Chapter Eleven Test Item File Problems

TIF PROBLEM ELEVEN - 1
Tax Payable For Individuals Revisited - Essay Questions

1. ITA 110.2 provides for a deduction of "lump-sum payments", for example a court ordered termination benefit. What tax policy objective is served by this provision?

2. The carry forward periods for losses varies with the type of loss. Briefly describe the carry forward periods that the *Income Tax Act* provides for the types of losses that it identifies.

3. When an enterprise has several types of loss carry forwards, why is it necessary to keep separate balances for each type?

4. Briefly describe the tax treatment of losses on listed personal property.

5. John Broley has a $50,000 non-capital loss carry forward and a $50,000 net capital loss carry forward. During the current year, his only income is a $50,000 taxable capital gain. He has asked your advice as to which of the two loss carry forwards he should deduct. What advice would you give him?

6. If an individual dies and has a net capital loss in that taxation year or unused net capital losses from previous years, these balances are subject to a different treatment than would be the case if the individual were still alive. Briefly describe how this treatment is different.

7. What is an Allowable Business Investment Loss? What special tax provisions are associated with this type of loss?

8. What is a Small Business Corporation as defined in the *Income Tax Act*?

9. With respect to the deductibility of their losses, farmers fall into three categories. What are these three categories and how are losses treated in each category?

10. The $750,000 lifetime capital gains deduction is available when the taxpayer has a gain on the disposition of shares in a "qualified small business corporation". What are the conditions that must be met for an enterprise to be a qualified small business corporation?

11. The alternative minimum tax is an attempt to deal with a tax policy issue. What is this issue and, in general terms, how does the alternative minimum tax deal with this issue?

TIF PROBLEM ELEVEN - 2
Tax Payable For Individuals Revisited - True Or False

1. If an individual has no loss carry overs from other years, the current year Net Income For Tax Purposes will be equal to Taxable Income.

   True or False?

2. An individual has a non-capital loss. It can be carried back three years and forward indefinitely.

   True or False?

3. An individual sells shares in a Canadian controlled private corporation that qualifies as a small business corporation to an arm's length party. The adjusted cost base of the shares is $50,000 and they are sold for $30,000. The $20,000 loss is an Allowable Business Investment Loss.

   True or False?

4. A corporation sold a long-term investment in common shares with an adjusted cost base of $25,000, for $10,000 during the current year. It also sold a parcel of land that is considered capital property with an adjusted cost base of $8,000, for $12,000. Its net allowable capital loss for the year is $11,000.

   True or False?

5. Net capital losses can be carried forward or back, but can only be deducted to the extent of net taxable capital gains in the carry back or carry forward year.

   True or False?

6. Jennifer Nash is a plumber in Waterloo, Ontario, who spends all of her weekends and holidays operating a farm she purchased this year. She is confident that within two years her farm will be making a profit. In the current year, the farm had a loss of $18,000.

   i. In the current year, she can deduct a maximum of $2,500 of the farm loss against other income.

      True or False?

   ii. Any loss that is not deductible in the current year can be carried forward for a maximum of seven years.

      True or False?

   iii. Any loss that is not deductible in the current year can only be applied to the extent of farm income in the carry over year.

      True or False?

7. During the current year, an individual has taxable capital gains on the disposition of a qualified farm property and on the disposition of shares in a qualified small business corporation. The lifetime capital gains deduction can be used to eliminate up to $375,000 of the taxable capital gains on either disposition.

   True or False?

8. An individual is holding bonds issued in a foreign country. Tax of $2,000 is withheld in that country from the gross interest of $10,000. The foreign tax credit deductible from federal Tax Payable cannot exceed $1,500.

True or False?

9. In situations where such a transfer would result in the creation of, or an increase in, the spousal tax credit for the taxpayer, dividends received by the spouse or common-law partner of the taxpayer can be transferred to him and included in his tax return.

True or False?

10. When an individual makes a gift of publicly traded securities to a registered charity, any capital gain that results from the disposition is deemed to be nil.

True or False?

TIF PROBLEM ELEVEN - 3

Tax Payable For Individuals Revisited - Multiple Choice

Taxable Income

1. Martin is worried about how much tax he will have to pay this year and he is looking for anything that he might have missed that will decrease his Taxable Income. All of the following could decrease his Taxable Income, with the exception of:

   A. a deduction for contributions to an RPP.
   B. application of a net capital loss carryforward.
   C. application of a non-capital loss carryforward.
   D. a credit for a charitable donation.

2. Which of the following would reduce an individual's Taxable Income?

   A. A non-capital loss carried forward from a previous year.
   B. A charitable donation carried forward from a previous year.
   C. Adoption expenses.
   D. Medical expenses.

3. Shelly is seeking your advice on how she can claim various deductions and credits. Which of the following amounts would reduce the amount of her Taxable Income?

   i. A net capital loss carried forward from a previous year.
   ii. A charitable donation.
   iii. Contributions to an RESP.
   iv. Childcare costs paid during the year.

   A. i, ii, and iv
   B. ii and iv
   C. i and iv
   D. i, iii, and iv

4. Which of the following statements is correct with respect to the disposition of a valuable coin collection?

   A. If a loss occurs, it cannot be deducted against any source of income.
   B. If a loss occurs, one-half of this amount can be applied against one-half of any capital gain.
   C. If a gain occurs, one-half of this amount can be used to offset allowable capital losses on any disposition of capital property.
   D. If a gain occurs it will not be taxed because this is personal use property.

5. As a part time employee, Derek earns $20,000 per year. He recently started up his own business as a sole proprietorship. For the current year, his business revenues were $12,000 and his business expenses were $28,000. Derek has some investments that resulted in taxable dividend income of $1,400 and incurred interest expense of $2,000. Assuming this accounts for all of Derek's sources of income, what is his non-capital loss carry forward for the year?

   A. Nil.
   B. $600.
   C. $3,400.
   D. $16,000.

6. With respect to net capital loss balances, which of the following statements is not correct?
   A. When such balances are deducted, the amount deducted will be based on the capital gains inclusion rate which applied in the year in which the loss was realized.
   B. When such balances are carried back, they can be deducted only to the extent of taxable capital gains arising in the carry back period.
   C. Such balances can be carried back three years.
   D. Such balances can be carried forward indefinitely.

Allowable Business Investment Losses

7. Which of the following statements about Allowable Business Investment Losses is correct?
   A. They are losses that result from the disposition of shares or debt in a Canadian controlled public corporation.
   B. They can only be deducted against business income.
   C. If they are not used during the current year, they are added to the net capital loss balance.
   D. If they are not used during the current year, they are added to the non-capital loss balance.

8. With respect to an Allowable Business Investment Loss, which of the following statements is not correct?
   A. An Allowable Business Investment loss can be deducted against any source of income.
   B. If not used during the current year, an Allowable Business Investment Loss can only be applied against taxable capital gains in a carry forward or carry back period.
   C. An Allowable Business Investment Loss results from the disposition of shares of a small business corporation.
   D. An Allowable Business Investment Loss is the deductible portion of a Business Investment Loss.

Lifetime Capital Gains Deduction

9. Which of the following transactions would result in the taxpayer being able to make a lifetime capital gains deduction?
   A. An individual sells 100 percent of the shares of a CCPC that uses 85 percent of its assets in the operation of an active business.
   B. An individual sells 15 percent of the shares of a CCPC that uses 95 percent of its assets in the operation of an active business.
   C. A CCPC sells 100 percent of the shares of another CCPC that uses 100 percent of its assets in the operation of an active business.
   D. An individual sells 25 percent of the shares of a CCPC that uses 30 percent of its assets to produce property income.

10. With respect to the lifetime capital gains deduction, which of the following statements is not correct?
    A. The deduction is only available to individuals.
    B. The Cumulative Gains Limit is reduced by any CNIL balance at the end of the year.
    C. The Annual Gains Limit is reduced by Allowable Business Investment Losses realized during the year.
    D. The deduction is available on the disposition of shares of any small business corporation.

Split Income

11. Which of the following statements with respect to the tax on split income (the "kiddie tax") is not correct?

    A. For purposes of this tax, a "specified individual" is anyone who has not reached the age of 17 years before the beginning of the year.
    B. The tax is applied at a 29 percent rate to all of the income of a specified individual.
    C. Split income includes taxable dividends received from private companies.
    D. The only tax credits that can be applied against the Tax Payable on split income are dividend tax credits and foreign income tax credits.

Charitable Donations

12. An individual has Net Income For Tax Purposes of $147,500. During the current year, the individual donates a depreciable capital asset with a fair market value of $300,000. The capital cost of this asset is $225,000 and it has a UCC $147,000. It is the only asset in its CCA class and no additions are made subsequent to the gift. If he elects to have the donation valued at its fair market value, what is the maximum amount that this individual can claim as the basis for his charitable donations tax credit?

    A. $300,000
    B. $110,625
    C. $139,500
    D. $148,875

Foreign Tax Credits

13. Assume that any foreign income is taxed in the foreign jurisdiction. Which one of the following types of foreign income generates foreign tax credits that may be applied to other taxation years?

    A. Business income only.
    B. Capital gains only.
    C. Employment income only.
    D. Investment income only.

Alternative Minimum Tax

14. In the calculation of Adjusted Taxable Income in the alternative minimum tax calculation, which of the following are not considered tax preference items?

    A. Losses arising through the deduction of CCA on Certified Canadian Films.
    B. Dividend tax credits.
    C. Employee stock option deductions.
    D. Limited partnership losses.

15. Which one of the following would not affect the calculation of the alternative minimum tax?

    A. Stock options not yet exercised.
    B. The deduction of an Allowable Business Investment Loss.
    C. A taxable capital gain resulting from the sale of a cottage.
    D. Dividends received from a taxable Canadian corporation.

TIF PROBLEM ELEVEN - 4
Tax Payable For Individuals Revisited - Exam Exercises

Exam Exercise Eleven - 1 (Listed Personal Property Losses)

During 2009, Ms. Jessica Michaels was unemployed and had no income of any kind. In order to survive, she sold a painting on December 1, 2009 for $78,000. This painting had been left to Ms. Michaels by her father and, at the time of his death, it had a fair market value of $102,000. During 2010, Ms. Michaels finds a job and has employment income of $69,000. In addition, during June, she sells a second painting for $7,000. She had purchased this painting several years ago for $1,100.

Determine Ms. Michaels' Net Income For Tax Purposes and Taxable Income for 2010. Indicate the amount and type of any losses available for carry forward at the end of the year. Assume the December 1, 2009 sale had been of publicly traded shares instead of a painting. How would this change your solution?

Exam Exercise Eleven - 2 (Loss Carry Overs)

Mr. John Klaus has an unincorporated business with a December 31 year end. During 2009, its first year of operation, the business has a Net Income For Tax Purposes and Taxable Income of $22,000. The Net Income For Tax Purposes includes taxable capital gains of $3,000 [(1/2)($6,000)]. The following amounts relate to the year ending December 31, 2010:

Business Loss	($56,000)
Capital Gains	3,200
Capital Losses	(9,800)

Mr. Klaus has no other source of income or loss in either year. Assume he wishes to minimize his net capital and non-capital loss carry overs at the end of 2010, without regard to his ability to claim his tax credits for the preceding year (2009). Calculate his Net Income For Tax Purposes and Taxable Income for 2010 and any amended amounts for 2009. Indicate the amount and type of any losses available for carry forward at the end of 2010.

Exam Exercise Eleven - 3 (Loss Carry Overs)

Ms. Jean Claus has an unincorporated business with a December 31 year end. During 2009, its first year of operation, it has a Net Income For Tax Purposes and Taxable Income of $45,000. The business also had an allowable capital loss during the year of $5,250 [(1/2)($10,500)], which could not be deducted. The following amounts relate to the year ending December 31, 2010:

Business Loss	($83,000)
Capital Gains	12,600
Capital Losses	(6,300)

Ms. Claus has no other source of income or loss in either year and does not anticipate realizing capital gains in the foreseeable future. Assume she wishes to minimize her net capital and non-capital loss carry overs at the end of 2010, without regard to her ability to claim her tax credits for the preceding year (2009). Calculate her Net Income For Tax Purposes and Taxable Income for 2010 and any amended amounts for 2009. Indicate the amount and type of any losses available for carry forward at the end of 2010.

Exam Exercise Eleven - 4 (Net Capital Losses At Death)

Ms. Tanya Forester dies during August, 2010. At the time of her death, she has a net capital loss from 1996 of $31,500 [(3/4)($42,000)]. As the result of a deemed disposition at her death, she has a taxable capital gain of $15,500 [(1/2)($31,000)]. Her 2010 employment income in the period prior to her death was $47,000. Describe the tax treatment of these items in her final tax return.

Exam Exercise Eleven - 5 (ABILs)

During 2009, Mrs. Lacinda Brown used her lifetime capital gains deduction to eliminate a taxable capital gain of $15,000 [(1/2)($30,000)]. During 2010, she has capital gains on publicly traded securities of $21,000, and a loss of $47,000 on the disposition of shares of a small business corporation. Her employment income for 2010 is over $250,000. Determine the amount of the Allowable Business Investment Loss that can be deducted in 2010, as well as the amount and type of any losses available for carry over at the end of the year.

Exam Exercise Eleven - 6 (Lifetime Capital Gains Deduction)

During the period 1985 through 2009, Ms. Henny Close has had two capital gains and one capital loss. In 2005, she had a capital gain of $18,000 and in 2007, she had a capital gain of $54,000. In both cases, she used her lifetime capital gains deduction to eliminate the taxable amount of these gains. She has a net capital loss balance from 2008 of $30,000 (a capital loss of $60,000), which she deducts in 2010. She has never experienced a Business Investment Loss.

During 2010, she has a $748,000 capital gain on the sale of shares in a qualified small business corporation. Ms. Close has a CNIL balance on December 31, 2010 of $23,000. Determine Ms. Close's maximum lifetime capital gains deduction for 2010.

Exam Exercise Eleven - 7 (Ordering Of Losses)

At the beginning of 2010, Joanne Chance had the following loss carry forwards available:

Restricted Farm Losses	$ 7,200
Non-Capital Losses	41,000
Net Capital Losses [(1/2)($50,000)]	25,000

During 2010, she had the following amounts of income:

Taxable Capital Gains [(1/2)($21,000)]	$ 10,500
Business Income	14,200
Employment Income	61,000
Farm Income	2,950

Determine Joanne's Net Income For Tax Purposes, as well as her minimum Taxable Income for 2010 Indicate the amount and type of any losses available for carry forward at the end of the year.

Exam Exercise Eleven - 8 (Tax On Split Income)

During 2010, Harriet Humber, who is 15 years old, receives non-eligible dividends of $13,000 from a private corporation controlled by her father. In addition, she has income of $13,100 from her modeling contracts. Assume her only tax credits are the basic personal credit and the dividend tax credit. Determine Harriet's federal Tax Payable for 2010.

Exam Exercise Eleven - 9 (Transfer Of Dividends To A Spouse)

Mrs. Mary Senton is 42 years old and has over $250,000 in 2010 Taxable Income. Her husband's only source of 2010 income is $9,000 (grossed up amount of $12,960) in eligible dividends received from taxable Canadian corporations. In terms of federal Tax Payable, would Mrs. Senton benefit from the use of the ITA 82(3) election to include the dividends received by her spouse in her Net Income For Tax Purposes? Justify your conclusion.

Exam Exercise Eleven - 10 (Donation Of Non-Depreciable Property)

Ms. Katrina Wave owns a painting that she purchased many years ago for $22,000. Its current fair market value is $132,500. During 2010, she gifts the painting to the Renfrew Art Gallery. As the Gallery is a registered Canadian charity, it provides Ms. Wave with a tax receipt for the fair market value of $132,500. Before consideration of any income resulting from this gift, Ms. Wave's only other income is investment income of $12,500. She has no tax credits other than her basic personal credit and the charitable donations credit resulting from the gift of the painting.

Determine Ms. Wave's maximum federal charitable donations tax credit for 2010 and the amount of the donation she should claim in 2010 in order to reduce her federal Tax Payable to nil. Calculate any carry forward of unused amounts that will be available in future years.

Exam Exercise Eleven - 11 (Donation Of Depreciable Property)

Mr. Gerald Deveau owns a rental property that, during 2010, he gave to a charity to house its continuing operations. The building had originally cost Mr. Deveau $172,000, of which $34,000 was allocated to the land. At the time of the gift, the UCC of the building is $43,000, and the fair market value of the property is $346,000, including $86,000 for the land. The charity issues a tax receipt for $346,000. Before consideration of any income resulting from this gift, Mr. Deveau's only other income is net rental income of $8,300. His only tax credits are his basic personal credit and the charitable donations credit resulting from the gift of the building.

Determine Mr. Deveau's maximum federal charitable donations credit for 2010 and the amount of the donation he should claim in 2010 in order to reduce his federal Tax Payable to nil. Calculate any carry forward of unused amounts that will be available in future years.

Exam Exercise Eleven - 12 (Foreign Tax Credit)

During 2010, Kevin Fung has Net Income For Tax Purposes of $56,500, a figure that includes $3,900 of foreign non-business income. The foreign jurisdiction withheld 13 percent of this amount, resulting in a net receipt of $3,393. In calculating Taxable Income, he deducts a $5,000 non-capital loss carry forward and a $3,200 net capital loss carry forward, resulting in a figure of $48,300. His only tax credits are the basic personal credit and the credit for foreign tax paid. What is the amount of his foreign non-business income tax credit for 2010?

Exam Exercise Eleven - 13 (Alternative Minimum Tax)

During 2010, Mr. Glenn Leigh has Net Income For Tax Purposes of $145,344. This amount is made up of taxable capital gains of $120,000 and taxable eligible dividends of $25,344 [(144%)($17,600)]. As the taxable capital gain was on a disposition of qualified farm property, he reduced his Taxable Income to $25,344 through the use of the lifetime capital gains deduction. His only tax credits are the basic personal credit and the dividend tax credit. Determine whether Mr. Leigh would have a liability for the federal alternative minimum tax and, if so, the total amount of such tax.

TIF PROBLEM ELEVEN - 5
Tax Payable For Individuals Revisited - Key Term Matching

The following five key terms are listed at the end of Chapter 11, "Taxable Income And Tax Payable For Individuals Revisited".

A. Small Business Corporation
B. Net Capital Loss
C. Business Investment Loss
D. Split Income
E. Purification Of A Small Business Corporation

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. The excess of allowable capital losses over capital gains for the current year.
2. A loss resulting from the disposition of shares or debt of a small business corporation.
3. A corporation that is a Canadian controlled private corporation that uses all or substantially all (90 percent or more) of the fair market value of its assets in an active business that is carried on primarily (more than 50 percent) in Canada.
4. Certain types of income received by children from their parents that will be taxed at the maximum federal rate of 29 percent.
5. A process of disposing of corporate assets that are not being used to produce active business income, so that the corporation meets the 90 percent of assets test required to qualify as a small business corporation.
6. A corporation that, at the time of its disposition, has been owned by no one other than the taxpayer or a related party during the preceding 24 months, and during that 24 month period, more than 50 percent of the fair market value of its assets were used in an active business carried on primarily in Canada.
7. A process of taking actions that ensure that a loss on the disposition of a particular small business corporation's shares will qualify as a Business Investment Loss.
8. Certain types of income received by a specified individual from non-arm's length sources that will be taxed at the maximum federal rate of 29 percent.
9. The excess of allowable capital losses over taxable capital gains for the current year.
10. A loss resulting from the disposition of shares or debt of a qualified small business corporation.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM ELEVEN - 6
Net And Taxable Income For Individuals

Mr. Andrew Fine is a lawyer with an established practice in Prince Edward Island. The following represents a summary of the operating figures for his practice for the taxation year ending December 31, 2010:

Gross Billings	$162,000
Salaries For Staff	42,900
Office Rent	12,000
Allowance For Bad Debts:	
Opening Balance	2,500
Closing Balance	1,800
Bad Debts Written Off During Year	1,300
Bad Debts From Previous Year Recovered In Current Year	300
Cost Of Attending Legal Convention	800
Office Expenses	33,700

In addition to his law practice, Mr. Fine operates a small farm that experienced a $4,500 loss during the year. While Mr. Fine views the farm as a sideline, he anticipates that it will become profitable within two years.

Mr. Fine has been married for several years and has two children under the age of 18. During 2010, Mr. Fine made charitable donations of $515.

Required: Calculate Mr. Fine's minimum Net Income For Tax Purposes and Taxable Income for the year ending December 31, 2010. Indicate any loss carry over that is present at the end of the year, and the rules applicable to claiming this amount.

TIF PROBLEM ELEVEN - 7
Comprehensive Tax Payable For Individuals

Mr. Jack Leonard has asked you to assist him in preparing his 2010 tax return. To this end, he provides you with the following information.

Mr. Leonard's employer is a large, publicly traded corporation. During 2010, Mr. Leonard received a gross annual salary of $58,000, living accommodations having a fair market value of $1,000 per month, and an award of $2,100 in recognition of outstanding job performance. Awards for performance are paid instead of investing in employee benefits, so there is no pension plan and Mr. Leonard's 2009 Pension Adjustment amount is nil. His employer withheld the maximum for CPP contributions and EI premiums.

On August 1, 2010, his employer granted him an option to purchase 100 of its shares at a price of $7 per share. The market price of the shares at that time was $7 per share. On December 1, 2010, the market price of the shares had increased to $16 per share. On that date, Mr. Leonard exercises his option and purchases the 100 shares. He is still holding the shares on December 31, 2010.

Mr. Leonard provides the following list of receipts and disbursements for the 2010 taxation year:

Receipts	
Director's Fees	$ 1,300
Royalties On Patent Purchased In 2002	24,070
Bond Interest	430
Disbursements	
RRSP Contribution On July 6, 2010	$3,600
Rent Paid To Employer For Living Accommodation	1,200
Financial Support Of His Aunt	7,100

You ascertain that his aunt is physically infirm, is wholly dependent upon Jack Leonard for support, had income of $3,000 during the year, and lives in Florida for health reasons.

Mr. Leonard provides you with the following information on his dispositions of property during the year:

	Proceeds	Cost
Diamond Ring	$1,200	$ 950
Painting	1,100	1,800
Pistol Collection	2,000	1,400

On further enquiry, you learn that he is married and has one 19 year old son. Mr. Leonard's wife had income of $2,990 during the year.

His son lives at home and was employed during twelve weeks of the summer at a golf course as a greens keeper, at a salary of $250 per week. In September, he left his employment to commence full time studies at university. Tuition fees paid for the 2010 calendar year amounted to $3,000, and were paid by Mr. Leonard. The son's only other source of income was $700 in interest on bonds received from his father as a birthday gift in 2000. He will transfer any unused credits to his father.

Assume Mr. Leonard's 2009 Earned Income for RRSP purposes was equal to his 2010 Earned Income.

Required: For 2010, compute the following amounts for Mr. Leonard in accordance with the provisions of the *Income Tax Act*. Indicate any available loss carry over amounts and the applicable loss carry over provisions.

