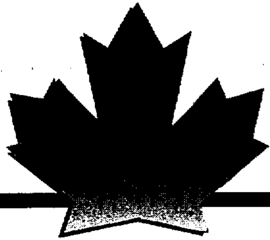
# Farming Income Tax Guide

T4003

1989

Your Guide



Revenue Canada offers services to the public in both official languages.

Revenu Canada offre ses services aux contribuables dans les deux langues officielles.

Canada

## WHAT'S NEW FOR 1989?

The major changes are outlined below and are highlighted in yellow throughout this Guide. If your tax situation is affected by any of these items, please pay special attention to them when calculating your farming income.

- For fiscal periods that commence after 1988, farmers who compute their income under the cash method must reduce the amount of any farm loss for the fiscal period by the mandatory inventory adjustment.
- The optional inclusion into income of livestock on hand at the end of the fiscal period has been expanded to include all other inventory on hand at the end of the fiscal period. This amendment applies to farmers who compute their income under the cash method and is effective for fiscal periods that commence after 1988.
- In a news release dated January 24, 1989, the Department of Finance issued revised draft regulations and legislation relating to capital cost allowance claims for passenger vehicles that cost more than $20,000. These amendments are effective for fiscal periods and taxation years commencing after June 17, 1987 that end after 1987.
- Effective September 1, 1989, there are revised limits concerning capital cost allowance, interest on money borrowed and deductible lease costs in respect of passenger vehicles.
- There is legislation proposed regarding the leasing of certain properties. If the property qualifies and the lessor and lessee jointly elect, the property will be deemed to have been acquired by the lessee.
- Beginning with the 1989 fiscal period, certain partnerships are required to file a Partnership Information Return.

## DATES TO REMEMBER

**December 31, 1989** — Calculate the amount of your 1989 instalment payment on form T7B, *Farmers and Fishermen — 1989* and make your instalment payment of tax and Canada Pension Plan contributions.

**February 28, 1990** — File your 1989 T4-T4A Return (form T4-T4A Summary and related forms T4 and T4-A Supplementary) and deliver the Supplementary slips to employees.

**March 31, 1990** — File your 1989 Partnership Information Return, financial statements, schedules and information slips.

**April 30, 1990** — File your 1989 income tax return and pay your balance of tax and Canada Pension Plan contributions due.

**April 30, 1990** — File form T2011, *Election to Average Income* if you elect to average your income with your income tax return.

**This Guide is not a legal document.** It uses plain language to explain some of the laws about income tax, unemployment insurance, and the Canada Pension Plan. For official purposes, please consult the *Income Tax Act*, the *Unemployment Insurance Act*, the *Canada Pension Plan*, and their related Regulations or contact your district office.

# CONTENTS

Page

**CHAPTER 1 — INTRODUCTION** .................... 4
Methods of computing income.......................... 4
Cash method
Accrual method
Changing your method
Fiscal period............................................ 5
Keeping records ......................................... 5
Forms ................................................... 6
Improving the Guide...................................... 6

**CHAPTER 2 — INCOME AND EXPENSES**
Statement of farming income and expenses .............. 6
Amounts to be included in income....................... 6
Amounts to be claimed as an expense .................... 9
Net income (loss) before adjustments.................... 14
Adjustments to income .................................. 14
Net farming income (loss)............................... 18

**CHAPTER 3 — CAPITAL COST ALLOWANCE SCHEDULE, FORM T2041** .......... 18
Types of capital cost allowance......................... 18
General comments concerning capital cost allowance..... 18
Revised rules concerning capital cost allowance ......... 18
How to complete form T2041, capital cost allowance schedule ............................................ 19
Special points concerning capital cost allowance......... 23
Depletion allowance ..................................... 24

**CHAPTER 4 — ELIGIBLE CAPITAL EXPENDITURES** .................... 24
Cumulative eligible capital account...................... 24
Annual allowance ...................................... 24
Proceeds of disposition................................ 25
Replacement property.................................. 26

**CHAPTER 5 — FARM LOSSES** ..................... 26
Farm losses — fully deductible.......................... 26
Restricted farm losses — partially deductible............ 27
Farm losses — non-deductible........................... 28

**CHAPTER 6 — CAPITAL GAINS AND OTHER SPECIAL PROVISIONS FOR FARMERS** ........................... 28
Principal residence ..................................... 28
Restricted farm losses .................................. 29
Lifetime capital gains deduction ......................... 29
Special registered retirement savings plan provisions for farmers................................. 30
Transfer of farm property to a child ..................... 30
Rollover of farm property where death occurred in 1989 .................................. 30
Rollover of farm property to a child during the parent's lifetime .................... 31
Transfer of farm property to spouse ...................... 31

**CHAPTER 7 — INVESTMENT TAX CREDIT** ....... 32
Qualified property....................................... 32
Qualified transportation equipment ...................... 32
Approved project property............................... 32
How to calculate your investment tax credit ............. 32
When to claim your investment tax credit................ 32
Current year deduction................................ 32
Previous year deduction............................... 33
Future year deduction................................. 33
Refundable investment tax credit ........................ 33
Other adjustments ...................................... 33

**CHAPTER 8 — PARTNERSHIPS** .................... 33
What is a partnership?.................................. 33
Partnership information return .......................... 34
Partnership income ..................................... 34
Partnership losses....................................... 34
Income averaging........................................ 34
Capital cost allowance on depreciable property of partnership ....................................... 34
Restricted farm losses .................................. 35
Basic herds ............................................. 35

**CHAPTER 9 — CANADA PENSION PLAN AND UNEMPLOYMENT INSURANCE**
What employers are required to deduct .................. 35
What is payable by self-employed individuals — Canada Pension Plan.............................. 35
Non-capital losses ...................................... 36
Averaging of income .................................... 36
Unemployment insurance................................. 36

**CHAPTER 10 — AVERAGING OF INCOME**
Forward averaging....................................... 36
Five-year block averaging ............................... 36
How to complete form T2011, election to average income.................................... 37

**CHAPTER 11 — GENERAL INFORMATION**
Filing an income tax return ............................. 39
What happens after you file your return.................. 40
Further review or audit — inspection of records .......... 40
Appeal process .......................................... 40
Non-resident withholding tax ............................ 40

**REFERENCES** ....................................... 41

**RATES OF CAPITAL COST ALLOWANCE** ........ 43

# 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 to calculate your farming income to report on your 1989 return. The *1989 General Tax Guide* contains information on how to complete your 1989 return. If you are completing a return for a deceased taxpayer, obtain the *1989 Deceased Persons Income Tax Guide.*

The 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 at the back of the Guide.

**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 that 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 it. If the cheque is not honoured, you may make an adjustment to income. On the other hand, if you accept a post-dated cheque as security for a debt, bring the amount of the cheque into income on 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, bring the amount of the cheque into income on 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, if you have a loss from your farming business, you may have to account for purchased inventory on hand at the end of your 1989 fiscal period. This is discussed in detail in Chapter 2 under "Mandatory inventory adjustment."

In addition, for fiscal periods commencing after 1988, you may include in income the value of your inventory on hand. See the comments in Chapter 2 under "Optional inventory adjustment" 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 their cost or fair market value, whichever is lower; and
- unit price basis (for livestock only). An election form, T2034 is available at your district 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.

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 your fiscal period must be the same as the value of the inventory at the close of your previous fiscal period.

A physical stock-taking should be done at the end of each fiscal period.

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. File a return using the cash method and include 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 office. Make this request 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 filing income tax returns 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 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, 1988 to March 31, 1989 on your 1989 return because the fiscal period ends in the **1989** 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 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 incur business expenses. 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, the Department may reduce the expenses claimed.

You must keep business records and supporting documents for at least six years from the end of the last taxation year to

### 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 | |

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 office in your area. For further details, obtain Information Circular 78-10R2, *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 it to your taxation centre by April 30, 1990.
- Form T2038 – Investment Tax Credit (Individuals)
  If you acquired property in 1989 that is eligible for the investment tax credit, complete this form and submit it with your 1989 return. You must do this whether or not you are claiming an investment tax credit for 1989. 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 are available to help taxpayers prepare the statements necessary for income tax purposes. Their use is optional. Additional copies are available at your district office.

## Improving the Guide

This Guide is reviewed each year and changes are made to improve the explanations provided. If you had problems with a particular explanation or you have comments or suggestions on the Guide, we would be pleased to hear from you.

Just write a short letter expressing your concerns to:

Tax Forms Directorate, 875 Heron Road, Ottawa, Ontario K1A 0L8.

# 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 form T2042 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.

The statement is divided into various sections.

- Income and Expense Statement,
- Adjustments to the Income and Expense Statement,
- Mandatory Inventory Adjustment,
- Optional Inventory Adjustment,
- Business-use of home expenses, and
- Partnership Schedule.

