SUCCESSION PLANNING

WHAT SHOULD WE BE DOING?

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Overview to a successful Succession Plan - 5 Important Steps in the Process

Step 1: collect information

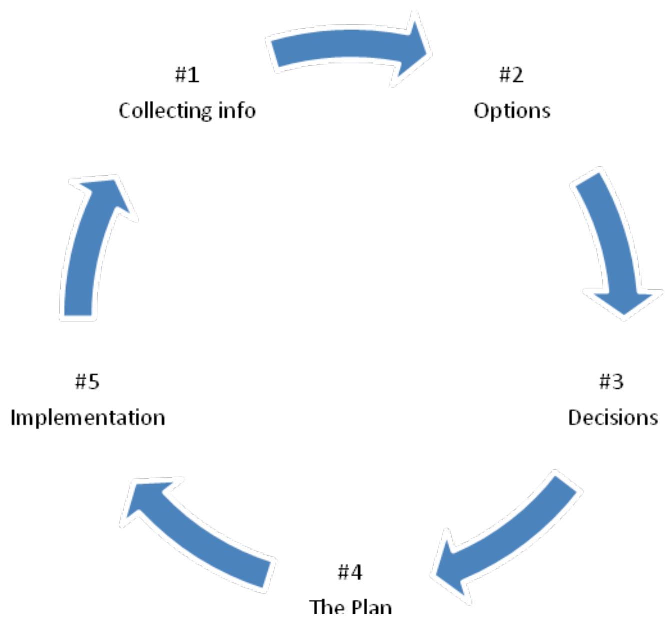
Step 2: generate options – gift, transfer, outright sale to 3rd party; partnership; incorporation.

Step 3: make preliminary decisions

Step 4: decide on a plan

Step 5: implement the plan

(Need to monitor the plan where this is being implemented over a number of years)



Important points:

1. Consult with spouse during step one and two
2. Consult the family for steps three, four and five
3. Bring in professional advisors as is necessary throughout the process – accountants, lawyers, and financial advisors/ag reps.

Step One:

Some technical issues:

- Is the present business profitable? Or is it marginal?
- Can it be sustained in the future? 5-10-20 years?
- Is the farm able to make payments to both you and support your child? Is the farm at a critical stage where it should either be expanded or downsized?
- Insuring retirement financial security. What importance do you, as parents place on security? Are you prepared to act as the banker on a sale to your child, or will you want him to buy you out? If you are going to be acting as a banker then you will have to decide upon what payments of principal/interest the farm can realistically afford. Be prepared to guarantee some bank indebtedness that your child may incur to buy you out. In the alternative do not expect to be in a first position, as banks and rarely accept anything else. Do you wish to receive a lump-sum capital payment either at the time of sale or in the future? Treat this farm transfer really as your pension. Are you prepared for the change from being a farmer to a creditor? Can you afford a shortfall should there be a default in payment? Once you have sold the farm, do you really want to re-possess it in the event of a default?
- Financing the transfer; methods of transfer; creative financing. Are we looking for an interim arrangement at this stage, or are we considering a full sale. Do the parents wish to retain ownership of some assets (land base)? – Typical step approach over time.
- Understanding some of the tax implications; capital gains, recapture, rollovers.
- Be acquainted with some of the legal implications: wills, business arrangements and legislative constraints.
- Independent legal advice: some agreements are very one-sided. If so, it is extremely important that all parties receive independent legal advice. Failure to do so may result in certain provisions of the agreement being set aside by a very understanding court.

Some human issues:

- What are everyone's goals?
- What each person expects, wants and needs to happen. Unless the child acquires an interest in the business he or she may become frustrated. At the same time if a child demonstrates a lack of managerial ability and responsibility, the parents may be hesitant to delegate. Is it enough that you have some influence over major decisions that affect the farm - property acquisition; new equipment; quota increases? How much control are you prepared to relinquish?
- Retirement lifestyle - when is this to happen and where. How is it to be financed?

- What do the children expect to happen with the farm? Do they expect an even split as opposed to a fair split? What financial commitments do you have to your other children? Typically you would look at whether there are non-farming assets which the non-farming children might inherit. Insurance policies, investments, Tax Free Savings Accounts, and registered plans play a role here. Where there is a mortgage back, consider giving to the other children the outstanding balance on the mortgage at your death. If this is a consideration, then it is necessary to not jeopardize the ongoing farming operation and it would be prudent to allow the farming child to extend the term of the mortgage for a defined period of time, such that on the parents death the farming child would not be forced to immediately re-mortgage the farm to pay off the other siblings. Are you guided strictly by what the fair market value is of your assets? Will your "last Will and Testament" be contested by the other children after your death? Certain challenges can be raised against the validity of a will: incapacity, undue influence, lack of formalities associated with the execution thereof (these are discussed later on).

  How effective is communication between the two generations?
- Are you concerned about the stability of your farming child's up-coming or existing marriage? In the event of an untimely death by your farm child, are you concerned about who will gain management and control of the farm? If there is a marriage breakdown, a son or daughter-in-law could acquire a larger share of your estate than your own non-farming children, and if this is possible then what steps are you going to take to minimize this risk.

Familiarize yourself as much as you can about the farm
This will include -

Gathering financial information:

- What is the original cost of your land and buildings?
- How are your farming assets registered? Sole proprietor - one owner; joint tenants as opposed to tenants-in-common; partnership or corporation. Who owns the quota?
- Are there any leases – ex. wind farms with long term commitments
- What are the liabilities associated with the farm. Short-term loans, lines of credit, mortgages, conditional sales contracts, personal property security agreements, guarantees. Is it realistic to expect that your guarantees will be released by the Bank?
- The amount of your quota write off may mean recapture – how much is this transaction going to cost you now and in the future – potential clawback of the OAS.
- your significant non-farming assets and liabilities
- details of any life insurance policies - term, whole, or one that is connected to the mortgage for the outstanding balance only.

