership.

Real property or eligible capital property must be used in carrying on a farming business in Canada. The conditions to meet this requirement depend on the date you, your spouse, or your family farm partnership acquired the property.

Real property or eligible capital property acquired before June 18, 1987 or after June 18, 1987 under the terms of a written agreement entered into before that date will meet this requirement if

- in the year you dispose of the property it or the property for which it was substituted was used in carrying on a farming business in Canada by either an individual, a partnership, or a corporation referred to above, or
- it was used in carrying on a farming business in Canada in at least five years during which the property was owned by either an individual or a partnership referred to above.

Real property or eligible capital property acquired **after June 17, 1987** will meet this requirement if it is owned by an individual or partnership referred to above throughout the 24 months immediately before its disposition and

- if the property or property for which it was substituted was used by an individual, for at least two years while the property was so owned, the individual's gross revenue from the farming business in Canada in which the individual was actively engaged on a regular and continuous basis must have exceeded the individual's income from all other sources in the year, or
- if the property was used by a family farm corporation or partnership, the corporation or partnership used the property in carrying on a farming business in Canada for at least 24 months, during which time you, your spouse or any of your children, grandchildren, great-grandchildren or parents were actively engaged in the farming business.

Qualified farm property may also include property owned by a personal trust and property used in a farming business by

certain trust beneficiaries. For further information, contact your district taxation office.

Refer to the *1988 Capital Gains Tax Guide* for more details.

SPECIAL REGISTERED RETIREMENT SAVINGS PLAN PROVISIONS FOR FARMERS

With the introduction of the lifetime capital gains deduction in 1985, the special registered retirement savings plan contribution is no longer available for farmers who disposed of qualified farm property after 1984.

However, if you disposed of qualified farm property in 1984 and are bringing the taxable capital gain into income over a number of years by means of a capital gains reserve, you will continue to be eligible to claim the special registered retirement savings plan contributions. The maximum lifetime contribution limit is $120,000 and is available for each year in which a portion of the 1984 capital gain is brought into income.

TRANSFER OF FARM PROPERTY TO A CHILD

You may transfer your farm to your child during your lifetime without incurring any liability for tax on capital gains if

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

The same is true, if as a consequence of your death, your farm is transferred to your child. The capital gain that is ordinarily taxed in the deceased's hands is passed on to the child and will be recalculated if the farm is subsequently disposed of to a person other than a spouse or child.

If you transfer such property, the term **child** includes

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

For purposes of these transfer rules, the child relationship must exist at the time of the transfer.

You may also defer the reporting of recapture of capital cost allowance on depreciable property until the property is sold by the child.

Rollover of farm property when death occurred in 1988

In certain circumstances, the general rules on deemed disposals and acquisitions on the death of a taxpayer do not apply. A tax-free rollover of Canadian farm property from a deceased taxpayer to his or her child is permitted if

- the child is a resident of Canada at the time of the taxpayer's death,
- immediately before the taxpayer's death, the property was used by the taxpayer, the taxpayer's spouse or any of his or her children in a farming business, and
- the property vests indefeasibly in the child no later than 36 months after the taxpayer's death. This period may be extended upon approval from the Department.

The types of property that qualify for these tax-free rollovers include

- land, buildings and other depreciable property used in a farming business,
- a share of the capital stock of a family farm corporation, and
- an interest in a family farm partnership.

If a taxpayer's legal representative elects in the taxpayer's return of income for the year in which the taxpayer died, these properties may be transferred at any amount between cost (and/or undepreciated capital cost) and fair market value. The child is then deemed in most circumstances, to have acquired these transferred properties at the amount so elected.

Similar rules also apply to the transfer of a farm property that is leased by a taxpayer to his or her family farm corporation or partnership.

If a child has obtained a farm from a parent, and the child later dies, the farm property may be rolled over to the surviving parent.

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

The rules for determining the costs to be applied for such transfers, when the taxpayer's legal representative has so elected are as follows:

- Depreciable properties are deemed to have been disposed of at a value between their fair market value and their undepreciated capital cost.
- Land is deemed to have been disposed of for an amount between the fair market value and the decedent's adjusted cost base.
- The shares of a family farm corporation or an interest in a family farm partnership are deemed to have been disposed of for an amount between the fair market value and the adjusted cost base to the taxpayer immediately before the taxpayer's death.
- The child is deemed to have acquired the property at the amount determined as deemed proceeds to the decedent.

For more information, obtain Interpretation Bulletin IT-349R2, *Intergenerational Transfers of Farm Property on Death* and IT-449R, *Meaning of 'Vested Indefeasibly'*.

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

If you are a farmer a similar rule allows you during your lifetime to rollover Canadian farm property to your child tax-free. You may do this if immediately before the transfer

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

The types of properties that qualify for this tax-free rollover include

- farm land,
- buildings and other depreciable property,
- eligible capital property,

- a share in a family farm corporation, and
- an interest in a family farm partnership.

Your proceeds of disposition (as agreed to), may be any amount between fair market value and undepreciated capital cost (or adjusted cost base).

In the case of eligible capital property, the proceeds of disposition may be any amount between fair market value and 1.3333 times the cumulative eligible capital for the business immediately before the transfer.

Your deemed proceeds of disposition are deemed to be the child's cost of acquisition.

Example

Orlando wishes to transfer some farm property to his son. The property consists of a parcel of land valued at $100,000 for which he paid $85,000 in 1972, and a combine valued at $9,000 upon which he has claimed capital cost allowance under Part XI. The combine cost $16,000 in 1972 and has an undepreciated capital cost of $7,840.

Orlando could elect to transfer the property as follows:

- the land at an amount between fair market value ($100,000) and adjusted cost base ($85,000) say, $91,000
- the combine at its undepreciated capital cost of $7,840.

His son would acquire the assets at these same amounts.

Under this election, Orlando can defer income tax on the recapture of capital cost allowance on the combine. However, he will realize a taxable capital gain of $4,000 (2/3 of $6,000) on the land.

Further details on this are provided in Interpretation Bulletin IT-268R3, *Inter Vivos Transfer of Farm Property to Child.*

Property owned by the transferor before December 31, 1971 is subject to special rules.

TRANSFER OF FARM PROPERTY TO SPOUSE

Farm property may be transferred to a spouse or spousal trust

- as a consequence of the farmer's death, or
- during the farmer's lifetime.

The results are similar to those that occur when you transfer farm property to a child. That is, you may defer the paying of income tax until the property is disposed of to a person other than your spouse or child.