A. Net employment income.
B. Income from property.
C. Taxable capital gains less allowable capital losses.
D. Net Income For Tax Purposes.
E. Taxable Income.
F. Federal Tax Payable.

TIF PROBLEM ELEVEN - 8
Comprehensive Tax Payable For Individuals

Mr. Daniel Tong is employed as a project manager for Portus Ltd., a Canadian public corporation. He is married and has two children. The younger child is 16 and the older child is 19. Mr. Tong has requested that you assist him in the preparation of his 2010 income tax return. Relevant financial information for 2010 is provided as follows:

1. Mr. Tong received a gross salary of $78,000 for the year. From this amount, Portus Ltd. deducted CPP contributions of $2,163, EI premiums of $747, and company pension contributions of $3,900. In addition, in February, 2010, Portus Ltd. paid Mr. Tong a $6,000 bonus based on his 2009 work performance. A 2010 bonus of $9,500 was received on March 1, 2011.

2. In addition to his salary, Portus Ltd. paid the following employee benefits on Mr. Tong's behalf:

Company Pension Contributions	$2,300
Group Term Life Insurance Premium ($90,000 coverage)	650
Dental Insurance Premium	625

3. Mr. Tong has the full use of a company automobile that Portus Ltd. leases for an annual payment of $5,200. Portus Ltd. paid all of the $4,300 in operating costs. During the year, Mr. Tong drove the car 21,000 kilometers, of which 7,000 kilometers were for employment purposes.

4. Mr. Tong's employment contract requires that he work on a full time basis from an office in his home. Portus Ltd. pays Mr. Tong an annual allowance of $2,400 to cover his expenses for the office and equipment. The home office occupies 30 square meters of his 300 square metre home. During the year, he incurred the following expenses:

Home Expenses (100 Percent):		
Utilities	$2,100	
Maintenance	750	
Insurance	820	
Property Tax	2,500	
Mortgage Interest	7,830	$14,000
Office Supplies		230
Computer And Fax Machine Purchase		2,700
Total Expenditures		$16,930

5. During the year, Mr. Tong took his children to visit their grandparents using airline tickets acquired through frequent flyer points accumulated while he travelled on company business. The tickets were valued at $1,300.

6. On December 25, 2010, Mr. Tong sold all of his 800 shares of Global Inc., a public corporation, for proceeds of $8,600. The shares were acquired for $11,000. On January 10, 2011, on the advice of his broker, he acquired 800 shares of Global Inc. for $5,800.

7. Mr. Tong participates in Portus Ltd.'s stock option plan. In January, 2010, he received options to purchase 2,500 shares at $12 per share. At this time, the shares were trading for $12 per share. He exercises the options in May, 2010, when the shares are trading for $15 per share using funding from a bank loan to pay the option price. During 2010, he paid $1,200 interest on the bank loan.

8. In September, 2010, Mr. Tong receives an eligible dividend on his Portus shares of $4,500. He uses the funds to purchase 250 more Portus shares at $18 per share. In November, 2010, Mr. Tong sold 1,250 shares of Portus Ltd. at $21 per share.

9. In 2009, Mr. Tong contributed $4,300 to a spousal RRSP. His wife had not previously contributed to an RRSP. In August, 2010, Mr. Tong's wife withdrew $1,000 from the RRSP to fund a jewelry purchase. Mrs. Tong had no other income in 2010. On February 10, 2011, Mr. Tong contributes $8,000 to a spousal RRSP.

10. At the beginning of 2010, Mr. Tong had undeducted RRSP contributions carried forward from 2009 of $2,200. Mr. Tong's 2009 Earned Income was $61,500. Because he was only admitted to his employer's pension plan at the beginning of 2010, he has no 2009 PA.

11. Mr. Tong's oldest child, Marion, is 19 years of age. During the year, she attended university on a full time basis for eight months, had interest income of $3,000 and earned a scholarship of $10,000. Mr. Tong paid her paid tuition fees of $7,150. Any unused credits are available to be transferred to her father.

12. Mr. Tong purchased a sports car for $2,500 on February 20, 2010, with the intent of restoring it for resale. He rebuilt the car and sold it to a collector for $14,500 on April 10, 2010. He incurred costs of $8,100 for new parts and supplies.

13. Mr. Tong incurred net capital losses of $2,500 in 2004 [(1/2)($5,000)], $6,000 in 2005 [(1/2)($12,000)], and $3,000 in 2007 [(1/2)($6,000)]. He has not been able to deduct any of these amounts in previous years.

Required:

A. Determine Mr. Tong's minimum Net Income For Tax Purposes and his minimum Taxable Income for the 2010 taxation year. Ignore any GST or PST considerations.

B. Based on your answer to Part A, calculate Mr. Tong's minimum federal Tax Payable for the 2010 taxation year before consideration of any income tax withheld by his employer. Include in your solution any amounts available for carry forward by Mr. Tong or his family at the end of 2010.

Chapter Twelve Test Item File Problems

TIF PROBLEM TWELVE - 1

Taxable Income And Tax Payable For Corporations - Essay Questions

1. One of your more socially conscious friends has just learned that dividends received by a Canadian corporation from other Canadian corporations are not subject to any form of taxation. In his view, this is additional evidence of how the government is allowing corporations to "rip-off" the Canadian public. Do you agree with the view being expressed by your friend? Explain your position.

2. What is the purpose of the stop loss rule applicable to shares that a corporation sells at a loss? When does this rule apply?

3. Compare the tax treatment of charitable donations for corporations with the treatment of charitable donations for individuals.

4. A corporation has non-capital loss carry forwards and net capital loss carry forwards. How does management decide which of these carry forwards should be deducted first?

5. How does a corporation determine the amount of Taxable Income that will be allocated to the various provinces?

6. What is a specified investment business? This definition represents a solution to an administrative problem that caused difficulties for the CRA for many years. What was this problem?

7. With respect to both the small business deduction and the M&P deduction, the available amount is limited by the corporation's Taxable Income for the year. Why is this limitation included in the calculation of these tax credits?

8. In the formula that limits the amount of the small business deduction, the Taxable Income limit is reduced by 3 times the corporation's foreign tax credit on business income. What is the reason for this reduction?

9. Explain why the M&P deduction is no longer important in the determination of federal Tax Payable. Given this, why has the legislation for this provision not been eliminated from the *Income Tax Act*?

10. In calculating the foreign business income tax credit, the "tax otherwise payable" does not include a deduction for the 10 percent federal tax abatement. Why is this the case?

TIF PROBLEM TWELVE - 2
Taxable Income And Tax Payable For Corporations - True Or False

1. Charitable contributions that are not used during the current year can be carried forward for five years, without regard to whether the taxpayer is an individual or a corporation.

   True or False?

2. Dividends received from taxable Canadian corporations are not included in the Net Income For Tax Purposes of Canadian corporations.

   True or False?

3. A corporation can deduct all dividends received, without regard to the source of the dividends.

   True or False?

4. A net capital loss carry forward can only be deducted to the extent that there are net taxable capital gains in the carry forward year.

   True or False?

5. Non-capital loss carry overs must be deducted in the order in which they were incurred, the oldest one first, followed by amounts arising in later years.

   True or False?

6. The federal tax abatement is always equal to 10 percent of a corporation's Taxable Income.

   True or False?

7. For 2010, the general rate reduction provides for a deduction equal to 10 percent of a corporation's Full Rate Taxable Income.

   True or False?

8. For purposes of calculating the small business deduction, interest revenue can never be included in active business income.

   True or False?

9. The base used for calculating the M&P deduction is reduced by the amount of the small business deduction.

   True or False?

10. A corporation's non-business foreign income tax credit is limited to 15 percent of foreign non-business income earned.

    True or False?

TIF PROBLEM TWELVE - 3
Taxable Income And Tax Payable For Corporations - Multiple Choice

Taxable Income

1. When dividends are paid by one taxable Canadian corporation to another taxable Canadian corporation, the recipient corporation will include the dividends in:

   A. Both Taxable Income and Net Income For Tax Purposes, but with an offsetting credit against Tax Payable.
   B. Both Taxable Income and Net Income For Tax Purposes, with no offsetting credit against Tax Payable.
   C. Neither Taxable Income nor Net Income For Tax Purposes.
   D. Net Income For Tax Purposes, but not Taxable Income.
   E. Taxable Income, but not Net Income For Tax Purposes.

2. With respect to charitable donations made by a corporation, which of the following statements is correct?

   A. They create a credit against Tax Payable, based on the corporation's tax rate prior to the deduction of the federal abatement.
   B. If they cannot be used during the current year, they can be carried back three years.
   C. They are a deduction in the determination of corporate Taxable Income but not corporate Net Income.
   D. The amount of contributions that can be deducted is only limited by the corporation's Net Income For Tax Purposes for the year.

3. Which of the following items cannot be deducted in the determination of Taxable Income for a corporation?

   A. Dividends from taxable Canadian corporations.
   B. Charitable contributions.
   C. The lifetime capital gains deduction.
   D. Net capital losses.

4. During the current year, Loner Ltd. has a business loss of $250,000, net taxable capital gains of $45,000, an Allowable Business Investment Loss of $15,000, and receives dividends from taxable Canadian corporations in the amount of $35,000. What is the amount of the non-capital loss for the year?

   A. $185,000.
   B. $220,000.
   C. $250,000.
   D. $265,000.

Tax Payable

5. With respect to the determination of Tax Payable for a corporation, which of the following statements is correct?

   A. Provincial tax is calculated as a percentage of federal Tax Payable.
   B. The general rate reduction percentage is applied to full rate taxable income.
   C. The basic federal tax rate is equal to 28 percent of Taxable Income.
   D. The federal tax abatement is always equal to 10 percent of Taxable Income.

6. With respect to the determination of Tax Payable for a corporation, which of the following statements is not correct?

   A. The federal tax abatement percentage is reduced when less than 100 percent of the corporation's income is allocated to a province.
   B. The basic tax rate applicable to corporations is 38 percent.
   C. Provincial corporate taxes are based on a flat rate applied to a taxable income figure.
   D. Full rate taxable income includes any income that is not eligible for the small business deduction.

Small Business Deduction

7. The 17 percent small business deduction is only available on:

   A. Income earned in Canada by a resident corporation.
   B. The first $500,000 in manufacturing and processing income earned by a Canadian controlled private corporation.
   C. The active business income of a private corporation with no more than five full-time employees devoted to the production of property income.
   D. All of the income earned in Canada by a Canadian controlled private corporation.
   E. None of the above.

8. Which of the following is an example of a Canadian controlled private corporation?

   A. A Canadian corporation in which 55 percent of the common shares are owned by Canadian residents and the remaining 45 percent of the common shares are owned by non-residents. The shares are all privately held.
   B. A wholly-owned Canadian subsidiary of a public company.
   C. A Canadian corporation in which Mr. Adams and Mr. Peters each own 50 percent of the shares. Both Mr. Adams and Mr. Peters are Canadian residents.
   D. Both B and C.
   E. Both A and C.

9. Caribbean Cruise Tours (CCT) is a Canadian controlled private corporation that operates a chain of travel agencies. In its most recent fiscal year, the Company had the following financial results:

Active business income earned in Canada	$125,000
Active business income earned outside Canada	25,000
Taxable capital gains	Nil
Investment income earned in Canada	100,000
Net Income For Tax Purposes	$250,000
Taxable Income	$175,000

The company paid no foreign taxes on its foreign operations.

CCT has no associated corporations. Which one of the following amounts represents the **maximum** amount of income on which CCT may claim the small business deduction?

   A. $125,000.
   B. $150,000.
   C. $175,000.
   D. $225,000.

10. Village Concrete Inc. (Village) is a Canadian controlled private corporation (CCPC) with a year end of December 31, 2010. The owner of Village also controls Bob's Roofing Inc. (Bob's), another CCPC with active business income for the year ended December 31, 2010 of $116,500. The owner has agreed to allocate a sufficient amount of the small business deduction to Bob's to ensure that all of its active business income is taxed at the lower rate.

    Other than the income related items listed below, you may assume that Village's income is from active business in Canada.

    Other information about Village:

    1. Village had a taxable capital gain in the year of $2,000.
    2. Charitable donations were $2,500.
    3. Recaptured CCA from operating assets was $1,000.
    4. Net Income For Tax Purposes for the year was $185,000.

    What is the appropriate small business deduction for Village?

    A. $30,940.
    B. $31,025.
    C. $31,110.
    D. $48,195.

Manufacturing And Processing Deduction

11. Giganto Inc. is a CCPC that is not associated with any other company. As determined by ITR 5200, Giganto Inc. has M&P profits of $575,000, with all of this amount being Canadian source active business income. Its total Net Income For Tax Purposes is $625,000, with the additional $50,000 being foreign source business income. The foreign government withheld 10 percent of this amount which is equal to the foreign business income tax credit. In determining Taxable Income, Giganto deducted a non-capital loss carry forward of $75,000. What is Giganto's M&P deduction for the year?

    A. $75,000
    B. $ 7,500
    C. $ 3,500
    D. $35,000

12. With respect to the manufacturing and processing deduction, which of the following statements is not correct?

    A. The manufacturing and processing deduction is available to any corporation that has manufacturing and processing profits.
    B. At the federal level, there is no tax advantage associated with the use of the manufacturing and processing deduction.
    C. The amount of manufacturing and processing profits is determined by a formula that is found in the Income Tax Regulations.
    D. The base for the manufacturing and processing deduction cannot exceed manufacturing and processing profits, reduced by the amount eligible for the small business deduction.

General Rate Reduction

13. Which of the following statements with respect to the general rate reduction for corporations is not correct?

    A. The general rate reduction is calculated by applying a specified percentage to full rate taxable income.
    B. Full rate taxable income for a public company is equal to regular Taxable Income, reduced by the income eligible for the manufacturing and processing deduction.
    C. The general rate reduction is not available to Canadian Controlled Private Corporations (CCPCs).
    D. While the basic tax rate for corporations remains at 38 percent, the general rate reduction serves to reduce the effective tax rate for corporations that have full rate taxable income.

Foreign Tax Credits

14. With respect to foreign non-business tax credits for corporations, which of the following statements is correct?

    A. If the credit cannot be used during the current period, it can be carried back three years and forward ten years.
    B. The amount of the credit is limited to 15 percent of the foreign source non-business income.
    C. The credit will be equal to the amount of foreign taxes withhold.
    D. The full amount of foreign non-business income earned must be included in the corporation's Taxable Income.

15. With respect to foreign business tax credits for corporations, which of the following statements is not correct?

    A. If the credit cannot be used during the current period, it can be carried back three years and forward ten years.
    B. In the formula that limits this credit, the Tax Otherwise Payable is reduced by the federal tax abatement.
    C. In the formula that limits this credit, the Tax Otherwise Payable is reduced by the general rate reduction.
    D. In the formula that limits this credit, the Adjusted Division B Income is reduced by dividends that are deducted in the determination of Taxable Income.

TIF PROBLEM TWELVE - 4
Taxable Income And Tax Payable For Corporations - Exam Exercises

Exam Exercise Twelve - 1 (Schedule 1 Reconciliation)

You have been asked to prepare a Schedule 1 reconciliation of accounting Net Income and Net Income For Tax Purposes for the year ending December 31. Available information includes the following:

1. A capital asset was sold near the end of the year for $93,000. It had a cost of $89,300 and a net book value of $26,400. It was not the last asset in its CCA class and the UCC of this class was $263,000 before the disposition. There were no other additions or dispositions during the year.
2. During the year, the company has expensed estimated warranty costs of $22,000.
3. During the year, the Company acquired goodwill at a cost of $68,000. Since there was no impairment of the goodwill during the year, no write-down was required for accounting purposes.
4. Discount amortization on the company's bonds payable was $2,300 for the current year.

Required: Determine the addition and/or deduction that would be made in Schedule 1 for each of the preceding items.

Exam Exercise Twelve - 2 (Corporate Taxable Income)

The FG Company had Net Income For Tax Purposes for the year ending December 31, 2010 of $275,000. This amount included $13,720 in taxable capital gains, as well as $15,600 in dividends received from taxable Canadian corporations. Also during 2010, the Company made donations to registered charities of $9,100. At the beginning of the year, the Company had a non-capital loss carry forward from 2006 of $74,000, as well as a net capital loss carry forward from 2005 of $20,000 [(1/2)($40,000)].

Determine the Company's minimum Taxable Income for the year ending December 31, 2010 and the amount and type of any carry forwards available at the end of the year.

Exam Exercise Twelve - 3 (Stop Loss Rules)

On February 21, 2010, Markham Inc. acquires 1,000 shares of Darcy Ltd., a widely held public company, at a cost of $27.60 per share. On March 1, 2010, these shares pay a dividend of $1.97 per share. Markham sells the shares on March 25, 2010 for $22.11 per share. Markham Inc. has taxable capital gains of $23,000 in the year.

What is the amount of the allowable capital loss, if any, that Markham Inc. will include in its tax return for the taxation year ending December 31, 2010?

Exam Exercise Twelve - 4 (Non-Capital Loss Carry Forward)

Badon Inc. is a Canadian public company. The following information is for its taxation year ending December 31, 2010:

Capital Gains On Capital Asset Sales	$204,000
Capital Losses On Public Company Stock Sales	(171,000)
Allowable Business Investment Loss	(10,450)
Dividends Received	87,000
Canadian Source Interest Income	53,100
Business Loss	(427,500)

The Company also has a net capital loss carry forward from the 2005 taxation year of $37,400 [(1/2)($74,800)]. It would like to deduct this loss during the current year.

Determine the non-capital loss balance [ITA 111(8)(b)] for Badon Inc. at the end of the 2010 taxation year and any available net capital loss carry forward.

Exam Exercise Twelve - 5 (Net Capital And Non-Capital Loss Carry Forwards)

During the year ending December 31, 2009, Melanor Ltd. reported accounting Income Before Taxes of $225,000. This was followed in the year ending December 31, 2010, by an accounting Loss Before Taxes of $372,000. Both of these amounts were determined using generally accepted accounting principles. Included in the above income figures were the following amounts:

	2009	2010
Donations To Registered Charities	$ 7,100	$ 9,600
Gains (Losses) On Sale Of Shares	33,000	(17,000)
Dividends Received	23,000	37,000

The above accounting gains (losses) on the sale of shares are equal to the capital gains (losses) on the sale of the shares.

At the beginning of the 2009 taxation year, the Company has a non-capital loss carry forward of $12,000 and a net capital loss carry forward from 2006 of $10,000 [(1/2)($20,000)]. There has not been sufficient Net Income For Tax Purposes to deduct these amounts in any previous year.

It is the policy of Melanor Ltd. to minimize non-capital loss carry overs.

Required: Calculate the minimum Net Income For Tax Purposes and Taxable Income for each of the two years 2009 and 2010 and indicate the amount and type of any carry overs that are available at the end of each year.

Exam Exercise Twelve - 6 (Geographical Allocation)

Ramsden Inc., a Canadian public company, has Taxable Income for the taxation year ending December 31, 2010 in the amount of $242,000. It has Canadian permanent establishments in Saskatchewan and Alberta. The Company's gross revenues for the 2010 taxation year are $3,013,000, with $1,520,000 of this accruing at the permanent establishment in Saskatchewan, and $912,000 accruing at the permanent establishment in Alberta. Wages and salaries total $192,000 for the year. Of this total, $63,000 is at the permanent establishment in Saskatchewan and $85,000 is at the permanent establishment in Alberta. Ramsden has sales to the U.S. through a U.S. permanent establishment.

Calculate federal Tax Payable for the taxation year ending December 31, 2010. Ignore any foreign tax implications.

Exam Exercise Twelve - 7 (Small Business Deduction)

Meridian Inc. is a CCPC throughout the year and is not associated with any other corporation. For the year ending December 31, 2010, Meridian has Net Income For Tax Purposes of $522,000. This amount is made up of dividends from taxable Canadian corporations of $72,000, active business income of $400,000, and foreign non-business income of $50,000. The foreign income was subject to withholding in the foreign jurisdiction at a rate of 13 percent. Meridian receives a foreign tax credit against federal Tax Payable that is equal to the amount withheld. Meridian has a non-capital loss carry forward of $145,000 which it intends to deduct during 2010.

Determine the amount eligible for the small business deduction for the year ending December 31, 2010.

Exam Exercise Twelve - 8 (Small Business Deduction Reduction)

Teeny Ltd. is a Canadian controlled private corporation. Its Net Income For Tax Purposes is $652,000 for the year ending December 31, 2010, all of which is active business income, except for $21,000 in foreign source non-business income. Ten percent of this amount was withheld in the foreign jurisdiction, and the corporation receives a foreign tax credit against federal Tax Payable that is equal to the amount withheld. The corporation's only deduction in the calculation of Taxable Income is for a non-capital loss carry forward of $415,000. The corporation had Taxable Capital Employed In Canada of $12,950,000 for the year ending December 31, 2009, and $13,100,000 for the year ending December 31, 2010. It is not associated with any other corporation.

Determine the amount of Teeny Ltd.'s small business deduction for the year ending December 31, 2010.

Exam Exercise Twelve - 9 (M&P And SBD)

Bartlett Operations Inc. is a Canadian controlled private corporation throughout 2010. It has Net Income For Tax Purposes of $476,000, a figure that includes $424,000 in manufacturing and processing profits (as per ITR 5200). The $476,000 also includes foreign source business income of $25,000 and taxable capital gains of $27,000. Because of withholding on the foreign source business income, the Company is entitled to a foreign tax credit of $3,700. The Company's only deduction in the calculation of Taxable Income is donations to registered Canadian charities in the amount of $201,000. Bartlett is not associated with any other company and anticipates large increases in Taxable Income in the next few years.

Determine the amount of Bartlett's small business deduction and M&P deduction for the year ending December 31, 2010. Include in your answer any alternatives that could be used to save taxes.

Exam Exercise Twelve - 10 (Simple Federal Tax Payable - Public Company)

For the year ending December 31, 2010, Tuleta Ltd., a Canadian public company, has Taxable Income of $296,000. Of this total, $165,000 qualifies for the M&P deduction. Calculate Tuleta Ltd.'s federal Tax Payable for the year ending December 31, 2010.

Exam Exercise Twelve - 11 (Simple Federal Tax Payable - CCPC)

Danforth Inc. is a Canadian controlled private corporation. For the year ending December 31, 2010, the Company has Taxable Income of $262,000, all of which is active business income. Of this amount, $201,000 results from M&P activity. As it is associated with two other corporations, its share of the annual business limit is $117,000. Determine the Company's federal Tax Payable for the year ending December 31, 2010.