**It is important to complete each section in the order it appears on form T2042.** If you are preparing your own statement, you must still prepare it following the same order as shown on form T2042. The comments in this chapter will indicate when a section must be completed and how you should complete each section.

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 office along with the *1989 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 fiscal period you receive them. You must include the full amount of the sale of these crops as income in the **fiscal period** the sale actually takes place.

**Other produce**

You may 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 through 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 fiscal period in which you receive them.

**Codes 440 to 444**
**Livestock**

Generally, you must include in income the amounts you 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 give cattle or other marketable items to your spouse or children, you must include in your income the fair market value of these items on 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.

If your farming business was carried on in an area that was, at some time during a fiscal period that ends after 1987, a prescribed drought region, and as a result you were forced to sell part or all of your breeding herd, you may defer a portion of the proceeds of sale in the year of disposition.

A prescribed drought region is a region that is identified by the Minister of Agriculture as suffering from drought conditions.

The amount of the proceeds of sale you may defer is calculated as follows:

- where your breeding herd has been reduced by at least 15 per cent but less than 30 per cent, you may defer up to 30 per cent of the proceeds of sale;
- where your breeding herd has been reduced by 30 per cent or more, you may defer up to 90 per cent of the proceeds of sale.

The proceeds from the sale of breeding animals eligible for deferral in your fiscal period are **net of the cost** of any breeding animals acquired in the same fiscal period.

"Breeding animals" are horses over 12 months of age that are kept for breeding in the commercial production of pregnant mare's urine, bovine cattle, bison, goats and sheep over 12 months of age that are kept for breeding and are held in the course of carrying on a farming business.

A "breeding herd" is the number determined by the formula

$$A - (B - C)$$

A is the total number of breeding animals;
B is the total number of female bovine cattle that have not given birth to calves; and
C is the number determined as the value of B or one half of the total number of breeding animals that are female bovine cattle that have given birth to calves, whichever number is less.

For information regarding prescribed drought regions, contact your district office or the nearest office of the Department of Agriculture.

If your farming business was carried on in a prescribed drought region, and as a result of the drought conditions in 1988 you deferred any amount of the proceeds of sale of your breeding herd in your 1988 fiscal period, the following rules apply.

- Where no part of your farming business was carried on in a prescribed drought region during your 1989 fiscal period, you must include in your 1989 income the amount of the proceeds of sale deferred in 1988.
- Where you carried on a farming business in a prescribed drought region for part of your 1988 and 1989 fiscal periods, you are not required to include in your 1989 income the amount of the proceeds of sale deferred in 1988.

**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 *1989 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 to purchase 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 you received to purchase depreciable property) most **inducements, reimbursements, contributions, and allowances** you received in the course of earning farming income must be included in your income. However, if the amount received is related to the acquisition of a property, when you file your return you may **elect** to reduce the cost or the capital cost of the related property by the amount you received. If you make this election, do not include the amount in your income.

**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 you receive it to the extent that you claimed the taxes as an expense against your farm income. Under this program, 100 per cent of the taxes levied on eligible farm land and outbuildings for 1989 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 farming 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 office along with the *1989 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 you receive 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 explained in more detail in Chapter 3 of this Guide.

If you sell property such as small tools that you have previously claimed as an expense, you must add any amounts you receive from the sale of the property 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 you

receive 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 some of these items.

The growing of Christmas trees is considered 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 income tax return and, in the case of investment income, also on Schedule 5.

**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 your fiscal period. 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 fiscal period. This option does not include animals of a basic herd.

***Note:***
*You may include the value of livestock on hand in income only if your 1989 fiscal period commenced before 1989.*

## 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, *Statement of Farming Income and Expenses.* 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 as expenses those amounts you spent to earn farming income.

**Prepaid expenses**

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

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

Normally, you must deduct Canada or Quebec Pension Plan contributions, Unemployment Insurance premiums, and income tax from total 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. Since 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 1989 taxation year, you must complete this return and mail it to your taxation centre by February 28, 1990. You must also give your employees their copies of the T4 and T4A Supplementaries by February 28, 1990. For instructions on how to complete the T4-T4A Return, obtain the *1989 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 paid the wages;
- the services provided by the child were necessary for earning farming income and would otherwise have required you to employ some other person, and
- the wages are reasonable, considering the age of the child and the amount you would have paid 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 are the same as 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 you gave to your 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 you borrowed to earn your farming income, for example, interest on money borrowed to buy farm equipment. However, 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, see the section, "Motor vehicle expenses."

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.

**Code 225**
**Motor Vehicle expenses**

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

In addition, if your motor vehicle is a "passenger vehicle" as defined by the Income Tax Act, there is a limitation on the amount of 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 explained 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, 1989 fiscal year-end. Throughout 1989 he owned a pick-up truck that he uses in his business for picking up farm supplies and other farming 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 his 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 1989 is $6,300 and is calculated as follows:

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

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

There is a limit on the interest you may deduct on money borrowed to purchase, or on an amount payable to acquire a passenger vehicle used in a business. If you **acquired a passenger vehicle before September 1, 1989,** your claim cannot be more than $8.33 multiplied by the number of days for which the interest was paid. If you **acquired a passenger vehicle after August 31, 1989,** your claim cannot be more than $10.00 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 *1989 Business and Professional Income Tax Guide.*

**CHART 1**

| | | |
|---|---|---|
| Enter the total interest paid in the year | ______ | (A) |
| $_____* × the number of days for which the interest was paid | ______ | (B) |
| **Available interest expense is (A) or (B), whichever amount is less** | ______ | |

* for passenger vehicles acquired before September 1, 1989 enter $8.33.
for passenger vehicles acquired after August 31, 1989 enter $10.00

### *Example*

Frank's farming business has a December 31, 1989 fiscal year-end. In **September 1988** he purchased a new car that he uses for both personal and business purposes. He borrowed money to purchase the car, and the interest he paid on this loan in 1989 was $5,000. Frank recorded the following information concerning the car for 1989:

| | |
|---|---|
| Business kilometres | 20,000 km |
| Total kilometres | 25,000 km |
| Gasoline and oil | $2,000 |
| Repairs and maintenance | 1,000 |
| Insurance | 1,900 |
| Interest (on loan to purchase car) | 3,040* |
| License and registration fees | 60 |
| 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 $3,040. The available interest expense is the lesser of

- the total interest he paid in 1989 of $5,000, and
- $8.33 × the number of days for which the interest was paid = $8.33 × 365 = $3,040

As Frank purchased the passenger vehicle in September 1988 he must use the rate of $8.33 which is applicable to passenger vehicles acquired before September 1, 1989.

The motor vehicle expense that Frank may claim for his car in 1989 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 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 *1989 Business and Professional Income Tax Guide.*

### *Note:*

*You may use Chart 2 if you entered into or extended a lease agreement before September 1, 1989. If you entered into, renewed or extended a lease agreement after August 31, 1989, you may still use Chart 2 with the following changes.*

- *the amount of $23,529 in line (5) is changed to $28,235,*
- *the amount of $600 in line (10) is changed to $650, and*
- *the amount of $20,000 in line (11) is changed to $24,000.*

**CHART 2**

| | | |
|---|---|---|
| Enter the total lease charges paid in the year for the vehicle. | ______ | (1) |
| Enter the total lease payments **deducted** in computing farming income for the vehicle in previous years. | ______ | (2) |
| Enter the total number of days for this year and previous years that the vehicle was leased. | ______ | (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 $23,529 or line (4), whichever amount is greater. ______ × 85% = | ______ | (5) |
| Calculate and enter the imputed interest that would have been earned **for the period in the year** and **all previous years** on that part of the total of all refundable deposits for a vehicle that is more than $1,000. This is calculated using the prescribed rate of interest for each year the refundable amounts are outstanding (see "Imputed interest" in this chapter). | ______ | (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 is more than $1,000. This is calculated using the prescribed rate of interest for the period in the year during which the refundable amounts were outstanding (see "Imputed interest" in this chapter). | ______ | (7) |
| Enter the total of all reimbursements receivable by you for **this year and previous years** for the leased vehicle. | ______ | (8) |
| Enter the total of all reimbursements receivable by you for **this year** for 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 line (10) or line (11), whichever amount is less.** | ______ | |

### *Example*

Lyle's farming business has a December 31 fiscal year-end. On August 1, 1988 he started leasing a car that is a "passenger vehicle." The car is used for both business and personal purposes. Lyle recorded the following information concerning the car:

| | |
|---|---|
| Business kilometres for 1989 | 12,000km |
| Total kilometres for 1989 | 24,000km |
| Gasoline and oil | $2,000 |
| Insurance | 1,195 |
| Leasing cost | 5,805* |
| Total car expenses for 1989 | $9,000 |

| | |
|---|---|
| Monthly lease payment | $550 |
| Lease payments for 1989 | $6,600 |
| Lease payments deducted in computing 1988 income | $2,420 |
| Manufacturer's suggested list price | $25,000 |
| Provincial sales tax | $1,750 |
| No. of days in 1989 the car was leased | 365 |
| No. of days in 1988 the car was leased | 153 |