If, before the farmer's death, the transferee spouse disposes of property which the farmer transferred after 1971, any resulting capital gain must be reported in the farmer's income and not in the income of the spouse. If the farmer transfers depreciable property to the spouse, any claim for capital cost allowance by the spouse on these properties must be made under Part XI. The spouse cannot continue to claim capital cost allowance under Part XVII.

There are other rules that allow you to defer tax on capital gains in certain circumstances. **For example:**

If you disposed of capital property before November 13, 1981, or after November 12, 1981 under the terms of an offer or agreement in writing made or entered into before that date, you may deduct a reasonable reserve for the proceeds not due until after the end of the year. This reserve must be treated as a capital gain in the following year. A new reserve would be permitted if, in that following year, there are still proceeds not yet due.

If you disposed of capital property after November 12, 1981 (other than as a result of property stolen, destroyed or expropriated) you may deduct a reasonable reserve for proceeds not due until after the end of the year. Depending on the circumstances of the disposition, you may deduct one of the following reserves:

- A reserve for up to **ten years** on the disposition to your child of any land or depreciable property of a prescribed class for the proceeds of disposition that are not due until after the end of the year. The property must have been used by you or your family in the business of farming immediately before the disposition. This reserve is also available on the disposition of a share of a family farm corporation or an interest in a family farm partnership. In all cases, your child must have been resident in Canada immediately before the disposition. At least one-tenth of the taxable capital gain must be reported in each of the ten years.
- A reserve for up to **five years** on the disposition of property to any other person for the proceeds of disposition that are not due until after the end of the year. At least one-fifth of the taxable capital gain must be reported in each of the five years.

If property has been disposed of involuntarily, such as by expropriation, you may defer any resulting capital gain if you replace the property. See the section, "Election to defer gain on disposal of property" in Chapter 3 for further details.

If you realize a capital gain on the sale of a farm, and use the proceeds to purchase another farm, there are also provisions for deferring that capital gain. Refer to the section, "Election to defer gain on disposal of property" in Chapter 3 for further details.

CHAPTER 7
INVESTMENT TAX CREDIT

You may qualify for this tax credit if you have

- acquired qualified property,
- acquired qualified transportation equipment,
- acquired an approved project property, or
- incurred a qualified expenditure.

In all cases the property you acquired must be new. This means that it must not have been used or acquired for use or lease for any other purpose whatsoever before you acquired it.

QUALIFIED PROPERTY

Qualified property includes certain new buildings, machinery, and equipment acquired for use in Canada primarily for a designated purpose. However, qualified property does not include an approved project property.

A designated purpose includes certain qualifying activities, of which farming is one.

Cars or trucks designed for use on highways or streets do not normally qualify for the investment tax credit as qualified property even if you use them in your farming business. However, trucks may qualify for the investment tax credit as **qualified transportation equipment** which is described below.

The credit available on qualified property may vary depending on the date you purchased it and the area in Canada where you are using it. The rates for qualified property are detailed on form T2038(IND.).

QUALIFIED TRANSPORTATION EQUIPMENT

If you purchase a new truck or trailer and use it principally for the purpose of transporting property in Canada, or to and from Canada, it may qualify for the investment tax credit. The truck or trailer must be designed for carrying freight, or hauling a trailer that carries freight, on highways. It also must meet certain weight restrictions. If you acquire a truck or trailer and use it in your farming business principally for one of the purposes noted above, contact your local district taxation office to determine if you qualify.

APPROVED PROJECT PROPERTY

Approved project property means property you acquired after May 23, 1985, that the Minister of Regional Industrial Expansion has certified to be new property to be used in **Cape Breton** in an **approved project.** Projects will be eligible for approval if the total capital cost of the depreciable property to be used is at least $25,000.

The property must also be used for an approved purpose, of which farming is one.

Refer to Information Circular 78-4R3, *Investment Tax Credit Rates*, for details of the Cape Breton boundary lines for purposes of this credit.

QUALIFIED EXPENDITURE

To be a qualified expenditure, the amount must relate to scientific research and experimental development. Information Circular 86-4R2, *'Scientific Research and Experimental Development'*, provides details on this type of expenditure.

New for 1988

For all taxation years ending after 1987:

- you may use investment tax credits to reduce your federal individual surtax;
- the annual investment tax credit limit is a new limit restricting the deductibility of credits;
- the carry-over period for credits earned after April 19, 1983 has been extended from seven to ten years;
- you may now claim a partial refund of the investment tax credit; and
- the capital cost of related property is reduced in the year following the year in which you deduct or receive a refund for an investment tax credit.

HOW TO CALCULATE YOUR INVESTMENT TAX CREDIT

You must use form T2038(IND.) to calculate the investment tax credit. Remember to attach one completed copy to your return.

For details on claiming this credit when block averaging, see Chapter 10 of this Guide.

The investment tax credit is based on a percentage of the **investment cost** (the cost of the property you acquired or the expenditure you made). In certain circumstances, you must increase or decrease the investment cost. For example, you decrease the investment cost by the amount of any government or non-government assistance you received for the property. Similarly, 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 that you applied to the original investment cost.

An individual who carries on an unincorporated business must calculate the investment tax credit at the end of the calendar year. However, the fiscal year-end of your business may differ from the end of the calendar year. In this case, you must include in your investment tax credit for that calendar year any investment tax credit earned on property acquired or expenditures made in the calendar year but after your fiscal year-end.

Form T2038(IND.) lists the rates to use when you calculate the investment tax credit for each type of property or expenditure. It also contains additional information concerning this credit.

WHEN TO CLAIM YOUR INVESTMENT TAX CREDIT

In certain circumstances, you may use the investment tax credit you earn in 1988 to reduce your taxes

- in the current year,
- in a prior year, or
- in a future year.

Current year deduction

The maximum investment tax credit you may deduct for 1988 is 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 **federal tax.** *

**Note:*

Your federal tax is the amount before deducting the investment tax credit, the federal forward averaging tax credit and the minimum tax carry-over.

However, if you are subject to minimum tax in the year, you cannot use the investment tax credit to reduce your federal tax below the minimum amount.

The term annual investment tax credit limit is new for 1988. It is an amount equal to

$24,000 + ¾ (your **federal tax** minus $24,000).

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

- the investment tax credit you earned in the current year, and
- the balance of your unused credits carried forward from the previous year.

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

Beginning in 1988 you may also use your investment tax credits to reduce your **federal individual surtax** for the year. The maximum additional investment tax credit that you may deduct is limited to the lesser of

- ¾ of your federal individual surtax (before deducting the investment tax credit), and
- the balance in your investment tax credit pool less the credit used to reduce your federal tax in the year.