Exam Exercise Twelve - 12 (Foreign Tax Credits)

Tembina Ltd. is a Canadian public company. For the year ending December 31, 2010, it has Net Income For Tax Purposes of $135,000, including foreign business income of $27,000. The foreign government withheld $4,050 in taxes on this income, resulting in a net remittance of $22,950. None of the Company's income involves manufacturing and processing and, based on the ITR 402(3) formula, 91 percent of the Company's income was allocated to a province. In calculating Taxable Income, the Company deducts $23,000 in dividends received from taxable Canadian corporations, a non-capital loss carry forward of $51,000, and a net capital loss carry forward of $19,000.

Determine the Company's Part I Tax Payable for the year ending December 31, 2010. Include in your answer any carry overs available at the end of the year.

TIF PROBLEM TWELVE - 5
Taxable Income And Tax Payable For Corporations - Key Term Matching

The following five key terms are listed at the end of Chapter 12, “Taxable Income and Tax Payable For Corporations”.

A. Specified Investment Business

B. Net Capital Loss

C. General Rate Reduction

D. Canadian Controlled Private Corporation

E. Annual Business Limit

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. The excess of allowable capital losses over taxable capital gains for the current year.
2. A corporation that has five or more full time employees throughout the year, whose principal purpose is to derive income from property.
3. The maximum amount of income that is eligible for the small business deduction in a particular taxation year.
4. A corporation that is controlled by persons resident in Canada and that does not have any of its shares listed on a designated stock exchange.
5. The excess of taxable capital gains over allowable capital losses for the current year.
6. A percentage point deduction in the calculation of corporate Tax Payable that is designed to reduce the general corporate tax rate to 38 percent.
7. A corporation that does not have five or more full time employees throughout the year, whose principal purpose is to derive income from property.
8. A corporation that is controlled by individuals who are citizens of Canada and that does not have any of its shares listed on a designated stock exchange.
9. The maximum amount of active business income that is eligible for the small business deduction in a particular taxation year.
10. A percentage point deduction in the calculation of corporate Tax Payable that is designed to reduce the general corporate tax rate of 38 percent.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM TWELVE - 6
Corporate Net Income For Tax Purposes

One of your junior assistants, Mr. John Ying, has been calculating Net Income For Tax Purposes for Yang Inc. for the current year ending December 31. While he has completed the Schedule 1 reconciliation, there are a number of items on which he is asking for your verification of his conclusion. The items are as follows:

1. During the year ending December 31, the Company made charitable donations of $15,000. This amount was deducted in the accounting records and your assistant is certain that this amount will be considerably less than 75 percent of the current year's Net Income For Tax Purposes.

2. During December of the current year, the Company sold its only Class 43 asset for $120,000. The original cost of the asset was $215,000 and its net book value at the time of sale was $162,000. At the beginning of the year, the Class 43 UCC was $131,500. No additional Class 43 assets were acquired during the current year.

3. At the beginning of the current year, Yang Inc. acquired all of the assets of another business and, in the process, paid $97,000 for the goodwill of the business. For accounting purposes, a $19,400 write-down for a goodwill impairment loss was taken for the current year. The goodwill qualifies as an eligible capital expenditure for tax purposes.

4. During the current year, the Company has recorded amortization expense of $176,000. The maximum CCA that the Company could deduct for the current year is $220,000. They have instructed you to deduct the maximum CCA.

5. During December of the current year, the Company sold a parcel of unneeded land for $250,000, receiving one-quarter of this amount in cash and the other three-quarters in the form of a note to be paid after five years. The cost and adjusted cost base of the land was $175,000.

6. The Company has a variety of bond issues outstanding, some of which were issued at a discount and others at a premium. The interest expense deducted in the accounting records on these bonds was $122,500. This amount reflected $3,000 in premium amortization and $4,200 in discount amortization.

7. The Company paid $25,000 for five memberships in a local golf club for its employees. These employees were all commission sales persons and, during the current year, they spent $47,000 entertaining clients at the club. The Company did not reimburse the sales persons for these expenses.

Required: For each of the items listed, indicate the addition to and/or deduction from accounting Net Income that would be required in the calculation of the minimum Net Income For Tax Purposes.

TIF PROBLEM TWELVE - 7
Corporate Net Income, Taxable Income, And Tax Payable

For its taxation year ending December 31, 2010, the condensed Income Statement of Manipee Systems Limited (MSL), prepared in accordance with generally accepted accounting principles, was as follows:

Manipee Systems Limited
Condensed Income Statement
Year Ending December 31, 2010

Revenues	$926,000
Expenses (Excluding Taxes)	(713,000)
Income Before Taxes	$213,000

Other Information:

1. The Company was Canadian controlled throughout the year. All of its shares are privately held by Ms. Mildred Manipee and her immediate family. It is not associated with any other company.
2. The Company's Expenses included amortization of $126,000. The Company's accountant has calculated maximum CCA for the year to be $138,000.
3. The Company's Revenues include a gain on the sale of a depreciable asset of $27,000. The asset had a cost of $109,000, a net book value of $105,000, and was sold for $132,000. It was not the last asset in its CCA class, and the UCC balance in the class at the end of the year was positive.
4. Revenues include dividends from taxable Canadian corporations in the amount of $12,000.
5. The Company has a net capital loss carry forward from 2009 of $22,500 [(1/2)($45,000)].
6. At the beginning of 2010, MSL has a non-capital loss carry forward of $126,000.
7. During the year, the Company's Canadian active business income totalled $156,000.
8. The Company had permanent establishments in Ontario and Manitoba and also carried on business in the United States. The amount of revenues and salaries in these locations were as follows:

	Ontario	Manitoba	United States
Revenues	$427,000	$310,000	$150,000
Salaries	162,000	87,000	26,000

The operations in the United States did not make a profit and, as a consequence, no foreign taxes were withheld.

Required:

A. Calculate the minimum Net Income For Tax Purposes for MSL for the year ending December 31, 2010.

B. Calculate the minimum Taxable Income for MSL for the year ending December 31, 2010. Indicate the amount, and type, of any loss carry overs that are available at the end of the year.

C. Calculate the minimum federal Part I Tax Payable for MSL for the year ending December 31, 2010.

TIF PROBLEM TWELVE - 8
Corporate Tax Payable With Foreign Tax Credit

Worldwide Enterprises was established in 1995 and has been a Canadian controlled private corporation since its incorporation. Its head office is located in Vancouver and it has branches in both Seattle, Washington and Portland, Oregon. Its taxation year ends on December 31. All income of the Company is derived from the sale of seafood in local markets.

During the 2010 taxation year, the Company's Net Income For Tax Purposes and Taxable Income amount to $219,000. This amount includes $32,000 (Canadian) that was earned by the two branches operating in the United States. The $32,000 earned by these branches is before the deduction of any U.S. or Canadian income taxes. As a result of earning this amount in the United States, the Company was required to pay $6,200 (Canadian) in U.S. federal income tax and $3,400 (Canadian) in state income taxes.

Required:

A. Calculate Worldwide Enterprises' federal Part I Tax Payable for the 2010 taxation year. For the purposes of calculating the small business deduction, assume the foreign business income tax credit is equal to the foreign tax withheld.

B. Using your results from Part A, verify that the foreign business income tax credit is equal to the foreign tax withheld.

Show all calculations, whether or not they are necessary to the final solution.

Chapter Thirteen Test Item File Problems

TIF PROBLEM THIRTEEN - 1
Corporate Investment Income - Essay Questions

1. The concept of integration is central to the Canadian system of corporate taxation. Briefly explain the basic objective of integration as it is applied in the Canadian system of corporate taxation.

2. Explain, without using examples, how the dividend gross up and tax credit procedures assist in achieving the goal of the integration approach to taxing CCPCs and their shareholders. Assume any dividends paid are not designated eligible.

3. Eligible dividends, with their enhanced gross up and tax credit procedures, were introduced to correct a flaw in the Canadian system of integration. Describe the flaw and briefly explain how these enhanced procedures serve to correct this problem.

4. What are the components of "aggregate investment income" as described in ITA 129(4)?

5. In the absence of the Part I refundable tax, the total personal and corporate taxes on investment income earned by, and flowed through, a CCPC could approach an unreasonably high 60 percent. While the Part I refundable tax reduces this combined rate to a more reasonable level, the same result could have been achieved by lowering the tax rate applicable to the investment income of a CCPC. Why did the government not adopt this less complex alternative?

6. What is the objective of the Additional Refundable Tax (ART) that is assessed under ITA 123.3? Briefly explain your conclusion.

7. What is the objective of the Part IV Refundable Tax on certain types of dividends received by a private company? Briefly explain your conclusion.

8. What is a connected corporation? Under what circumstances will Part IV tax be applicable to dividends received from such corporations?

9. Briefly describe the components of the Refundable Dividend Tax On Hand (RDTOH) account.

10. A CCPC can only designate dividends as eligible to the extent that it has a GRIP balance. Indicate the two most common sources of additions to this balance.

TIF PROBLEM THIRTEEN - 2
Corporate Investment Income - True Or False

1. A major goal of integration is to ensure that, if an individual has a given income source, he will retain the same after tax amount of cash from that source, without regard to whether he receives the income directly or, alternatively, the income is routed through a corporation prior to his ultimate receipt of the after tax amount.

   True or False?

2. For integration to work properly for a CCPC eligible for the small business deduction, the combined federal/provincial tax rate on corporations must be equal to 20 percent, while the combined federal/provincial dividend tax credit must be equal to two-thirds of the gross up.

   True or False?

3. For integration to work properly, the combined federal/provincial dividend tax credit must be equal to the gross up. For eligible dividends, this will occur in 2010 when the provincial dividend tax credit rate is equal to 7/17 of the gross up.

   True or False?

4. The Part I refundable tax procedures are designed to prevent deferral of taxes on income from investments that have been transferred to a corporation by an individual.

   True or False?

5. Aggregate investment income as defined in ITA 129(4) includes interest, rents, dividends, and taxable capital gains.

   True or False?

6. The Part IV refundable tax is assessed on portfolio dividends and on all dividends received from connected companies.

   True or False?

7. Company A owns 12 percent of the voting shares, and 15 percent of the fair market value of all of the issued shares of Company B. Company B is connected with Company A.

   True or False?

8. The Refundable Dividend Tax On Hand (RDTOH) balance at the end of the year includes the refundable Part I tax for the current year, the refundable Part IV tax for the current year, the corporation's RDTOH balance at the end of the preceding year, with this total reduced by the corporation's dividend refund for the preceding year.

   True or False?

9. A corporation's dividend refund for the year will be the lesser of the balance in the RDTOH account at the beginning of the year and one-third of the taxable dividends paid for the year.

   True or False?

10. In 2010, a CCPC's GRIP balance is increased by 69 percent of eligible dividends received during the year.

    True or False?

TIF PROBLEM THIRTEEN - 3
Corporate Investment Income - Multiple Choice

Integration

1. Which of the following statements with respect to eligible dividends declared in 2010 is not correct?

   A. The recipient individual shareholder must gross them up by 44 percent.
   B. They generate a federal tax credit equal to 10/17 of the gross up.
   C. They can only be designated as eligible dividends by public companies.
   D. They can be designated as eligible dividends by a CCPC with a positive GRIP balance.

2. Which of the following statements with respect to non-eligible dividends declared in 2010 is correct?

   A. The combined federal/provincial dividend tax credit will be equal to the gross up.
   B. The recipient individual shareholder must gross them up by 44 percent.
   C. Dividends paid by CCPCs are always non-eligible.
   D. To the extent that the company has an LRIP balance, dividends paid by public companies will be non-eligible.

3. With respect to integration, which of the following statements is correct for 2010?

   A. For integration to be effective in situations where non-eligible dividends are paid, the combined federal/provincial tax rate on corporations must be equal to 30.6 percent.
   B. For integration to be effective in situations where non-eligible dividends are paid, the provincial tax rate on individuals must be 14 percent.
   C. For integration to be effective in situations where eligible dividends are paid, the provincial dividend tax credit must be equal to one-third of the dividend gross up.
   D. For integration to be effective in situations where non-eligible dividends are paid, the combined federal/provincial tax rate on corporations must be equal to 20 percent.

Refundable Part I Tax

4. Aggregate investment income, as defined in ITA 129(4), includes the following:

   A. Dividends from any source.
   B. Net taxable capital gains for the year, less net capital loss carry overs deducted.
   C. Interest and rents, but not foreign source property income.
   D. Interest, rents, and dividends.

5. During the current year, Norton Tools Ltd. has net taxable capital gains of $45,000, receives dividends of $34,000, and earns interest income of $21,000. Taxable Income for the year equals $280,000, of which $210,000 is eligible for the small business deduction. The Company's additional refundable tax for the year is equal to:

   A. $4,667
   B. $6,667
   C. $4,400
   D. $3,667

6. A Ltd. is a Canadian controlled private corporation that operates a chain of fast-food restaurants. In its most recent fiscal year, the Company had the following financial results:

Active business income eligible for the small business deduction	$200,000
Taxable capital gains	Nil
Foreign investment income	55,000
Investment income earned in Canada	45,000
Net Income For Tax Purposes	$300,000
Taxable Income	$250,000

The Company paid no foreign taxes on its foreign investment income. A Ltd. is not associated with any other corporations.

Which one of the following amounts represents the refundable portion of Part I tax?

A. $12,000.
B. $13,333.
C. $26,667.
D. $66,667.

7. With respect to Part I refundable taxes, which of the following statements is correct?

A. It is an additional tax which must be paid on aggregate investment income.
B. It is applicable to all public companies with aggregate investment income.
C. It is always refundable at the rate of $1 for each $3 of dividends paid.
D. It is designed to prevent the deferral of taxes on investment income that is retained by a CCPC.

Part IV Tax Payable

8. Premier Investments Inc. (Premier) is a private corporation. Premier received $20,000 of dividends from its investments in publicly traded Canadian shares during its taxation year ended June 30, 2010. Premier has loss carry forwards as follows: non-capital losses of $3,000, net capital losses of $5,000, and farm losses of $7,000. All of these losses are available for application in Premier's 2010 taxation year. Assuming Premier has no other income, what is Premier's minimum 2010 Part IV Tax Payable?

A. Nil.
B. $1,667.
C. $3,334.
D. $5,666.

9. Which of the following statements with respect to Part IV tax is correct?

A. Only CCPCs are required to pay Part IV tax.
B. The Part IV tax is assessed on all dividends received from connected companies.
C. The refundable portion of Part IV tax is equal to 26-2/3 percent of aggregate investment income.
D. The Part IV tax is assessed on portfolio dividends.

RDTOH

10. Morgan Ltd., a CCPC, had a $25,000 balance in its Refundable Dividend Tax On Hand (RDTOH) account on December 31, 2009, the end of its taxation year. Its refundable portion of Part I tax, before any refunds, for the 2010 year is $10,000. It did not receive any dividends in 2010. Morgan Ltd. paid dividends of $15,000 in each of 2009 and 2010. What is the balance in Morgan Ltd.'s RDTOH account at December 31, 2010?

    A. $25,000.
    B. $30,000.
    C. $35,000.
    D. $40,000.

11. With respect to the RDTOH account, which of the following statements is not correct?

    A. The balance is increased by the amount of Part IV tax paid during the taxation year.
    B. The balance is reduced by one-third of any dividends paid during the taxation year.
    C. The balance is increase by the portion of Part I tax that is designated as refundable.
    D. The balance is reduced by any dividend refund for its preceding taxation year.

GRIP And LRIP

12. At the end of 2009, Gomez Inc., a CCPC, has a GRIP of $53,400. During 2009, the company designated $13,700 of dividends as eligible. For 2010, the Company has Taxable Income of $143,000. This includes aggregate investment income of $19,000. In addition, the Company receives eligible dividends of $12,300. In calculating 2010 Tax Payable, the Company has a small business deduction of $14,450. Dividends paid during the year total $51,000, with $18,400 of this amount being designated as eligible. What is the amount of the Company's GRIP at the end of the 2010 taxation year?

    A. $78,910
    B. $92,610
    C. $66,610
    D. $74,210

13. With respect GRIP and LRIP balances, which of the following statements is not correct?

    A. A CCPC's GRIP balance is increased by 100 percent of eligible dividends received.
    B. As long as a public company has an LRIP balance, all of its dividends will be non-eligible.
    C. A public company's LRIP balance will be increased by the amount of non-eligible dividends received.
    D. A CCPC's GRIP balance will be reduced by 100 percent of the amount eligible for the small business deduction.

TIF PROBLEM THIRTEEN - 4
Corporate Investment Income - Exam Exercises

Exam Exercise Thirteen - 1 (Integration - Non-Eligible Dividends)

Patrick Innes has a business that he estimates will produce income of $130,000 per year. If he incorporates this business, all of the income would be eligible for the small business deduction and dividends paid would not be designated eligible. In the province where he lives, such corporate income is taxed at a combined federal/provincial rate of 17 percent.

Mr. Innes has other income sources that place him in a combined federal/provincial tax bracket of 42 percent. In his province, the provincial dividend tax credit is equal to 20 percent of the gross up. Would Mr. Innes save taxes if he was to channel this source of income through a corporation? Justify your conclusion.

Exam Exercise Thirteen - 2 (Flow Through Of Investment Income)

Mr. Marcus Fisher has investments that generate interest income of $94,000 per year. Because of his employment income, he is in the top tax bracket, with a combined federal/provincial rate of 47 percent. He is considering the transfer of these investments to his CCPC which would be subject to a tax rate on investment income of 47 percent. The dividend tax credit in his province is equal to 39 percent of the gross up. Any dividends paid by the CCPC out of investment income will be non-eligible. Advise him as to whether there would be any tax benefits associated with this transfer.

Exam Exercise Thirteen - 3 (Refundable Part I Tax)

Starfare Ltd. is a Canadian controlled private corporation. During the taxation year ending December 31, 2010, the Company has the following amounts of property income:

Net Rental Income	$17,600
Capital Gains	91,500
Dividends From Portfolio Investments	41,300
Interest On Long-Term Investments	17,450
Foreign Non-Business Income -	
Net Of 8 Percent Withholding	18,400

The Company's 2010 Net Income For Tax Purposes is $232,350. The Company has a net capital loss from 2005 of $24,000 [(1/2)($48,000)], which is deducted from Taxable Income. A $12,750 small business deduction and a foreign non-business tax credit of $1,600 served to reduce Tax Payable. Assume that the Company's Part I Tax Payable has been correctly determined to be $36,019. Determine the refundable amount of Part I tax for the year ending December 31, 2010.

Exam Exercise Thirteen - 4 (Dividend Refund)

Ho Trading Company is a Canadian controlled private corporation. At the end of the previous year, it had an RDTOH account balance of $43,500. It paid dividends during the previous year of $18,000, resulting in a dividend refund of $6,000. During the current year, Ho Trading Company's only income is $43,000 in taxable capital gains and $12,350 in dividends received from a temporary investment in Royal Bank shares. During the year, the Company declares and pays a $35,000 dividend on its common shares. Determine the Company's dividend refund for the year.

Exam Exercise Thirteen - 5 (GRIP Balance)

Simard Ltd., a CCPC, had no GRIP balance at its year end on December 31, 2008. During 2009, the Company received eligible dividends of $167,000 and designated $153,000 of its dividends paid as eligible. At the end of 2009, Simard has a GRIP of $167,000.

For 2010, Simard has Taxable Income of $476,000. This amount includes taxable capital gains of $13,000, interest income on long-term bonds of $8,000, and a net capital loss deduction of $14,000. In addition, the Company receives eligible dividends during the year of $7,000. In determining 2010 Tax Payable, the Company has a small business deduction of $68,000. During 2010, Simard Ltd. pays dividends of $25,000, with $18,000 of this amount being designated as eligible.

Determine the Company's GRIP balance at the end of 2010.

TIF PROBLEM THIRTEEN - 5
Corporate Investment Income - Key Term Matching

The following five key terms are listed at the end of Chapter 13, "Taxation Of Corporate Investment Income".

A. Aggregate Investment Income

B. Part IV Tax

C. General Rate Income Pool (GRIP)

D. Portfolio Dividend

E. Integration

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a corporation to all of its shareholders, are subject to the same amount of tax as would be the case if the shareholders had received the income directly from its source.

2. As defined in ITA 129(4), this concept of investment income includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, interest income, rents, and dividends received from Canadian corporations.

3. A notional account that tracks amounts of a private company's income that can be used for the payment of eligible dividends.

4. A refundable tax, applicable to private corporations and subject corporations, and assessed on portfolio dividends received as well as some dividends received from connected corporations.

5. A dividend received from a corporation to which the recipient is not associated.

6. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a corporation to its individual shareholders, are subject to the same amount of tax as would be the case if the individuals had received the income directly from its source.

7. As defined in ITA 129(4), this concept of investment income includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, interest income, rents, and royalties.

8. A notional account that tracks amounts of a CCPC's income that can be used for the payment of eligible dividends.

9. A dividend received from a corporation to which the recipient is not connected.

10. A refundable tax, applicable to Canadian controlled private corporations, and assessed on portfolio dividends received as well as some dividends received from connected corporations.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM THIRTEEN - 6
Part I And Part IV Refundable Taxes

Conrod Holdings Ltd. is a Canadian controlled private corporation that sells farm supplies. It owns 70 percent of the outstanding shares of Morsal Inc. On November 1, 2010, Morsal Inc. declared and paid a dividend of $21,000, of which Conrod Holdings Ltd. received $14,700 (70 percent). As a result of paying the $21,000 dividend, Morsal Inc. received a dividend refund in the amount of $7,000.

Other income that was reported by Conrod Holdings consisted of the following amounts:

Capital Gain	$9,200
Dividends From Imperial Oil	500
Interest	450

The capital gain was on the sale of land that was formerly used as a storage area for inventories. Improved inventory control procedures have eliminated the need for this land.

The interest is on deposits of temporary cash balances set aside for the purchase of inventories.

At the end of 2009, the Company's Refundable Dividend Tax On Hand balance was $8,950. The 2009 dividend refund was $4,000.

The Company's Taxable Income for the year ending December 31, 2010 was $44,000. No foreign income was included in this total. Assume the Part I Tax Payable for the year ending December 31, 2010 was correctly calculated as $9,250. Because of its association with Morsal Inc., its share of the annual business limit on income eligible for the small business deduction is $10,000. Conrod's active business income is equal to its share of the annual business limit.

Conrod Holdings paid taxable dividends of $10,000 during 2010.

Required: For the taxation year ending December 31, 2010, calculate the following items for Conrod Holdings:

A. Part IV Tax Payable.
B. Refundable Part I Tax.
C. The balance in the Refundable Dividend Tax On Hand account on December 31, 2010.
D. The dividend refund, if any.

TIF PROBLEM THIRTEEN - 7
Simple Part I With SBD, ART, FTC, M&P And GRR

The following data is for Masterson Ltd., a Canadian controlled private corporation. The data is for the taxation year ending December 31, 2010:

Canadian Source Active Business Income (Includes $99,000 Of Manufacturing And Processing Profits)	$133,000
Foreign Investment Income (Net Of $1,200 In Withheld Foreign Taxes)	6,800
Net Income For Tax Purposes (Division B Income)	141,000
Taxable Income	95,000

No net capital loss carry forwards were deducted during 2010.

