The Department of Finance Canada and its civil servants in complete disarray (Part 1) – Section B

MAJOR MISTAKES AND OMISSIONS, BLUNDERS CAUSED BY "PRACTICAL" INCOMPETENCE, AND LETHARGY ARE CAUSING MAJOR HARM TO TAXPAYERS AND COSTING THE FEDERAL GOVERNMENT A FORTUNE!

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B. "Paved" farmland: several hundreds of millions of dollars exempt from tax for no reason… since 1988!

Did you know that if an individual sells farmland they've inherited (or received in any other way) from their mother 10 years ago and they sell it now at a very high price to a real estate developer, they can still claim a $1,000,000 capital gains tax exemption, even if the last person to grow anything on the land was the individual's direct ascendant (father, grandfather, great grandfather) in the 1950s? Even if the land has been zoned "commercial" for the past 25 years? Did you know that this author has acted as a tax advisor in several situations of this kind and that transactions worth tens of millions of dollars were tax exempted? Did you know that those who take part in our seminars (more than 9,000 last year) have also exempted significant amounts for clients over their professional career? Did you know that tax authorities have published myriad technical interpretations since 1990 submitted by professionals who confirm these outlandish benefits exist for an individual who has simply had the luck of being born in a family that owns what had previously been farmland?

Let's start from the beginning… Such a surprising (and unacceptable) situation stems from the White Paper on Tax Reform published on June 18, 1987 by then Minister of Finance Michael H. Wilson. As part of the reform, the civil servants at the Department of Finance wanted to restrict access to the $500,000 capital gains tax exemption (the limit applicable at the time, it has now increased to $1 million for farm and fishing property). They introduced a "gross revenue test" and a "24-month holding period test".

These changes were announced in 1987 under the pretext of preventing part-time farmers from claiming this exemption. **However**, as part of legislative measures adopted within Bill C-139 at the time, the federal government also added a new clause to this law. They added the "father or mother" to the list of people having owned the farm property or operated the farm business in the individual's family history, for the purposes of eligibility to the tax exemption. By doing so, the federal government paved the way for a $1 million ($500,000 at the time) tax exemption on farmland. A jaw-droppingly generous gift! In fact, for the specific purposes of this legislation, the words "father and mother" also include grandparents and great-grandparents (first generation).

This means that if an individual inherited land from their father in 1998 and that this land generated gross revenue higher than the net income from other sources in 1959 and 1960 for the father (the 2-year gross revenue test), it is considered farmland for tax purposes, even if today that same land is zoned "commercial" and has not been used for agriculture in 60 years! Zoning has no impact on the definition of "qualified farm property" and the added value of the land may have occurred in the last decade even if nothing has grown on the land for 60 years.

Think we're making this up? Unfortunately, we are not. As mentioned above, dozens of technical interpretations published by the CRA since the 1990s confirm this.

A first case in 1988: five siblings enjoy a $2.3 million tax-exempt gain for a land unused for farming since 1963!

We first encountered an example of this scenario very shortly after the tax reform of June 1987. A CPA (CA at the time) came to us because his clients (five siblings) had inherited land when their mother passed away in 1981 and they had been approached by a real estate developer in the west end of Montreal with an offer of $2.3 million for the land. They wanted to know how much they'd have to pay in taxes because the land itself had a low tax cost (ACB). In fact, as mentioned above, they inherited the land after the death of their mother in 1981 and those a bit older will remember that 1981 was a time of recession and "20% interest rate"! The market value of the land was low in the early 80s but 1988 marked the upcoming end of a real estate boom that began around 1983.

When we spoke to the siblings, we learned that until 1963, the land had only been used for farming purposes by their father. After that, the land remained untouched. Their father passed away and left it to his wife (the mother of the five siblings). By analyzing the new legislative provisions in force since 1988 when the civil servants at the Department of Finance added the possibility of taking into account the family history dating back to great-grandparents, we were shocked to realize that **each** of the siblings, joint owners of the land, qualified for a $500,000 (at the time) exemption for a total of $2.5 million (which would be $5 million in 2017!). The capital gain amounted to $2.3 million, and this was the amount exempted from tax. Honestly, we were so surprised that a $2.3 million capital gain which had accumulated from 1983 to 1988 could be exempt from taxes because it was a "qualified farm property" even though the land had been unused for farming since 1963. In fact, this was so outrageous that we wondered if we were wrong. We consulted a very renowned tax expert, and after going over the new legal provisions of 1988 with a fine-tooth comb, she reached the same conclusion. These were tax-exempt gains which should not have been exempt. In fact, there should be a capital gain exemption on qualified farm property, but only up to the maximum of the land's fair market value (FMV) on the day it stopped being used for farming purposes by a member of the family (direct ascendants or descendants). Any increase in value after the land is no longer used for farming should be considered the same as any other investment (real estate or stock). Is this so difficult to understand? Of course not. But for nearly 30 years now, it has been a free-for-all when it comes to exempting sellers of "paved" farmland whose gains should have been taxed, due in part to the real estate development caused by urban sprawl. For the past 25 years, we've been bringing up this unfair advantage in our seminars.

Because an individual can retroactively request a tax adjustment 10 years later due to ignorance of the rules (such as on the capital gains tax exemption on "paved" farmland), and **until 2004**, it was possible to retroactively request adjustments for issues dating back to 1985, we don't need to tell you that we discussed this "loophole" with thousands of our participants (CPAs, tax experts, accountants, financial planners, etc.) to modify tax returns as old as 1988 of their clients to claim this exemption, if applicable.

To those who still believe that this situation has not occurred frequently since 1988, we're here to tell you that you are wrong. We are not talking about tens of thousands of dollars uselessly exempt over 30 years, but at least several hundreds of millions of dollars over 30 years (which would be a meager $30 million in tax-exempt capital gains per year throughout Canada for a total of $900 million, and it's perfectly within the realm of possibility that this sum is much higher due to urban sprawl). Trust us when we say that we are talking about incredibly large sums of money. This author has acted as a tax adviser in several transactions where tens of millions of dollars were exempt from tax for no reason other than a fortunate family history.

How is it then that the civil servants at the Department of Finance remained unaware of this situation for the past 30 years, despite the numerous technical interpretations published by the CRA to this effect (see technical interpretation 2005-0144881E5, among many others)? Do they not read these publications? The answer is that this is simply one of the many cases of **practical incompetence** and not simply a mistake. Despite repeated warnings, such numerous technical interpretations from the CRA, articles on tax issues (including one penned by this author in November 2002), a recommendation from the Québec Taxation Review Comittee in a March 2015 report, and more, nothing has been done. And yet, the rule only needs a simple modification: to limit the tax-exempt gain to the FMV of the land at the moment it ceases being used in farming by an eligible individual.

Some might ask why we are revealing this “secret” (which isn’t really one) to the tax authorities since it might prevent other people from benefiting from this tax exemption. Because it is other taxpayers (including those in the middle-class) who are bearing the burden for this bureaucratic indifference. Our jaws almost dropped when we read page 211 of the March 22, 2016 budgetary plan:

> *“In addition, the Government remains committed to ensuring federal tax expenditures are fair for Canadians, efficient and fiscally responsible.”*

And this is only the first of a series of examples. You’ll see… your blood will boil!