To calculate your claim for the additional investment tax credit, complete section 2 of form T2038(IND.). Enter the amount of your **additional investment tax credit** on line 518 of Schedule 1 of your return package.

Prior year deduction

You may carry back the investment tax credit earned in 1988 for up to three years and use it to reduce your federal taxes payable. However, you can only carry back this credit if you reduce to the fullest extent possible your

- 1988 federal taxes, and
- 1988 federal individual surtax.

Note:

The maximum investment tax credit that you may deduct in 1985, 1986 and 1987 cannot exceed the federal taxes payable in the year.

Future year deduction

An investment tax credit earned in 1988 and **not** used to reduce taxes in 1988 or in a prior year may be carried forward for up to ten years. The unused credit is included in your investment tax credit pool and may be used to reduce your taxes in a future year. Any credits not applied ten years after they are earned cannot be used.

REFUNDABLE INVESTMENT TAX CREDIT

If you were unable to fully use your investment tax credit to reduce your taxes in the year, a portion of the credit may be refundable to you in cash. You may only claim this refundable investment tax credit in the year you make a qualifying acquisition or expenditure. You may choose the amount of the refund. However, it cannot exceed 40% of the investment tax credit you earned in 1988 that was not used to reduce

- your federal tax and federal individual surtax for 1988, and
- your federal taxes payable for 1985, 1986 or 1987.

The amount of refundable investment tax credit that has been refunded to you reduces the balance in your investment tax credit pool.

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

OTHER ADJUSTMENTS

You must reduce the capital cost of the related property by the amount of any credit carried back as well as by the credit deducted and/or refunded in the current year. Starting in 1988, you must reduce the capital cost of the related property in the year following the year in which the credit is deducted or refunded. This adjustment reduces the amount of capital cost allowance that you may claim for the property. It also reduces the capital cost of the property for determining any capital gain arising on its disposal.

If the carry-forward relates to a depreciable property that was previously disposed of, but other property still remains in that class, you must reduce the undepreciated capital cost by the amount of credit deducted or refunded. However, if no property remains in the class, you must report this amount as income in the year following the year in which the credit was deducted or refunded.

CHAPTER 8
PARTNERSHIPS

This chapter outlines some of the special features of the Income Tax Act that relate to partnerships. The comments below are general. For more specific information obtain, Interpretation Bulletins IT-90, *What is a Partnership?* and IT-138R, *Computation and Flow-through of Partnership Income*.

WHAT IS A PARTNERSHIP?

Generally, a partnership is the relationship that exists between persons carrying on business in common to earn a profit. A valid partnership may exist without a written partnership agreement. Therefore, the type and extent of a person's involvement in the business is important in determining whether the individual is in fact a partner. For guidance on whether a particular arrangement is a partnership, you should refer to the relevant provincial law on the subject. The Department will view such law as persuasive.

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

- whether the relationship or arrangement is a partnership;
- that when individual partners contribute properties to a partnership there are special rules concerning capital gains or losses and the recapture of capital cost allowance;
- that there are special rules for the dissolution of a partnership; and
- that when partners dispose of their interests in a partnership, they may realize a gain or loss on the disposal.

The above points are not all-inclusive, but are indicative of the factors which must be considered in determining the amount of income or loss of the individual partners for a taxation year.

PARTNERSHIP INCOME

You determine partnership income as if the partnership was a separate person. A partnership carrying on a farming business may use the cash method of computing income only if **all** partners elect to use this method.

The statement of income and expenses must show the total income and expenses of the partnership. Each partner must file a return reporting his or her share of the income from the partnership.

If you have the personal use of partnership property, the costs that the partnership incurred and claimed relating to that property are a benefit to you. You must include in your income the value of the personal benefit you received from the use of that property.

If your partnership employs your spouse, your spouse must report the full amount of any wages received. The partnership may claim these wages as an expense if they are reasonable and are incurred to earn income.

A partnership may own and amortize eligible capital property. Also, partnership income includes any capital gains and losses on the disposition of property owned by the partnership.

PARTNERSHIP LOSSES

The loss carry-over provisions apply to each individual partner, not to the partnership. For example, in your own return you combine your share of partnership farming losses with any other non-partnership farming losses you have in the year. You apply this amount against your other income in accordance with the normal loss carry-over provisions.

INCOME AVERAGING

The income averaging provisions, including the five-year block averaging, apply to each individual partner and not to the partnership. To make the averaging calculation, combine your share of partnership income or loss with any other income or loss that you have.

CAPITAL COST ALLOWANCE ON DEPRECIABLE PROPERTY OF PARTNERSHIP

The partnership, and not the individual partners, may claim capital cost allowance on the depreciable property owned by the partnership.

If the partnership disposes of depreciable property, it must include any capital gains or recaptures of capital cost allowance in partnership income before allocation of that income to the partners.

The capital cost of depreciable property to a partnership is reduced by the amount of any investment tax credit allocated to the individual partners. The capital cost is also reduced by any other forms of assistance received from a government, municipality or other public authority. Grants, subsidies, and forgivable loans are some examples of government assistance.

When a partnership disposes of depreciable property, there can be no capital loss.

RESTRICTED FARM LOSSES

The rules outlined in Chapter 5 regarding restricted farm losses apply to each individual partner, not the partnership.

BASIC HERDS

The rules outlined in Information Circular 86-6, *Basic Herds*, apply to each partner, not the partnership.

PARTNERSHIP SCHEDULE

If you are a partner in a farming business you should complete the **Partnership Schedule** on the reverse of form T2042 and submit it with your income tax return.

New for 1988

Starting in the 1988 taxation year, members of a partnership may be subject to an automobile standby charge. For example, if a partnership makes an automobile available to

- a partner, or
- a person related to a partner,

the partner must include a reasonable standby charge in income.

Similarly, if a partnership provides an automobile to an employee of a partner, or a person related to the employee, the employee must include a reasonable standby charge in income.

In either case, to determine the amount of the standby charge, use the same rules that apply when calculating a standby charge for an employee.

For information on calculating a reasonable standby charge, obtain the *1989 Income Tax Deductions at Source Tables.*

CHAPTER 9
CANADA PENSION PLAN AND UNEMPLOYMENT INSURANCE

The Canada Pension Plan and Unemployment Insurance legislation, as they apply to farmers, can be divided into two main areas:

- what employers are required to deduct on behalf of their employees, and
- what is payable by farmers on their own behalf as self-employed individuals.

In Quebec, similar rules apply for the Quebec Pension Plan. See the Guide included with your Provincial Return of Income for more information.