Assume that the tax credit on foreign investment income is equal to the $1,200 in taxes withheld.

Required: Calculate the federal Part I Tax Payable for the taxation year ending December 31, 2010. Show all of the calculations used to provide the required information, including those for which the result is nil.

TIF PROBLEM THIRTEEN - 8
Part I Tax With SBD, ART, FTC, M&P, And GRR

Landor Ltd. is a Canadian controlled private corporation. For the taxation year ending December 31, 2010, its Net Income For Tax Purposes has been correctly calculated as $223,500. The components of this income are as follows:

Canadian Active Business Income (Note One)	$183,450
Taxable Capital Gains	11,250
Foreign Business Income (Note Two)	28,800
Net Income For Tax Purposes	$223,500

Note One This includes $146,700 of manufacturing and processing profits, determined using the formula in the Income Tax Regulations.

Note Two This amount is before withholding by tax authorities in the foreign jurisdiction of 10 percent.

Other Information:

1. During 2010, Landor Ltd. declares and pays taxable dividends of $46,000.

2. It is estimated that 88 percent of Landor's wages and 92 percent of Landor's sales are associated with permanent establishments located in a Canadian province.

3. The balance in Landor Ltd.'s Refundable Dividend Tax On Hand (RDTOH) account was nil on December 31, 2009. Landor paid no dividends in 2009.

4. At the beginning of 2010, Landor has a net capital loss carry forward from 2008 of $5,250 [(1/2)($10,500)].

5. Landor Ltd. is associated with another company. They have agreed that Landor's share of the annual business limit will be $110,000.

6. Assume that the foreign tax credit on foreign business income is equal to the amount withheld.

Required: Calculate Landor Ltd.'s minimum federal Tax Payable, net of any available dividend refund, for the year ending December 31, 2010. Show all of the calculations used to provide the required information, including those for which the result is nil.

TIF PROBLEM THIRTEEN - 9
Tax Payable With SBD, ART, GRR, And GRIP

Kinsmore Industries Ltd. is a Canadian controlled private corporation. It is not associated with any other corporation. The Company manufactures small tools and also handles some of its own retail distribution. As all profits are earned in a province that does not have a special tax rate for M&P activities, the Company does not bother with the ITR 5200 calculation of M&P profits that is required for the use of the M&P deduction.

The following aggregate Income Statement has been prepared to assist you in completing Kinsmore's tax return for the year ending December 31, 2010:

Revenues From Operations	$6,300,000
Expenses From Operations	(5,640,000)
Income From Operations	$ 660,000
Canadian Source Interest Income	55,000
Eligible Portfolio Dividends	48,000
Income Before Taxes	$ 763,000

All of the revenues of Kinsmore are earned in Canada and are taxable during 2010. The expenses are all deductible for tax purposes except for amortization expense of $1,250,000. Your calculations indicate that maximum capital cost allowance would be $1,350,000 and you intend to claim this amount.

Other Information:

1. During 2010, a total of $97,000 in taxable dividends were paid to the shareholders of Kinsmore Industries. Of this total, $51,800 was designated as eligible.

2. On December 31, 2009, the balance in the Refundable Dividend Tax On Hand account is nil. Dividends of $50,000 were paid in 2009.

3. At the end of 2009, Kinsmore has a GRIP of $42,500. During 2009, the company designated $31,300 of its dividends paid as eligible.

Required:

A. Calculate Kinsmore Industries Ltd.'s minimum Net Income For Tax Purposes and Taxable Income for the year ending December 31, 2010.

B. Calculate Kinsmore Industries Ltd.'s minimum federal Tax Payable for the year ending December 31, 2010.

C. Determine the amount of Kinsmore Industries Ltd.'s dividend refund for 2010.

D. Determine the December 31, 2010 balance in Kinsmore's GRIP.

Show all of the calculations used to provide the required information, including those for which the result is nil.

TIF PROBLEM THIRTEEN - 10
Tax Payable With SBD, ART, M&P, FTC, GRR, And GRIP

Glandly Inc. is a Canadian controlled private corporation throughout its taxation year ending December 31, 2010. Its Net Income For Tax Purposes for the year is $563,000. The components of this total are as follows:

Foreign Business Income (Before Foreign Taxes Withheld)	$ 83,000
Foreign Non-Business Income (Before Foreign Taxes Withheld)	18,000
Eligible Dividends From Non-Connected Corporations	22,670
Non-Eligible Dividends From Wholly-Owned Subsidiary (The Subsidiary Received A Refund Of $6,000 On Payment)	21,600
Net Taxable Capital Gains	38,250
Manufacturing And Processing Profits (From ITR 5200 Formula)	184,230
Other Canadian Active Business Income	117,100
Canadian Source Interest Income	78,150
Net Income For Tax Purposes	$563,000

Other Information:

1. During 2010, Glandly Inc. declared and paid dividends of $162,000. Of this total, $24,000 was designated as eligible dividends.

2. Glandly Inc. makes donations to registered charities during 2010 in the amount of $49,500.

3. Using the formula described in ITR 402, it has been determined that 87 percent of Glandly Inc.'s Taxable Income was earned in Canada.

4. Glandly Inc. has a net capital loss balance from 2009 of $45,000 [(1/2)($90,000)] and a non-capital loss balance from 2009 of $10,200. Management has indicated that they would like to deduct as much of these amounts as possible in the 2010 tax return.

5. Glandly Inc. is associated with two other Canadian controlled private corporations. They have agreed to allow Glandly to claim $120,000 of the total annual business limit.

6. The December 31, 2009 balance in the Refundable Dividend Tax On Hand (RDTOH) account was $193,500. The dividend refund for the year ending December 31, 2009 was $47,300.

7. At the end of 2009, Glandly has a GRIP of $32,400. During 2009, the company designated $26,800 of its dividends as eligible.

8. The foreign jurisdiction withheld $4,150 for the foreign business income and $4,500 for the foreign non-business income. Assume the foreign tax credits for business and non-business income are equal to the amounts withheld.

Tax Payable With SBD, ART, M&P, FTC, GRR, And GRIP

Required:

A. Determine Glandly Inc.'s minimum Taxable Income for the year ending December 31, 2010.

B. Determine Glandly Inc.'s Part I Tax Payable for the year ending December 31, 2010. In making the required calculations here, assume that in Part A you calculated Glandly Inc.'s Taxable Income to be $420,780 (this may or may not be the correct answer).

C. Determine Glandly Inc.'s Part IV Tax Payable for the year ending December 31, 2010.

D. Determine the December 31, 2010 balance in Glandly Inc.'s Refundable Dividend Tax On Hand (RDTOH) account.

E. Determine Glandly Inc.'s dividend refund for the year ending December 31, 2010.

F. Determine the December 31, 2010 balance in Glandly's GRIP.

Show all of the calculations used to provide the required information, including those for which the result is nil.

Chapter Fourteen Test Item File Problems

TIF PROBLEM FOURTEEN - 1
Other Issues In Corporate Taxation - Essay Questions

1. Briefly describe the basic tax consequences that result from an acquisition of control.

2. When control of a corporation is acquired, ITA 111(4)(e) permits the acquired corporation to elect to have a deemed disposition of any of its capital properties on which there is either unrealized recapture of CCA or unrealized capital gains. Under what circumstances would you advise a client to make this election? Briefly explain your conclusion.

3. Why is it necessary to have the associated company rules?

4. For purposes of applying the associated company rules, how is control defined?

5. For purposes of applying the associated company rules, there is a deeming rule with respect to the holding of rights. Briefly describe this rule.

6. If the government wanted to provide additional tax benefits, how would they choose between using a general rate reduction and, alternatively, one or more investment tax credits?

7. The per share value for Paid Up Capital (PUC) will often be different than the per share value for Adjusted Cost Base (ACB). Briefly explain how such differences arise.

8. For accounting purposes, Shareholders' Equity is divided into Contributed Capital and Retained Earnings. What are the basic components of Shareholders' Equity for tax purposes and how do they relate to the components that are used for accounting purposes?

9. What is the basic purpose of the capital dividend account?

10. A redemption of shares may result in an ITA 84(3) deemed dividend. As the redemption is also a disposition, there may also be a capital gain. Explain how tax legislation avoids some part of the proceeds received for the shares from being double counted as both a deemed dividend and a capital gain.

TIF PROBLEM FOURTEEN - 2
Other Issues In Corporate Taxation - True Or False

1. Any net capital losses that remain unused after an acquisition of control, cannot be used in years subsequent to the acquisition of control.

   True or False?

2. When there is an acquisition of control, depreciable assets must be written down to their fair market value if this amount is less than their capital cost.

   True or False?

3. When there has been an acquisition of control, the acquired corporation can choose to have a deemed disposition of any of its capital assets at any value that is elected for this purpose.

   True or False?

4. For purposes of determining whether corporations are associated, shares owned by a taxpayer's children who are under 18 years of age are deemed to be owned by the taxpayer.

   True or False?

5. Mr. Darby owns 75 percent of the shares of Darby Inc. and his spouse owns 80 percent of the shares of MS Darby Ltd. Darby Inc. and MS Darby Ltd. are associated.

   True or False?

6. For an individual, 40 percent of investment tax credits are eligible for a refund if the individual does not have sufficient Tax Payable to use them during the current taxation year.

   True or False?

7. The tax concept of Paid Up Capital (PUC) is, in general, the same as the accounting concept of contributed capital.

   True or False?

8. If a corporation acquires goodwill for $200,000, deducts maximum CEC for three years, and then sells the goodwill for $250,000, there will be an addition to the capital dividend account of $37,500.

   True or False?

9. When a corporation redeems all or part of its outstanding shares, the difference between the proceeds of redemption and the PUC of the shares will be treated as a capital gain for tax purposes.

   True or False?

10. Capital dividends that have been declared using the ITA 83(2) election are not subject to the usual gross up and tax credit procedures.

    True or False?

TIF PROBLEM FOURTEEN - 3
Other Issues In Corporate Taxation - Multiple Choice

Acquisition Of Control

1. Which of the following is not a consequence of an acquisition of control?

   A. A deemed year end.
   B. The inability to deduct non-capital losses subsequent to the acquisition of control.
   C. The inability to deduct net capital losses subsequent to the acquisition of control.
   D. A requirement to write down non-depreciable assets to their fair market value.

2. Rushmore Limited, a distributor of leather raw materials, currently owns 15 percent of the outstanding common shares of Mount Limited. Bush Limited and Trailco respectively own 52 percent and 33 percent of the outstanding common shares of Mount Limited. Mount Limited, a large shoe manufacturer, has had several years of large losses.

   Which one of the following percentages represents the **minimum** percentage of additional common shares of Mount Limited that Rushmore Limited must purchase in order that there be an acquisition of control?

   A. 33%.
   B. 36%.
   C. 50%.
   D. 51%.

3. Which of the following statements with respect to acquisition of control procedures is not correct?

   A. Prior to the deemed year end, non-depreciable assets will have to be written down to their fair market value.
   B. Net capital losses cannot be carried back to a year prior to the acquisition of control.
   C. Subsequent to the deemed year end, non-capital losses can be deducted against any type of income.
   D. Prior to the deemed year end, the acquired company can elect to have a deemed disposition of any of their capital assets.

Associated Companies

4. Mr. Hanes owns 100% of the common shares of Jimbo Corp. and 40% of the common shares of Hughes Corp. Hughes Corp. owns 80% of the common shares of ARC Ltd. Mr. Hanes' daughter-in-law also owns 5% of the common shares of Hughes Corp., and 15% of the common shares of ARC Ltd. The remaining shares are held by parties who deal at arm's length with Mr. Hanes and his daughter-in-law. The following Companies are associated under ITA 256 of the *Income Tax Act*:

   A. Jimbo Corp. and Hughes Corp.
   B. Jimbo Corp. and ARC Ltd.
   C. Jimbo Corp., Hughes Corp., and ARC Ltd.
   D. Hughes Corp. and ARC Ltd.
   E. None of Jimbo Corp., Hughes Corp., and ARC Ltd. are associated.

5. In which of the following situations are A Ltd. and B Ltd. associated?

   A. Mrs. Jax owns 60% of A Ltd. and Mrs. Jax's niece owns 80% of B Ltd. Mrs. Jax's husband owns the other 40% of A Ltd. and 20% of B Ltd.
   B. Mr. B. owns 60% of A Ltd. and 20% of B Ltd. Mrs. B, Mr. B's spouse, owns the remaining 40% of A Ltd. The remaining 80% of B Ltd. is owned equally by Mr. and Mrs. D, who are not related to Mr. and Mrs. B.
   C. Amos Dans owns 35% of each of A Ltd. and B Ltd. Amos Dan's brother owns an additional 20% of A Ltd. and 30% of B Ltd. The remaining 45% of A Ltd. and 35% of B Ltd. are owned by XYZ Ltd. and JBC Ltd., respectively. XYZ Ltd. and JBC Ltd. are not associated companies.
   D. Young Ltd. owns 55% of B Ltd. and 40% of A Ltd. Boyle Holdings Ltd. owns the remaining 45% of B Ltd., and Kula Holdings Ltd. owns the remaining 60% of A Ltd. Kula Holdings Ltd. and Boyle Holdings Ltd. are owned by L. Kula and A. Boyle, respectively, who are not related.

6. Simon Williams owns 100 percent of Wonder Technologies Inc. Peter Maximoff owns 100 percent of Speedy Delivery Service Ltd. Simon and Peter each own 50 percent of Scarlet Decorating Ltd. Simon is married to Peter's sister, Wanda.

   Assuming each of the three corporations is a CCPC and has at least $500,000 of active business income earned in Canada, what is the maximum combined corporate income on which the three corporations can claim the small business deduction?

   A. Nil.
   B. $ 500,000.
   C. $1,000,000.
   D. $1,500,000.

PUC And ACB

7. Torin Inc. has 500,000 shares issued and outstanding. These shares were issued for total consideration of $1,125,000. At a later point in time, Jane Dow acquired 1,000 of these shares at a total cost of $3,500. With respect to Ms. Dow's holding of Torin shares, which of the following statements is not correct?

   A. The PUC of Ms. Dow's shares is $2,250.
   B. The adjusted cost base of Ms. Dow's shares is $3,500.
   C. If she were to sell the Torin shares for $4,000, she would have a taxable capital gain of $250.
   D. If she were to sell the Torin shares for $4,000, she would have a deemed dividend of $500.

Capital Dividend Account

8. Which of the following items would not be added to the capital dividend account of a private company?

   A. Life insurance proceeds received.
   B. Dividends received from other taxable Canadian corporations.
   C. Capital dividends received from other corporations.
   D. The non-taxable portion of capital gains.

Stock Dividends

9. Vadel Inc., a Canadian public company, has 1,000,000 shares outstanding with a total PUC of $1,750,000. Mr. Vincent Dorval owns 5,000 of these shares with an adjusted cost base of $11,250. Vadel Inc. declares a non-eligible, 5 percent stock dividend at a time when its shares are trading at $2.50 per share. Which of the following statements is correct?

   A. Mr. Dorval's Taxable Income will increase by $781.25 as a result of the dividend.
   B. After the dividend, the adjusted cost base of Mr. Dorval's shares will be $11,875.
   C. After the dividend, the PUC of Vadel's shares will be $1,875,000.
   D. All of the above.
   E. None of the above.

10. Martin Borak owns 50 percent of the shares of a CCPC. The CCPC has declared a 10 percent stock dividend which has resulted in a $22,000 increase in its Paid-Up Capital. The CCPC has no balance in its GRIP account. Which of the following amounts must be included in Martin's income as a result of the stock dividend?

   A. $11,000.
   B. $5,500.
   C. $13,750.
   D. $22,000.

Dividends In Kind

11. Mark is the only shareholder of Sico Ltd., a Canadian controlled private corporation. The CCPC has no balance in its GRIP account. In 2010, Sico paid a dividend in kind by distributing securities with fair market value of $72,000 and an adjusted cost base of $56,000. Which of the following statements properly reflects the tax consequences of this transaction?

   A. Sico has Taxable Income of $8,000 and Mark has Taxable Income of $72,000.
   B. Sico has Taxable Income of $8,000 and Mark has Taxable Income $90,000.
   C. Sico has Taxable Income of nil and Mark has Taxable Income of $72,000.
   D. Sico has Taxable Income of $16,000 and Mark has Taxable Income of $90,000.

Deemed Dividends

12. Which of the following transactions will not result in a deemed dividend?

   A. Paying off $500,000 in debt by issuing shares with a fair market value of $525,000.
   B. Redeeming shares for $350,000. The PUC of the shares was $350,000 and the adjusted cost base was $250,000.
   C. A liquidating dividend is paid to shareholders in the amount of $400,000. At this time, PUC is reduced by $300,000.
   D. A total of $1,000,000 was paid to shareholders as part of a winding-up. The PUC of the shares was $200,000 and there was no capital dividend account balance.

13. Aris Ltd. has 2,000,000 shares outstanding with a total PUC of $30,000,000. The Company is a CCPC and has no balance in its GRIP account. John Aris owns 10 percent of these shares. They were acquired at a total cost of $2,250,000. During the current year, John's shares were redeemed by the corporation for proceeds of $3,500,000. Which of the following amounts must be included in John's income as a result of this redemption?

   A. $625,000
   B. $800,000
   C. $925,000
   D. $750,000

TIF PROBLEM FOURTEEN - 4
Other Issues In Corporate Taxation - Exam Exercises

Exam Exercise Fourteen - 1 (Acquisition Of Control)

Lead Services Ltd. operates two separate lines of business, one of which sells drafting pencils, the other provides professional engineering services. In its first year of operations ending December 31, 2009, the engineering services business had a loss of $104,000, and the pencil business had income of $24,600, resulting in a Net Income For Tax Purposes of nil.

For the taxation year ending December 31, 2010, the engineering services business had income of $21,250 and the pencil business had income of $133,400, resulting in a Net Income For Tax Purposes of $154,650. Determine the minimum Taxable Income for each of the two years, and any loss carry forward available at the end of the year assuming that there was no acquisition of control in either year. How would your answer be different if there was an acquisition of control on January 1, 2010?

Exam Exercise Fourteen - 2 (Election On Acquisition Of Control)

Static Controls Inc. has a December 31 year end. On May 1, 2010, all of the Company's shares are acquired by a new owner. On April 30, 2010, the Company has a net capital loss carry forward from 2009 of $125,000 [(1/2)($250,000)], non-depreciable assets with an adjusted cost base of $610,000 and a fair market value of $740,000, and depreciable assets with a capital cost of $375,000, a UCC of $280,000, and a fair market value of $515,000. For the period January 1, 2010 through April 30, 2010, the Company has an operating loss of $91,000.

Advise the Company with respect to the most appropriate elections to be made prior to the acquisition of control.

Exam Exercise Fourteen - 3 (Associated Companies)

Anderson Inc., BDO Ltd., and Copper Inc., are three Canadian controlled private corporations. The common share ownership is as follows:

Anderson Inc. John Anderson owns 100 percent of the common shares of this Company.

BDO Ltd. John Anderson owns 30 percent of the common shares and his spouse, Wilma Anderson, owns 10 percent of the common shares. Basil Copper owns 35 percent of the common shares and his spouse, Holly Copper, owns 25 percent of the common shares. Holly Copper is John Anderson's sister.

Copper Inc. Basil Copper and Holly Copper each own 50 percent of the common shares of this Company.

Indicate which of the Companies described are associated. Explain your conclusions.

Exam Exercise Fourteen - 4 (Investment Tax Credit Procedures)

During 2010, Dwanto Ltd. makes current expenditures of $460,000 on which a 10 percent investment tax credit is available. In addition, it acquires $675,000 of Class 10 assets on which a 20 percent investment tax credit is available. Describe the 2010 and 2011 tax consequences associated with making these expenditures and claiming the related investment tax credits. Include in your solution the CCA for 2010 and 2011.

Exam Exercise Fourteen - 5 (Refundable Investment Tax Credits)

Future Ventures has made a number of expenditures that qualify for investment tax credits. They have invested $132,000 in Qualified Property in the Gaspe Peninsula. In addition, they have $1,060,000 in current expenditures for Scientific Research And Experimental Development, as well as $2,310,000 in capital expenditures for Scientific Research And Experimental Development. The Company is a Canadian controlled private corporation and has Taxable Income for the previous year of $161,000 and Taxable Capital Employed In Canada for the previous year of $8,500,000. The Company has no Tax Payable for the current year or the three preceding years.

Determine the amount of the refund that Future Ventures will receive as a result of earning these investment tax credits and any available carry forwards. Include in your answer any other tax consequences of these investment tax credits.

Exam Exercise Fourteen - 6 (ACB And PUC)

When it was first established, Lichter Inc. issued 123,000 shares at a price of $5.60 per share. Four years later, an additional 32,000 shares were issued for $8.62 per share. During the current year, a further 81,000 shares were issued for $10.15 per share. One of the investors in the Company acquired 1,350 shares of the first group of shares issued, and an additional 4,230 shares from the most recent issue. Determine the adjusted cost base per share, as well as the total PUC of this investor's shares.

Exam Exercise Fourteen - 7 (Capital Dividend Account)

The following transactions involve the Logic Corporation's capital dividend account:

- In 1987, they sold a capital asset with an adjusted cost base of $105,000, for cash of $129,000, resulting in a $12,000 taxable capital gain [(1/2)($24,000)].
- In 1996, they sold a capital asset with an adjusted cost base of $91,000, for cash of $83,000, resulting in an allowable capital loss of $6,000 [(3/4)($8,000)].
- During the year ending December 31, 2009, the Company received a capital dividend of $10,600.
- On July 1, 2010, they sold goodwill for proceeds of $50,000. They had paid $39,500 for this goodwill in the previous year. It is the Company's policy to make maximum CCA and CEC deductions.
- On October 31, 2010, the Company paid an ITA 83(2) capital dividend of $13,750. The appropriate election was made.

Determine the balance in the capital dividend account at December 31, 2010.

Exam Exercise Fourteen - 8 [ITA 84(1) Deemed Dividend]

At the beginning of the current year, Scott Inc. has 131,000 shares of common stock outstanding. The shares were originally issued at $11.25 per share for total proceeds of $1,473,750, with this amount constituting the PUC. During the current year, a creditor holding $505,000 of the Company's debt agrees to accept 43,000 newly issued common shares of the Company in exchange for settlement of the debt obligation. At the time of this exchange, the shares are trading at $12.05 per share. Subsequent to the exchange, Mr. Scott, who had purchased 7,000 Scott Inc. shares at the time of their original issue, sells the shares for $14.36 per share.

Describe the tax consequence(s) to all of the shareholders of Scott Inc. as a result of the exchange of debt for common shares. In addition, describe the tax consequences to Mr. Scott resulting from the sale of his Scott Inc. shares.