* As Lyle is leasing a "passenger vehicle," the leasing cost he may include in this total car expenses is limited to $5,805. 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 computing farming income for the vehicle in previous years. | $2,420 (2) |
| Enter the total number of days for this year and previous years that the vehicle was leased. | 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 $23,529 or line (4), whichever amount is greater. $26,750 × 85% = | $22,738 (5) |
| Calculate and enter the imputed interest that would have been earned **for the period in the year** and **all previous years** on that part of the total of all refundable deposits for a vehicle that is more than $1,000. This is calculated using the prescribed rate of interest for each year the refundable amounts are outstanding. | 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 is more than $1,000. This is calculated using the prescribed rate of interest for the period in the year during which the refundable amounts were outstanding. | 0 (7) |
| Enter the total of all reimbursements receivable by you for **this year and previous years** for the leased vehicle. | 0 (8) |
| Enter the total of all reimbursements receivable by you for **this year** for the leased vehicle. | 0 (9) |
| $\frac{\$600 \times 518}{30} - \$2,420 - 0 - 0 =$ | $ 7,940 (10) |
| $\left[\frac{\$20,000}{\$22,738} \times \$6,600\right] - 0 - 0 =$ | $ 5,805 (11) |
| **Your available leasing cost is line (10) or line (11), whichever amount is less.** | $ 5,805 |

The motor vehicle expense that Lyle may claim for the leased car in 1989 is $4,500 and is calculated as follows:

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

**Imputed interest**

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.

Imputed interest is calculated on the portion of the deposit that exceeds $1,000 and is calculated for each year using quarterly rates as prescribed by the Income Tax Regulations. As the calculation is based on the simple interest method, it is not necessary to compound the interest. The rates for 1989 are as follows:

- January 1, 1989 to March 31, 1989 — 11%
- April 1, 1989 to June 30, 1989 — 12%
- July 1, 1989 to September 30, 1989 — 13%
- October 1, 1989 to December 31, 1989 — 13%

**Lease prepayments**

If you prepay all or part of your lease charges for a passenger vehicle, the leasing cost determined in accordance with Chart 2 may be less than the amount paid. In this case, you may be permitted to deduct all or part of the amount you actually paid. For further information, contact your district office.

**Joint ownership**

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.

**More than one 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 Interpretation Bulletin IT-521, *Motor Vehicle Expenses Claimed by Self-Employed Individuals.*

Code 255

**Veterinary fees, medicine and breeding fees**

Claim the total amount you 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. However, where the repairs improve the property beyond its original condition, then you must capitalize these

costs. For further details regarding capital expenditures on depreciable property versus current expenditures on repairs and maintenance see Interpretation Bulletin IT-128R, *Capital Cost Allowance - Depreciable Property.*

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, legal, office, advertising, memberships and subscriptions expenses**

Generally, you may deduct legal costs you 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 in the year.

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

- obtain advice and assistance to prepare and file 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.*

Fees for membership in organizations and subscriptions relating to your farming activities are allowable expenses.

The cost of office expenses such as stationery, invoices, receipt books and accounting books used in your farming business are also allowable expenses.

**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 may be deducted as an expense.

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

You must allocate the amounts you 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 which applies to your other farm properties as an expense but you may not deduct the farm house portion of these expenses unless you are claiming a deduction for the business-use of your home. For more details, see the section entitled, "Business-use of home expenses" 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 office along with the *1989 Rental Income Tax Guide.*

**Code 310**
**Clearing or levelling land and 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 installing a land drainage system 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.

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.

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.

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 per cent.

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 per cent. 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 as long as the installations remain the property of the public utility. Also, you may claim as an expense, a payment made to a co-op under the **The Co-operative Associations Act** for the construction of a distribution system under a gas service contract.

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

**Code 320**
**Other 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.

**Leasing costs**

If you lease property used in your farming business you may deduct the amount of lease payments paid in the year. If you are leasing a ''passenger vehicle'' refer to the comments under ''Motor vehicle expenses'' in this chapter.

### *Note:*

*There is legislation proposed regarding the leasing of property. If the lessor and the lessee jointly elect, in a prescribed form filed by the lessee with the return for the year the lease was entered into, the following rules apply.*

- *the lessee will be deemed not to have leased the property,*
- *the lessee will be deemed to have acquired the property, and*
- *the lessee will be deemed to have borrowed an amount equal to the fair market value of the leased property.*

*For income tax purposes, the lease payments will be treated as blended payments of principal and interest on the loan. The lessee will be able to deduct the interest portion of the loan and capital cost allowance.*

*The proposed legislation does not apply where the total fair market value of all the property subject to the lease is $25,000 or less. In addition, only certain types of property qualify for this type of tax treatment. A combine is an example of the type of property that would qualify, whereas, office furniture and automobiles are examples of property that do not qualify for this type of tax treatment.*

*If you and the lessor entered into a leasing contract after April 26, 1989 and have agreed to this type of tax treatment, contact your district office for additional information.*

**Code 325**
**Optional value of livestock, end of previous year**

Any amount for optional value of livestock that you included in your income for 1988 **must be deducted** when computing income for 1989. Therefore, if you included such an amount in your income for 1988, you must claim the same amount as an expense when you calculate your 1989 farming income.

**Code 330**
**Capital cost allowance**

Enter your capital cost allowance claim that you 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.''

## Net income (loss) before adjustments

The difference between the amount of gross farming income on line 505 and total farming expenses on line 515 is the net income (loss) before adjustments. Enter this amount on line 520.

## Adjustments to income

It is often necessary to adjust the amount of **net income (loss) before adjustments** to determine the net income or loss to report on your income tax return. These adjustments are listed on form T2042.

### *Note:*

*It is important to calculate each adjustment in the order they appear on form T2042. Please read the following instructions carefully before doing the calculations.*

**Adjustment to the income and expense statement**

The more common adjustments to the income and expense statement as listed on form T2042 are

- salary or wages paid to yourself 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.*

**Code 605**
**Salary or wages paid to yourself 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 into 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 into 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 an expense 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 into income, and
- enter them on line 340 on page 2 of your return.

Code 635
Mandatory inventory adjustment

If you have a **net loss after adjusting the income and expense statement,** you must reduce the amount of the loss by the lesser of

- the net loss after adjusting the income and expense statement, and
- the value of inventory purchased and owned at the end of your 1989 fiscal period.

***Note:***
*The mandatory inventory adjustment is only applicable to fiscal periods that start after 1988. If your 1989 fiscal period commenced in 1988 and you have a net loss after adjusting the income and expense statement, you are not required to reduce your net loss by the amount of the mandatory inventory adjustment.*

**Value of inventory purchased and owned at the end of the 1989 fiscal period**

In general terms, inventory is defined as property that a business holds for re-sale. However, in the farming business, inventory also includes livestock other than livestock in a basic herd.

For the purpose of determining the **mandatory inventory adjustment,** the property in your inventory is valued at either the **cash cost** or **fair market value,** whichever is less. Cash cost is defined as the amount paid to purchase your inventory. Fair market value is the price that you would sell the property in a normal business transaction.

An exception to the above rule is inventory that is a "specified animal." A "specified animal" is a horse or, if you so elect, a bovine animal that is registered under the *Livestock Pedigree Act.* In this situation, and for the 1989 fiscal period, inventory is valued at an amount that is not more than the cash cost but not less than 70 per cent of the cash cost.

The **first step in the calculation** is to determine the cash cost for inventory that is **purchased and still owned at the end of your 1989 fiscal period.** Complete Chart 3 to arrive at the **cash cost** for your inventory.

**CHART 3**

**Specified animals purchased during the 1989 fiscal period**
Enter the amount paid for specified animals purchased during the 1989 fiscal period. ________(1)

**Specified animals purchased before the 1989 fiscal period**
For the fiscal period of purchase, multiply the amount paid (by the end of the 1989 fiscal period), by the applicable percentage and enter the total for all years on line (2).

| Fiscal Period of Purchase | Amount Paid | Percentage | Cash Cost |
|---|---|---|---|
| 1988 | ________ | 100% | ________ |
| 1987 | ________ | 50% | ________ |
| 1986 | ________ | 50% | ________ |
| 1985 and prior years | ________ | 25% | ________ |
| Total | | | ________ |

Total cash cost of specified animals purchased before the 1989 fiscal period. ________(2)

**Other inventory purchased during the 1989 fiscal period**
Enter the amount paid (by the end of the 1989 fiscal period) for all other inventory purchased in the 1989 fiscal period. ________(3)

**Other inventory purchased before the 1989 fiscal year**
Enter the amount paid for all other inventory purchased before the 1989 fiscal period. ________(4)

The **second step** in the calculation is to determine the **value of inventory** as of the end of the 1989 fiscal period. The value of inventory for specified animals is an amount that is not more than the cash cost but not less than 70 per cent of the cash cost. For other inventory, the value is either the cash cost or fair market value, whichever amount is less. Complete Chart 4 to determine the value of inventory.