WHAT EMPLOYERS ARE REQUIRED TO DEDUCT

All employees must contribute to the Canada Pension Plan if they are

- employed in pensionable employment other than in the province of Quebec,
- 18 years of age or over and under 70, and
- not receiving a Canada or Quebec Pension Plan retirement or disability pension.

Employers must deduct this contribution from the employee's salary and wages.

Similarly, every employee employed in Canada who is not in excepted employment must pay Unemployment Insurance premiums. Employers must deduct these premiums from the employee's salary and wages.

In both cases, the employer calculates the deductions on the employee's gross salary and wages. Gross salary and wages include the value of board and lodging and other benefits provided by the employer.

The Canada Pension Plan and Regulations require the employer to match the employee deduction. The Unemployment Insurance Act requires the employer to pay a premium of 1.4 times the employee's premium.

Employers must remit to the Receiver General both

- the employee's contributions and premiums, and
- the employer's contributions and premiums.

These remittances must be received by the Department or a Canadian financial institution on or before the 15th day of the month following the month in which the employees were paid.

In addition to regular employees, you may have employees who are employed in farming for short periods of time during the year. For Canada Pension Plan purposes, contributions will be applicable from the first day these part-time employees worked if they

- work for 25 days or more in a calendar year, and
- are paid $250 or more in that year.

Similarly, for Unemployment Insurance purposes, employees employed in farming for seven days or more with the same employer are insurable from the first day they work.

For further information, please refer to the *Canada Pension Plan Contribution and Unemployment Insurance Premium Tables*.

WHAT IS PAYABLE BY SELF-EMPLOYED INDIVIDUALS — CANADA PENSION PLAN

Complete the "**Canada Pension Plan Contributions on Self-employment Earnings**" area on page 3 of your return. If you are a member of a partnership, include only your share of the partnership net income or loss.

Rental income from farm property received by the owner of a farm is not considered to be self-employment earnings for purposes of the Canada Pension Plan. This includes rental income you received, which is based on the tenant's gross production from the farm, as in the case of share crop rental agreements.

If you require more information obtain the booklet, *The Canada Pension Plan – Information for the Self-Employed.*

NON-CAPITAL LOSSES

Non-capital losses incurred in other years cannot be used in the calculation of your contribution to the Canada Pension Plan.

AVERAGING OF INCOME

Averaging has no effect on your contributions to the Plan. You calculate your contribution on your actual income for the year, not on your averaged income.

UNEMPLOYMENT INSURANCE

Most self-employed persons (other than fishermen) are not in insurable employment for purposes of the Unemployment Insurance Act.

CHAPTER 10
AVERAGING OF INCOME

New for 1988

Forward averaging — Forward averaging is no longer available for taxation years ending after 1987. If you wish to withdraw previously averaged amounts, you must do so before 1998. For more information concerning a forward averaging amount withdrawal, refer to Line 237 in the *1988 General Tax Guide*.

FIVE-YEAR BLOCK AVERAGING

New for 1988

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

For the purposes of block averaging, the "minimum tax" provisions do not apply when you are calculating average tax nor will any minimum tax assessed be taken into account when determining federal tax assessed for preceding years.

The block averaging provisions allow you to calculate your income tax payable for the last year of a five-year averaging period based on the average income of those five years. The tax for each year must have been paid when due. You cannot defer it on the assumption that less tax or no tax will be payable when the income is averaged.

An averaging period consists of the year of averaging and four of the six immediately preceding years. If a return for a preceding year for which there was net federal tax payable was not filed on time, you cannot include it in the averaging period. Also, you cannot include in the averaging period a year in which you disposed of a capital property, had a taxable capital gain, or received a child tax credit prepayment unless the return was filed on time. A preceding year in which there was neither net federal tax payable nor any other requirement to file a return may only be included in the averaging period if it is filed by April 30, 1989.

You would group the latest four of these years with the year of averaging to establish an averaging period.

For example, you wish to average your income in 1988 and have filed returns for 1987, 1986, 1985, 1983, and 1982. In 1984 you did not file a return as there was no net federal tax payable and there was no other requirement to file a return for this year. Unless you file your 1984 return on or before April 30, 1989, your averaging period would consist of 1988 (the current year), and the prior years 1987, 1986, 1985, and 1983.

You may not include a year that was included in a previous averaging period, or a year earlier than the sixth year prior to the year of averaging.

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

- Your chief source of income in the averaging period was farming or fishing.
- You have filed income tax returns for each of the five years for which you had net **federal** tax payable, disposed of a capital property, had a capital gain, or received a child tax credit prepayment. In these years a return must have been filed on or before April 30 following the end of that year.

  For a year in which there was no net federal tax payable and if there was no other requirement to file a return, you must file the return for that year on or before the date that the form, **Election to Average Income,** is due.
- You must file a completed form T2011, *Election to Average Income*, on or before April 30 of the year following the year of averaging. The centre pages of this Guide contain two copies of the required form T2011. You may also obtain this form at your district taxation office.

You must not, either in the year of averaging or in any previous taxation year included in the averaging period, have elected to forward average, or elected to include in your taxable income any portion of your **Accumulated Averaging Amount** for amounts previously forward averaged.

Rental income based on the tenants' gross production in the course of farming (such as share crop rentals) is considered, for purposes of averaging, to be income from farming. If you rent a farm to a tenant on any other basis, the income from this source is not income from farming for the purposes of averaging.

If you have elected to block average, you may cancel this election if you notify your district taxation office

- before you are initially assessed for the year of averaging, or
- within 30 days after you are assessed or reassessed for that year.

Do not file form T2011 with your return unless you are electing to average your income.

HOW TO COMPLETE FORM T2011, ELECTION TO AVERAGE INCOME

Print your name, address and Social Insurance Number and complete the following lines:

Line 1.
Taxable income

For the year of averaging, enter the amount of taxable income shown on your current return.

For each of the preceding years, enter the amount of taxable income which has been assessed.

If in any year before 1988 the total of the allowable deductions (such as personal exemptions, charitable donations, etc.) used in determining taxable income exceeds the net income, the excess should be shown as a minus quantity on this line. However, the minus quantity must not exceed the amount of the personal exemptions.

If for any year in the averaging period before 1988 you had a farm loss or non-capital loss which exceeded your other income for that year, the minus quantity to be entered on line 1 is the amount of the personal exemptions. The farm loss or the non-capital loss should be used on line 4 to reduce the income of the other years in the averaging period. Refer to Chapter 5 for more details about losses.

Line 2.
Add: personal exemptions

For each of the preceding years before 1988, enter the amount of personal exemptions deducted in computing taxable income. Personal exemptions do not include the disability and education deductions, charitable donations or medical expenses.