Exam Exercise Fourteen - 9 [ITA 84(3) Deemed Dividend]

At the time of its incorporation, Alleham Ltd. issued 176,000 common shares in return for $3,960,000 in cash ($22.50 per share). All of the shares were issued to Mr. Izaak Alleham, the founder of the Company. Mr. Alleham is still holding all of the originally issued shares, except for 30,000 shares that Mr. Alleham sold to his sister for $18.75 per share, the estimated fair market value of the shares at that time. Because Mr. Alleham does not approve of his sister's increasingly liberated lifestyle, he would prefer to sever all relations with her. To facilitate this goal, he arranges to have Alleham Ltd. redeem all of her 30,000 Alleham Ltd. shares at a price of $24.35 per share. Any dividends resulting from the redemption will be non-eligible.

Determine the tax consequences of this redemption to Mr. Alleham, as well as to his sister.

Exam Exercise Fourteen - 10 [ITA 84(4) Deemed Dividend]

Ms. Daniels owns all of the outstanding shares of Daniels Inc., a CCPC. The shares have a PUC of $390,000 and an adjusted cost base of $545,000. Because it has recently consolidated its operations, Daniels Inc. pays a liquidating dividend of $299,000, accompanied by a PUC reduction of $217,000.

What are the tax consequences of this distribution to Ms. Daniels?

TIF PROBLEM FOURTEEN - 5
Other Issues In Corporate Taxation - Key Term Matching

The following five key terms are listed at the end of Chapter 14, “Other Issues In Corporate Taxation”.

A. Paid Up Capital

B. Capital Dividend Account

C. Stock Dividend

D. Group Of Persons

E. Redemption Of Shares

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. A transaction in which a shareholder redeems some or all of its shares in a CCPC.

2. A balance that is equal to Shareholders’ Equity as determined under generally accepted accounting principles.

3. A dividend paid in stock that the paying company has held as a long-term investment.

4. A group of items, defined in ITA 89(1), that can be distributed by private corporations to shareholders as a tax free capital dividend (e.g., the non-taxable portion of realized capital gains).

5. For purposes of determining control of a corporation, a group of persons is any two or more related persons, each of whom owns shares in the corporation.

6. A transaction in which a corporation purchases some of its own outstanding shares, either in the open market, or through a direct purchase from shareholders.

7. A balance that is, in general, equal to legal stated capital as determined under the legislation governing the particular corporation. The equivalent of contributed capital in accounting usage.

8. A pro rata distribution of a corporation's shares to its existing shareholders.

9. For purposes of determining control of a corporation, a group of persons is any two or more persons, each of whom owns shares in the corporation.

10. A group of items, defined in ITA 89(1), that can be distributed by a CCPC to shareholders as a tax free capital dividend (e.g., the non-taxable portion of realized capital gains).

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM FOURTEEN - 6
Acquisition Of Control

Seeman's Hats Ltd. (SHL) has a December 31 year end and, as of December 31, 2009, the Company had been operating for three years. Mr. Seeman, the founder of the Company, designed a line of hats with a battery operated fan inside the crown that provided a cooling effect for the wearer during hot weather. As this concept had not met with great public enthusiasm, the Company had consistently lost money.

As at December 31, 2009, the Company had an accumulated non-capital loss of $173,000. In addition, Mr. Seeman disposed of some of the capital assets of the business during December of 2009, resulting in a net capital loss carry forward of $79,000 [(1/2)($158,000)].

Early in 2010, Mr. Seeman is approached by Fred's Fast Foods Inc. (FFFI) with an offer to acquire the shares of SHL. FFFI operates a chain of novelty restaurants and the Company's management believes that they can market Mr. Seeman's hats as part of the image that they are establishing for their restaurants. On April 1, 2010, they acquire all of the SHL shares.

During the period January 1, 2010 through March 31, 2010, Seeman's records taxable revenues of $41,000 and deductible expenses of $27,000. At April 1, 2010, the values of the Company's assets were as follows:

Asset	Cost	UCC	Fair Market Value
Inventories	$126,000	N/A	$115,000
Land	35,000	N/A	127,000
Building	160,000	$132,000	151,000
Fixtures And Equipment	126,000	85,000	71,000

FFFI has a December 31 year end and, as a consequence, they have decided to continue the use of a December 31 year end for SHL.

After the acquisition, FFFI decides to use some of SHL's extra facilities for producing its signature product, heart shaped french fries. During the period April 1, 2010 through December 31, 2010, SHL's results in the two separate businesses were as follows:

Business	Income (Loss)
Hats	$78,000
French Fries	(26,000)

Required:

A. If SHL makes all possible elections to minimize unused loss carry forwards, determine the amount of the non-capital loss balance that will be carried forward after the acquisition of control. In addition, indicate the amount of any net capital loss that will be lost as a result of this change in ownership.

B. Indicate the amount of SHL's Net Income For Tax Purposes and Taxable Income for the period ending December 31, 2010. In addition, indicate the amount of any remaining non-capital loss carry forward on January 1, 2011.

TIF PROBLEM FOURTEEN - 7
Associated Companies

The following situations are **independent** of each other. All of the corporations involved are Canadian controlled private corporations.

A. Barton Ltd. owns 51 percent of the shares of Norton Inc.

B. Thomas Boulding owns 60 percent of the shares of Boulding Ltd. and 70 percent of the shares of Boulding Inc.

C. Mary Cunningham and Brenda Parton each own 50 percent of the shares of Elm Ltd. In addition, they each own 50 percent of the shares of Maple Inc. Mary and Brenda are not related.

D. Alice Fielding owns 100 percent of the shares of Fielding Inc. and 40 percent of the shares of Lawson Ltd. Betty Falcon owns 100 percent of the shares of Falcon Inc. and 40 percent of the shares of Lawson Ltd. Alice is the sister of Betty's husband. The remaining 20 percent of the shares of Lawson Ltd. are owned by unrelated parties.

E. Michael Forbes owns 70 percent of the shares of Forbes Ltd. and 30 percent of the shares of Malcom Inc. Forbes Ltd. also owns 30 percent of the shares of Malcom Inc.

F. Richard Barnes, Susan Firth, and Terry Anson each own one-third of the shares of Rastau Ltd. In addition, Richard and Susan each own 50 percent of the shares of Sucrol Inc.

Required: For each of the preceding situations, indicate whether the corporations are associated and explain your conclusion with reference to the *Income Tax Act*. In order to assist you in answering this question, we have provided you with the content of ITA 256(1).

> **ITA 256(1) Associated corporations** — For the purposes of this Act, one corporation is associated with another in a taxation year if, at any time in the year,
>
> (a) one of the corporations controlled, directly or indirectly in any manner whatever, the other;
> (b) both of the corporations were controlled, directly or indirectly in any manner whatever, by the same person or group of persons;
> (c) each of the corporations was controlled, directly or indirectly in any manner whatever, by a person and the person who so controlled one of the corporations was related to the person who so controlled the other, and either of those persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof;
> (d) one of the corporations was controlled, directly or indirectly in any manner whatever, by a person and that person was related to each member of a group of persons that so controlled the other corporation, and that person owned, in respect of the other corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof; or
> (e) each of the corporations was controlled, directly or indirectly in any manner whatever, by a related group and each of the members of one of the related groups was related to all of the members of the other related group, and one or more persons who were members of both related groups, either alone or together, owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof.

TIF PROBLEM FOURTEEN - 8
Corporate Surplus Distributions

Deemit Inc. is a Canadian controlled private corporation. However, it is not a qualified small business corporation. All of the shares of the Company are held by individuals resident in Canada. On December 31 of the current year, its condensed Balance Sheet is as follows:

Total Assets		$790,000
Total Liabilities		$110,000
Shareholders' Equity:		
20,000 Preferred Shares	$150,000	
185,000 Common Shares	370,000	
Retained Earnings	160,000	680,000
Total Equities		$790,000

There are 20,000 Preferred Shares outstanding and they were issued at a price of $7.50 per share. The Paid Up Capital (PUC) of these shares is equal to their carrying value of $150,000.

There are 185,000 Common Shares outstanding and they have been issued at various prices. The PUC of these shares is equal to their carrying value of $370,000.

Any taxable dividends paid or deemed to be paid by Deemit Inc. would be non-eligible.

Required: Indicate the tax consequences to the relevant shareholders of the transaction(s) described in each of the following **independent** Cases. Tax consequences would include both the increase or decrease in the individual shareholder's Taxable Income, as well as any change in the adjusted cost base of any shares that are still in the hands of the individual shareholder after the described transaction(s).

Case A An individual owns 10,000 of the outstanding Preferred Shares. His adjusted cost base for the shares is $72,000. The Company redeems these shares, providing the individual with a payment of $78,000.

Case B The Company declares a dividend of $.50 per share on the outstanding Common Shares. The total amount of the dividend is less than the balance in the capital dividend account, and the Company makes the appropriate election under ITA 83(2).

Case C In order to partially liquidate the Company, a dividend of $2.10 per share is declared on the Common Shares. This dividend is accompanied by a $370,000 reduction in the PUC of the Common Shares.

Case D A $50,000 loan from an individual who is not a shareholder of the Company, is settled by the issuance of 8,000 Preferred Shares with a PUC of $60,000. The Preferred Shares received by this individual are immediately sold at their fair market value of $60,000.

Chapter Fifteen Test Item File Problems

TIF PROBLEM FIFTEEN - 1
Management Decisions - Essay Questions

1. Frank Labelle has an unincorporated business that produces just enough income to meet his personal consumption needs. He anticipates that its income will exceed his consumption needs in the foreseeable future. Will he save taxes by incorporating? Will he defer taxes by incorporating? Explain your conclusions.

2. Ms. Copeland has invested in the common shares of a number of large Canadian public companies, all of which pay regular dividends that are eligible for the enhanced dividend gross up and tax credit procedures. She has no intention of selling the shares in the foreseeable future. She has asked your advice as to whether there would be either tax deferral or tax savings if she transferred these shares to a private company. She would be the only shareholder of this new company. Ms. Copeland has sufficient other sources of income that she is in the 29 percent federal tax bracket. She lives in a province where her marginal tax rate is 12 percent and the provincial dividend tax credit on both eligible and non-eligible dividends is equal to 25 percent of the dividend gross up.

3. Varying provincial tax rates on corporations and individuals can result in imperfections in the integration system. Briefly explain how these imperfections can influence the decision to use a corporation to earn business income.

4. One of the advantages that is cited for the use of a corporation is limited liability. Explain this concept and indicate whether you believe that it is an advantage for a small private corporation with a single shareholder.

5. Provinces have sometimes declared a tax holiday (i.e., a period in which no provincial taxes will be assessed) for new Canadian controlled private corporations that start up business operations within their boundaries. The province's objective in granting this tax free period is to encourage economic growth and employment within the province. Describe the impact of such tax holidays on the type of compensation that will be used for the owner-manager of the business. Explain your conclusion.

6. An individual with no other source of income can receive nearly $41,000 in non-eligible dividends without incurring any tax liability. In contrast, such an individual would start paying taxes after receiving only $10,382 in interest income. Explain this difference in treatment of the two types of income.

7. An individual is the only shareholder of a CCPC that is earning in excess of $500,000 per year. He has heard of "bonusing down" and has asked you to explain the concept. Provide the required explanation.

8. One of your friends who is the sole shareholder of a private corporation has decided that it would be a good idea to have his company pay for a swimming pool at his personal residence. He has concluded that this would be better than paying himself sufficient salary to construct the pool with his own funds. Do you agree? Explain your conclusion.

9. If the owner-manager of a private corporation is provided with a loan by his corporation, he will not have to include the principal amount in income if he can demonstrate that he received the loan in his capacity as an employee, rather than as a shareholder of the corporation. Explain why this may be difficult for him to do.

10. Even in situations where provincial tax and dividend tax credit rates favour the use of dividends, owner-managers may retain more after tax income if they receive some part of their compensation in the form of salary. Explain this statement.

TIF PROBLEM FIFTEEN - 2
Management Decisions - True Or False

1. The use of a corporation can provide tax deferral only if the owner of the shares can leave the income in the corporation.

   True or False?

2. If all of the income earned by a business is active business income, flowing the income through a Canadian controlled private corporation, as opposed to earning the income in an unincorporated business, will always provide a tax savings.

   True or False?

3. All other things being equal, higher provincial tax rates on corporations favour the use of a corporation to earn business income.

   True or False?

4. In cases where a corporation is subject to a low tax rate (e.g., a combined federal/provincial rate of 15 percent), charitable donations in excess of $200 have less value to a corporation than they do to an individual.

   True or False?

5. Income splitting refers to procedures which are designed to spread an individual's Taxable Income over several taxation years.

   True or False?

6. All other things being equal, a higher provincial dividend tax credit favours the use of a corporation.

   True or False?

7. All other things being equal, high corporate tax rates favour the use of salary to compensate the owner/manager of a CCPC.

   True or False?

8. All other things being equal, a low provincial dividend tax credit favours the use of dividends to compensate the owner/manager of a CCPC.

   True or False?

9. If the owner/manager of a CCPC has a large Cumulative Net Investment Loss (CNIL) balance, he should pay himself dividends rather than salary.

   True or False?

10. Any resident Canadian individual over the age of 17 can receive over $40,000 in non-eligible dividends from a CCPC without paying any taxes.

    True or False?

Management Decisions - True Or False

11. A construction company sells a house with a fair market value of $200,000 to a shareholder of the corporation for $160,000. The shareholder is liable for tax on the $40,000 difference.

True or False?

12. If a shareholder of a company that is in the business of lending money receives a loan from the company with terms applicable to its preferred clients, the principal amount will not have to be included in his income.

True or False?

TIF PROBLEM FIFTEEN - 3
Management Decisions - Multiple Choice

The Decision To Incorporate

1. Which of the following is not a possible advantage of incorporating a business?

   A. The ability to defer taxes on income left in the business.
   B. The ability to absorb business losses against employment income.
   C. Limiting personal liability to the amount paid for shares.
   D. The ability to use the lifetime capital gains deduction.

2. The use of a corporation is most likely to result in a reduction in total taxes if:

   A. The corporation is a public company earning manufacturing income.
   B. The corporation is a CCPC earning dividends.
   C. The corporation is a CCPC earning investment income.
   D. The corporation is a CCPC earning active business income.

3. Which of the following statements about the use of a corporation is correct?

   A. Use of a corporation will always result in the deferral of taxes.
   B. Use of a corporation can result in a tax saving.
   C. Use of a corporation is more desirable in a province that has low tax rates on individuals.
   D. Use of a corporation is more desirable in a province that has a low dividend tax credit.

4. John is thinking about incorporating his charter boat business. Which of the following describes an advantage that could be associated with incorporating the business as compared to running it as a proprietorship?

   A. John could use any future business losses to offset his taxable employment income.
   B. John could protect himself from being held personally liable if a client sustained injuries by falling overboard.
   C. John could hire his brother to pilot the boat on days when he is not available. His brother's salary would be deductible in calculating the corporation's income.
   D. John will not pay CPP on any salary paid to him by the corporation if he owns more than 40 percent of the voting shares.

5. Lynn Baily paid $150,000 for 3,000 shares in Baily Inc., a company for which she is the managing director. She also personally guaranteed a bank loan to Baily Inc. in the amount of $75,000. If Baily Inc. goes bankrupt, which of the following statements is correct?

   A. Lynn's financial risk is unlimited.
   B. Lynn's financial risk is limited to $75,000.
   C. Lynn's financial risk is limited to $150,000.
   D. Lynn's financial risk is limited to $225,000.

6. An individual's only source of income is dividends from public companies. He is considering transferring the public company shares to a corporation. If he was to do so, which of the following statements is correct?

   A. There would be a reduction in the total taxes paid.
   B. There would always be deferral of taxes as long as the dividend income was left in the corporation.
   C. All of the federal corporate taxes paid on the dividends would be refunded when all of the dividends received by the corporation are paid out to the individual.
   D. The individual taxes on the dividends would be lower after they have passed through the corporation.

7. With respect to the incorporation of a proprietorship, which of the following statements is correct?

   A. Incorporation will always result in an overall reduction in taxes because it combines the small business deduction with the dividend tax credit.
   B. Incorporation will result in an overall reduction in taxes because corporations are able to deduct many items that cannot be deducted by an unincorporated business.
   C. Incorporation will result in a deferral of taxes to the extent profits can be left in the corporation.
   D. Incorporation will be beneficial because it will always limit the shareholders' obligations to creditors.

8. An individual owns a retail business that is unincorporated. The business earns about $150,000 per year, all of which is needed by the individual for his personal living expenses. The individual is considering incorporating this business. Which of the following statements is correct?

   A. There can be a small tax advantage associated with incorporation.
   B. The application of the small business deduction will result in a significant reduction in overall taxes.
   C. The application of the small business deduction will result in a significant deferral of tax payments.
   D. The application of the gross up and tax credit procedures for dividends will result in a signification reduction in overall taxes.

9. Joan Farnun has employment income of about $100,000. This employment income is sufficient to cover her personal living expenses. In addition, she operates a consulting business which earns about $50,000 per year. Income from this business is invested in debt and equity securities. She is considering the incorporation of the consulting business. With respect to the incorporation, which of the following statements is correct?

   A. There will be an overall tax savings because of the small business deduction.
   B. There will be an overall tax savings because of the dividend tax credit.
   C. There will be tax deferral because of the small business deduction.
   D. There will be no tax deferral because of the integration provisions in the *Income Tax Act*.

Shareholder Loans

10. A corporation loans a shareholder $30,000 on April 1, 2010, interest free. The shareholder is not an employee of the corporation. The fiscal year end of the corporation is October 31. Assume the prescribed rate is 2 percent for all years under consideration. For each of the **independent** parts of the question, choose one of the following answers. Each answer can be used more than once.

A. $450	D. $30,450
B. $600	E. $30,600
C. $30,000	F. Nil

   i. The shareholder purchases investment property using the $30,000. The loan is to be repaid on December 31, 2013. The increase in 2010 Taxable Income of the shareholder due to the loan and the investment of the proceeds is:

   ii. The shareholder purchases investment property using the $30,000. The loan is to be repaid on April 1, 2011. The increase in 2010 Taxable Income of the shareholder due to the loan and the investment of the proceeds is:

iii. The shareholder sells his home and purchases another, larger house, in the same neighbourhood, using the $30,000. The loan is to be repaid on December 31, 2013. The increase in 2010 Taxable Income of the shareholder due to the loan and the investment of the proceeds is:

11. Albert Jay is an employee and 15 percent shareholder of Rick's Welding Shop Ltd. (Rick's). During the 2010 calendar year, Albert Jay was having cash flow problems. Rick's gave Albert Jay a loan of $5,000 on May 1, 2010 to help him out. Rick's also gave Albert Jay's son, Jake, a loan of $2,000 on September 30, 2010 to help him meet expenses while at college. Rick's has said that Albert Jay and Jake can repay the loans whenever they can afford it. The loans remain outstanding as at January 31, 2012. Rick's year end for accounting and taxation purposes is December 31.

    How much, and in which taxation year, is Albert Jay required to include in his Taxable Income as a result of the above transactions?

    A. $5,000 - 2010.
    B. $5,000 - 2011.
    C. $7,000 - 2010.
    D. $7,000 - 2011.
    E. None of the above.

12. Jacquie is the sole shareholder of Holdings Ltd., which has a January 31 year end. On January 1, 2010, Jacquie borrowed $10,000 on an interest-free basis from Holdings Ltd. She used $8,000 of this amount to acquire shares of Arrow Inc. and the remaining $2,000 for personal purposes. Arrow Inc. is a small Canadian controlled private company that manufactures cross-bows. In March 2010, Arrow Inc. paid a non-eligible dividend of $1,100 to Jacquie. Jacquie repaid her $10,000 loan to Holdings Ltd. on June 30, 2010. Assume that these were her only transactions with Holdings Ltd. and the prescribed interest rate was 4 percent for the first quarter of 2010 and 3 percent for the second quarter. Which one of the following represents Jacquie's 2010 Taxable Income as a result of these transactions?

    A. $1,100.00.
    B. $1,375.00.
    C. $1,409.68.
    D. $1,548.42.

13. Paul is one of six shareholders, but not an employee, of a Canadian controlled private corporation that manufactures doors. The corporation has a large amount of cash on hand and the other shareholders have agreed that the corporation can lend him $200,000 for a few years. To avoid having the principal included in his Taxable Income, the loan must meet which of the following conditions?

    A. It must be made at the interest rate prescribed by the Regulations to the *Income Tax Act*.
    B. It must be for the purchase of the company's shares.
    C. It must be repaid within one year of the end of the fiscal year in which it was made.
    D. It must have a specific repayment date.

14. Martin Locks owns 100 percent of the shares of Locks Inc., a corporation with a December 31 year end. In January 2009, the corporation loans Martin $350,000 in order to assist him in acquiring a new principal residence. The loan is interest free and will be paid back on December 30, 2010. The corporation has no employees other than Martin. Assume that the prescribed rate is 4 percent throughout 2009 and 5 percent throughout 2010. Which of the following statements is correct?

A. Martin will have to include $350,000 in his 2009 Net Income For Tax Purposes.
B. Martin will have to include $14,000 in his Net Income For Tax Purposes in both 2009 and 2010.
C. Martin will have to include $14,000 in his Net Income For Tax Purposes for 2009 and $17,500 in his Net Income For Tax Purposes for 2010.
D. Martin will have an inclusion in his 2009 Net Income For Tax Purposes, only if the loan is not repaid on December 30, 2010.

Salary Vs. Dividends

15. An owner-manager can generally choose whether he wishes to receive compensation in the form of dividends or, alternatively in the form of salary. All other things being equal which of the following would encourage the use of dividends?

A. A desire to make contributions to an RRSP.
B. A low provincial dividend tax credit.
C. A desire to eliminate a large CNIL balance.
D. A high provincial corporate tax rate.

16. Joan Barts owns all of the outstanding shares of Barts Ltd., a CCPC that is carrying on an active business. For the year ending December 31, 2010, she may prefer to pay herself salary instead of dividends if:

A. The corporation has a large RDTOH balance.
B. The corporation is located in a province with a low corporate tax rate.
C. The corporation has Taxable Income in excess of $500,000.
D. The corporation is located in a province with a high dividend tax credit.

17. Larry Watts, a Canadian resident, owns 49 percent of the shares of Zatch Ltd., a Canadian corporation. Laura Marsh, who lives in England, owns the remaining 51 percent. For the current year, the corporation has $150,000 in income, all of which will be paid out as either salary or eligible dividends. Because of other sources of income, Larry is in the 29 percent federal tax bracket and an 18 percent provincial tax bracket. On both eligible and non-eligible dividends, the provincial dividend tax credit is equal to 7/17 of the gross up. Zatch Ltd. pays taxes at a combined federal/provincial rate of 41 percent. With respect to Larry's choice between receiving his share of the after tax corporate income in the form of salary or dividends, which of the following statements is correct?

A. It does not matter whether he receives salary or dividends as he would retain the same after tax amount with either alternative.
B. He should take the salary because he will have more left after tax.
C. He should take the dividends because he will have more left after tax.
D. In order to fully use his personal tax credits, he should receive a combination of salary and dividends.