**CHART 4**

**Specified animals purchased during the 1989 fiscal period**
Enter an amount that is not more than the amount on line (1) but not less than 70% of the amount on line (1). ________(5)

**Specified animals purchased before the 1989 fiscal period**
Enter an amount that is not more than the amount on line (2) but not less than 70% of the amount on line (2). ________(6)

**Other inventory purchased during the 1989 fiscal period**
Enter an amount that is the lesser of
– the cash cost on line (3) and
– the fair market value ________(7)*

**Other inventory purchased before the 1989 fiscal period**
Enter an amount that is the lesser of
– the cash cost on line (4) and
– the fair market value ________(8)*

* To determine which is the lower, **cash cost** or **fair market value,** compare each item or class of items in the inventory separately.

**Fixed dollar method and elective method**

The **final step** in the calculation is to determine the **mandatory inventory adjustment.** The two methods for computing the **mandatory inventory adjustment** are the **fixed dollar method** and the **elective method.** You may select the method that is more beneficial to you. If you wish

to use the elective method, you must state in your return for each year that you are electing to use this method. If no election is made in a given year, it will be assumed that the fixed dollar method is being used.

Complete the following charts to determine which method is more beneficial for the mandatory inventory adjustment.

**Fixed Dollar Method**

| | | |
|---|---|---|
| Enter the amount of your **net loss after adjusting the income and expense statement** (from line 630 on form T2042) | | ______(9) |
| Enter the **value of inventory** from Chart 4 | | |
| – the amount on line (5) | ______ | |
| – the amount on line (6) | ______ | |
| – the amount on line (7) | ______ | |
| – the amount on line (8) | ______ | |
| Total **value of inventory** | ______ | ______(10) |
| Enter the amount on line (9) or line (10), whichever amount is less | | ______(11) |
| Deduct: | | $15,000 |
| Mandatory inventory adjustment under the **fixed dollar method** | | ______(12) |

**Elective Method**

| | | |
|---|---|---|
| Enter the amount of your **net loss after adjusting the income and expense statement** (from line 630 on form T2042) | | ______(13) |
| Enter the **value of inventory** purchased during your 1989 fiscal period. | | |
| – the amount on line (5) | ______ | |
| – the amount on line (7) | ______ | |
| Total | | ______(14) |
| Enter the **value of inventory** purchased before your 1989 fiscal period. | | |
| – the amount on line (6) | ______ | |
| – the amount on line (8) | ______ | |
| Sub-total | ______(15) | |
| Multiply line (15) by: | .143 | |
| Total | | ______(16) |
| Add lines (14) and (16) | | ______(17) |
| **Mandatory inventory adjustment** under the **elective method** is the amount on line (13) or line (17), whichever amount is less. | | ______(18) |

If you choose the **fixed dollar method** for the mandatory inventory adjustment, enter the amount on line (12) under code 635 on form T2042. If you choose the **elective method,** enter the amount on line (18) under code 635 on form T2042.

### *Example*

Guy's farming business has a December 31 fiscal year-end. Guy recorded the following information regarding his inventory purchased and owned at the end of his 1989 fiscal period.

| | | |
|---|---|---|
| Livestock purchased: | 1989 | $20,000 |
| | 1988 | 16,000 |
| | 1987 | 14,000 |
| | 1986 | 12,000 |
| | 1985 | 10,000 |
| Other inventory: | 1989 | 15,000 |
| | 1988 | 6,000 |

Guy's livestock is registered under the Livestock Pedigree Act and he is electing "specified animal" treatment. In valuating his inventory, Guy has designated 70% of the cash cost for specified animals. For his other inventory, the cash cost is less than fair market value. Since Guy has a **net loss after adjusting the income and expense statement** of $35,000, he must reduce this loss by the **mandatory inventory adjustment.**

Guy's calculations are as follows:

**CHART 3**

**Specified animals purchased during the 1989 fiscal period**

Enter the amount paid for specified animals purchased during the 1989 fiscal period. $20,000 (1)

**Specified animals purchased before the 1989 fiscal period**

For the fiscal period of purchase multiply the amount paid (by the end of the 1989 fiscal period) by the applicable percentage and enter the total for all years on line (2).

| Fiscal Period of Purchase | Amount Paid | Percentage | Cash Cost |
|---|---|---|---|
| 1988 | $16,000 | 100% | $16,000 |
| 1987 | 14,000 | 50% | 7,000 |
| 1986 | 12,000 | 50% | 6,000 |
| 1985 | 10,000 | 25% | 2,500 |
| Total | | | $31,500 |

Total cash cost of specified animals purchased before the 1989 fiscal period. $31,500 (2)

**Other inventory purchased during the 1989 fiscal period**

Enter the amount paid (by the end of the 1989 fiscal period) for all other inventory purchased in the 1989 fiscal period. $15,000 (3)

**Other inventory purchased before the 1989 fiscal period**

Enter the amount paid for all other inventory purchased before the 1989 fiscal period. $ 6,000 (4)

**CHART 4**

**Specified animals purchased during the 1989 fiscal period**

Enter an amount that is not more than the amount on line (1) but not less than 70% of the amount on line (1). $14,000 (5)

**Specified animals purchased before the 1989 fiscal period**

Enter an amount that is not more than the amount on line (2) but not less than 70% of the amount on line (2). $22,050 (6)

**Other inventory purchased during the 1989 fiscal period**

Enter an amount that is the lesser of
– the cash cost on line (3)
– the fair market value $15,000 (7)

**Other inventory purchased before the 1989 fiscal period**

Enter an amount that is the lesser of
– the cash cost on line (4)
– the fair market value $ 6,000 (8)

**Fixed Dollar Method**

| | | |
|---|---|---|
| Enter the amount of your **net loss after adjusting the income and expense statement** | | $35,000 (9) |
| Enter the **value of inventory** from Chart 4 | | |
| – the amount on line (5) | $14,000 | |
| – the amount on line (6) | $22,050 | |
| – the amount on line (7) | $15,000 | |
| – the amount on line (8) | $ 6,000 | |
| Total **value of inventory** | $57,050 | $57,050 (10) |
| Enter the amount on line (9) or line (10), whichever amount is less. | | $35,000 (11) |
| Deduct: | | $15,000 |
| **Mandatory inventory adjustment** under the **fixed dollar method** | | $20,000 (12) |

**Elective Method**

| | | |
|---|---|---|
| Enter the amount of your **net loss after adjusting the income and expense statement** | | $35,000 (13) |
| Enter the **value of inventory** purchased during your 1989 fiscal period. | | |
| – the amount on line (5) | $14,000 | |
| – the amount on line (7) | $15,000 | |
| Total | | $29,000 (14) |
| Enter the **value of inventory** purchased before your 1989 fiscal period. | | |
| – the amount on line (6) | $22,050 | |
| – the amount on line (8) | $ 6,000 | |
| Sub-total | | $28,050 (15) |
| Multiply line (15) by: | .143 | |
| Total | | $ 4,011 (16) |
| Add lines (14) and (16) | | $33,011 (17) |
| **Mandatory inventory adjustment** under the **elective method** is the amount on line (13) or (17), whichever amount is less. | | $33,011 (18) |

Under the **fixed dollar method** the **mandatory inventory adjustment** is $20,000 whereas under the **elective method** the **mandatory inventory adjustment** is $33,011.

Guy must reduce his **net loss after adjusting the income and expense statement** by at least $20,000 but may reduce his net loss by $33,011 if he chooses.

**Optional inventory adjustment**

The **optional inventory adjustment** applies for all fiscal periods starting after 1988 and replaces the optional inclusion of value of livestock on hand at the end of the current year.

If you report your income on the cash basis, you may include in your income an amount not exceeding the fair market value of all inventory on hand at the end of the year **less** the amount, if any, of the mandatory inventory adjustment. This option does not include animals of a basic herd. The meaning of ''inventory'' and ''fair market value'' are discussed under the ''Mandatory inventory adjustment'' above.

If you include an amount in income for this adjustment in your 1989 fiscal period, you must deduct the amount in calculating your income for 1990.

**Business-use of home expenses**

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.

The expenses you may deduct for the business-use of your home cannot exceed the net income from the farming business before claiming business-use of home expenses. This means these expenses cannot be used to create or increase your farming loss. You may carry forward any such expenses that you cannot deduct in the year and deduct them, subject to the same limitations, from the net income of your farming business in the following year.

If you own or rent the home that you live in and use it for business purposes, you may deduct a reasonable portion of your home expenses. These expenses may include light, heat, water, home insurance, and property tax costs. The expenses should be apportioned on a reasonable basis, between business and non-business use, 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 that is 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).

For more details, obtain Interpretation Bulletin IT-514, *Work Space in Home Expenses*.