Line 3.
Total

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

Line 4.
Less: All fishing, farm or non-capital losses available for application to 1988 not deducted in computing taxable income on line 1

If you have farm or non-capital losses available for application to 1988, they should be entered here and the total carried to the TOTAL column at the right.

Note:

Any capital loss of other years that is not absorbed at the time of filing form T2011 will not be absorbed on the same basis as a farm loss or a non-capital loss at this line but must be carried forward to the following year or years.

Line 5.
Gross income for the period

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

Line 6.
Average gross income
(⅕ of Total on Line 5)

Divide the **Gross income for period** (amount on Line 5) by five, and enter the result in each of the five columns.

Line 7.
Less: personal exemptions

For each of the preceding years before 1988, deduct the personal exemptions allowable for that year.

Line 8.
Average net income

The amount on this line is the result of subtracting line 7 from line 6 for each year.

Line 9.
Average tax on average net income for each year

Calculate the **Federal Tax** on the **Average Net Income** using Schedule 1 in your return for **each year** in question. The Federal Tax is the tax arrived at after you deduct, where applicable, the

Federal Tax Reduction, (for years prior to 1986 only);
Dividend Tax Credit;
Federal Foreign Tax Credit;
Federal Political Contribution Tax Credit;
Employment Tax Credit, (for years prior to 1988 only);
Scientific Research Tax Credit, (for years prior to 1987 only);
Share-Purchase Tax Credit, (for years prior to 1988 only);
Labour-Sponsored Funds Tax Credit; and
Total Non-Refundable Tax Credits (for 1988 only.)

Do not include any investment tax credit claimed in any of the preceding years on this line.

Example:

1988 Average Net Income	$18,607.82
Federal Income Tax on average net income for 1988: $18,607.82 @ 17%	$ 3,163.33
Add: Tax Adjustments	NIL
	$ 3,163.33
Less: Total Non-Refundable Tax Credits	1,020.00
	$ 2,143.33
Less: Federal Dividend Tax Credit (see below)	143.33
	$ 2,000.00
Less: Investment Tax Credit	NIL
Average Tax	$ 2,000.00

Refundable Quebec Abatement

Farmers in the province of Quebec who elect to average in 1988 are entitled to a refundable Quebec Abatement of 16.5% of the **Basic Federal Tax** on the **Average Net Income** for 1988. To determine the Basic Federal Tax, complete Schedule 1 included with your 1988 income tax package. Multiply the amount shown opposite **Basic Federal Tax** on the schedule by 16.5% and enter this amount on line 440 of the 1988 return.

Dividend Tax Credit

If you received dividends from taxable Canadian corporations in any of the averaging years, the total of the dividend tax credits allowable for those years (whether or not the total credit was used in those years) should be divided by five and the result allocated to each year in the averaging period. The following represents an example of this:

Year	Taxable Amount Dividends	Rate	Maximum of Credits Allowable
1984	$1,000.00	22⅔%	$226.67
1985	1,000.00	22⅔%	226.67
1986	500.00	22⅔%	113.33

1987	500.00	16⅔%	83.33
1988	500.00	13⅓%	66.67
			$716.67

The dividend tax credit to be **allocated to each year** in the averaging period is therefore $716.67 divided by five = $143.33.

Line 10.
Investment tax credit claimed in each year

Enter any investment tax credit claimed in each of the preceding years. However, do not include any amount of **refundable investment tax credit.**

Note:

*If minimum tax was assessed for 1986 or 1987, in all cases, enter **NIL** on line 10 as the amount of investment tax credit claimed for each year the minimum tax was assessed.*

If the total investment tax credits **claimed** (total on line 10) exceeds the total on line 9, enter an amount up to, but not exceeding, the total on line 9. Any balance remaining becomes part of your investment tax credit pool and is eligible for carry-forward from the year of averaging. For example, if 1988 is the year of averaging and the investment tax credits claimed in the averaging period (i.e. 1984, 1985, 1986, and 1987) exceed the average tax for those years, the excess becomes part of your investment tax credit pool and is eligible for a ten year carry-forward from the year of averaging. For more information on the application of the investment tax credit in the **year of averaging,** refer to the comments at line 18 below.

Unclaimed investment tax credits (credits earned but not deducted) cannot be applied if the year of averaging (i.e. 1988) is after the last year of the carry-forward period, even though one or more of the preceding years were within that period. The carry-forward period is five years for investment tax credits earned **before** April 20, 1983 and ten years if the credits were earned **after** April 19, 1983.

Line 11.
Subtotal

Deduct line 10 from line 9 and enter a subtotal on line 11.

Line 12.
Add: Refundable Quebec Abatement allowed in each of the preceding years

Enter the amount of any refundable Quebec abatement **allowed** in each of the years in the averaging period.

Line 13.
Subtotal

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

Line 14.
Deduct: Refundable Quebec Abatement allowable

Enter the amount of refundable Quebec abatement **allowable** in the previous years. This abatement is calculated as 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 a subtotal on line 15.

Line 16.
Deduct: Federal tax assessed

Enter the amount of federal tax assessed for each of the preceding years, add and extend under TOTAL.

Note:

Enter only the federal tax assessed. Do not include any Individual Surtax that was assessed for the preceding years. Also, the federal tax assessed does not include any minimum tax assessed for 1986 and/or 1987 nor any minimum tax carryover applied in 1987.

Line 17.
Subtotal

Deduct line 16 from line 15 and enter a subtotal on line 17. If the total on line 16 exceeds the total on line 15, the difference represents a **REFUND,** in which case, no amount may be entered on line 18.

Line 18.
Deduct: Investment tax credit claimed for 1988

An investment tax credit may be claimed in 1988 if

- you had a balance in your investment tax credit pool for 1988 (see information for line 10 above), or
- you have earned an investment tax credit in the year 1988.

If either or both of the above apply, you may deduct an investment tax credit in 1988. The amount you may deduct cannot exceed the least of the following amounts:

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

If no tax is payable, or a refund is indicated on line 17, enter NIL on line 18.

For more information concerning investment tax credits, please refer to Chapter 7 of this Guide.

Line 19.
Subtotal

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

Line 20.
Add: Federal individual surtax

To determine the amount of federal individual surtax, complete the section entitled **Federal Individual Surtax** on *Schedule 1 – Detailed Tax Calculation*, enclosed with your 1988 General tax package. The **Basic Federal Tax** to be used in this calculation will be the amount on line 506 from Schedule 1 you completed to arrive at the average tax for 1988 (on line 9). This amount is the base (amount A) on which the surtax is calculated.