18. Sharon Hartly is the owner-manager of a CCPC from which she receives an annual salary of $70,000 per year. For 2010, after deducting her salary, the CCPC will have additional income of $150,000. Sharon would like to take additional funds of $40,000 out of the corporation. Which of the following statements is correct?

A. The best solution is to take the funds out as salary as this will increase her pensionable earnings for CPP purposes.
B. The best solution is to take the funds out as a dividend as this will have the lowest tax cost.
C. The best solution is to take the funds out as salary because this will reduce her CNIL balance for purposes of the lifetime capital gains deduction.
D. The best solution is to take the funds out as salary so that she can maximize her contribution to her RRSP.

TIF PROBLEM FIFTEEN - 4
Management Decisions - Exam Exercises

Exam Exercise Fifteen - 1 (Use Of A Corporation For Tax Deferral And Savings)

Stephen Lee has an unincorporated business that he anticipates will have active business income of $98,000 during the coming year. Mr. Lee has employment income in excess of $800,000 with additional amounts subject to a provincial tax rate of 16 percent. The provincial dividend tax credit is equal to one-third of the dividend gross up for all dividends. Also in this province, the corporate tax rate is 4 percent on income eligible for the small business deduction and 15 percent on other income.

Mr. Lee has asked your advice as to whether he should incorporate this business. Advise him with respect to any tax deferral that will be available on income left in the corporation and on any tax savings that will be available if all of the income is paid out in dividends.

Exam Exercise Fifteen - 2 (Incorporation Of Interest Income)

Ms. Shauna MacDonald has investments that she anticipates will earn interest income of $143,000 during the coming year. She has employment income in excess of $300,000 with additional amounts subject to a provincial tax rate of 15 percent. The provincial dividend tax credit is equal to 25 percent of the dividend gross up for all dividends. Also in her province of residence, the corporate tax rate is 5 percent on income eligible for the small business deduction and 14 percent on other income.

Ms. MacDonald has asked your advice as to whether she should transfer these investments to a corporation in which she would own all of the shares. Advise her with respect to any tax deferral that could be available on income left in the corporation and on any tax savings that could be available if all of the income is paid out in dividends.

Exam Exercise Fifteen - 3 (Incorporation Of Interest And Dividends)

One of your clients has asked your advice on whether she should transfer a group of investments to a new corporation that can be established to hold them. The corporation will be a Canadian controlled private corporation and she anticipates that the transferred investments will have the following amounts of income during the current year:

Non-Eligible Dividends On Portfolio Investments	$39,000
Non-Eligible Dividends From 100 Percent Owned Subsidiary	
(A Dividend Refund Of $20,000 Will Be Received by The Payor)	75,000
Interest Income	36,500

Despite having employment income of over $250,000, your client needs all of the income that is produced by these investments. On additional amounts, your client is subject to a provincial tax rate of 12 percent. The provincial dividend tax credit is equal to 25 percent of the dividend gross up for all dividends. The corporation will be subject to a provincial tax rate of 3 percent on income eligible for the small business deduction and 10 percent on other income. Provide the advice requested. Justify your conclusion.

Exam Exercise Fifteen - 4 (Incorporation Of Capital Gains)

Sandra Peterson has asked your advice on whether she should transfer a group of investments to a new corporation that can be established to hold them. The corporation will be a Canadian controlled private corporation and she anticipates that, during the coming year, the market value of these investments will increase by $142,000. No other income will be generated by the investments. The corporation will be subject to a provincial tax rate of 5 percent on income eligible for the small business deduction and 15 percent on other income.

Despite having employment income in excess of $200,000, Sandra will sell these investments by the end of the year to realize the capital gains. On additional amounts, Sandra is subject to a marginal provincial tax rate of 15 percent. The provincial dividend tax credit is equal to one-third of the dividend gross up for all dividends. Provide the requested advice.

Exam Exercise Fifteen - 5 (Shareholder Loans)

Ms. Janice Thiessen is an employee of Thiessen Ltd., a company in which her husband owns 60 percent of the outstanding shares. Ms. Thiessen owns the remaining 40 percent of the shares. Thiessen Ltd. has a December 31 year end. It is the policy of the Company to provide an interest free loan of up to $25,000 to any employee who wished to acquire a new home.

On April 1 of the current year, Ms. Thiessen receives a $25,000 interest free loan from the Company to purchase a new home. The loan does not qualify as a home relocation loan. On the same day, she receives an additional $15,000 interest free loan to purchase furnishings for the home. Both loans are to be repaid in four annual instalments to be made on March 31 of each year. Assume the prescribed rate for the current year is 2 percent. What are the current year tax implications of these loans for Ms. Thiessen?

Exam Exercise Fifteen - 6 (Salary Compensation)

Cloister Inc. is a Canadian controlled private corporation with Net Income For Tax Purposes and Taxable Income of $197,000. All of this income is from active business activities. The cash balance of the Company, prior to any payments on the current year's taxes, is also equal to this amount. It is subject to a provincial tax rate of 5 percent on income eligible for the small business deduction and 14 percent on other income.

Its only shareholder, Ms. Sally Cloister, has no income other than the dividends or salary paid by the corporation and has combined personal tax credits of $3,375. Assume she lives in a province that has a personal flat tax rate equal to 12 percent and a dividend tax credit equal to one-third of the dividend gross up for all dividends. Determine the amount of after tax cash that Ms. Cloister will retain if the maximum salary is paid by the corporation out of the available cash of $197,000. Ignore CPP contributions and the Canada employment tax credit.

Exam Exercise Fifteen - 7 (Dividend Compensation)

Cloister Inc. is a Canadian controlled private corporation with Net Income For Tax Purposes and Taxable Income of $197,000. All of this income is from active business activities. The cash balance of the Company, prior to any payments on the current year's taxes, is also equal to this amount. It is subject to a provincial tax rate of 5 percent on income eligible for the small business deduction and 14 percent on other income.

Its only shareholder, Ms. Sally Cloister, has no income other than the dividends or salary paid by the corporation and has combined personal tax credits of $3,375. Assume she lives in a province that has a personal flat tax rate equal to 12 percent and a dividend tax credit equal to one-third of the dividend gross up for all dividends. Determine the amount of after tax cash that Ms. Cloister will retain if the maximum dividend is paid by the corporation out of the available cash of $197,000.

Exam Exercise Fifteen - 8 (Salary Vs. Dividend)

Ramsden Inc. has Net Income For Tax Purposes and Taxable Income for the year ending December 31, 2010 of $23,600. The Company's cash balance, prior to the payment of any taxes for the year is $17,300. The Company's Taxable Income is subject to a combined federal/provincial tax rate of 15 percent. There is no payroll tax in this province.

Ms. Ramsden, the Company's president and sole shareholder has no other source of income. She has combined federal/provincial personal tax credits of $4,120 and lives in a province that has a personal tax rate on the first $40,970 of Taxable Income equal to 11 percent. The provincial dividend tax credit is one-third of the gross up for all dividends. Ms. Ramsden would like to remove all of the cash from the corporation and has asked your advice as to whether it would be better to take it out in the form of non-eligible dividends or salary. Provide the requested advice. Ignore the required CPP contributions and the Canada employment tax credit.

Exam Exercise Fifteen - 9 (Salary Vs. Dividend)

Hughes Ltd. has Net Income For Tax Purposes and Taxable Income for the year ending December 31, 2010 of $175,000. The Company's cash balance is over $300,000. It is subject to a combined federal/provincial tax rate of 16 percent. Mr. Hughes, the Company's only shareholder, has employment income of over $200,000 and, under normal circumstances, does not make withdrawals from the corporation. However, because of a newfound appreciation of casino gambling, he needs an additional $17,000 in cash.

Mr. Hughes lives in a province where the provincial tax rate in his bracket is equal to 17 percent and the provincial dividend tax credit is equal to 23 percent of the dividend gross up for all dividends. He has asked your advice as to whether the payment of salary or, alternatively, the payment of non-eligible dividends, would have the lowest tax cost. Provide the requested advice.

TIF PROBLEM FIFTEEN - 5
Management Decisions - Key Term Matching

The following five key terms are listed at the end of Chapter 15, "Corporate Taxation And Management Decisions".

A. Bonusing Down

B. Limited Liability

C. Integration

D. Aggregate Investment Income

E. Income Splitting

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. A process whereby bonuses are declared by a corporation in one year and paid to the owner-manager of a CCPC in a subsequent year. The objective of this process is tax deferral.

2. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a corporation to its individual shareholders, are subject to the same amount of tax as would be the case if the individuals had received the income directly from its source.

3. A reference to corporate shares that have a specific provision added that limits the liability of the holder to the amount of his equity investment.

4. The use of a group of related corporations to divide a single source of income into separate components for purposes of maximizing the small business deduction.

5. As defined in ITA 129(4), this concept of investment income includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, dividends received, interest income, rents, and royalties.

6. A process of paying deductible salary to the owner-manager of a CCPC, or related parties, in order to eliminate corporate Taxable Income that is not eligible for the small business deduction.

7. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a public corporation to its individual shareholders, are subject to the same amount of tax as would be the case if the individuals had received the income directly from its source.

8. As defined in ITA 129(4), this concept of investment income includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, interest income, rents, and royalties.

9. A group of tax planning techniques designed to divide a given stream of income among family members or other related parties. The value of these techniques is based on progressive tax rates which means that, if a stream of income can be divided into a group of smaller streams, a larger portion of it will be taxed at lower rates, resulting in aggregate tax

savings.

10. A reference to the fact that the liability of investors in equity shares of a corporation is limited to the amount of their invested capital.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM FIFTEEN - 6
Incorporation Of Investment Income

Ryan Taylor lives in a province with a combined federal and provincial corporate tax rate on the investment income of CCPCs of 48 percent. This rate includes the ITA 123.3 tax on the investment income. Assume that provincial tax is assessed on individuals at a flat rate of 12 percent. The provincial dividend tax credit is equal to 35 percent of the dividend gross up on all dividends.

Ryan owns the following investments, and anticipates the following Canadian source income for 2010.

	Value At 31/12/2009	Type Of Income	Expected Income For 2010
ABC Company Bonds	$100,000	Interest	$11,000
XYZ Canada Company Shares	400,000	Dividends	20,000
Ace Technology Shares	50,000	Capital Gains	10,000
Safe Bank Of Canada Shares	50,000	Dividends	4,000
		Capital Gains	3,500
Totals	$600,000	N/A	$48,500

Ryan only invests in the shares and debt of large, publicly traded companies. He does not own more than 1 percent of the shares or debt in any of these corporations. All of the dividends received will be designated as eligible by the paying corporation.

In 2010, in addition to the above investment income, Ryan expects to earn $110,000 in employment income. He has combined federal/provincial personal tax credits of $2,650. The total adjusted cost base for his investments is $450,000.

Ryan asks you whether it is financially more attractive for him to have his investments owned by a corporation or to own them directly, as he currently does. Assume that he and his investments will generate the anticipated amounts of income.

Ryan's lifestyle requires him to use all available income. As a consequence, he would like you to assume that, if the investments are transferred to his corporation, the corporation will pay out all available funds as dividends.

Required: Provide an appropriate analysis for Ryan Taylor.

TIF PROBLEM FIFTEEN - 7
Shareholder loans

Mr. Jerome Farr owns all of the outstanding shares of Farr Flung Ltd. (FFL), a Canadian controlled private corporation with an October 31 year end. The Company has been extremely successful and, as a consequence, it has accumulated over $1,500,000 in cash that is not needed in the operations of the business. Given this situation, Mr. Farr has decided to have the corporation provide him with loans for a variety of purposes. Because of the abundance of cash in the corporation, Mr. Farr has indicated that, with respect to loans that will be used to acquire a dwelling or an automobile to be used in the business, loans will be extended to other employees of the Company on the same basis that they are extended to himself. Mr. Farr spends at least 40 hours per week working in the business and, in most years, receives a significant amount of salary from the Company.

He has been advised by his accountant that he should keep detailed records with respect to the date on which each loan was made and the purpose of the loan. During the calendar year ending December 31, 2010, his records indicate the following:

Personal Expenditures Because of his increasing appreciation of the finer things in life, Mr. Farr experienced a need for larger amounts of cash to be used for personal expenditures. During 2010, his Company loans him three separate amounts, with the details of the loans as follows:

- June 30, 2010 The Company loans him $20,000 on an interest free basis. The loan is to be repaid on June 30, 2011.
- October 31, 2010 The Company loans him $40,000 with an interest rate of 1 percent per annum. The loan is to be repaid on November 1, 2011.
- December 1, 2010 The company loans him $60,000 with an interest rate of 2 percent per annum. The loan is to be repaid on January 1, 2012.

Dwelling On January 1, 2010, FFL provides Mr. with a $100,000 loan to acquire a dwelling. The rate on the loan is 1 percent per annum and the loan agreement calls for five annual payments of $20,000, plus accrued interest, commencing January 1, 2011. The loan does not qualify as a home relocation loan.

Automobile On June 30, 2010, FFL provides Mr. Farr with an interest free $50,000 loan to acquire an automobile to be used in the business. Because of his commitment to repay the other loans, Mr. Farr is not sure when he will be able to repay this loan.

All repayments are made as scheduled. In all of the years under consideration, assume the prescribed rate is 2 percent (not including the extra 2 or 4 percent on amounts owing to or from the CRA).

Required Indicate the tax consequences, in each of the years 2010, 2011, and 2012, that will accrue to Mr. Farr as a result of receiving these loans. Briefly explain your conclusions. Base your interest calculations on the number of months the loans are outstanding.

TIF PROBLEM FIFTEEN - 8
Salary Vs. Dividend Decisions

Mr. Shields is the sole shareholder and only employee of Shields Inc., a Canadian controlled private corporation with 2010 Taxable Income in excess of $200,000. All of the income from this corporation is derived from active business operations. Shields Inc. qualifies for the small business deduction on all of its 2010 income and it is subject to a combined federal/provincial tax rate of 15 percent on its income. Its fiscal year end is December 31.

The provincial tax rate applicable to Mr. Shields' personal income is a flat rate of 10 percent. The provincial dividend tax credit is equal to one-third of the dividend gross up for all dividends.

It is now November, 2010 and the Corporation has paid salary totalling $75,000 to Mr. Shields during 2010. Mr. Shields estimates that he will have 2010 Taxable Income of $85,000 before consideration of any additional salary or dividend payments from Shields Inc. Any dividends paid by Shields Inc. would be non-eligible.

In reviewing his budget, it is clear to Mr. Shields that by the end of 2010, he will need an additional $18,000 of after tax funds to meet all of his personal expenditures. As the Corporation has had a very successful year, he expects Shields Inc. to be the source of this additional amount. He would like to acquire the funds in a manner that will minimize the combined tax cost to both himself and his corporation.

Required: Determine whether the payment of additional salary by Shields Inc. or, alternatively, the payment of dividends by Shields Inc., would provide the required $18,000 in after tax funds at the lowest combined tax cost to Mr. Shields and Shields Inc.

TIF PROBLEM FIFTEEN - 9
Salary Vs. Dividend Decisions

Ms. Rhonda Tyler is the only employee and shareholder of Tyler Inc., a Canadian controlled private corporation. The Company's activities are confined to a province in which the applicable corporate rate of taxation is 5 percent on income that is eligible for the small business deduction. The province does not levy a payroll tax for health care or post-secondary education. All of the Company's income qualifies as active business income. Any dividends paid by the corporation will be non-eligible.

The Company has a December 31 year end and, at December 31, 2010, Ms. Tyler determines that the Taxable Income of the Company will be $26,400. The Company has this amount available in cash, prior to the payment of taxes, dividends, or salary.

Ms. Tyler has no other source of income. In her tax bracket, the combined federal/provincial rate for individuals is 23 percent. For both eligible and non-eligible dividends, the provincial dividend tax credit is equal to 25 percent of the dividend gross up. Ms. Tyler has combined personal tax credits for the 2010 taxation year in the amount of $3,680.

Required:

A. Determine the after tax amount of cash that Ms. Tyler will retain if all of the Company's income is paid to her in the form of salary. Ignore CPP contributions and the Canada employment tax credit.

B. Determine the after tax amount of cash that Ms. Tyler will retain if the Company pays her the maximum possible dividend.

C. Can Ms. Tyler improve her after tax cash balance by using a combination of salary and dividends? Explain your conclusion.

D. Determine the combination of salary and dividends that will produce the maximum after tax cash balance for Ms. Tyler. Calculate the amount of this after tax cash retention.

Chapter Sixteen Test Item File Problems

TIF PROBLEM SIXTEEN - 1
Rollovers Under Section 85 - Essay Questions

1. In the absence of ITA 85(1), tax considerations could make it difficult to incorporate an existing unincorporated business. Briefly explain the basis for this statement.

2. Section 85 of the *Income Tax Act* allows the rollover of many types of assets to a corporation at elected values, a procedure that can avoid taxes being incurred at the time of the transfer. There are, however, certain categories of assets that are ineligible for this rollover provision. Indicate which categories of assets are ineligible for rollover under the provisions of Section 85. Briefly explain the reasons for these exclusions.

3. When ITA 85(1) is being used, careful consideration must be given to the price that is elected for the transfer. Briefly explain the importance of this transfer value.

4. What is boot? What is its significance in the application of ITA 85(1)?

5. When assets are transferred to a corporation using ITA 85, the transferor can take back as consideration a combination of common shares, preferred shares, and non-share consideration. Briefly explain how the total adjusted cost base of the consideration received would be determined, and how it would be allocated to each type of consideration received by the transferor.

6. An individual wishes to transfer the assets of an unincorporated business to a corporation using ITA 85. He wishes to remove the maximum amount of cash from the corporation without incurring current taxation. In addition to cash, he will receive common shares in the new company. What values should he elect for the transfer of the assets? If he elects these values and removes the maximum amount of tax free cash, what will be the PUC and adjusted cost base of the common shares?

7. One of the most useful types of tax planning available to individuals with large amounts of income is income splitting. In implementing an income splitting arrangement, one of the most useful techniques is to have the individual transfer assets to a corporation under the provisions of Section 85 of the *Income Tax Act*. However, if such a transfer is not carefully designed, the full objectives of the income splitting plan may not be achieved. What steps must be taken to ensure that transfers of property under Section 85 do, in fact, achieve the desired income splitting goals?

8. Mr. Lawson, who is a resident of the United States, owns a number of rental properties in various cities throughout Canada. Having reached age 65, he would like to see these properties transferred to his children. However, he does not have sufficient cash to pay the taxes that would accrue if he simply gave the property to his children. He is somewhat aware of the provisions of Section 85 of the Canadian *Income Tax Act,* and is considering transferring the properties to a U.S. corporation in which his children would hold the residual equity shares. Advise Mr. Lawson as to the soundness of his plan.

9. What is the objective of the legislation contained in ITA 84.1, the dividend stripping rules?

10. What is the objective of the legislation contained in ITA 55(2), the capital gains stripping rules?

TIF PROBLEM SIXTEEN - 2
Rollovers Under Section 85 - True Or False

1. Accounts receivable cannot be transferred under the provisions of ITA 85(1).

   True or False?

2. The taxpayer who is the transferor in an ITA 85(1) rollover must receive at least one share of the transferee corporation.

   True or False?

3. The elected transfer price in an ITA 85(1) rollover can never be below the capital cost of the asset being transferred.

   True or False?

4. The elected transfer price in an ITA 85(1) rollover can never be below the amount of non-share consideration received.

   True or False?

5. If land is transferred in an ITA 85(1) rollover and the elected value is less than its adjusted cost base, a loss can always be recognized on the transfer.

   True or False?

6. In a Section 85 rollover, the lowest value that can be elected is the greater of the fair market value of the boot and the least of 4/3 of the cumulative eligible capital balance, the cost of the individual eligible capital property, and the fair market value of the individual eligible capital property.

   True or False?

7. The adjusted cost base of the consideration received by a transferor in an ITA 85 rollover is always allocated first to the fair market value of any non-share consideration, with the remaining value going to the common shares issued by the transferee.

   True or False?

8. If an asset is transferred in an ITA 85 rollover at an elected value that results in a capital gain to the transferor, the cost to the transferee for CCA purposes will be the transferor's cost, plus one-half of the excess of the elected value over the transferor's cost.

   True or False?

9. In an ITA 85 rollover, any required PUC reduction will be allocated first to the preferred shares, with any remaining value allocated to the common shares.

   True or False?

10. In an ITA 85 rollover, if the non-share consideration received by the transferor is equal to the aggregate elected value for the assets transferred, the PUC of any common or preferred shares issued by the transferee corporation will be nil.

    True or False?

TIF PROBLEM SIXTEEN - 3
Rollovers Under Section 85 - Multiple Choice

Section 85 Rollovers

1. Which of the following assets cannot be transferred to a corporation under the provisions of ITA 85(1)?

   A. Depreciable capital property.
   B. Canadian resource properties.
   C. A group of real properties that are being held for immediate resale.
   D. Eligible capital property that is being held for immediate resale.

2. In general, the elected transfer price in an ITA 85(1) rollover will not serve as which of the following values?

   A. The adjusted cost base of non-depreciable property transferred to the transferee.
   B. The proceeds of disposition for the transferor.
   C. The adjusted cost base of the consideration given to the transferor.
   D. The capital cost of depreciable property transferred to the transferee.

3. Which of the following would not be considered part of the boot received by a transferor in an ITA 85(1) rollover?

   A. Debt securities of the transferee.
   B. Redeemable preferred shares of the transferee.
   C. The assumption of transferor debt by the transferee.
   D. Cash.

4. John Torros has an unlimited life franchise that cost $150,000. His cumulative eligible capital balance is $90,490 and the current fair market value of the franchise is $225,000. Using the provisions of ITA 85(1), this asset is transferred to a corporation in return for cash of $100,000 and common shares with a fair market value of $125,000. Which of the following amounts is the minimum value that John could elect for the transfer.

   A. $120,653.
   B. $150,000.
   C. $ 90,490.
   D. $100,000.

5. Eric Lehnserr owns 100 percent of Magnus Products Ltd. The shares were originally issued in 1982 for $20,000. In 1986, they were acquired by Eric's father for $25,000. In 2002, Eric's father died and left the shares to Eric. At that time, they were deemed to have been disposed of for $100,000. On the terminal return for Eric's father, a capital gain of $75,000 was reported, and tax was paid on the taxable capital gain of $37,500. Eric wishes to transfer the shares, now valued at $250,000, to a holding corporation owned by himself, electing under Section 85(1) of the *Income Tax Act*. Magnus Products Ltd. has never paid dividends of any kind.

   Which one of the following amounts represents the minimum possible elected amount under Section 85(1), ignoring the impact of consideration received?