**Partnership schedule**

If you are a member of a partnership that is exempt from filing a *Partnership Information Return*, you must provide

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

The **partnership schedule** on form T2042 may be used to provide the necessary information. This section consists of the following areas:

**Area I**

Enter in this area you own income and each partner's share of the net income of the partnership, 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 or from copy 2 of form T5013 Supplementary.** 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.

You may also use this area to claim any expenses for business-use of your home. Refer to the section "Business-use of home expenses" above for details.

## Code 665
## 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 business is a proprietorship, the **net** amount is the **net farming income (loss)** after completing the section **Business-use of home expenses** on the same form.

If you operate as a partnership, the **net** amount is the **net farming income (loss)** after completing the section **adjustment to partnership income.**

# 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 before January 1, 1972 and that you are still using in your farming operation in 1989. 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. Attach one completed copy to your income tax return and keep a copy for your records.

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

## General comments 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. For example, discs, cultivators and tools costing more than $200 are included in Class 8. The Income Tax 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 period. 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).

## Revised rules concerning capital cost allowance

**In a news release dated January 24, 1989, the Department of Finance issued revised draft regulations and legislation relating to capital cost allowance claims for passenger vehicles that cost more than $20,000. These amendments are effective for fiscal periods and taxation years commencing after June 17, 1987 that end after 1987.**

The new rules regarding passenger vehicles that you use in your farming business are as follows:

- **Each passenger vehicle** that you own at any time during the year and that cost more than $20,000 must be included in a new separate class. The new class is 10.1 and the maximum rate of capital cost allowance applicable to this class is 30 per cent.
- 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 do not apply to Class 10.1 properties.

- In the year you dispose of a passenger vehicle that was included in Class 10.1, you may claim one half of the capital cost allowance that would otherwise have been allowed for that year in respect of the vehicle, provided certain conditions are met. These conditions are that
  - the Class 10.1 property you disposed of was owned by you at the end of your preceding fiscal period, and
  - you acquired another Class 10.1 property and still own it at the end of your current fiscal period.

Your 1988 claim for CCA will be correct, as long as you did not dispose of your Class 10.1 property during your 1988 fiscal period that started after June 17, 1987.

Your 1988 claim for CCA may be incorrect if

- your 1988 fiscal period started after June 17, 1987,
- in your 1988 fiscal period you disposed of a passenger vehicle included in Class 10.1,
- the passenger vehicle you disposed was owned by you at the end of your 1987 fiscal period, and
- you acquired another Class 10.1 passenger vehicle during your 1988 fiscal period and still owned it at the end of your 1988 fiscal period.

If you meet all of the above conditions you are entitled to claim one half of the CCA that you would have otherwise been allowed for that year. If you are entitled to an increased CCA claim in 1988, see the section, "Changing your return after you mail it" in the 1989 General Tax Guide for information on how to request an adjustment to a completed return, or contact your local district office.

In addition, you may be required to transfer property from one class to another. For instructions on completing a transfer see "Column (2) - UCC at beginning of 1989."

### Note:

*The meaning of "motor vehicle", "passenger vehicle" and "automobile" are fully discussed in Chapter 2 of this Guide under the section "Motor vehicle expenses."*

### Note:

*For passenger vehicles acquired after August 31, 1989, see the comments under "Column (3) — Cost of additions during 1989."*

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

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

Print your name, address and social insurance number and complete each column if applicable.

**Column (1) — Class no.**

If you started your business in 1989

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

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.

If you made a claim for capital cost allowance in any previous year, enter the class numbers in column (1).

**Column (2) — UCC at beginning of 1989**

If you made a claim for capital cost allowance in any previous year, enter in column (2) the **undepreciated capital cost** of each class at the end of your previous fiscal period.

**Classes 10 and 10.1**

**If your 1988 fiscal period started after June 17, 1987** and you transferred all motor vehicles included in Class 10 at the end of your 1987 fiscal period and which you still owned at the end of your 1988 fiscal period to new Class 10.1, these motor vehicles may have to be transferred back to Class 10.

### Note:

*Only motor vehicles and passenger vehicles which have a cost of $20,000 or less have to be transferred back to Class 10.*

In order to transfer the motor vehicle back to Class 10, the undepreciated capital cost for Class 10 at the beginning of your 1989 fiscal period must be adjusted.

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

To perform any such transfer, you may use the following chart as a guideline. This calculation must be performed for **each** property transferred.

**Transfer from Class 10.1 to Class 10**

| | | |
|---|---|---|
| Enter the capital cost of the vehicle being transferred. | ________(1) | |
| Enter the undepreciated capital cost of Class 10.1 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 amount from line (3) or line (4), whichever amount is greater. | | ________(6) |
| **Amount transferred to Class 10** equals line (5) minus line (6). | | ________ |

**If your 1988 fiscal period began before June 18, 1987,** you were not required to include in new Class 10.1 passenger vehicles acquired after June 17, 1987 that cost more than $20,000. However, you will be required to transfer these vehicles from Class 10 to Class 10.1 at the beginning of your 1989 fiscal period.

To perform the transfer of the passenger vehicle to Class 10.1, you adjust the undepreciated capital cost for Class 10.1 at the beginning of your 1989 fiscal period. This amount is equal to the amount transferred from Class 10.

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

As 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 on line (1) in the calculation below.

### Note:

*As the actual cost of the vehicle is more than $20,000, you must reduce the undepreciated capital cost of Class 10 by the*

*difference between the actual cost and $20,000 before doing the transfer calculation.*

To perform any such transfer, you may use the following chart as a guideline. This calculation must be performed for **each** property transferred.

**Transfer from Class 10 to Class 10.1**

| | | |
|---|---|---|
| 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 amount from line (3) or line (4), whichever amount is greater. | | ________(6) |
| **Amount transferred to Class 10.1** equals line (5) minus line (6). | | ________ |

**Investment tax credit**

If you claimed the investment tax credit on your 1988 return, you must reduce the UCC of the related property at the beginning of your 1989 fiscal period by the amount of the credit claimed. For additional information regarding the investment tax credit see Chapter 7 of this Guide.

**Column (3) — Cost of additions during 1989**

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 to calculate 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 to which the property belongs.

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 1989 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 on 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) | | | $________ |

**Passenger vehicles - Class 10.1**

If you acquired a passenger vehicle during your 1989 fiscal period there is a limit on the capital cost.

- for passenger vehicles acquired **before September 1, 1989 that cost more than $20,000,** and the vehicle is used entirely for business purposes, enter the **deemed cost** of $20,000 in column (3).
- for passenger vehicles acquired **after August 31, 1989 that cost more than $24,000,** and the vehicle is used entirely for business purposes, enter the **deemed cost** of $24,000 in column (3).

**Construction costs and/or cost of improvements**

If you construct a depreciable property for use in your farming business, its capital cost includes the cost of materials, labour and other costs you actually incur. 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. For further information regarding the cost of improvements, see the section, ''Building repairs'' in Chapter 2 of this Guide.

**Survey or valuation costs**

The costs to survey or value 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 acquired 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.

When 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.

If you acquire a passenger vehicle that is included in Class 10.1 and the vehicle is used for both business and personal use, show the cost of the addition as follows:

- in cases where the business and personal use will remain constant in future years, enter in column (3) only that portion of the **deemed cost** that relates to the business use.
- in cases where the business use varies from year to year, enter in column (3) the entire **deemed cost** of the passenger vehicle. You must then add the personal-use portion of the capital cost allowance claimed back into income as an adjustment.

***Note:***
*The deemed cost of a passenger vehicle is explained in the above section, "Passenger vehicles - Class 10.1."*

**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 you 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 considered **not** to be at **arm's length.** For further details, see 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 on 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.

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

- the fair market value of the vehicle at the time you acquired it,
- the undepreciated capital cost of the vehicle to the vendor immediately before you acquired it.
- $20,000, if acquired before September 1, 1989 or $24,000, if acquired after August 31, 1989.

**Column (4) — Proceeds from disposals during 1989**

If you disposed of a property during 1989, 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 1989 and that building 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 *1989 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.*

**Column (5) — UCC after additions and disposals**

Enter in column (5) the amount obtained by adding column (2) to column (3) and subtracting column (4).

Except in the case of Class 10.1, you cannot claim capital cost allowance if either of the following situations occur

- the amount in column (5) is **negative**.
- the amount in column (5) is **positive** and no property is left in the class at the end of your fiscal period.

If either of the above situations occurs for property included in Class 10.1, see the comments under "Column (7) - Base amount for capital cost allowance" to calculate your capital cost allowance claim for 1989.

**Recapture**

If the amount in column (5) is **negative,** this amount is a recapture of capital cost allowance and you must include it as income for 1989. For example, recapture can result from disposing of property, receiving government assistance or claiming an investment tax credit.