Starting in 1988 you may also use your investment tax credits to reduce your federal individual surtax for the year. The maximum additional investment tax credit you may deduct is limited to the lesser of

- ¾ of the individual surtax (line 517 on Schedule 1), and
- the balance in your investment tax credit pool less the credit deducted on line 18 above.

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

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

Line 21.
Federal tax or refund

The total of line 19 and line 20 represents the 1988 **FEDERAL TAX** or **REFUND.**

Enter this amount, if any, on page 4 of your return on line 420, **Net Federal Tax** with the note, **Averaged.**

Line 22.
Provincial income tax

If you elected to average for federal purposes, you must also average for provincial purposes. The conditions for averaging for federal and provincial purposes are the same, i.e., the chief source of income for the five-year period must be farming or fishing.

The provincial income tax (except Quebec income tax) is obtained by applying the appropriate net provincial tax rates to **Basic Federal Tax** as applicable for each year as determined for the purpose of line 9.

Do not include any credit claimed under the Saskatchewan tax incentives program in each of the preceding years on this line.

Line 23.
Deduct any credits claimed under the Saskatchewan tax incentives program in each year

Enter any credit claimed in each of the preceding years under the Saskatchewan tax incentives program.

If the total on line 23 exceeds the total on line 22, enter an amount up to, but not exceeding, the total on line 22. Any balance remaining becomes part of a Saskatchewan tax credit pool and is eligible for a seven year carry-forward.

Line 24
Subtotal

Deduct line 23 from line 22 and enter a subtotal on line 24.

Line 25.
Deduct: Provincial income tax assessed

Enter the amount of provincial tax assessed for each of the preceding years, add and extend under TOTAL. This amount should be taken from your notice of assessment or latest notice of reassessment for each of the years required.

Line 26
Subtotal

Deduct line 25 from line 24 and enter a subtotal on line 26.

Line 27
Deduct: Saskatchewan tax credits claimed for 1988

A tax credit under the Saskatchewan tax incentives program may be claimed in 1988 if

- you had a balance in your tax credit pool for 1988 (see information for line 23), or
- you have earned a tax credit under this program in the year 1988.

If either or both of these conditions apply, deduct the amount of credit available up to the amount required to reduce the amount showing on line 26 to nil.

Note:
All unused tax credits, except the Labour-Sponsored Venture Capital Tax Credit, can be carried forward and applied against net Saskatchewan tax payable during the next seven taxation years. They must, however, be applied in each year as the tax becomes due.

Line 28.
Provincial income tax or refund

The difference between the totals of line 26 and line 27 is the **PROVINCIAL INCOME TAX OR REFUND** for the year of averaging. If the amount on line 26 is greater than the amount on line 27, then the difference is the net provincial tax, otherwise, it represents a refund. This amount is transferred to page 4 of your return and entered opposite **Net (Provincial) Tax,** line 427 with the note, **Averaged.**

CHAPTER 11
GENERAL INFORMATION

FILING AN INCOME TAX RETURN

The Canadian income tax system is one of self-assessment. You must file an income tax return for the year if you

- have tax payable for the year,
- received a child tax credit prepayment,
- must pay Canada Pension Plan contributions because you had self-employment earnings, or both self-employment earnings and pensionable wages of $2,600 or more in 1988 (and did not reside in the province of Quebec on December 31),
- disposed of capital property or have a taxable capital gain,
- have a basic herd established,
- plan to include the income or loss for the year for the five-year block averaging, or
- receive a demand from Revenue Canada to file a return.

You must also file if you wish to obtain

- a child tax credit,
- a federal sales tax credit,
- a refundable investment tax credit,
- a provincial tax credit, or
- a refund of your overpayment of tax, Canada Pension Plan contributions or Unemployment Insurance premiums.

WHAT HAPPENS AFTER YOU FILE YOUR RETURN

When your taxation centre initially processes your 1988 return, only a very limited review of the information provided in your financial statements is done. Your notice of

assessment is normally based on the business income you report on your return. You should not take this to mean that the Department has accepted your income and deductions as reported. Some time after the initial processing and assessment we may select your return for further review or audit.

The Income Tax Act authorizes the Department to reassess a return of income or make additional assessments, or assess tax, interest or penalties

(1) within three years from the day we mailed either
   - your original notice of assessment, or
   - a notification that no tax is payable for the taxation year, or

(2) within six years after the day we mailed your original notice of assessment, to permit or revise a carry-back of certain deductions such as a loss or unused investment tax credit from a subsequent taxation year. The additional three years provided here are only to permit a reassessment related to the carrying back of these deductions.

For example, if you carry a non-capital loss arising in 1988 back to 1985, and it is later determined that the actual loss is less than the amount reported, the loss carried back may be changed accordingly. The Department can do this only if we do it within six years of the date on which we mailed your 1985 notice of assessment. However, for anything that does not directly relate to the carry-back, the Department is generally limited to three years in reassessing your 1985 return .

Most reassessments made by the Department originate from a request made by the taxpayer. For example, after mailing your 1988 return you may find that you forgot to claim a deduction, or made a mistake in calculating your income. As long as you bring the error to our attention within the time period during which we are permitted to reassess the return, it is the Department's practice to correct the error. To assist you in requesting an adjustment to your return, form T1-ADJ, *T1 Adjustment Request* is available from your district taxation office. If you paid too much tax, the difference, plus interest, will be refunded to you. Alternatively, the refund may be used to reduce other amounts you may owe to the Department at that time. The vast majority of adjustments made to returns at the request of taxpayers are processed without any need to file a notice of objection.

In certain situations, it is the Department's policy not to reassess a return unless the request is made within the period during which you are entitled to file a notice of objection. These situations are explained in Information Circulars 75-7R3, *Reassessment of a Return of Income*, and 84-1, *Revision of Capital Cost Allowance Claims and Other Permissive Deductions*.

If unusual circumstances are going to prevent a reassessment being made until after the time frames within which the Department may reassess your return, you may choose to **waive** the time limit. You do this by filing form T2029, *Waiver in Respect of Three Year Time Limit* with your district taxation office before the time limit expires.

FURTHER REVIEW OR AUDIT — INSPECTION OF RECORDS

While there is a high level of public compliance with the law, a self-assessment tax system can be maintained only through continuous inspection of returns. Obvious errors can be corrected at the time the returns are initially processed and before the notice of assessment is issued. However, in-depth reviews, such as audits, are conducted after the notice of assessment for the return in question has been issued.