   A. $20,000.
   B. $25,000.
   C. $100,000.
   D. $250,000.

6. Lyndon Taylor transferred a piece of machinery to his corporation, making use of Section 85 of the *Income Tax Act*. The equipment's fair market value was $20,000 and its undepreciated capital cost was $15,000. The elected transfer price was $15,000. As consideration, Lyndon received a $14,900 promissory note and 5,100 preferred shares with a redemption amount of $1 per share. What is the aggregate adjusted cost base of Lyndon's preferred shares?

   A. $100.
   B. $5,000.
   C. $5,100.
   D. $15,000.

7. Barry Hicks owns a building with a capital cost of $200,000, a UCC balance of $150,000, and a fair market value of $600,000. This property is transferred to a corporation under the provisions of ITA 85(1). The corporation assumes the $50,000 mortgage on the building. In return for the building, Barry receives a promissory note for $40,000 and preferred shares with a fair market value of $510,000. If Barry elects a value that will maximize tax deferral, the adjusted cost base of the preferred shares is:

   A. Nil.
   B. $60,000.
   C. $110,000.
   D. $600,000.

8. In transferring a business to a corporation, accounts receivable can be transferred using either ITA 22 or ITA 85(1), but not both. One advantage of using ITA 22 is:

   A. The vendor will be able to deduct a capital loss.
   B. The acquiring corporation will be able to deduct a bad debts reserve after the transfer.
   C. The vendor will not have to add back to income any previously deducted reserve.
   D. The vendor will have a loss that may be considered superficial.

9. Mary Hanson is holding 1,000 shares of Hanson Operations. They have an adjusted cost base and Paid Up Capital of $20,000. Their current fair market value is equal to $200,000. Electing under ITA 85 in a manner that will maximize tax deferral, the shares are transferred to Hanson Holdings Inc., in return for $8,000 in cash and 250 Hanson Holdings shares with a fair market value of $192,000. The Paid Up Capital of the Hanson Holdings shares will be:

   A. $12,000.
   B. $20,000.
   C. $192,000.
   D. $200,000.

10. Harold Warren incorporated Warren Enterprises Ltd. at the beginning of the current year. In addition to a $100,000 cash contribution, Harold contributed assets with a total tax value of $100,000 and a total fair market value of $150,000. In return, he receives 25,000 voting shares in the new corporation. If he elects a value that will result in minimum current Tax Payable, the adjusted cost base of the voting shares will be:

    A. $100,000.
    B. $150,000.
    C. $200,000.
    D. $250,000.

Dividend Stripping

11. Which of the following conditions is not required for ITA 84.1 (dividend stripping rules) to be applicable?

    A. The shares that are disposed of must have been held as capital property.
    B. The subject corporation must be associated with the purchaser corporation after the disposition of the shares.
    C. The share disposition must be made to a corporation with which the taxpayer does not deal at arm's length.
    D. The taxpayer who disposes of the shares must be a Canadian resident.

12. Jean Hill, a Canadian resident, transfers 100 percent of the shares in Hill Inc. to a new company, Jean Ltd. The Hill Inc. shares have an adjusted cost base and PUC of $100,000, and a fair market value of $1,000,000. The transfer is made under the provisions of ITA 85 at an elected value of $850,000. Ms. Hill receives cash of $850,000 and retractable preferred shares with a fair market value of $150,000. What are the immediate tax consequences to Ms. Hill, resulting from this transfer?

    A. A capital gain of $900,000.
    B. An ITA 84.1(1) deemed dividend of $750,000.
    C. An ITA 84.1(1) deemed dividend of $750,000, plus a capital gain of $150,000.
    D. A capital gain of $750,000.

Capital Gains Stripping

13. Which of the following conditions is not required for ITA 55(2) (capital gains stripping rules) to apply?

    A. There is a disposition of shares by a corporation to an arm's length party.
    B. The corporation that has disposed of the shares has received dividends that are deductible under ITA 112(1).
    C. One of the purposes of the dividend received by the corporation was to significantly reduce a capital gain on the disposition of shares..
    D. The corporation selling the shares must be a private company.

TIF PROBLEM SIXTEEN - 4
Rollovers Under Section 85 - Exam Exercises

Exam Exercise Sixteen - 1 (Elected Value For Non-Depreciable Property)

Natasha Pulski's unincorporated business has inventories with a fair market value of $47,000 and a tax cost of $55,000. In addition, it has land with a fair market value of $275,000 and a tax cost of $83,000. She intends to transfer these assets to a new corporation, taking back $47,000 in cash for the inventories and $122,000 in cash for the land. If she uses Section 85(1) for the transfer, what is the possible range of values that can be elected for the two properties? If, in each case, she elects the lowest possible value, what are the tax consequences for Ms. Pulski?

Exam Exercise Sixteen - 2 (Elected Value For Depreciable Property)

Ms. Helen Nasser has two depreciable assets - a Class 1 building and a Class 8 piece of equipment. The assets are to be transferred to a corporation using ITA 85. Relevant information on the assets is as follows:

	Class 1	Class 8
Fair Market Value Of The Property	$390,000	$15,000
UCC Of Class (Last Asset In Class)	134,000	10,000
Cost Of The Property	191,000	27,000
Fair Market Value Of The Boot	246,000	11,000

What is the possible range of values that can be elected for the two properties? If, in each case, she elects the lowest possible value, what are the tax consequences for Ms. Nasser?

Exam Exercise Sixteen - 3 (Elected Value For CEC)

During 2008, Trang Ventures acquires an unlimited life franchise at a cost of $121,000. Maximum CEC is deducted for that year. At the beginning of 2009, all of the assets of Trang Ventures are transferred to a new corporation. At this time, the fair market value of the franchise is estimated to be $168,000. Trang's consideration for this asset is made up of $121,000 in cash, plus shares in the new corporation with a fair market value of $47,000. What is the possible range of values that can be elected for the franchise? If the minimum value is elected, what would be the tax consequences for Trang Ventures?

Exam Exercise Sixteen - 4 (ACB Of Consideration Received)

Using ITA 85, Tom Leung transfers non-depreciable property to a corporation at an elected value of $86,800. The property has an adjusted cost base of $86,800 and a fair market value of $246,400. As consideration, he receives a note for $71,400, preferred shares with a fair market value of $74,200, and common shares with a fair market value of $100,800. Indicate the adjusted cost base of the individual items of consideration received by Mr. Leung.

Exam Exercise Sixteen - 5 (Section 85 - PUC Reduction)

Using ITA 85, Ms. Robyn Tunney transfers non-depreciable property to a corporation at an elected value of $91,200. The property has an adjusted cost base of $91,200 and a fair market value of $187,200. As consideration, she receives a note for $66,400, preferred shares with a fair market value and legal stated capital of $77,600, and common shares with a fair market value and legal stated capital of $43,200. Indicate the adjusted cost base and the PUC of the preferred and common shares that were issued to Ms. Tunney.

Exam Exercise Sixteen - 6 (Section 85 Rollover)

Jerri Smolt has operated her alternative medicine pharmacy as an unincorporated business for a number of years. The tangible assets of this business have a fair market value of $850,000 and a tax cost of $275,000. In addition, as the business has been extremely profitable, she estimates that the business has goodwill of $300,000. The total liabilities of the business amount to $83,000.

As she no longer needs all of the income that the business is producing, she would like to transfer the business to a new corporation and, in order to defer taxation, she would like to use the provisions of ITA 85(1) for the transfer.

She will make the transfer at an elected value of $275,000. The corporation will assume the $83,000 in business liabilities and, in addition, issue a note payable to Ms. Smolt in the amount of $17,000. Other consideration will be made up of redeemable preferred shares with a fair market value of $125,000 and common shares with a fair market value of $925,000. Any dividends will be non-eligible.

Required: Determine the following:

1. The adjusted cost base of each type of consideration received by Ms. Smolt.
2. The paid up capital of each type of share issued by the new corporation.
3. The tax consequences to Ms. Smolt of the new preferred shares being redeemed at their fair market value immediately.

Exam Exercise Sixteen - 7 (Section 85 - Gift To Transferee)

Samual Rosen establishes a new corporation, arranging to have all of its common shares issued to his daughter for cash of $500. Mr. Rosen then transfers, using ITA 85, non-depreciable property with an adjusted cost base of $67,500 and a fair market value of $148,500. The transfer is made at an elected value of $67,500. As consideration for this property, the corporation gives Mr. Rosen a note for $67,500 and preferred stock with a fair market value and a legal stated capital of $20,250.

Describe the tax consequences of these transactions for both Mr. Rosen and his daughter.

Exam Exercise Sixteen - 8 (Section 85 - Benefit To Transferor)

Mrs. Jeanne Keanings uses ITA 85 to transfer non-depreciable property to a new CCPC. The adjusted cost base of the property is $136,000 and it has a fair market value of $224,000. In consideration for this property, Mrs. Keanings receives a note for $193,000 and preferred stock with a fair market value and a legal stated capital of $90,000. Mrs. Keanings elects to make the transfer at the fair market value of $224,000. Any dividends will be non-eligible.

What are the tax consequences of this transaction to Mrs. Keanings? Include in your answer the effect of the transfer on Mrs. Keanings' Net Income For Tax Purposes and the ACB and PUC of the preferred shares.

Exam Exercise Sixteen - 9 (Dividend Stripping)

Mr. Marshal Stack owns 100 percent of the outstanding shares of Stack Ltd., a qualified small business corporation. The shares have a PUC and an adjusted cost base of $132,000 and a fair market value of $699,000. The Company has no balance in its GRIP account. Mr. Stack uses ITA 85(1) to transfer these shares to Stack's Investments Ltd., at an elected value of $699,000. As consideration, he receives a note for $390,000 and preferred shares with a fair market value and a legal stated capital of $309,000. Mr. Stack owns all of the shares of Stack's Investments Ltd. and has made no use of his lifetime capital gains deduction.

What are the tax consequences of this transaction to Mr. Stack? Include in your answer the adjusted cost base and the PUC of the new preferred shares.

Exam Exercise Sixteen - 10 (Capital Gains Stripping)

Foral Inc., a Canadian public company, owns 80 percent of the outstanding shares of Matlin Ltd. Matlin Ltd. is also a Canadian public company. The shares of Matlin Ltd. have an adjusted cost base of $125,000 and a fair market value of $940,000. Included in the Retained Earnings balance of Matlin Ltd. is $285,000 of income that has been earned since its acquisition by Foral.

Foral Inc. wishes to dispose of these shares, and Sored Company is interested in acquiring them. In order to accomplish this goal, the Matlin Ltd. shares are transferred to Sored, under the provisions of Section 85, at an elected value of $125,000. As consideration for the transferred shares, Foral Inc. receives redeemable preferred shares issued by the Sored Company. These shares have a fair market value of $940,000. Their adjusted cost base and PUC are equal to the elected value of $125,000. Foral Inc. redeems these shares immediately. Describe the tax consequences to Foral Inc. of the redemption.

TIF PROBLEM SIXTEEN - 5
Rollovers Under Section 85 - Key Term Matching

The following five key terms are listed at the end of Chapter 16, "Rollovers Under Section 85".

A. Boot

B. Capital Gains Stripping

C. Affiliated Person

D. Rollover

E. Non-Share Consideration

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. A colloquial term used by tax practitioners to refer to cash consideration.

2. For an individual, an affiliated person is that individual's spouse or common-law partner. For a corporation, an affiliated person is a person or an affiliated group of persons who controls the corporation, or the spouse or common-law partner of either the person who controls, or a member of the group that controls.

3. As this term is used in tax work, it refers to any tax free transfer of assets between related persons.

4. Consideration received by a taxpayer from a corporation that is in the form of cash or a note payable.

5. A colloquial term used by tax practitioners to refer to non-share consideration.

6. Procedures designed to allow a corporation to convert a taxable capital gain resulting from the disposition of investment shares to a non-arm's length party, into a tax free intercorporate dividend.

7. For an individual, an affiliated person is that individual's spouse, common-law partner, parents, and children. For a corporation, an affiliated person is a person or an affiliated group of persons who controls the corporation, or the spouse or common-law partner of either the person who controls, or a member of the group that controls.

8. Consideration received by a taxpayer from a corporation that is in the form of assets other than shares of the corporation.

9. Procedures designed to allow a corporation to convert a taxable capital gain resulting from the disposition of investment shares to an arm's length party, into a tax free intercorporate dividend.

10. As this term is used in tax work, it refers to a tax free transfer of assets under circumstances that, in the absence of a rollover provision, would be considered a taxable transfer.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM SIXTEEN - 6
Section 85 Estate Freeze

Mr. Billy Bob Barnes is 72 years old and has operated an unincorporated retail business at the same location for over 40 years. The business is called The Leaping Trout, and it specializes in various types of fishing equipment and supplies. As all of the sales of the business are for cash, the only tangible assets of the business are cash, inventories, a building, and the land on which the building is situated.

On December 31, 2010, the tax values and current fair market values for these tangible assets, as well as the liabilities of the business, are as follows:

	Tax Value	Fair Market Value
Inventories	$164,000	$164,000
Land	53,000	298,000
Building (Cost = $350,000)	161,000	506,000
Accounts Payable	(76,000)	(76,000)
Mortgage Payable	(140,000)	(140,000)
Total	$162,000	$752,000

It would appear that the business has goodwill, as Billy Bob received an arm's length offer to purchase the net assets described above for $900,000. The buyer would assume the liabilities of the business.

Billy Bob would like to have his 51 year old son, Jeb, eventually assume control of the business. To this end his accountant, Bubba Hyder, has advised him that he can use a fancy tax procedure called a Section 85 rollover to transfer the assets to a new corporation called Leaping Trout Inc. (LTI). Under this procedure, all of the assets of The Leaping Trout business would be transferred to LTI at elected values equal to their tax values. LTI would assume all of the liabilities of the business. LTI does not have a balance in its General Rate Income Pool (GRIP) account in any of the years under consideration.

Under the plan developed by Bubba, Billy Bob will receive consideration with a fair market value equal to $900,000. He will receive non-share consideration in the form of a $100,000 note from the corporation, payable on demand. The share consideration received by Billy Bob will include:

- Common shares with a fair market value of $10,000 (Billy Bob will sell these shares to Jeb when he believes that he is mature enough to take over the business).
- Redeemable preferred shares with a fair market value of $790,000.

Required: (Show all calculations to support your answers.)

A. Indicate the immediate tax consequences to Billy Bob of the proposed rollover. Indicate the tax basis to LTI of the assets it will acquire in the rollover.

B. Determine the adjusted cost base of each component of the consideration received by Billy Bob.

C. Compute the PUC of the common and preferred shares issued in the rollover.

D. Describe the tax consequences to Billy Bob when:

1. the corporation pays off the note issued to Billy Bob;
2. the corporation redeems the preferred shares issued to Billy Bob; and
3. Billy Bob sells the common shares to his son, Jeb, for their fair market value of $10,000.

TIF PROBLEM SIXTEEN - 7
ACB Of Consideration And PUC - 3 Short Cases

Miss Suzanne Blake intends to transfer a parcel of land to a new corporation using the provisions of Section 85. The land has an adjusted cost base of $400,000 and a fair market value of $800,000. Miss Blake will transfer the land at an elected value of $400,000.

Miss Blake is considering the following alternative consideration packages:

	Alternative		
	One	**Two**	**Three**
Debt Of The New Corporation	$300,000	$200,000	$320,000
Preferred Shares	50,000	600,000	Nil
Common Shares	450,000	Nil	480,000
Total	$800,000	$800,000	$800,000

All of the amounts in the preceding table are fair market values.

Required:

A. For each of the three alternatives, determine the adjusted cost base of the individual items of consideration received by Miss Blake.

B. For each of the three alternatives, determine the legal stated capital and the Paid Up Capital for the preferred and/or common shares issued.

TIF PROBLEM SIXTEEN - 8
Dividend Stripping

Ms. Linda Bradley owns all 500 of the common shares of Bradley Inc., a Canadian controlled private corporation. The corporation was established 12 years ago, with an initial investment of $100,000. The 500 common shares that were issued at this time have a PUC equal to the initial investment of $100,000. The corporation has a December 31 year end and the common shares currently have a fair market value of $1,900,000.

Ms. Bradley would like to freeze the present value of the Bradley Inc. shares so that any future increase in value would accrue to her companion of the last 20 years, Mr. Johnny Wadd. Mr. Wadd cohabits with Ms. Bradley in a conjugal relationship. To accomplish this goal, she will have Johnny incorporate a new company, Wadd Industries, with a nominal amount of his own money being used to acquire all of the common shares of the new company.

Ms. Bradley would then transfer all of her common shares in Bradley Inc. to Wadd Industries, using the provisions of ITA 85(1). As Bradley Inc. is a qualified small business corporation, she would like to structure the rollover in a manner that would utilize the full $750,000 of her lifetime capital gains deduction.

In order to accomplish this goal, she plans to make the transfer at an elected value of $850,000, taking back an interest bearing note with a fair market value of $850,000, and retractable preferred shares with a fair market value and a PUC of $1,050,000.

Neither of the Companies would have a balance in their General Rate Income Pool (GRIP) account in any of the years under consideration.

Required:

A. Explain the tax consequences of the proposed ITA 85(1) transfer of the Bradley Inc. shares to Wadd Industries.

B. Describe how you would change the transaction to improve Ms. Bradley's tax position, and determine the tax implications that would result from this new approach.

C. Assume that rather than transfer her common shares to Wadd Industries, Ms. Bradley sold sufficient common shares to Wadd Industries for cash in order to realize a capital gain that would absorb her $750,000 lifetime capital gains deduction. Explain the tax consequences of this transaction.

Show all calculations to support your answers.

Chapter Seventeen Test Item File Problems

TIF PROBLEM SEVENTEEN - 1
Chapter 17 - Essay Questions

1. Describe, in general terms, the type of situation in which ITA 85.1 (Share For Share Exchange) is used. What is the major tax advantage of using this rollover provision?

2. Jerome Barris is 85 years old and, while his spouse is deceased, he has three children, ages 45, 50, and 52. He owns all of the outstanding common shares of Barris Ltd., a Canadian controlled private corporation. These shares have a PUC and adjusted cost base of $50,000, and a current fair market value of $3 million. He would like to retain operating control of Barris Ltd. However, given his advanced age, he would like to transfer any future growth in the value of the Company to his three children. Briefly explain how ITA 86 (Exchange Of Shares In A Reorganization) could be used to accomplish the results desired by Mr. Barris.

3. When preferred shares are issued in an ITA 86 reorganization, it is important that they contain provisions which establish the market value of such shares. List three provisions that are used to accomplish this goal.

4. When new shares are issued in an ITA 86 reorganization, how is their adjusted cost base determined?

5. When new shares are issued in an ITA 86 reorganization, how is their paid up capital determined?

6. ITA 86(2) has special rules that must be applied when a Section 86 reorganization involves a gift to a related party. What circumstances create such a gift situation?

7. If a parent company wishes to incorporate the assets of a majority owned subsidiary into its operations, this goal can be accomplished either through an amalgamation, under ITA 87, or through the wind-up procedures established in ITA 88(1). Briefly describe the different tax effects that result from choosing one or the other of these alternative procedures.

8. The vendor of a business may have a significant amount of assets that are used under the provisions of capital leases. In most situations, any existing leasing arrangements can be transferred in the process of selling a business. Further, some leased properties may have experienced significant increases in value (e.g., a long-term lease on office space in a market where such space has become scarce). In such circumstances, a long-term lease may be of significant value to the purchaser of a business. Despite the presence of such values, it is not uncommon for leases to be ignored in the purchase agreement and, as a consequence, in the allocation of tax values for the purchasing company. This, in effect, means that the value of these leases ends up as a component of purchased goodwill. Discuss the tax consequences, to both the purchaser and the vendor, of not specifying the value of any long-term capital leases in the agreement of purchase and sale of a business.

9. When the assets of a Canadian controlled private corporation are sold, the following assets will usually be involved in the sale:

   - Accounts Receivable
   - Inventory
   - Depreciable Assets
   - Goodwill

   Briefly describe the tax implications resulting from the sale of each of the preceding types of assets to both the selling company and its shareholders.

10. In general, the purchaser of a corporation would prefer to buy its assets rather than its shares. Provide three reasons for this preference.

TIF PROBLEM SEVENTEEN - 2
Chapter 17 - True Or False

1. In a share for share exchange under ITA 85.1, the transferor cannot control the acquiring company subsequent to the rollover transaction.

   True or False?

2. The most common application of the ITA 86 exchange of shares in a reorganization is to transfer an unincorporated business to a corporation.

   True or False?

3. In an ITA 86 exchange of shares in a reorganization, the transferor must transfer all of the shares of all classes that he owns in the transferee corporation.

   True or False?

4. In an ITA 86 exchange of shares in a reorganization, if the transferor received non-share consideration in excess of the PUC of the old shares, the PUC of the new shares issued will be reduced to nil.

   True or False?

5. In an ITA 86 exchange of shares in a reorganization, if the transferor receives shares with a fair market value that is greater than the fair market value of the shares given up, it may be considered a gift to a related party.

   True or False?

6. If a parent company has a subsidiary, its assets can always be transferred to the parent on a tax free basis using either an ITA 87 amalgamation or, alternatively, an ITA 88(1) winding-up of a 90 percent owned subsidiary.

   True or False?

7. The tax values associated with the excess of the cost of a subsidiary over its carrying value at the time of acquisition can be partially retained in an ITA 88(1) winding-up of a 90 percent owned subsidiary.

   True or False?

8. One of the similarities between an ITA 87 amalgamation and an ITA 88(1) winding-up of a 90 percent owned subsidiary is that both types of rollovers create a deemed year end for all of the participant companies.

   True or False?

9. When there is a winding-up of a subsidiary under ITA 88(1), any unused loss carry forwards of the subsidiary cannot be used by the parent until the first taxation year beginning after the wind-up.

   True or False?

10. When there is a wind-up of a corporation under ITA 88(2), if the amount distributed to the shareholders exceeds the PUC of the corporation's shares, there will be a capital gain equal to this difference, one-half of which will be taxable.

    True or False?

Chapter 17 - True Or False

11. When a corporation is being sold to an arm's length party, the purchaser will generally prefer to acquire the assets of the company, rather than its shares.

True or False?

12. One of the advantages associated with selling the shares of a corporation, rather than selling the assets, is that any resulting gain may be eligible for the lifetime capital gains deduction.

True or False?

TIF PROBLEM SEVENTEEN - 3
Chapter 17 - Multiple Choice

ITA 85.1

1. Which of the following statements with respect to an ITA 85.1 share for share exchange is correct?

   A. This rollover provision is commonly used in estate freezes.
   B. This rollover provision is commonly used in business combination transactions.
   C. This rollover provision is commonly used when a parent wishes to amalgamate with a subsidiary.
   D. This rollover is commonly used to transfer assets of an unincorporated business to a corporation.

2. An individual owns 100 percent of the shares of a CCPC. He wishes to exchange these shares for shares of a large public company without incurring a tax liability. Which roll-over provision would be the easiest to use for this purpose?