**Terminal Loss**

If the amount in column (5) is **positive, and you no longer own any property of that class,** this amount is a terminal loss and you must deduct it from income in 1989. However, if the property disposed of was a building, adjustments to the amount of the terminal loss may be required.

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

Column (6) — **Adjustment for current year additions**

This column enables you to adjust the cost of property you 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 1989 fiscal period, your capital cost allowance claim, as a general rule, is limited to 50 per cent 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 per cent 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 you disposed of.

Subject to the exceptions explained below, enter in column (6) one half of the amount by which column (3) exceeds column (4).

One exception to the 50 per cent rule occurs when you acquire 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 1989 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 per cent rule. Additions to Class 12, other than computer software (but not including systems software), are eligible for a 100 per cent 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, 14, 24, 27, 29 or 34.

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. Subject to the exceptions explained below, enter in column (7) the amount obtained when you subtract column (6) from column (5).

If you **disposed** of a passenger vehicle during 1989 that was included in Class 10.1, you may claim one half of the capital cost allowance that would otherwise have been allowed for that year, provided certain conditions are met. These conditions are that

- the Class 10.1 property you disposed of was owned by you at the end of your 1988 fiscal period, and
- you acquired another property included in Class 10.1 and still own it at the end of your 1989 fiscal period.

If you meet the above conditions, enter in column (7) one half of your opening undepreciated capital cost in column (2).

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 1989**

Enter in this column the capital cost allowance you are claiming for 1989. 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.

**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 per cent.

Property previously included in Class 3 cannot be 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 per cent 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 Classes 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 (ACCA) 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 to prevent, reduce or eliminate pollution. Application forms and more details may be obtained by writing to the

Manager ACCA 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 per cent, 50 per cent, and 25 per cent, 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 office, as special capital cost allowance rules apply.

**Column (10) — UCC at the end of 1989**

Your undepreciated capital cost at the end of your 1989 fiscal period is the amount obtained by subtracting column (9) from column (5). This amount will also be your undepreciated capital cost for the beginning of your 1990 fiscal period.

In the following situations, you will not have a balance for undepreciated capital cost at the end of your 1989 fiscal period:

- you deducted a terminal loss from income,
- you included an amount for recapture in income, and
- you disposed of a Class 10.1 property.

## Special points concerning capital cost allowance

**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. For further information on capital gains, obtain a copy of the *1989 Capital Gains Tax Guide.*

**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.; and
- 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 *1989 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 farm property to a child**

There are special rules that 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.

**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-413R, *Election by Members of a Partnership under Subsection 97(2).*

## 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 making a claim for capital cost allowance, commonly known as a **depletion allowance.**

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

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.*

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

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

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

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

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

If your operations are on a small scale, you may claim $100 or the amount of the sales of the product in the year, whichever is less, 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 for an unlimited period.

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.*

## 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. A separate cumulative eligible capital account must be kept for each business.

The balance in your cumulative eligible capital account is calculated as follows:

- you determine the balance in your cumulative eligible capital account as of the beginning of your 1989 fiscal period.
- you would add 50 per cent of your cumulative eligible capital account balance that was on hand at the beginning of your 1989 fiscal period only **if your 1989 fiscal period started in 1988.**
- you add three quarters of your eligible capital expenditures made in your 1989 fiscal period.
- you subtract three quarters of all proceeds receivable in your 1989 fiscal period.

### Annual allowance

If there is a positive balance in your cumulative eligible capital account at the end of your 1989 fiscal period, you may deduct up to 7 per cent of the account balance from your farming income for that year. The annual allowance for fiscal periods that started before 1988 was 10 per cent.

The following are examples of how to calculate the maximum allowance you may claim.

### *Example A*

Ralph started a farming business on January 1, 1989. His 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 1989 is calculated as follows:

| YEAR | | CUMULATIVE ELIGIBLE CAPITAL |
|---|---|---|
| 1989 | **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*

Charlie started a farming business in 1987 that has a December 31 fiscal year-end. In 1987 he purchased a milk quota for $8,000. Each year Charlie claimed the maximum allowance on eligible capital property available to him. The balance in Charlie's cumulative eligible capital account as of the beginning of his 1989 fiscal period is calculated as follows:

| YEAR | | CUMULATIVE ELIGIBLE CAPITAL |
|---|---|---|
| 1987 | **Eligible capital expenditure:** cost of milk quota ($8,000) × 1/2 .................... | $4,000 |
| | **Annual allowance** maximum: 10% of year-end balance | 400 |
| | Balance | $3,600 |
| 1988 | **Add: 50% of existing balance ($3,600)** .......................... * | **1,800** |
| | Balance | $5,400 |
| 1988 | **Annual allowance** maximum: 7% of year-end balance | 380 |
| **Balance in the cumulative eligible capital account as of the beginning of the 1989 fiscal period** | | **$5,020** |

#### * *Note:*

*Charlie added fifty per cent of his cumulative eligible capital account at the beginning of his 1988 fiscal period since his 1988 fiscal period was the first that commenced after December 31, 1987.*

In 1989, Charlie purchased another milk quota for $12,000. The maximum allowance he may claim for his 1989 fiscal period is calculated as follows:

| | | |
|---|---|---|
| **Balance in the cumulative eligible capital account as of the beginning of the 1989 fiscal period** | | **$5,020** |
| 1989 | **Eligible capital expenditure:** cost of milk quota ($12,000) × 3/4 ................... | $9,000 |
| | Balance | $14,020 |
| | **Annual allowance** maximum: 7% of year-end balance | 980 |
| | Balance | $13,040 |

**Proceeds of disposition**

If you disposed of eligible capital property during your 1989 fiscal period, you must deduct three quarters of the proceeds receivable from the cumulative eligible account balance. The amount deducted is an **eligible capital amount.** Your proceeds receivable from the sale of eligible capital property are net of all outlays and expenses incurred in respect of the sale.

If the disposition creates a negative balance in your account 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 previous years' annual deductions claimed that were 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 543 of Schedule 3, *Summary of Dispositions of Capital Property in 1989* included with your return package. The deemed taxable capital gain is eligible for the lifetime capital gains deduction. For additional information regarding the lifetime capital gains deduction, see Chapter 6 of this Guide.

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

### *Example C*

Betty started a farming business in 1987 that has a December 31 fiscal year-end. In 1987 she purchased a milk quota for $10,000. Each year Betty claimed the maximum allowance on eligible capital property available to her. The balance in Betty's cumulative eligible capital account as of the beginning of her 1989 fiscal period is calculated as follows:

| YEAR | | CUMULATIVE ELIGIBLE CAPITAL |
|---|---|---|
| 1987 | **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 |
| 1988 | **Add: 50% of existing balance ($4,500)** ......................... * | **2,250** |
| | Balance | $6,750 |
| 1988 | **Annual allowance** maximum: 7% of year-end balance | 475 |
| **Balance in the cumulative eligible capital account as of the beginning of the 1989 fiscal period.** | | **$6,275** |

#### **Note:*

*Betty added fifty percent of her cumulative eligible capital account at the beginning of her 1988 fiscal period since her 1988 fiscal period was the first that commenced after December 31, 1987.*

In 1989, Betty sold the milk quota for $12,000 and recorded the following information.

| | |
|---|---|
| **Balance in the cumulative eligible capital account as of the beginning of the 1989 fiscal period.** | **$6,275** |

| 1989 | **Deduct: Eligible capital amount** sale of milk quota (\$12,000 × 3/4) .................. | | 9,000 |
|---|---|---|---|
| | Negative balance................ | (A) | \$(2,725) |

Betty must add \$975 to her 1989 farming income calculated as either \$2,725 (amount A), or the total of all previous years' annual deductions of \$975 (\$500 + \$475), whichever amount is less. She must also include in income the remaining \$1,750 (\$2,725 − \$975) as a taxable capital gain. The inclusion in income of these amounts also results in a nil balance in the account after the disposition.

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

Generally, 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 1989, 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 1989, 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 — 1989 farm loss

If you choose to carry your 1989 farm loss back, you may request an adjustment to your 1986, 1987 or 1988 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 1989 return.

Carry-forward of prior years' losses to 1989

Farm losses incurred in 1983, 1984, 1985, 1986, 1987 or 1988 that you have not deducted may be eligible for application in 1989.

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 1989, 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 1989 farm loss, and
- your 1989 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 1989 non-capital loss back, you may request an adjustment to your 1986, 1987 or 1988 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 1989 return.

Application of losses — exceptions to the rules

There are two exceptions to the general rules for applying farm losses or non-capital losses. These exceptions apply only when your income is block-averaged, as explained in Chapter 10.

First, the remainder of a farm loss or a non-capital loss incurred within an averaging period and 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 determine 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
- $6,250.

The maximum loss deductible in any one year is limited to $8,750. The balance of the loss which is not deductible in the year is your restricted farm loss.