4. What is your net worth? All this helps us deal with the tax aspects of any transfer.

Step Two:

Generating options:

- How does the senior generation prepare for and secure their retirement? Is it anticipated that the retiring parent will continue to assist in the farming operations? If so how, and to what degree? Will this diminish over time?
- Where will every one live? Is anticipated that there be a severed lot? When will this occur? What zoning bylaws are in effect to facilitate or restrain this from happening? MDS is a consideration. What if there are two children who are involved in the succession plan, and where it is not feasible to obtain a severance. In the event of a dispute how is this going to be handled?
- How is the ongoing management to be handled? Who takes care of the books? Is it manually entered or are we using a commercial software package?
- How do we treat non-family employees? i.e. the in-laws that become the outlaws, especially if they work off the farm.

Step Three:

Making the preliminary decisions:

- Go through the information and options that have been generated.
- Do the alternatives meet the various expectations wants, needs and goals of the various family members?
- There is <u>no</u> right answer here, only what do you feel best fits your particular situation. What may have worked for your neighbor, may not work for you.

Step Four:

Deciding on the plan:

- Discuss the various approaches with the professionals that you have chosen and review the advantages and disadvantages of each. You may find out that there are some disastrous tax ramifications associated with Plan A, that requires you to look at Plan B.
- Ask for feedback -you may be surprised with what you learn
- Finalize the plan

Typically, you will go back and refine your plan a number of times before you decide upon one that satisfies you, and this may even take a year or two.

Where you are able to control the outcome, the succession plan should typically include:

- a plan concerning the transfer of ownership
- an up-to-date will (more details comments later on)
- business agreements – like a partnership or shareholders contract
- addressing contingency plans in respect to death, divorce, and disputes that cannot be resolved
- a reasonable timetable to implement the plan.

Step Five:

Implementing the plan:

No plan will work unless you put it into action. This is a difficult stage for all parties because now the parents come to grips with their retirement, and the new generation then takes on the responsibility to ensure the ongoing profitability of the farm.

Fees: Typically, where a professional farm business consultant or a mediator is actively involved to get the parents and the children to the table and resolves overcomes the hurdles, then expect to pay for that person's time and effort. Depending on how serious the differences are, the bill can easily be $5- $10,000. Typical accounting and legal bills also run at $300-$400/per hour depending on the complexity of the case.

Advisors cannot force you to follow through with your plan. You have to be willing participants, and you should not wait for a crisis to present itself before a transfer takes place.

Managing Conflict:

Sources of Conflict:

- Authority, control, power. Where this cannot be shared, then hard feelings will occur and trouble will follow.
- Division of income. Is it to be 50-50? What sorts of withdrawals are being permitted? Can each party withdraw any agreed-upon amount each month from the farm account? What if one party exceeds the specified amount?
- Obligations and indebtedness
- Overworked, underpaid, and no recognition for what has been done to date (child's perspective)
- In laws – increased potential where they come from a non-farming background, or work off the farm.
- Differences in risk taking. This deals with the entire issue of insurance. How much insurance do we maintain on the buildings, machinery equipment and stock so as to provide adequate coverage against fire, smoke and water damage?
- While bricks and mortar can be replaced the same cannot be said for your breeding stock which quite often takes decades to build up. Is life insurance required under the terms of the agreement? What if the premiums are too high or a party does not qualify. Who pays for the life insurance premiums and who will be the beneficiaries for any amount in excess of the debt load that has been assumed?
- Timing concerning the legal transfer of property - Dad wants to postpone and son wants to move forward now!

Preventing conflict: one way to lose control is to not have a properly executed business agreement. It is always recommended that these documents be put in place while everybody is still on good talking terms. Independent legal advice ensures that what needs to be addressed is done so properly, with everyone fully appreciating what their rights and responsibilities are.

- Business agreements:
    - ✓ should be in writing
    - ✓ Describes the business relationship with enough clarity to limit conflict. Delineation of each party's responsibility
    - ✓ describes conflict resolution procedures
    - ✓ Sets out a way to deal with irresolvable differences. Can the agreement be terminated at any time by mutual agreement or by written notice given to the other party? How is the termination date to be established? On termination how will the value of the inventory, supplies, and assets be valued? How are these assets to be sold and distributed?

- Dispute resolution tools:

    - ✓ Conflict avoidance. Another word for "lose lose"
    - ✓ Informal discussions: most effective. Requires practice
    - ✓ negotiation
    - ✓ Mediation: involves the intervention of a third party to reconcile the situation as best as possible. A voluntary process.
    - ✓ Arbitration: more formal and binding on all parties. Costly but fast.
    - ✓ Judicial decision: it usually involves a lawsuit where a judge hands down a binding decision. This method is expensive and very time consuming. Any relationship between the parties is then broken.

You have to remember that parents cannot always win each battle. There has to be some give-and-take. Parents cannot take the attitude that even though the transfer has taken place, everything stays the same!

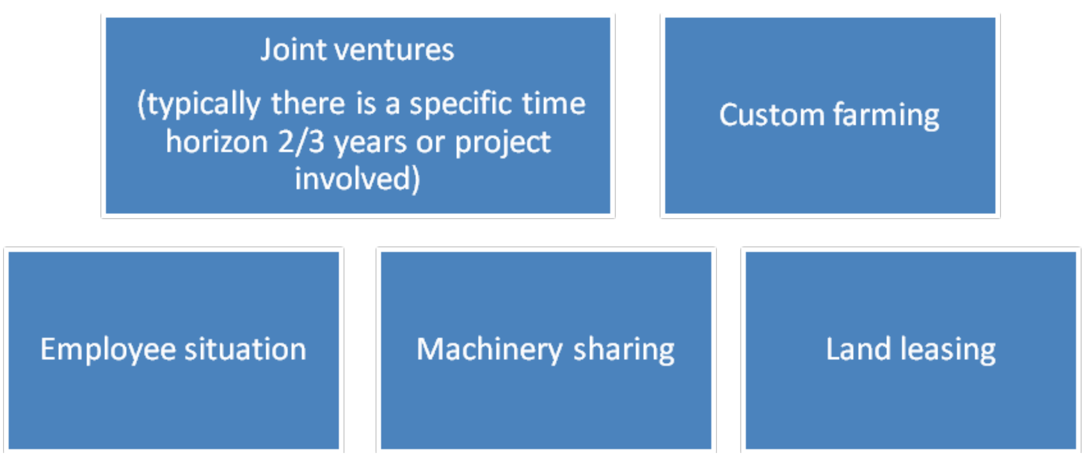
Types of Farm Arrangements:

Partnership:
The income tax act does not try to define the term partnership. However, it is basically a relationship that subsists between two or more parties carrying on the business in common with a view to profit. A partnership must calculate its net income as if it were a separate entity but it is not required to file a tax return. Instead, net income (or a loss associated therewith) is allocated to each partner according to their business agreement (ex. 60%/40%).

Each partner then includes his share of the partnership income or loss in his own individual tax return. In other words, net income is determined at the partnership level and then it is taxed at the individual level. Expenses are also recorded at the Partnership level.

The profit sharing ratio between the partners does not have to be the same from year to year. However, it does need to be consistent with the amount of capital and labour contributed by the members. There has to be a reasonable allocation for the work contributed to the partnership.

It is possible to have a partnership without a written agreement? Yes, but it is not recommended. Typically, all the parties are to share in a loss which the business might incur. If only one person stands to profit and not to lose, it is questionable whether the arrangement is a true partnership. All parties would participate in the management of the business. Every situation has to be reviewed on its own facts to determine whether an actual partnership exists for legal purposes. Upon closer scrutiny, it is possible that we have one of the following arrangements:



In the farming community, we are basically concerned with *general partnerships*.

General partnership:

- Each partner is liable jointly with the other partners for debts and obligations incurred by the farm while he is a partner.
- If for some reason the liabilities of a partnership exceed its assets, a creditor may sue the partnership and each partner for the full amount of his claim. Typically, creditors go after the partners who have the most available cash or assets - this is referred to as following the path of least resistance for collection. Often this would involve the parents.
- Any income splitting has to be reasonable otherwise it may be challenged by the Canada Revenue Agency. Take for example where one of the spouses works full time off the farm. Allocating 50% of the net income to that person would be unreasonable, and is subject to attack. The Canada Revenue Agency likes to see proper documentation, and will disallow and arrangements where there is no paperwork to support its existence.
- If you are silent about a particular point, the Partnership Act will dictate what is to happen in the circumstances.

Issues/Additional considerations:

1. Do you get interest on your capital account?
2. What happens if your capital account goes below zero (where one partner has withdrawn so much that he is now in a negative position).
3. Almost 60-70% of farm partnerships are not documented.
4. When you establish a bank account, the banks will typically request that you register your operating name which is quite often your prefix under the Business Names Act.
5. You can transfer assets into a partnership on a rollover basis – lessens the tax burden on the parents, but then that same tax position is inherited by the children. It amounts to a tax deferral.
6. Where a partnership is dissolved, the assets are deemed to be disposed of at fair market value. However, there are special rules which mitigate against triggering a capital gain. This would include transferring the partnership property to the individual partners, or to a corporation – often referred to as a rollover.
7. If there is an outright disposition to the child at a reduced price, what happens if the child decides in 5 years to sell the farm and reap the benefit of the accrued capital gain, and which you have worked for your entire life? Ex: initial sale for 1.5 million; FMV is roughly 2.6 million. Sale in 5 years time at 3 million. Who will benefit from the difference once the original indebtedness is retired? This is particularly disastrous if there is a separation or a divorce for then the in law will be the direct recipient of this unintended windfall.

Corporations:

Characteristics:

1. Is a separate legal entity which exists independent of the shareholders? A corporation has all the powers of a natural person. For example it may purchase, hold and transfer property, obtain financing and enter contracts in its own name.
2. In contrast to a partnership - it pays its own taxes. Do not forget that there are two levels of taxation. One at the corporate level and one at the personal level. When monies are received from the corporation they can be taxed as dividends, bonuses or salary. There is an opportunity for income splitting among various family members – this would include paying the children something for the work they do on the farm.
3. Caution where *dividends* are paid to minors as opposed to a salary that is reasonable for there is a penalty known as the kiddie tax. Please note that salaries are a deductible expense to the Corporation thereby reducing its taxable income. Dividends are not a deductible expense to the corporation but there is a dividend tax credit that is available to shareholders.
4. The shareholders have a financial interest in the company. In a typical estate freeze the farmer transfers property to the Company and takes back corporate shares. Please note that the owner of the property is then the Company. Share structure is critical in terms of succession and estate planning. You can have different classes of shares. On a restructuring of the farm, it is common to see the parents take back fixed value shares, with the growth shares being transferred to the second generation. Where a shareholder loans money to the corporation, he is considered as a creditor – shareholder loans.
5. Can either be a numbered company or a named company - 123456 Ontario Inc. or Greenhaven Farms Inc.
6. There are additional costs are associated with maintaining the Corporation including increased legal and accounting fees.
7. Incorporation costs are typically $1500, and where assets are being rolled into the Corporation one typically sees memorandums of agreement; promissory notes; mortgages; security agreements; pledges shares; assignment of milk quota; potential capital appreciation sharing agreements; life insurance; shareholder agreements. Encourage your professionals to talk to each other. Round table discussions eliminate time wasters.
8. Where the corporation is a Canadian control private corporation, it will enjoy the small business deduction which in essence is a preferential tax rate.

Advantages of a corporation:

- Farm business continuity is insured as a company has perpetual existence.
- Ease to transfer ownership - shares are transferred as opposed to specific assets.
- credit availability: where land, capital and equipment are aggregated together in one entity, this typically creates a stronger more efficient operation, that is able to obtain a

larger amount of credit, than a sole proprietorship.