Certain officials of the Department are authorized to examine or audit your records. These authorized officials carry identification cards, which they will produce at the beginning of an audit. These identification cards are for your protection against unauthorized persons claiming to be Taxation officials. For more information concerning the audit process, obtain Information Circular 71-14R3, *The Tax Audit*.

If an audit discloses that you have not been keeping adequate books and records, the Department will request a written agreement from you that all books and records will be maintained as required. The Department will follow up, by letter or a visit, to ensure that you have complied with the written agreement.

If you have not complied within the time allowed, the Department will issue a formal requirement letter. It will describe the information to be recorded in the books and advise you of the penalties for failing to comply. If you still fail to comply within the specified period of time as required, the Department may prosecute.

APPEAL PROCESS

If you object to an assessment you may, within 90 days from the day we mailed the notice of assessment, file a Notice of Objection in duplicate, setting out the reasons for the objection and all relevant facts. Form T400A, *Notice of Objection* may be obtained from your district taxation office, and should be forwarded by registered mail to the Deputy Minister of National Revenue for Taxation, Ottawa.

The Minister, upon receiving the notice of objection, will reconsider the assessment and may either vacate, confirm, or vary the assessment.

If the objection is not allowed, a formal notification will be sent to you by registered mail. You may then, if desired, appeal to the Tax Court of Canada within 90 days.

Currently, the law also provides for further appeal by you or the Minister to the Federal Court of Canada.

Pending the outcome of an impartial review by the Department or by a court, there is no requirement to pay disputed taxes. However, any tax assessed will be subject to normal interest charges. Before appealing a lower court's decision to a higher court, taxes which continue to be in dispute must be paid or acceptable security must be posted.

NON-RESIDENT WITHHOLDING TAX

If you pay or credit certain amounts to a non-resident of Canada, you may be required to withhold and remit non-resident withholding tax. For further details, obtain Information Circular 77-16R3, *Non-Resident Income Tax*.

REFERENCES

The Department issues a number of forms, guides and other publications for use by the public. A complete listing of these

publications is contained in Information Circular 88-1.

Listed below are publications which may be of assistance to you in preparing your 1988 Statement of Farming Income and Expenses. Complete the order form located on the inside back cover of this Guide. You may order by phone, mail, or in person at your district taxation office.

Interpretation Bulletins

Number	Title
IT-90	What is a Partnership?
IT-99R3	Legal and Accounting Fees
IT-138R	Computation and Flow-through of Partnership Income
IT-143R2	Meaning of Eligible Capital Expenditure
IT-179	Change of Fiscal Period; and Special Release dated June 13, 1986
IT-184R	Deferred Cash Purchase Tickets Issued for Grain
IT-200	Surface Rentals and Farming Operations
IT-220R	Capital Cost Allowance — Proceeds of Disposition of Depreciable Property; and Special Release dated June 5, 1984
IT-252	Agricultural and Rural Development Act Grants
IT-259R2	Exchanges of Property; and Special Release dated November 7, 1986
IT-268R3	Inter Vivos Transfer of Farm Property to Child
IT-273R	Government Assistance – General Comments; and Special Release dated December 31, 1981
IT-291R	Transfer of Property to a Corporation under Subsection 85(1)
IT-322R	Farm Losses
IT-336R	Capital Cost Allowance – Pollution Control Property
IT-348R	Cost Incurred in Conversion to Metric Measurement
IT-349R2	Intergenerational Transfers of Farm Property on Death
IT-373R	Farm Woodlots and Tree Farms
IT-378R	Winding-up of a Partnership
IT-405	Inadequate Considerations — Acquisitions and Dispositions
IT-413	Partnership as 'Person' or 'Taxpayer' for subsection 97(2)
IT-419	Meaning of Arm's Length
IT-433	Farming — Use of Cash Method
IT-449R	Meaning of 'Vested Indefeasibly'
IT-473	Inventory Valuation; and Special Releases dated May 25, 1984 and December 5, 1986
IT-481	Timber Resource Property and Timber Limits
IT-485	Cost of Clearing or Levelling Land
IT-491	Former Business Property
IT-492	Capital Cost Allowance — Industrial Mineral Mines

Information Circulars

Number	Title
IC71-14R3	The Tax Audit
IC75-7R3	Reassessment of a Return of Income
IC76-4R2	Unvouchered Expenditures
IC76-19R	Transfer Of Property To A Corporation Under Section 85
IC77-16R3	Non-Resident Income Tax
IC78-4R3	Investment Tax Credit Rates
IC78-10R	Books and Records Retention/Destruction
IC84-1	Revision of Capital Cost Allowance Claims and Other Permissive Deductions
IC86-4R2	Scientific Research and Experimental Development
IC86-5R	Part XVII – Capital Cost Allowance, Farming and Fishing
IC86-6	Basic Herds
IC88-1	List of Forms and Publications Available For Use by the Public

Guides and Other Publications

- 1989 Income Tax Deductions at Source Tables
- 1988 — Canada Pension Plan Contributions and Unemployment Insurance Premium Tables
- 1988 Employer's and Trustee's Guide
- 1988 Deceased Persons' Income Tax Guide
- 1988 Capital Gains Tax Guide
- 1988 Business and Professional Income Tax Guide
- Canada Pension Plan 1988, Information For The Self-Employed
- Instalment Guide For Farmers and Fishermen (T7B)

Forms

Number	Title
T1-ADJ	T1 Adjustment Request
T4-1988 Supplementary	Statement of Remuneration Paid
T4A-1988 Supplementary	Statement of Pension, Retirement, Annuity, and Other Income
T4-T4A Summary	Summary of Remuneration Paid
T400A	Notice of Objection
T657	Calculation of Capital Gains Deduction for 1988
T2029	Waiver in Respect of Three Year Time Limit
T2034	Election to Establish Inventory Unit Prices for Animals
T2090	Capital Dispositions Supplementary Schedule — Election Available to Farmers Disposing of Farmland
T2124	Statement of Income and Expenses from a Business

RATES OF CAPITAL COST ALLOWANCE

Allowances may only be claimed on property used to earn income.

This schedule shows opposite each property the class number under Part XI. The rates for these classes are shown at the bottom.