### *Note:*

*The $6,250 amount in the above calculation applies to taxation years starting after 1988. For taxation years starting before 1989, the amount used in the calculation is $2,500.*

### *Example:*

In 1989 you have employment income and have a loss from farming of $9,200. If farming or a combination of farming and some other source of income is not your chief source of income, and the farming business is carried on for profit or with a reasonable expectation of profit, you are allowed to deduct from your employment income a **farm loss** equal to the lesser of

(a) $9,200, and

(b) $2,500 plus the lesser of

- 1/2 × ($9,200 − $2,500) = 1/2 × $6,700 = $3,350 and
- $6,250.

$2,500 + $3,350 = $5,850

The lesser of (a) and (b) is the amount of the loss that you can deduct in 1989 (i.e., $5,850).

Your **restricted farm loss** (balance of the loss not deductible) is $3,350 ($9,200 minus $5,850).

### Carry-back — 1989 restricted farm loss

If you incur a restricted farm loss in 1989, you may carry it back three years to 1986, 1987, or 1988 and deduct it against any farming income in those years. You may also carry any undeducted portion of your 1989 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 1989

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, 1987 or 1988 which you have not deducted against your net farming income in 1989.

### *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 *1989 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 does not need to 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 you disposed of farm land in 1989 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, and
- the remainder of the farm property (land, buildings and equipment).

The amount of land that qualifies as part of your principal residence is normally limited to one half hectare unless you can demonstrate that the portion in excess of one half hectare was necessary for the use and enjoyment of your residence.

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

- the fair market value of one-half hectare and any additional portion necessary for use and enjoyment as a principal residence, 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 attributed 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 when you compute your income.

To make the election, attach a letter to your return

- stating that you are electing under subparagraph 40(2)(c)(ii) of the Income Tax Act;
- describing the property; and
- 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); and
- the type of farming operation carried on.

## Restricted farm losses

If you disposed of farm land in 1989, you may deduct restricted farm losses incurred in previous 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 1989, you may claim a deduction equal to the least of

- your annual gains limit for 1989,
- your cumulative gains limit at the end of 1989,
- your net taxable capital gains in 1989 from the disposition of qualified farm property after 1984, and
- the unused portion of your lifetime deduction limit.

### *Note:*

*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. 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.*

For further information on the capital gains deduction, obtain a copy of the *1989 Capital Gains Guide*.

**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;*
- 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.

### * *Note:*

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

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 17, 1987 under the terms of a written agreement entered into on or 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 for 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 office.

Refer to the *1989 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 not available for qualified farm property disposed of in any calendar year other than 1984.

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

## Transfer of farm property to a child

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

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 1989**

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 and Special Release, *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, or
- acquired an approved project property.

Qualified property or qualified transportation equipment that 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.

### Note:

*Qualified transportation equipment does not include equipment acquired after 1988.*

## 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 purchased before January 1, 1989, a new truck or trailer 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 acquired a truck or trailer and use it in your farming business principally for one of the purposes noted above, contact your local district 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.

## How to calculate your investment tax credit

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). 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 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. 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 1989 to reduce your taxes

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

**Current year deduction**

The maximum investment tax credit you may deduct for 1989 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 annual investment tax credit limit is an amount equal to:

$24,000 + 3/4 (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.

## Note:

*Unused investment tax credits for properties acquired before April 20, 1983, cannot be used in the calculation of your investment tax credit pool for 1989.*

To calculate your current year claim, 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.

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

- three quarters 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.

**Previous year deduction**

You may carry back the investment tax credit earned in 1989 for up to three years and use it to reduce your federal taxes payable. However, you can only carry back this credit if you first use it to reduce to the fullest extent possible your

- 1989 federal taxes, and
- 1989 federal individual surtax.

## Note:

*The maximum investment tax credit that you may deduct in 1986 and 1987 cannot exceed the federal taxes payable in the year. For 1988, the maximum investment tax credit that you may deduct is the least of your annual investment tax credit limit for the year, the balance in your investment tax credit pool and your federal tax.*

**Future year deduction**

An investment tax credit earned in 1989 and not used to reduce taxes in 1989 or in a previous year may be carried forward for up to ten years. The unused credit is included in your investment tax credit pool and may be used to reduce your taxes in a future year. Any credits not 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. You may choose the amount of the refund. However, it cannot exceed 40 per cent of the investment tax credit you earned in 1989 that was not used to reduce

- your federal tax and federal individual surtax for 1989; and
- your federal taxes payable for 1986, 1987 or 1988.

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

The amount of any investment tax credit deducted or refunded in 1989, or any 1989 investment tax credit carried back to prior years, reduces the capital cost of the related property in 1990. 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 investment tax credit deducted or refunded in 1989 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 of the class in 1990 by the amount of credit deducted or refunded. However, if no property remains in the class, you must report this amount as income in 1990.

# 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 when determining the amount of income or loss of the individual partners for a taxation year.

## Partnership information return

If you are a member of a partnership, there are two different ways your partnership income is reported. Beginning with the 1989 fiscal period, certain partnerships are required to file a *Partnership Information Return*. Partnerships with 5 members or less, investment clubs which file a T3 return, and certain limited partnerships are exempted from filing such a return.

If a *Partnership Information Return* is required to be filed, you should receive two copies of form T5013 Supplementary, *Statement of Partnership Income*. Report the gross partnership income on your *T1 General Return* as well as your share of the net partnership income or loss as indicated on form T5013 Supplementary. Attach copy 2 of the form to your return.

### *Note:*

*Your share of the net partnership income or loss as indicated on form T5013 Supplementary may require adjustment for any expenses you incurred to earn partnership income but for which you have not been reimbursed by the partnership. Refer to the comments in Chapter 2 under "Partnership schedule" for details.*

If you are a member of a partnership that must file a *Partnership Information Return,* do not include a statement of income and expenses of the partnership with your T1 General Return. This and other documentation is required to be filed with your *Partnership Information Return.*

If you are a member of a partnership that is exempted from filing a *Partnership Information Return,* you will not receive copies of form T5013 Supplementary. Therefore, you must include a statement of income and expenses of the partnership with your *T1 General Return,* and a partnership schedule that determines your share of partnership income. A schedule is provided on form T2042. Report the gross partnership income on your *T1 General Return* as well as your share of the net partnership income or loss as calculated on form T2042.

For complete details, refer to the *Partnership Information Return Guide* and the new Information Circular, *Partnership Information Return.*

## 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 an income tax 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 may be a benefit to you. Include in your income the value of the personal benefit you received from the use of that property.

If a partnership makes an automobile available to

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

the partner must include a reasonable automobile 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 *1990 Income Tax Deductions at Source Tables* and Interpretation Bulletin IT-63R3, *Benefits Including Standby Charge for an Automobile, from the Personal Use of a Motor Vehicle Supplied by an Employer.*

If 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 taxable capital gains and allowable capital 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. The income averaging provisions are explained in Chapter 10 of this Guide.

## 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 taxable capital gains or recaptures of capital cost allowance in partnership income before allocation of that income to the partners. The individual partners, not the partnership, are entitled to the capital gains deduction.

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.

# 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.

***Note:***
***The Canada Pension Plan has been amended to allow Status Indians who are paid by an employer located on a reserve, or who have self-employed earnings on a reserve, to make contributions to the Plan. If you employ Status Indians, your participation as an employer is optional. Should you choose not to participate, your Status Indian employees may join the Plan as self-employed persons. At the present time, the Quebec Pension Plan does not cover Status Indian employees working on reserves in Quebec.***

## 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.

Beginning in 1990, there are three categories of remittances, monthly, twice monthly and four times a month. The category depends on your average monthly withholding amount.

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 apply from the first day these part-time employees work 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. Subtract the net loss, if any,

from the net profit of all businesses to calculate self-employment earnings.

Rental income from farm property received by the owner of a farm is not considered to be self-employed 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 to calculate 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

## 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 *1989 General Tax Guide*.

## Five-year block averaging

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 the applicable return is filed by April 30, 1990.

You 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 1989 and have filed returns for 1988, 1987, 1986, 1984, and 1983. In 1985 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 1985 return on or before April 30, 1990, your averaging period would consist of 1989 (the current year), and the previous years 1988, 1987, 1986, and 1984.

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

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.

### *Note:*

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

**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 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 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.

If you have elected to block average, you may cancel this election if you notify your district 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 the total of the allowable deductions used in determining taxable income exceeds the net income, the excess should be shown as a minus quantity on this line. However, for any year before 1988, 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 farming 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. You include the farming loss or the non-capital loss 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 1989 not deducted in computing taxable income on line 1**

If you have farming or non-capital losses available for application to 1989, enter them at this line and carry the total 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 farming loss or a non-capital loss on 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**
**(1/5 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 before 1986 only);
dividend tax credit;
federal foreign tax credit;
federal political contribution tax credit;
employment tax credit, (for years before 1988 only);
scientific research tax credit, (for years before 1987 only);
share-purchase tax credit, (for years before 1988 only);
labour-sponsored funds tax credit; and
total non-refundable tax credits, (for 1988 and subsequent years only).