- Tax savings: a Canadian Controlled Private Corporation is taxed at a fixed rate on the first $300,000 of taxable income in each year which is more beneficial than earning the income personally (debt can be retired quickly).
- Limited liability: the liability of the shareholder is limited to the value of his shares in the company. This is what you have at risk. Please note that investments outside of the Company are not required to be used to settle the company's debts. A bank or other financial institution avoids this conundrum by obtaining personal guarantees. It is therefore important to obtain a return of all personal guarantees once the loan for which the personal guarantee is given, is paid off. Otherwise, the financial institution will keep stacking the guarantees ($100,000; $200,000 etc.) and the potential liability will then become cumulative.

Disadvantages of a corporation:

- High cost of incorporation, and subsequent planning associated with rolling assets into the corporation.
- High cost of dissolution
- Potential income tax disadvantage where the principal residence is transferred to the Corporation. If this can be avoided, then the residence does not have any tax liability when the property is subsequently sold for an amount in excess of its cost base, providing the home is used as such throughout the period of ownership.
- Extra administration. Sometimes farmers treat the corporation as their own and there are penalties when corporate funds are used for personal use. Loans have to be paid back within a specified period of time otherwise the full face amount of the loan is added to your income. Accurate and careful accounting is therefore essential.

When do we incorporate?

- consistent high level of income
- paying a spousal salary of over $20,000 a year
- where there is debt
- capital gains exemption available – now $750,000.00
- typically seen where there is an estate freeze for succession planning.

Buy-Sell Checklist:

- ☐ If there is life insurance, who pays the premiums? Who receives the proceeds? And how are the surplus proceeds to be applied? Is it to pay off the in laws, the Bank, or some combination thereof?
- ☐ Is there a need to have the insurance proceeds held by a trustee - an independent third party who will insure that the provisions of the agreement are carried out appropriately
- ☐ How is the price for the interest of each party going to be determined?
- ☐ What should be the valuation procedure in the event that a specific price has not been revised within a certain period of time? Typically, you see that the parties are to get together within a 2 or 3 month period following the preparation of the year-end financial statements to hammer out a specific value. Sometimes this is done; sometimes this is not done. Problems occur with the latter. There is a price you pay for being lackadaisical, and which often ends up in court.
- ☐ What do you do when the value of the person's interest is more than the insurance proceeds? It will be necessary to address this. Is it to be paid over a 5 to a 10 year period? Is interest to be charged, and if so at what rate. Does the rate change annually on the anniversary date or every 2 or 3 years? What are you comfortable with? What has the farm been able to generate?
- ☐ Would it be advisable to take out a separate insurance policy for the in-law, to insure that this party is adequately taken care of in the event of an untimely death? This may be a necessity where the in law has signed a marriage contract releasing all interest in the farm.
- ☐ What if the insurance proceeds are more than the price of the deceased's interest. How is this surplus to be dealt with? Who does it belong to?
- ☐ What happens if the person wishes to dispose of his interest during his or her lifetime?
- ☐ Should you address a disability as accidents do happen on farms?
- ☐ What happens in the event that certain assets cannot be replaced due to a disaster?
- ☐ What about spouses who were not family members? Should they be parties to the agreement? Yes. Should they receive ***independent legal advice***? Yes, especially when you are dealing with the matrimonial home, and any increased value in underlying assets of the farm between the date of the marriage and the date of the separation. Egg quota - 1995 $30; 2007 $180. What do you do when the in law refuses to sign?

Typical Instruments in a Farm Sale:

Outright Sale - Institutional Mortgage: In some cases, the children would rather buy at a reasonable price than face the uncertainty associated with the parents making appropriate provisions in their will; which may frequently change over time. From the parent's perspective, this is a preferred choice since they are no longer tied to the financial viability of the farm. Likewise, in this scenario the child would gain outright ownership and have independence from the parent. Given family dynamics, we have seen situations where the child incurs a greater cost to avail himself of this independence. This is especially true when one of the parents remarries and there is a potential for meddling in the other's affairs.

Vendor take back: it is more usual for farm transfers to involve the parents holding a mortgage for some portion of the purchase price, and rank second to an institutional lender. There are certain risks associated with taking a second or a third mortgage. Make sure that the terms are clear such that in the event of the parent's death, the other non-farming children cannot change the terms of the mortgage or demand payment in full.

Agreement of purchase and sale long form: in this situation the child receives possession of the farm but the parent retains title until the payment of the farm is completed. In this case the parent has solid security and foreclosure can be implemented very quickly. It is a transfer and a mortgage combined together. Do not see this very often with strangers.

Promissory notes: this is typical when there is a transfer of machinery, livestock, quota and crops. Please note that quota itself cannot be taken as security since it is a license. Instead an irrevocable authorization and direction is filed with the DFO such that when the quota is sold the proceeds are remitted to the secured party for the amount of the indebtedness, and the residual then is passed over to the owner. Consider having any note payable 366 days after demand so that Revenue Canada does not take the position that the note is the equivalent of cash, and thereby avoiding having to add the face value of the note to your income in the year of the transfer.
Make sure that something is paid each year on the note to avoid the note becoming statute barred after 6 years. The amount can be modest, but if there is not payment then it becomes an unenforceable debt after 6 years!! Very important when dealing with separations and divorces.

Option to purchase: one typically sees this in a Will if the parent insists on retaining ownership. It would be necessary to set out the terms of the payment as well and as the price. If the option is included in a will, a rollover is permitted so long as the purchase is made within 36 months of death.

Gifts: most transfers will have a certain amount of gifting. Typically you see this as being the difference between the full fair market value of the assets and the actual transfer price. While a gift assists the child in starting the farm, it does not provide much flexibility or comfort to the parents. It takes away their control and potentially eliminates the opportunity to change their minds.