Depreciable Property	Part XI Class No.
Aircraft – acquired before May 26, 1976	16
Aircraft – acquired after May 25, 1976	9
***Automobiles	10
Bee Equipment	8
Boats and Component Parts	7
Breakwaters – Cement or Stone	3
– Wood	6
Brooders	8
Buildings and Component Parts	
– Wood, Galvanized or Portable	6
– Other: -acquired after 1978 and before 1988	3
-acquired after 1987	1
Buildings – Fruit and Vegetable storage (after Feb. 19, 1973)	8
Casing, Cribwork for Waterwells	8
Chain Saws	10
Cleaners – Grain or Seed	8
Combines – Drawn	8
– Self-propelled	10
Coolers – Milk	8
Cream Separators	8
Cultivators	8
Dams – Cement, Stone or Earth	1
– Wood	1
Discs	8
Diggers – All Types	8
Docks – Cement, Steel or Stone	3
– Wood	6
Drills – All Types	8
Dugouts, Dikes, and Lagoons	6
Electric Generating Equipment (Not exceeding 15 Kw)	
– (acquired after May 25, 1976)	8
– (acquired before May 26, 1976)	9
Electric Motors	8
Elevators	8
Engines – Stationary	8
Fences – All Type	6
Forage Harvesters – Drawn	8
– Self-propelled	10
Graders – Fruit or Vegetable	8
Grain Drying Equipment	8
Grain Loaders	8
Grain Separators	8
Grain Storage Building	
– Wood – Galvanized Steel	6
– Other	3
Greenhouses	6
Grinders	8
Harness	10
Harrows	8
Balers – Drawn	8
– Self-propelled	10
Hay Loaders	8
Ice Machines	8
Incubators	8
Irrigation Equipment – Overhead	8
Irrigation Ponds	6
Manure Spreaders	8
Milking Machines	8
Mixers	8
***Motor Vehicles (includes automobiles, passenger vehicles, and trucks)	10.1
Mowers	8
Nets	8
Office Equipment	8
Outboard Motors	10
Piping – Permanent	2
Planters – All Types	8
Ploughs	8
Pumps	8
Rakes	8
*Roads or other surface areas – paved or concrete	17
Silo	8
Silo Fillers	8
Sleighs	10
Sprayers	8
Stable Cleaners	8
Stalk Cutters	8
Swathers – Drawn	8
– Self-propelled	10
Tile Drainage (acquired prior to 1965)	8
Tillers – All Types	8
Threshers	8
Tools – Under $200	12
– $200 and over	8
Tractors	10
Trailers	10
***Trucks	10
Wagons	10
Water Towers	6
Welding Equipment	8
Well Equipment	8
Windchargers	6
**Wind-energy Conversion Equipment	34

RATES – PART XI

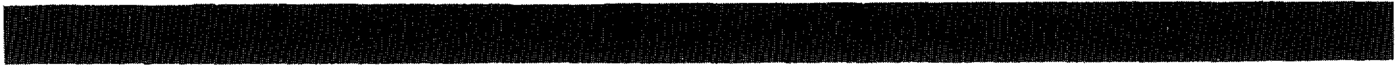
Class	Rate
*Class 1	4%
Class 2	6%
Class 3	5%
Class 6	10%
Class 7	15%
Class 8	20%
Class 9	25%
Class 10	30%
***Class 10.1	30%
Class 12	100%
Class 16	40%
Class 17	8%

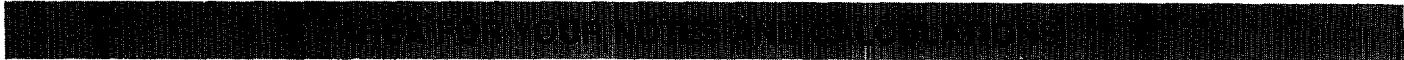
*If the construction of the road or surface area was completed before May 26, 1976, you must continue to claim capital cost allowance under Class 1.

**Wind-energy conversion equipment purchased after February 26, 1986, and certified as such by the Minister of Energy, Mines and Resources will be included in Class 34 and be eligible for a three-year write-off at 25%, 50%, and 25% respectively.

***If your 1988 fiscal period begins after June 17, 1987 you must include each motor vehicle you own at **the end of your 1988 fiscal period** in a separate class of new class 10.1. The terms motor vehicle, automobile, and passenger vehicle are discussed in the section "Motor vehicle expenses" in Chapter 2 of this Guide. Also, please refer to Chapter 3 of this Guide for more details concerning "Class 10.1."

If property is used partly for business and partly for personal purposes, you may claim capital cost allowance on the business portion only.

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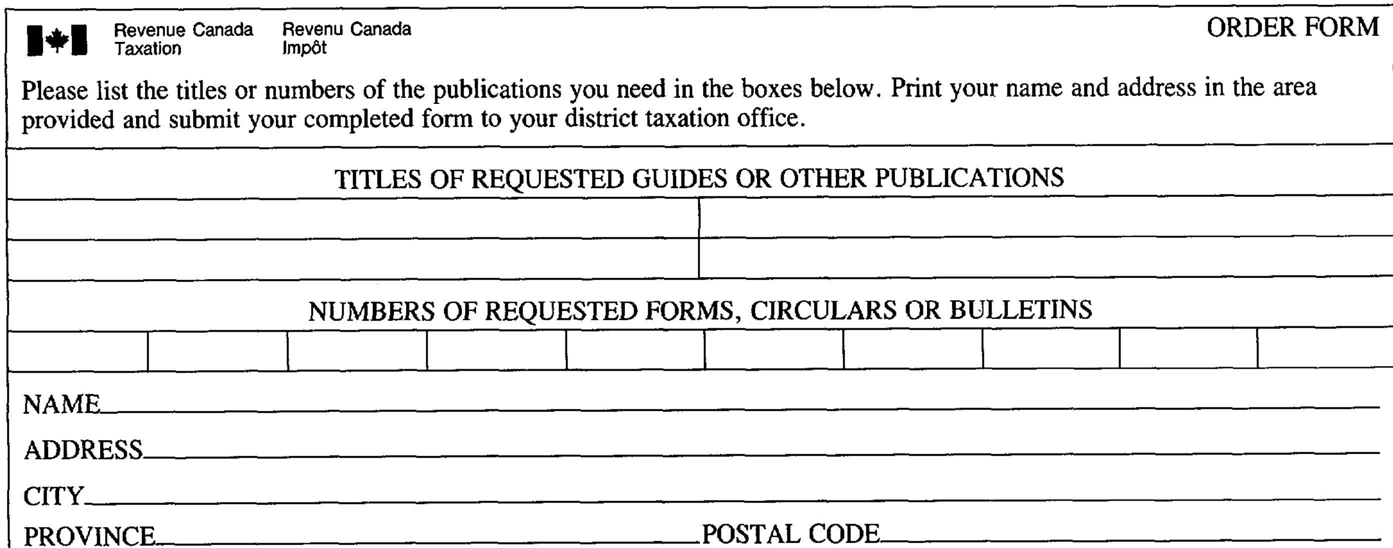

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