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

### *Example:*

| | |
|---|---|
| 1989 Average net income | $18,618.95 |
| Federal income tax on average net income for 1989: $18,618.95 @ 17% | $ 3,165.22 |
| Add: Tax adjustments | NIL |
| | $ 3,165.22 |
| Less: Total non-refundable tax credits | 1,031.22 |
| | $ 2,134.00 |
| Less: Federal dividend tax credit (see below) | 134.00 |
| | $ 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 1989 are entitled to a refundable Quebec abatement of 16.5 per cent of the **basic federal tax** on the **average net income** for 1989. To determine the basic federal tax, complete Schedule 1 included with your 1989 income tax package. Multiply the amount shown opposite **basic federal tax** on the schedule by 16.5 per cent and enter this amount on line 440 of the 1989 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 of Dividends | Rate | Maximum Credits Allowable |
|---|---|---|---|
| 1985 | $1,000.00 | 22 2/3% | $226.67 |
| 1986 | 1,000.00 | 22 2/3% | 226.67 |
| 1987 | 500.00 | 16 2/3% | 83.33 |
| 1988 | 500.00 | 13 1/3% | 66.67 |
| 1989 | 500.00 | 13 1/3% | 66.67 |
| | | | $670.01 |

The dividend tax credit to be **allocated to each year** in the averaging period is, therefore, $670.01 divided by five = $134.00.

**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, 1987 or 1988, 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 1989 is the year of averaging, and the investment tax credits claimed in the averaging period (i.e., 1985, 1986, 1987, and 1988) 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.

**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 per cent of the **basic federal tax** based on the **average net income** for those years.

**Line 15.**
**Subtotal**

Subtract line 14 from line 13, and 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, 1987 and/or 1988 nor any minimum tax carryover applied in 1987 and/or 1988.*

**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 1989**

An investment tax credit may be claimed in 1989 if

- you had a balance in your investment tax credit pool for 1989 (see information for line 10 above), or
- you have earned an investment tax credit in the year 1989.

If either or both of the above apply, you may deduct an investment tax credit in 1989. 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 see 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 1989 General tax package. The **basic federal tax** to be used in this calculation will be the amount on line 506 from Schedule 1 that you completed to arrive at the average tax for 1989 (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

- three quarters 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 apply even though the amount shown on line 19 is zero or represents a refund.*

Line 21.
**Federal tax or refund**

The total of lines 19 and 20 represents the 1989 **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, e.g., 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. You take this amount 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 1989**

A tax credit under the Saskatchewan tax incentives program may be claimed in 1989 if

- you had a balance in your tax credit pool for 1989 (see information for line 23), or
- you have earned a tax credit under this program in the year 1989.

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 423 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 make Canada Pension Plan contributions because you had self-employment earnings or pensionable wages, or both, which totalled more than $2,700 in 1989;
- disposed of a capital property or had a taxable capital gain in 1989;
- plan to include the income or loss for the year for the five-year block averaging;
- received a demand from Revenue Canada, Taxation to file a return; or
- must repay part of your family allowance benefits, Old Age Security benefits, or both.

You must also file if you wish to obtain

- a child tax credit;
- a federal sales tax credit, and to be eligible to receive the proposed "goods and services tax credit" payments for December 1990 and April 1991;
- 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 1989 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 1989 back to 1986, 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 1986 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 1986 return.

Most reassessments made by the Department originate from a request made by the taxpayer. For example, after mailing your 1989 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 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 owe or are about to owe 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 based on an informal request 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 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 office, and should be forwarded by registered mail to the Deputy Minister of National Revenue for Taxation, Ottawa.

Upon receipt of the notice of objection, the Minister 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 list of these publications is contained in Information Circular 89-1.

Listed below are publications which may be of assistance to you in preparing your 1989 Statement of Farming Income and Expenses. Complete the order form located at the back of the Guide. You may order by phone, mail, or in person at your district office.

## Interpretation Bulletins

| Number | Title |
|---|---|
| IT-90 | What is a Partnership? |
| IT-99R3 | Legal and Accounting Fees |
| IT-128R | Capital Cost Allowance — Depreciable Property |
| IT-138R | Computation and Flow-through of Partnership Income |
| IT-143R2 | Meaning of Eligible Capital Expenditure |
| IT-179 | Change of Fiscal Period; and Special Release dated June 13, 1986 |
| IT-184R | Deferred Cash Purchase Tickets Issued for Grain |
| IT-200 | Surface Rentals and Farming Operations |
| IT-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-413R | Election by Members of a Partnership under 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 |
| IT-514 | Work Space in Home Expenses |
| IT-521 | Motor Vehicle Expenses Claimed by Self-Employed Individuals |

## Information Circulars

| Number | Title |
|---|---|
| IC71-14R3 | The Tax Audit |
| IC75-7R3 | Reassessment of a Return of Income |
| IC76-19R | Transfer Of Property to a Corporation Under Section 85 |
| IC77-16R3 | Non-Resident Income Tax |
| IC78-4R3 | Investment Tax Credit Rates |
| IC78-10R2 | Books and Records Retention/Destruction |
| IC84-1 | Revision of Capital Cost Allowance Claims and Other Permissive Deductions |
| IC86-4R2 | Scientific Research and Experimental Development |
| IC86-5R | Part XVII – Capital Cost Allowance, Farming and Fishing |
| IC86-6 | Basic Herds |
| IC89-1 | List of Forms and Publications Available For Use by the Public |
| IC89-5 | Partnership Information Return |

## Guides and other publications

- 1990 Income Tax Deductions at Source Tables
- 1989 — Canada Pension Plan Contributions and Unemployment Insurance Premium Tables
- 1989 Employer's and Trustee's Guide
- 1989 Deceased Persons Income Tax Guide
- 1989 Capital Gains Tax Guide
- 1989 Business and Professional Income Tax Guide
- Canada Pension Plan 1989, Information For The Self-Employed
- Instalment Guide For Farmers and Fisherman (T7B)
- Partnership Information Return Guide

## Forms

| Number | Title |
|---|---|
| T1-A | Request for Loss Carry-back |
| T1-ADJ | T1 Adjustment Request |

| | |
|---|---|
| T4-1989 Supplementary | Statement of Remuneration Paid |
| T4A-1989 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 1989 on All Capital Property |
| T657A | Calculation of Capital Gains Deduction for 1989 on Other Capital Property |
| T936 | Calculation of Cumulative Net Investment Loss to December 31, 1989 |
| T2029 | Waiver in Respect of the 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 Part XI class number. 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 |
| (1) | 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 Types | 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 |
| | Mowers | 8 |
| | Nets | 8 |
| | Office Equipment | 8 |
| | Outboard Motors | 10 |
| (1) | Passenger Vehicles that cost more than $20,000 | 10.1 |
| | 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 |
| (1) | Trucks | 10 |
| | Wagons | 10 |
| | Water Towers | 6 |
| | Welding Equipment | 8 |
| | Well Equipment | 8 |
| | Windchargers | 6 |
| (2) | 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% |

(1) Class 10.1 includes passenger vehicles acquired before September 1, 1989 that cost more than $20,000 and passenger vehicles acquired after August 31, 1989 that cost more than $24,000. Each passenger vehicle is included in a separate class. Refer to Chapter 3 of this Guide for more details concerning "Class 10.1."

(2) Wind-energy conversion equipment certified as such by the Minister of Energy Mines and Resources will be included in Class 34 and be eligible for a 3-year write-off at 25%, 50%, and 25%, respectively.

## AREA FOR YOUR NOTES AND CALCULATIONS

## AREA FOR YOUR NOTES AND CALCULATIONS

## AREA FOR YOUR NOTES AND CALCULATIONS

Throughout the Guide, we direct you to forms that must be attached to your return. We also mention, where appropriate, other publications that cover topics in more detail.

If you need one of these forms or a publication, complete the order form below. Your order can be filled by your local district office by mail, telephone, or while you wait. Please refer to the 1989 *General Tax Guide* for addresses and telephone numbers.

If you prefer to mail the order form or leave it in person, please print your name and address on it. If you mail the order form, allow **three weeks** for delivery.

*CUT-ALONG LINE*

Revenue Canada Taxation — Revenu Canada Impôt

**ORDER FORM**

Please list the titles or numbers of the publications required in the boxes below. Print your name and address in the area provided and submit your completed form to your district office.

| NAMES OF REQUESTED GUIDES OR OTHER PUBLICATIONS | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | |
| | | | | | | | | | |
| **NUMBERS OF REQUESTED FORMS, CIRCULARS OR BULLETINS** | | | | | | | | | |
| | | | | | | | | | |
| NAME | | | | | | | | | |
| ADDRESS | | | | | | | | | |
| CITY | | | | | | | | | |
| PROVINCE | | | | | | POSTAL CODE | | | |