Bequests: these occur through a person's will. It is not recommended that the Will be your sole method of transfer. However it is acknowledged that this is an essential tool should you die prior to the transfer plan being completed? It is recommended that you have a will professionally done. If there is a chance of being invalid, there is a great potential that the farmer then dies intestate, with the disposition of his estate being directed by the provincial law (a portion to the surviving spouse - one third; and the balance to the children). Clearly this may not be in line with the intentions of the deceased. This is a very risky way to transfer farm assets to the second generation.

> Example: father and mother are in their 80s and have worked on the farm all of their life. There are four children. One of the children farms and has lived on the farm all of his life. There is no succession plan in place other than the father wanting to transfer, when he is ready, the farm to this farming child. All of the lands, buildings and quota are in the name of the mother and father, such that upon the death of the father, 80% of the farm will automatically pass to the mother by way of survivorship. In the father's will he sets out a typical provision that the farm is to go to his farming son. Unfortunately this only accounts for 20% of those assets which are registered in the father's name alone. In this situation, the mother will automatically inherit 80% of the farm when the husband dies and the Mother's testament will then need to be read, at the appropriate time, to determine how the farm, as she now owns it, is to be treated.
>
> UNFORTUNATELY, the mother felt differently than the father, and decides to leave her estate (which includes 80% of the farm) to her four children equally. The situation is further compounded because the mother is no longer capable of redoing her will and suffers from Alzheimer's disease. Obvious conflict. Other children in the family are aware of the situation, and fully intend to offer the farm to the farming child at full market value; otherwise they have indicated that the farm is to be sold as they want their money.
>
> Bad case scenario for the farming son who is now in his 50s.

Combination of bequests, gifts and sale: the appropriate combination depends upon your specific situation. Where there is a difference between the transfer price and the fair market value, quite often parents will include a provision that should the farm be sold within X number of years that the child will be required to pay back a certain portion of the difference. In other words it appears like a participating provision, with a certain portion being forgiven each year. It is important where the child for one reason or other only farms the property for five years, and then decides to sell. Obviously they trigger a large capital gain, and when the farm is sold the parents are paid their security, but nothing is paid on account of the difference. This should be addressed by all parties openly and candidly. Even more importantly, if there is a separation/divorce with the child then the in-law will have automatic rights to the increase.

Estate Planning Considerations:

- There are no death taxes in Canada. However there are additional income taxes which are payable on death because of the “deemed disposition” of assets. From a farmer’s perspective, capital gains may form the largest component of the tax liability arising upon death. The general rule is that all capital assets are deemed to have been disposed of at fair market value immediately prior to death. As such, this can create a capital gain if the fair market value is greater than the cost of the asset. Certain exemptions do apply - where assets are transferred on a rollover basis to your surviving spouse.

    ★ Consider a spousal trust. This is where the spouse is provided for during his/her lifetime yet ensures that the ownership of the deceased assets will pass to the intended beneficiaries. Even if the spouse remarries, his or her children will not be left out of the estate upon her death. Important where the spouse is relatively young. Typically, we are concerned with a testamentary spousal trust as opposed to an inter vivos spousal trust which are taxed at the highest marginal rates.

Wills: This is an important piece of the puzzle to an effective estate plan. There are two basic types of wills:

Holographic wills: this is a handwritten document that is signed and dated but not witnessed. Section 6 of the Succession Law Reform Act. Other than in an emergency, it is *not recommended*.

Legal Will Kits and stationery store wills have problems in that they do not lend themselves to anything other than a very simplistic estate. Moreover, 9 times out of 10 they are not completed properly, and have wording which is completely confusing, ambiguous or unenforceable.

What happens where the testator forgets to "revoke all former wills and testamentary dispositions"? What happens where the farm lands are improperly described - wrong lot/wrong concession? Holographic wills cause more problems than what they solve. It is possible for a holographic codicil to be used to amend a formal will but, it must clearly manifest a present intention to change the will.

Formal wills: this is a handwritten, typed or printed document or form that is signed, dated and witnessed by two people who were not the beneficiaries. The witnesses should be of legal age and mentally competent. It is important that the witnesses are present to watch each other, and the person who signs the Will.

Critical issues arising from a Will:

- Validity of the will: these requirements are set out in sections 3 and 4 of the Succession Law Reform Act. A beneficiary or a spouse of a beneficiary should not be a witness to the will. The effect of this action by the beneficiary is to invalidate the gift that is given to him or her.

- Improper execution: this is very strictly followed. Everybody has to be there at the same time. If a will does not meet these requirements, then it will be of no effect.

- Clear language: is important that the will be clear and precise to prevent any ambiguities which may prevent the intentions of the testator from being filled. Example: "I want you to set aside enough money to look after Maggie"; "I want the farm to stay in the family forever". This is probably unenforceable as being contrary to the rule against perpetuities.

- Testamentary capacity: the testator must have the ability to know and understand:
    - the action of making a Will

- the nature and extent of the property that he or she has
- And who should or will benefit under the will.

The onus of proof rests on those who are propounding the will. And you must establish this on the balance of probabilities.

- Undue influence and fraud: influence must be exerted in such a manner that it would be tantamount to coercion. There is no need to show physical violence or threats. Once again, the onus of proof rests on those who allege it. For fraud, it must be established that the testator was lied to, which motivated the disposition of the property in a certain manner. If established, the will or part of it will be set aside for mistake induced by fraud.

Considerations:

- *Executors*: is the person trustworthy and competent to carry out the duties associated with executing the will. Basic administration of the estate falls on this person.
  Is this person familiar with agriculture? Do they have any business experience? Prefer to have the executor to live nearby. What about family members? Do they get along with each other? What experience do they have?
  What happens in the event that the executors are in conflict and cannot resolve a problem?
  What happens if one of the Executors becomes incapable or dies prior to everything being wound up? Consider having a backup or alternate executor should something occur to the first executor prior to the completion of his administration. Do not appoint all of the children
  Note that an executor can charge compensation. This roughly 3% to 5% of the total value of the estate and is considered taxable income in the hands of the executor. Consider a non-taxable gift in lieu thereof.
  New buzz word for executors - estate trustees. Your authority as an executor flows from the will not from the certificate of appointment issued by the Court.

