

**CAPITAL GAINS AND TRANSFERS OF FISHING PROPERTY: 2006
FEDERAL BUDGET PROPOSALS**

Under the *Income Tax Act* of Canada, if a commercial fish harvester sells his or her fishing property for more than its tax cost, he or she must pay capital gains tax on one half of the gain. Even if the property is not sold for more than its cost, if the property is depreciable capital property and is sold for more than its depreciated value, tax must be paid on the part of the purchase price that exceeds the depreciated value. This is commonly referred to as recapture tax. If the property is gifted to a family member other than a spouse, the property is deemed to have been sold at its fair market value and tax is payable on the capital gain or recapture, despite the fact that no money actually changes hands.

Similarly, when a fish harvester dies, he or she is deemed to have sold his or her property immediately before death at fair market value and capital gains or recapture tax is payable by his or her estate, unless the property is left to a surviving spouse. If the property has any significant value, this often bumps the fish harvester up into a high tax bracket causing tax to be payable at a higher marginal rate. If not planned for, this can create hardship since the estate will have received no money from the sale of the property to use for payment of this tax.

The *Income Tax Act* does provide for a cumulative lifetime capital gains exemption of \$500,000, but this exemption only applies to the sale or transfer of: (a) qualifying farm property and (b) shares of a qualified small business corporation. Although some fishing corporations qualify for the small business corporation exemption, many do not as this exemption only applies if 90 per cent of the assets are active fishing assets and not passive assets such as term deposits.

2006 Federal Budget

In the Federal Budget announced in the Spring of 2006, the government indicated that commencing May 2, 2006 it would be providing some relief to the fishing industry from the strict application of capital gains tax similar to the relief already enjoyed by farmers. This relief includes the following:

- Tax deferred rollovers to children and grandchildren;
- Access to the \$500,000 life time capital gains exemption; and
- Extended reserve allowance on certain dispositions of fishing assets.

This article will examine each type of relief separately.

Access to Life Time Capital Gains Exemption

As a general rule when fish harvesters sell or transfer property used in a fishing business, the transfer is not eligible for the \$500,000 life long capital gains exemption unless he or she is selling shares of a qualified small business corporation. Although the exact details have not yet been enacted in to legislation, according the 2006 Budget papers fish harvesters will be allowed access to the \$500,000 life long capital gains exemption in respect of capital gains arising from the transfer or sale of qualifying fishing property. Although the term “qualifying fishing property” has not yet been defined, it appears that it will include boats, licences (eligible capital property) and other gear that is used principally in a fishing business carried on in Canada in which the owner, his or her spouse, children or grandchildren are actively engaged on a regular and continuous basis. It appears that it will also include shares of the capital stock of a family fishing corporation and interest in a family fishing partnership.

This change in the law should be helpful for many of the elderly fish harvesters who are looking to retire out of the fishing industry. So long as they have not previously used

their capital gains exemption, it will enable them to sell their fishing assets without paying tax on the first \$500,000 of any capital gain. Unfortunately, this proposed exemption does not extend to tax payable on recaptured depreciation.

Tax Deferred Rollovers to Children and Grandchildren

Although tax deferred rollovers to spouses have been allowed for some time and are widely used by estate planners for non-fishing assets, since spouses are often not interested in carrying on a fishing business (other than the leasing out licences), this exemption is not particularly useful when estate planning for fish harvesters. However, since children or grandchildren are normally much more interested in carrying on a family fish business, the proposed extension of this rollover to children and grandchildren is good news for fishing families. Although the exact details have not yet been enacted in to legislation, according the 2006 Budget papers, tax deferred rollovers will be allowed for transfers of qualifying fishing property as described above with respect to the lifetime capital gains exemption. This will give retiring fish harvesters (who have already used up their \$500,000 lifetime capital gains exemption or wish to retain it for some other purpose) the option of transferring fishing assets to their children or grandchildren without triggering capital gains or recapture tax. This tax will be deferred until the child or grandchild disposes of the asset.

Extended Reserve Allowance

In most circumstances when one sells property, one receives full payment at the time of sale and accordingly must pay tax on any capital gain when one's tax returned is filed for the year when the funds were received. However under the reserve allowance sections of the *Income Tax Act*, so long as at least 20 per cent of the purchase price is paid per year, the seller can spread the payment for the property over a five-year period and any capital gain can be recognized for tax purposes in the same proportion as the payments are received. This reserve allowance often allows the taxpayer to pay tax at a lower marginal

rate. Unfortunately, as with the \$500,000 capital gains exemption, the reserve allowance does not apply to recapture tax.

Under the proposed Budget, capital gains tax payable on funds received as a result of sales of qualifying fishing property to children or grandchildren can be spread out over a ten-year period. This extended reserve allowance will allow for greater flexibility by both giving children or grandchildren more time to earn the money to pay for the fishing assets and also by creating more opportunity to keep the seller's marginal rate of taxation as low as possible.

Comments and Conclusion

This proposed increased access to the \$500,000 lifetime capital gains exemption will simplify tax planning for fish harvesters who wish to sell their fishing assets and retire. In addition, the proposed extension of the tax-deferred rollover will be beneficial for those who wish to give their fishing assets to children or grandchildren. The proposed extension of the reserve allowance will be beneficial for those who wish to sell their fishing assets to their children or grandchildren over an extended period of time. While any assistance to the fishing industry is welcome, it is interesting to note that the estimated annual cost of the measure for the entire country is only 60 million dollars. In comparison, the estimated cost of a transit pass credit is 150 million and the estimated cost of a corporation dividend measure for large corporations is 375 million. It is likely that the reason for the relatively modest cost of the proposed Budget measures is the fact that in the vast majority of cases, fish harvesters do not require capital gains exemptions because the value of both their fishing vessels and licences have not increased above their original tax cost. While much fishing property has been depreciated for tax purposes, the Budget proposal provides only limited relief from the payment of recapture tax. In my view, while welcome, this Budget proposal is too little to late.

Cautionary note: Readers are cautioned that at press time, the 2006 Budget proposal has not yet been enacted into law. Prior to taking any action based upon the Budget proposal, readers should seek and obtain advice from their legal and accounting advisors.

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