- *Executor duties*: The estate executor must locate the assets and determine the nature and the value thereof as of the date of death. Must also compile a detailed inventory list and take the necessary steps to secure and safeguard the assets. The estate trustee has a duty to account and disclose information to the beneficiaries. Once the assets are located, there is a duty to pay debts and liabilities. This would include the settling any claims made against the estate under section 48(1) of the Trustee Act.

- The usual course is for the Estate Trustee to Advertise for Creditors in a newspaper to ensure that all creditors come forward on a timely basis. An estate trustee has a duty to invest assets of the estate and must act as a ***prudent investor***.
- Where trusts are involved this would include having an investment strategy and not merely liquidating the assets and placing everything into a checking account.
- Certain fiduciary obligations flow from being an executor: duty to act personally; and duty to act in good faith; duty of reasonable care; duty of loyalty to the beneficiaries; duty to act with an even hand. In respect to the latter obligation, the executor is not allowed to favour one beneficiary over another.
- Where a trustee has authority to sprinkle income or capital among the various beneficiaries, the estate trustee is expected to act with honesty, objectivity and with care.

- *Executor Liability:* an executor bears no personal liability for the actions or debts of the deceased. However, he will be personally liable if he mis-manages the estate, commits a breach of trust, or contravenes his obligations and duties. The will might offer some protection if it contains an exculpatory clause. In the past, courts will respect a very broad exculpatory clause as long as the estate trustee has not acted in bad faith or is grossly negligent.
- Section 35 of the Trustee Act gives the court an opportunity to excuse a breach of trust, provided that the trustee has acted honestly and reasonably and ought to be excused. This does not protect a trustee with respect to <u>investment losses</u>.
- Where a beneficiary has consented to the breach, or where he has released the trustee or acquiesced in the breach then the beneficiary is barred from suing the trustee.

- *Executor compensation*: a trustee is entitled to such fair and reasonable allowance for the care, pains in trouble and time expended in administering an estate, as may be allowed by a judge . There are five factors which are to be considered with respect to compensation: the magnitude of the trust; care and responsibility involved; time occupied in performing the duties; skill and ability displayed; success which has attended its administration. Rough rule of thumb would be 5% of the value of the estate, split among however many estate trustees we have.

- S*pecific items*: you should ensure that any assets required to operate the farming business are specifically given to the farming child so that he can continue on with the farming operations. Farm accounts; lines of credit; NISA.

- ***Rest and residue of the estate***: how do you wish to deal with the balance of your estate? If any of the children have problems/disabilities consider postponing their actual inheritance in a trust to a specific age - example 35. No child ever was injured because they had to wait a specific period of time to enjoy their inheritance. If anything, children sometimes suffer from affluenza.

- The estate is a separate taxpayer from the beneficiaries and this allows us to do certain tax planning.

- *Non-permanent nature*: a will can be changed at any time providing the testator has the requisite competency. As such, a child waiting for the farm to be passed to him in a Will provides no one with any security or peace of mind.

- *Probate fees*: probate fees are levied upon the value of an estate. Probate fees levied in Ontario are calculated as follows:

  - ✓ 0.5% on the first $50,000 ($250)
  - ✓ 1.5% on the amount over $50,000.

  <u>Example:</u> where the estate is worth $1.9 million there would be approximately $28,115 worth in probate fees to pay.

  The probate fee cannot be claimed as a deduction or a credit on the estate's income tax return. Probate is the process whereby the provincial Court approves your will. Most financial institutions will not release assets, where the value is in excess of $40,000, to your executor until the Will has been probated.

  Today this process is called the issuance of a "certificate of an appointment of an estate trustee with will attached". Prior to the certificate being granted assets will remain frozen and not be available to the executor to pay various debts (other than funeral expenses) or distribute the assets to the beneficiaries. In order to minimize probate fees, you should consider reducing those assets which would normally flow through your estate.

  Certain techniques would include joint ownership of assets, designated beneficiaries under insurance policies RRSPs and RRIFs, and gifting of assets prior to death.

  <u>Real property</u>: to deal with real property registered under the Land Titles

Act, probate is required, where the assets are not held in joint account. For those dealing with real property registered under the Registry Act probate may not be required because of section 53 of the Registry act, which allows for the registration of the Will with supporting affidavits.

Please note that many counties are subject to a project which is converting all Registry titles over to land titles. As such this is an important consideration that should be looked at by all parties.

<u>Multiple wills</u>: you can reduce probate fees by including those assets which are not subject to probate through one Will, and assets which must be probated through a secondary will.
In the case of private company shares, you can have what is considered a limited property will. Items such as cash, stocks, bonds, mutual funds and registered plans (which do not have a designated beneficiary) can be dealt with in your general will.
It is not recommended that multiple wills be prepared without professional assistance. For example, if the secondary will includes a revocation language and is executed after the primary Will, this would inadvertently have the effect of revoking the primary Will. It is important to ensure that there is revocation language only in the primary Will and that the secondary will is signed after the primary will and order to avoid this concern.

- ✓ Another issue when using multiple wills is the payment of liabilities and expenses. Where the beneficiaries under the primary and secondary wills are different, the wills must be carefully worded to address which will covers the payment of such liabilities and expenses.
- ✓ Where there are legacies provided in either of the primary or secondary will, it must be clear as to what happens if there are insufficient assets in the particular will to pay the legacies.

<u>Joint ownership</u>: common examples of this would be bank accounts, GICs, and stocks. While these assets would not form part of your estate there are certain inherent problems associated with placing assets into joint tenancy. Is the milk quota owned jointly or as tenants in common? If it is the latter, it forms part of the estate of the deceased, and the DFO ‘s policy booklet would have to be referred to (now available online). At one time the DFO did require probate, but now it appears that a certified copy of the will, a death certificate and confirmation from the estate solicitor will be

sufficient.

Example #1: parents decide to place $250,000 of their GICs into joint names with their son. The parents have not seen their daughter for a number of years. The parents decided to leave everything to their two children equally, and so provide for in their wills. Assets which are not jointly own constitute $50,000. Upon a death of the survivor of the parents, the will is read and the daughter feels that she is entitled to half of the $250,000.

The son refuses to cooperate and argues that it was a gift from the parents and for looking after them all these years. The parents had an opportunity to properly document the situation but did not wish to incur the legal costs associated with the transaction ($500). As a result, the daughter feels that the son unfairly took advantage of the parents and commences legal action. Time for trial two years. Legal fees in excess of $40,000 - each side. Worst decision ever made by the parents was not properly document the transaction, even though it may have been their intent that the son was to inherit all the $250,000. Do not assume that your wishes will be respected.

Example #2: mother owns the farm. One son resides on the farm and the mother decides to transfer all assets into joint ownership with the son. Mother wishes the son to pay $100,000 to each of his three sisters and two brothers. Son verbally agrees. Mother trusts son and in her will confirms the estate is to be given to the one son. Mother dies. Son marries. Daughter in Law does not get along with rest the family. Other siblings ask for their share of the estate as verbally indicated to them by the mother. Farming son says “show me the paper”. Other siblings don’t receive a cent.

♦ *Recommendation*: always document the intent and if it is a true gift then provide for a proper “deed of gift” in writing duly signed and witnessed.

Alter ego trusts:

Amendments to the income tax act have created a new type of inter vivos trust which allows the individual to keep assets from falling into his or her estate, thereby avoiding estate administration taxes (probate fees) , but without giving up the enjoyment of those assets during their lifetime.

Any capital gain is deferred until death - in other words they are transferred on a tax-deferred basis. This avoids triggering tax on accrued gains on the transfer of the property to the trust. In such cases the assets of the trust would no longer be considered assets of the individual owned at death and as such would not be subject to estate administration taxes.

Requirements:

- the transfer has to have occurred after December 31, 1999
- the individual is at least 65 at the time of the transfer to the trust
- the individual is entitled to receive all income from the trust prior to death
- No person other than the individuals entitled to receive income or capital during the life of the individual.

Alter ego trusts are not subject to the 21 year deemed disposition rollover if death occurs more than 21 years after the trust is established. This trust allows for the continuous management of the assets of the individual in the event of incapacity. Sometimes these trusts are used as an alternative to a power of attorney but unlike a power of attorney the terms of the trust will survive the death of the individual and his spouse.

Powers of attorney:

There are two types of powers of attorney.

One is called a power of attorney for *property* (signing authority), and the other is called a power of attorney for *personal care* (dealing with hospitals and nursing care - sometimes referred to as a living will but is actually more than that). The latter only comes into effect when you are incapacitated. Typically addressed matters like – DNR, tube feeding, no exploratory surgery, chemo, radiation, etc. No formal application to the court is necessary, unlike in Quebec.

Basically, this is a document which authorizes another person to act on your behalf once certain conditions are met. Where we are in a grey zone – then there are problems where the person fights the loss of control. Capacity is presumed. Mental incompetency proceedings – leading to a guardianship are time consuming and costly given the medical evidence required. Need active assistance of the medical profession.

While a Will only takes effect when you are dead, a power of attorney typically deals with the situation where you are alive but not capable.

These are important documents because where there are no conditions or restrictions, that attorney has complete control over your assets. The POA steps into your shoes. It is absolutely necessary to appoint someone you have complete confidence and trust in. Where this is not possible, restrictions or limitations must be built in.

Where two generations are farming, it is typical to see the parents give the children their power of attorney for property, and restrict it to the farming operations. Where the child does not have the appropriate skills, then another party should be appointed. It is possible to have two individuals acting jointly as your power of attorney.

When acting as a power of attorney, it is necessary to consider the following:

- *Accurate records* must be maintained. Original assets; original liabilities; investments; revenue expenses; capital expenses; revenue receipts; capital receipts; compensation.
- Decisions are to be made in the "*best interests of the donor*"- not what is good for you.
- *Compensation*: a POA is entitled to be fairly compensated and reimbursed for any out of pocket disbursement.
- *Limitations:* An attorney cannot change a person's Will nor can they designate beneficiaries under an insurance policy.
- just because you appoint someone to be your attorney, this is not automatically binding/obligatory on the attorney
- *Severe penalties* for not being able to justify where the money came and went
- you may get a call from the Public Guardian and Trustee to justify what you have done
- *Triggering Event:* consider inserting a triggering event for when the power-of-attorney comes into effect.

  <u>Example</u>: "when I am incapable of managing my affairs, as so confirmed by a letter from my physician". This would avoid the requirement to have a psycho geriatric assessment, however where an application to the Court is necessary for a judicial pronouncement on someone's capacity, such an assessment may very well be necessary, given the court's hesitancy to take away somebody's right to decide. Capacity being presumed!
- *Joint:* If two or more individuals are appointed as powers of attorney, then what happens in the event of a conflict? Is there a party who ultimately has the decision-making power? Recourse can be had to the courts, but this is expensive.
- *Estate Duties*: The power-of-attorney does have the right to look at the donor's will, to ensure that there is consistency between what the donor wanted, and what the attorney is doing with that person's assets.
- *Formalities: any* power of attorney requires two witnesses - similar to a Will. Obviously neither the attorney nor his spouse can be a witness to the signing of

the power-of-attorney. If so, the power-of-attorney is considered invalid.

- *Delegation:* Is there a provision in the power-of-attorney that allows the attorney to delegate authority to a third party. What happens if there is no alternate power-of-attorney appointed and there is a disability on behalf of the attorney? In such a case it is possible that the power-of-attorney would default to the Public Guardian and Trustee
- Typically you would prepare your powers of attorney at the same time as you prepare your will.
- Can be *General or Specific*.
- Can be *Limited to Time* or E*nduring/Continuing*.

★ Rule of thumb- review such documents every five years**.**

Flies in the ointment

- ❑ *Family Law Act Election*:

Regardless of what is put in the will, a surviving spouse has the right to make an equalization claim under subsection 5 (2) of the Family Law Act. If the net family property of the deceased spouse exceeds the net family property of the surviving spouse, the latter is entitled to one half of the difference between them. However, unless the deceased spouse's will expressly provides that the surviving spouse can have his or her entitlement under the will in addition to his or her entitlement under subsection 5 (2), the surviving spouse has six months from the date of the death of the deceased spouse to make an election. The surviving spouse may claim either the entitlement under the will or an equalization payment but not both.

Example: Net family property of husband $2 million
Net family property of wife $100,000
Equalization: $950,000.
Will provides for surviving spouse to have $500,000.
Which one does the surviving spouse elect to have?

We are talking about the value of net assets and not about the specific assets themselves.

Where there is no will, the surviving spouse must choose between the entitlement set out under the Succession Law Reform Act and the equalization claim. In this situation the estate trustee is obligated to not distribute assets within the first six months without court authorization or permission of the spouse.

Any action under the Succession Law Reform Act is limited to six months from the date of the issuance of the certificate of appointment.

- ❑ Dependents:

If a testator fails to adequately provide for his dependents, and order for support can be brought to the court by the dependent under section 58 of the Succession Law Reform Act. Similar six-month limitation applies.

- ❑ Intestacy:

If there is no will present, and intestacy occurs. If you have not completed your family transition plan, then it is of utmost importance to have a current Will.

Points to consider:

- ➢ no individual is able to act immediately upon death
- ➢ Leaves certain assets vulnerable. No legal right to deal with any matters in the intestate's estate until a proper appointment is made. Obviously leads to delays and can be very detrimental to certain farming assets and business.
- ➢ someone must apply to be appointed
- ➢ typically a family member
- ➢ must not reside outside of Ontario - section 5 of the Estates Act

☐ Plan Designations:

For RRSP and RRIF purposes, be mindful that the designated beneficiary typically receives the proceeds of the plan without tax being paid or remitted by the financial institution. In this case the general estate is liable for the tax associated with the registration of the plan. When giving different assets to different beneficiaries, make sure that where there is not a rollover involved that proper provision is made such that the designated beneficiary is required to absorb the tax associated with the deregistration/collapsing of the plan.

☐ Marriage Contracts:

Often an important tool to restrict a non-family's right to the increased value in an asset over the duration of the marriage - ex. Value of the farm; quota. Difficult to sell to the outsider. Always need independent legal advice to be given to the person, otherwise, it will not be enforceable. Full financial disclosure will be necessary. Very emotional, and could delay the marriage.

You have to determine how far you want to push the matter.

Often seen on second and third marriages, especially where there are prior families and obligations. More complicated where there are a number of family members on the same farm. A separation or a divorce will affect all Parties involved. The departing spouse will demand payment of their share, and some discretionary relief is given to farmers by the Courts to spread out this cost over 10 years.

☐ Wind Power Leases: Long Term Traps for the Unwary

These are very comprehensive documents generally favouring the developer! Some parts are negotiable, while others dealing with financing of the project may not be. Areas of concern:

- Length of the contract. Option to evaluate data often extends for 3-5 years. If the data is favorable, this would be followed by the actual lease which typically has a 20 year life, with 2-3renewals of 10 year terms. Determine whether having the contract is in the best interests of the farm. Is the contract something that is saleable as a commodity rather than a hindrance? Does it fit into your overall succession plan? If the project does not proceed, who owns the data – can be worth $20-30,000? You should ask for this in your negotiations.

- Extent of the contract: restrict activities to just the Towers and the access routes. Be specific about what rights the developer has – can they remove top soil beneath the easement or leased area.
- Are overhead lines permitted, or are they to be buried. Is this permitted only in certain areas – along fence lines and at the gates. Consent required anywhere else.
- Do not allow toxic materials to be stored on the property – PCBs.
- How is the revenue to be determined? Some much per tower or is it a percentage of Gross Revenues? How are Gross Revenues to be determined? 2-3% at the start of the operations, then increasing (8%) when the project is more stable and costs are being recovered – after 10-15 years. There is a lack of available information as these contracts have confidentiality clauses which prohibit the contents from being divulged once they are signed. This amounts to working in the dark. Make sure that any contract is geared into what the Ontario Power Authority is paying – this prevents the developer from entering into a non-arm's length agreement with a third party in which it sell the hydro at less than what is fair market. Make sure that any revenue generated by advertising on the Towers and green tags are added to the gross revenue calculation.
- Consider having a tower built for your purposes when the developer's equipment is available. These cranes are specialty items and are expensive to bring in afterwards. This could save $10,000.00.
- Damages: important to set out how any damages are to be determined if they are incurred by the farmer. Does the matter get referred to an arbitration panel, or is the sole recourse to the courts, which is time consuming and expensive. There may be crop loss for one year, which may be satisfactory for conventional farms, but this may be inappropriate where there is an organic farm and restrictions dictate that soil must be contaminant/spray free for at least 3 years.
- Taxes: there has to be a clause which clearly imposes an obligation on the developer to pay the taxes in a timely fashion, otherwise the farmer will get stuck being responsible to cover these costs. In the event of a default, the lease must be terminated on short order. Taxes typically have interest charges of 15% so it does not take long to rack up the arrears.
- The life span of a turbine is 20 years. If the project is faltering, one must address de-commissioning costs. If the developer falls in bankruptcy, who then absorbs the costs associated with removing the towers and cement foundations. The farmer will want there to be an escrow account to cover the reasonable costs of decommissioning less any salvage costs.
- Legal fees: when reviewing these complex options and leases, insure that the developer will be responsible to pay a portion of the legal costs. Given the one sided nature of these contracts, $10,000.00 is not out of line.