   A. ITA 85(1) - Transfer of property to a corporation.
   B. ITA 87 - Amalgamation.
   C. ITA 85.1 - Share for share exchange.
   D. ITA 51 - Convertible property.

ITA 86(1) And (2)

3. Several conditions are required in order that the provisions of ITA 86 (Exchange Of Shares In A Reorganization) apply. Which one of the following conditions is not required?

   A. All of the outstanding shares of the particular class must be exchanged.
   B. The transferor of the original shares must receive shares of the new corporation as consideration for his shares.
   C. The new shares that will be issued must be authorized by the corporation's articles of incorporation (currently, or through an amendment prior to the reorganization).
   D. The original shares must be held by the owner as capital property.

4. When preferred shares are issued in an ITA 86 reorganization, it is important that they have characteristics that serve to establish their fair market value. Which of the following would not be useful in establishing the fair market value of preferred shares?

   A. A fixed dividend rate.
   B. A claim to assets that has priority over the common shares in the event of liquidation.
   C. A provision which requires redemption at a specified value at the discretion of the shareholder.
   D. Voting rights.

5. With respect to an exchange of shares in an ITA 86 reorganization, which of the following statements is not correct?

   A. The cost of the new shares will be equal to the cost of the old shares, reduced by the non-share consideration received.
   B. The PUC of the new shares will be equal to their legal stated capital.
   C. The proceeds of redemption will be equal to the PUC of the new shares, plus any non-share consideration received.
   D. The proceeds of disposition will be equal to the cost of the new shares, plus any non-share consideration received.

6. John Smurt owns 80 percent of the common shares of Smurt Ltd. John's shares have an adjusted cost base of $600,000. The Smurt common shares have a total PUC of $1,000,000, and a total fair market value of $2,500,000. Using the provisions of ITA 86, John exchanged his shares for cash of $600,000 and preferred shares with a legal stated capital and fair market value of $1,400,000. What is the PUC of John's preferred shares?

   A. $1,400,000.
   B. Nil.
   C. $400,000.
   D. $200,000.

7. John Smurt owns 80 percent of the common shares of Smurt Ltd. John's shares have an adjusted cost base of $600,000. The Smurt common shares have a total PUC of $1,000,000, and a total fair market value of $2,500,000. Using the provisions of ITA 86, John exchanged his shares for cash of $600,000 and preferred shares with a legal stated capital and fair market value of $1,400,000. What is the adjusted cost base of John's preferred shares?

   A. Nil.
   B. $250,000.
   C. $1,400,000.
   D. $650,000.

8. Jeri Nardwal owns 80 percent of the common shares of Nardwal Ltd. Her son owns the other 20 percent. Her common shares have an adjusted cost base and PUC of $960,000. Their fair market value of her shares is $4,800,000. She exchanges these shares for $500,000 in cash and preferred shares with a legal stated capital and fair market value of $3,840,000. What is the adjusted cost base of the preferred shares?

   A. $460,000.
   B. $3,840,000.
   C. Nil.
   D. $960,000.

ITA 87 And ITA 88(1)

9. With respect to the application of ITA 87, which of the following statements is not correct?

   A. Losses of the two predecessor companies can be used by the amalgamated company in its first taxation year.
   B. The capital dividend accounts of the predecessor companies will be available to the amalgamated company, provided it is a private company.
   C. The depreciable capital property of the predecessor companies will be carried forward to the tax records of the amalgamated company at UCC values.
   D. If either predecessor company had a GRIP balance, it will always be available to the amalgamated company.

10. With respect to the application of ITA 88(1), winding up of a 90 percent owned subsidiary, which of the following statements is not correct?

   A. A write up of non-depreciable capital property may be available.
   B. Both the subsidiary and the parent will have a deemed year end.
   C. Subsidiary losses will become available to the parent company in its first taxation year which begins after the windup.
   D. The tax values of the subsidiary assets will be carried forward to tax records of the parent company.

Winding Up And Sale Of A Corporation

11. Jasmine Lee owns all of the shares of Tee Ltd. Her adjusted cost base for these shares is $50,000. Because of declining sales, she has decided to wind up the Company under the provisions of ITA 88(2) and, after the assets have been sold and all corporate taxes paid, there is $2,000,000 available for distribution. The balances in the tax accounts of Tee Ltd. are as follows:

Paid Up Capital	$ 100,000
RDTOH	Nil
Capital Dividend Account	400,000
Retained Earnings	1,500,000
Total	$2,000,000

Of the following statements, which one is correct?

A. Jasmine will receive dividends subject to tax of $1,500,000 (before any gross up), as well as a taxable capital gain of $25,000, when she receives the $2,000,000 distribution.
B. Jasmine will have a taxable capital gain of $975,000 when she receives the $2,000,000 distribution.
C. As a rollover provision is being used, there will be no current tax consequences when she receives the $2,000,000 distribution.
D. Jasmine will receive dividends subject to tax of $1,500,000 (before any gross up), as well as a taxable capital gain of $225,000, when she receives the $2,000,000 distribution.

12. Nancy recently received an offer for the shares of her corporation, Eager Beaver Consultants Ltd. Nancy's shares have an adjusted cost base of $600,000, and she has previously fully utilized her lifetime capital gains deduction. Although Nancy would like to sell her shares and retire, she will only sell her shares if her after tax retention from the sale totals at least $2 million. Assuming that Nancy's combined federal and provincial marginal tax rate is 50 percent, what is the minimum price Nancy should accept for her shares?

A. $2,466,667.
B. $4,600,000.
C. $2,840,000.
D. $3,400,000.

13. During the current year, all of the assets of Linden Enterprises, a Canadian controlled private corporation, were sold. Among the assets was goodwill with a fair market value of $425,000. As the goodwill was internally generated, the balance in the corporation's cumulative eligible capital account was nil. Which of the following statements is correct?

A. Linden will report active business income of $318,750, with no addition to the capital dividend account.
B. Linden will report a taxable capital gain of $212,500, and there will be a $212,500 addition to the capital dividend account.
C. Linden will report active business income of $212,500, and there will be a $212,500 addition to the capital dividend account.
D. Linden will report active business income of $318,750, and there will be a $106,250 addition to the capital dividend account.

14. Indicate which of the following items would not be a significant consideration in the purchase of an incorporated business?

    A. The RDTOH balance when the purchaser acquires the shares of the business.
    B. The fair market value of individual assets when the purchaser acquires the assets of the business.
    C. The tax values of the individual assets when the purchaser acquires the shares of the business.
    D. The fair market value of the individual assets when the purchaser acquires the shares of the business.

TIF PROBLEM SEVENTEEN - 4
Chapter 17 - Exam Exercises

Exam Exercise Seventeen - 1 (Share For Share Exchange)

Mr. Morgan Forbes is the sole shareholder of Forbes Ltd., a Canadian controlled private corporation. The corporation was established several years ago by Mr. Forbes with an investment of $540,000. It has identifiable net assets with a fair value of $2,640,000. The shares of his Company are acquired by a large publicly traded company, Megopolis Ltd., through the issuance of 75,000 new Megopolis shares. At the time of this business combination, the Megopolis Ltd. shares are trading at $36 per share. Mr. Forbes has fully utilized his lifetime capital gains deduction in the past. Indicate the tax consequences of this transaction to both Mr. Forbes and Megopolis Ltd.

Exam Exercise Seventeen - 2 (Exchange Of Shares In Reorganization)

Ms. Laura Cooper is the sole shareholder of Cooper Inc. It is a Canadian controlled private corporation and its common shares have a fair market value of $2,950,000, an adjusted cost base (ACB) of $1,375,000, and a paid up capital (PUC) of $1,375,000. At this time, Cooper Inc. has no balance in its GRIP account. Ms. Cooper exchanges all of her Cooper Inc. shares for cash of $1,375,000 and preferred shares that are redeemable for $1,575,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

Exam Exercise Seventeen - 3 (Exchange Of Shares In Reorganization)

Ms. Samantha Shields is the sole shareholder of Shields Ltd. It is a Canadian controlled private corporation and its common shares have a fair market value of $920,000, an adjusted cost base (ACB) of $500,000, and a paid up capital (PUC) of $400,000. At this time, Shields Ltd. has no balance in its GRIP account. Ms. Shields exchanges all of her Shields Ltd. shares for cash of $480,000 and preferred shares that are redeemable for $440,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

Exam Exercise Seventeen - 4 (Gift To A Related Party)

Mr. Jean Doyen owns 80 percent of the shares of Jondon Inc. The remaining shares are held by his 19 year old son. The corporation is a Canadian controlled private corporation and its shares have a total fair market value of $3,360,000, an adjusted cost base (ACB) of $525,000, and paid up capital (PUC) of $525,000. Mr. Doyen exchanged all of his Jondon Inc. shares for cash of $630,000 and preferred shares that are redeemable for $1,680,000. At this time, Jondon Inc. has no balance in its GRIP account.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction.

Exam Exercise Seventeen - 5 (ITA 87 Amalgamations)

During its taxation year ending December 31, 2009, Loser Inc. incurs a non-capital loss of $74,400 and an allowable capital loss of $120,000. Neither loss can be carried back. On January 1, 2010, using the provisions of ITA 87, the Company is amalgamated with Winner Ltd., a company that also has a December 31 year end. The combined company is named Combo Inc. and it elects to use a December 31 year end. The terms of the amalgamation give 16,000 Combo Inc. shares to the Loser Inc. shareholders, and 120,000 Combo Inc. shares to the Winner Ltd. shareholders.

During the year ending December 31, 2010, Combo Inc. has Net Income For Tax Purposes of $960,000, including over $240,000 in taxable capital gains. Will Combo Inc. be able to deduct the losses incurred by Loser Inc. prior to the amalgamation during its 2010 taxation year? Explain your conclusion.

Exam Exercise Seventeen - 6 (Winding-Up Of A 90 Percent Owned Subsidiary)

On January 1, 2006, Chipper Ltd. acquired 100 percent of the outstanding shares of Intell Inc. at a cost of $1,800,000. At this point in time, the fair market value of Intell's identifiable net assets was $1,275,000, including $405,000 for the Land. The tax value for the net assets at that time was $615,000.

On December 31, 2010, there is a winding-up of Intell Inc. under the provisions of ITA 88(1). Intell Inc. has paid no dividends since its acquisition by Chipper Ltd. On December 31, 2010, the condensed Balance Sheet of Intell Inc. is as follows:

Cash	$180,000
Land - At Cost (Purchased In 2002)	210,000
Depreciable Assets - At UCC (Purchased In 2002)	360,000
Total Assets	$750,000
Liabilities	$112,500
Shareholders' Equity	637,500
Total Equities	$750,000

Determine the tax values that will be recorded for Intell Inc.'s assets after they have been incorporated into the records of Chipper Ltd.

Exam Exercise Seventeen - 7 (Winding-Up Of A Canadian Corporation)

Sundown Inc. is a Canadian controlled private corporation. After disposing of all of its assets and paying all of its liabilities, including Tax Payable resulting from the asset dispositions, Sundown Inc. is left with cash of $2,854,500. The PUC of the Company's shares is equal to their adjusted cost base, an amount of $290,400. After the sale of assets, the Company has an RDTOH account balance of $155,100, a capital dividend account balance of $85,800 and a GRIP balance of nil.

Determine the tax consequences to the shareholders of Sundown Inc. associated with making the maximum cash distribution to the shareholders. Assume that appropriate elections will be made to minimize the taxes that will be paid by the shareholders. You are not required to calculate personal tax payable for the shareholders.

TIF PROBLEM SEVENTEEN - 5
Chapter 17 - Key Term Matching

The following five key terms are listed at the end of Chapter 17, "Other Rollovers And Sale Of An Incorporated Business".

A. Convertible Property

B. Winding-Up Of A 90 Percent Owned Subsidiary

C. Share For Share Exchange (ITA 85.1)

D. Merger

E. Amalgamation

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. A rollover provision that allows the assets of a 90 percent owned subsidiary to be transferred to its parent and minority shareholders, without tax consequences.

2. Equity securities that can be converted into a different class of equity shares, without tax consequences.

3. A rollover provision that allows one class of shares in a corporation to be exchanged for a different class of shares in the same corporation, without tax consequences.

4. A combination of two or more business enterprises. While widely used in the *Income Tax Act*, this term does not have a formal definition in that legislation.

5. A rollover provision that allows any two corporations to be combined into a single taxable Canadian corporation, without tax consequences.

6. A debt or equity financial instrument of a corporation that can be exchanged for a different debt or equity financial instrument of the same corporation, without the payment of additional consideration.

7. A rollover provision which allows two taxable Canadian corporations to be combined into a single taxable Canadian corporation, without tax consequences.

8. A rollover provision that allows one corporation to acquire shares in another corporation by issuing its own shares, without tax consequences to either of the corporations or their shareholders.

9. As defined in the *Income Tax Act*, a combination of two or more business enterprises.

10. A rollover provision that allows the assets of a 90 percent or more owned subsidiary to be combined with the assets of its parent company, without tax consequences.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM SEVENTEEN - 6
Section 86 Reorganization (With Deemed Gift)

Mr. John Kapp owns 75 percent of the outstanding common shares of Kapp Ltd., a Canadian controlled private corporation. His shares have a paid up capital and an adjusted cost base of $600,000. The current fair market value of Mr. Kapp's shares is $1,200,000.

The other 25 percent of the outstanding common shares of Kapp Ltd. are owned by Mr. Kapp's 35 year old daughter, Emily Kapp. Her shares have a paid up capital and an adjusted cost base of $200,000.

In May, 2010, Mr. Kapp arranges to exchange his common shares for cash of $225,000 and redeemable preferred shares with a fair market value of $775,000. The legal stated capital of these preferred shares is also $775,000. On September 28, 2010, Kapp Ltd. redeems the preferred shares.

Mr. Kapp has fully utilized his lifetime capital gains deduction. The Company has a nil balance in its General Rate Income Pool (GRIP) account for all years under consideration.

Required:

A. With respect to this reorganization, calculate:

- the amount of any gift that Mr. Kapp has made to his daughter;
- the PUC of the new preferred shares;
- the adjusted cost base for the new preferred shares;
- the amount of any deemed dividends arising on the exchange; and
- any capital gain or loss resulting from the exchange of the common shares.

B. Calculate the taxable capital gain or allowable capital loss that would accrue to Mr. Kapp on the redemption of his preferred shares for $775,000.

TIF PROBLEM SEVENTEEN - 7
Section 86 Reorganization

Espana Ltd. was incorporated with an initial investment of $465,000 in cash. In return for this investment, Ms. Portia Cruz received common shares with a fair market value and a paid up capital of $465,000.

In 2005, Mr. Jose Martinez acquired all of Ms. Cruz's shares in return for a payment of $1,340,000. As there was no additional investment in Espana Ltd. subsequent to its incorporation, Mr. Martinez became the sole shareholder of the Company at this point in time.

Under Mr. Martinez's direction, the Company continued to prosper, with the fair market value of the shares on December 1, 2010 estimated to be $3,500,000.

As he is nearly 70 years of age, Mr. Martinez would like to freeze the value of his holding of Espana Ltd. shares. To accomplish this, on December 1, 2010, he sells 25 percent of his shares to his 42 year old daughter for cash of $875,000 [(25%)($3,500,000)]. Also on this date, he exchanges the remaining 75 percent of the common shares for cash of $625,000, plus redeemable preferred shares with a fair market value and legal stated capital of $2,000,000.

Espana Ltd. is not a qualified small business corporation. The Company has a nil balance in its General Rate Income Pool (GRIP) account for all years under consideration.

Required: Determine the following:

A. The amount of the gift to a related party, if any, resulting from the exchange of shares.

B. The paid up capital of the newly issued preferred shares.

C. The adjusted cost base of the newly issued preferred shares.

D. The proceeds of redemption/disposition that Mr. Martinez received when he exchanged the old common shares of Espana Ltd. for preferred shares.

E. The immediate tax consequences for Mr. Martinez resulting from the sale of shares to his daughter and the exchange of shares.

F. The tax consequences for Mr. Martinez if the new Espana Ltd. preferred shares are immediately redeemed for their fair market value.

TIF PROBLEM SEVENTEEN - 8
Sale Of Assets And Winding-up

Pellerin Fabrication Ltd. is a Canadian controlled private corporation with a June 30 year end. All of the shares of the corporation are owned by Mr. Denis Pellerin, the founder of the corporation. On June 30, 2010, the Balance Sheet of the Company, after all closing entries and prepared in accordance with generally accepted accounting principles, is as follows:

Cash	$ 50,000
Accounts Receivable	215,000
Inventories (Lower Of Cost And Market)	375,000
Land (Cost)	132,000
Building (Cost)	850,000
Accumulated Amortization	(263,000)
Total Assets	$1,359,000
Liabilities	$ 373,000
Common Stock - No Par	600,000
Retained Earnings	386,000
Total Equities	$1,359,000

Mr. Pellerin wishes to retire and has agreed to sell all of the non-cash assets of the business, including goodwill, at their fair market values on July 1, 2010. The buyer will assume all of the liabilities of the corporation and will pay the purchase price in cash. The relevant fair market values and the resulting purchase prices are as follows:

Accounts Receivable	$195,000
Inventories	375,000
Land	193,875
Building	550,000
Goodwill	56,250
Liabilities	(386,125)
Purchase Price	$984,000

Other Information:

1. With respect to the transfer of the Accounts Receivable, the appropriate election is made under ITA 22.

2. The UCC of the Building is $492,000.

3. As at June 30, 2010, the corporation has a balance in its Refundable Dividend Tax On Hand account of $31,000. No dividends were paid during the previous year ending June 30, 2009.

4. As at June 30, 2010, the capital dividend account has a balance of $63,000 and there is a nil balance in the General Rate Income Pool (GRIP) account.

5. The PUC of the corporation is equal to the account balance for the Common Stock. This is also Mr. Pellerin's adjusted cost base for the shares.

6. The corporation is subject to a provincial tax rate of 5 percent on income eligible for the federal small business deduction and 13 percent on other income.

7. For 2010, Mr. Pellerin will have income from other sources in excess of $200,000. This means his marginal income is taxed at a 29 percent rate at the federal level and a 14 percent rate at the provincial level. The provincial dividend tax credit is equal to one-third of the gross up for all dividends.

8. Pellerin Fabrication Ltd. is not a qualified small business corporation.

Required:

A. Calculate the after corporate tax amount that will be available for distribution to Mr. Pellerin after the asset sale.

B. Calculate the amount that will be available to Mr. Pellerin, after personal taxes are paid, on the distribution of the funds resulting from the winding-up of Pellerin Fabrication Ltd. Assume that appropriate elections and designations will be made to minimize the taxes that will be paid by Mr. Pellerin.

Chapter Eighteen Test Item File Problems

TIF PROBLEM EIGHTEEN - 1
Partnerships - Essay Questions

1. Under the provisions of the *Income Tax Act*, only individuals, corporations, and trusts are considered to be taxable entities. Given this, explain how the business and property income earned by a partnership will be taxed.

2. Briefly describe the three basic elements that are required in the formation of a partnership.

3. Mr. Johns, Mr. Klien, and Ms. Langley are all qualified Chartered General Management Accountants (CGMA) who trained in large national firms. However, for the last few years they have each operated a small private practice. They are currently discussing the possibility of forming a partnership to combine their practices. List four major points to be considered in the formation of such a partnership and in drawing up a partnership agreement.

4. The degree to which partners have responsibility for partnership debts depends on the type of partnership. In terms of this responsibility, briefly describe the three types of partnerships that are discussed in your text.

5. Describe three factors that have been used to distinguish joint venture arrangements from partnership arrangements.

6. When it is allocated to individual partners, various types of income earned in a partnership will retain its tax characteristics. Explain this statement.

7. In determining the income of a partnership for tax purposes, how are salaries to the partners dealt with?

8. Partnership organizations sometimes make contributions to registered charities. How are these amounts dealt with in the determination of income at the partnership level?

9. In determining the adjusted cost base of a partnership interest, briefly describe the treatment of each of the following items:
   - capital contributions,
   - partner's share of partnership income, and
   - partner's drawings.

10. What is the objective of the "at-risk" rules that are applicable to limited partnerships?

TIF PROBLEM EIGHTEEN - 2
Partnerships - True Or False

1. If an organization is classified as a partnership, the *Income Tax Act* requires a separate calculation of income for the enterprise.

   True or False?

2. For an organization to be classified as a partnership, there is no requirement that its activities be carried on with a view to making a profit.

   True or False?

3. A limited liability partnership is an organizational form that is available to certain legislatively specified professionals that frees the partners from personal liability for all partnership obligations.

   True or False?

4. A partnership must calculate income as if it was a separate person resident in Canada and, as a consequence, it must file a separate tax return.

   True or False?

5. Income that is flowed through a partnership into the hands of the partners will retain its tax characteristics (e.g., the partnership's capital gains will be passed to the partners as capital gains).

   True or False?

6. In computing a partnership's income for tax purposes, salaries paid to the partners should be deducted if they are reasonable.

   True or False?

7. In computing a partnership's income for tax purposes, the amount of CCA to be deducted would be calculated using the same rules that are applicable to a corporation.

   True or False?

8. In computing a partnership's income for tax purposes, charitable donations made by the partnership should be deducted.

   True or False?

9. The adjusted cost base of a partnership interest is increased by the partner's share of income determined at the partnership level, and reduced by drawings made by the partner.

   True or False?

10. If, at the end of a taxation year, negative adjustments to a partnership interest exceed its cost plus positive adjustments, this "negative" balance must be taken into income by the partners.

    True or False?

TIF PROBLEM EIGHTEEN - 3
Partnerships - Multiple Choice

Partnership Characteristics

1. Which of the following is not a basic feature required to create a partnership?

   A. One of the partners must be an individual.
   B. There must be two or more persons involved.
   C. The persons must be carrying on a business.
   D. The business must be carried on with an expectation of a profit.

2. Which of the following statements about limited partners is not correct?

   A. They are entitled to share equally in profits and losses, unless there is an agreement to the contrary.
   B. They are jointly and severally liable for partnership debt and wrongful acts of other partners.
   C. They are not responsible for the wrongful acts of other partners, except to the extent of their actual and promised contributions to the partnership.
   D. Property that they contribute to the partnership is considered partnership property.

3. Which of the following statements is correct with respect to partnerships?

   A. A partnership must use the calendar year as its taxation year.
   B. Income that is flowed through a partnership loses its tax characteristics.
   C. The adjusted cost base of a partnership interest is increased by the partner's share of the grossed up dividends received by the partnership.
   D. A partnership must calculate income as if it were a separate person resident in Canada.

4. Which of the following statements is not correct with respect to partnerships?

   A. General partners are entitled to participate in the management of the company.
   B. General partners are a separate legal entity from the business.
   C. Unless the partnership agreement states otherwise, general partners are entitled to an equal share of the profits of the business.
   D. General partners are jointly and severally liable for the debts of the company.

5. What advantage is offered by a general partnership, as compared to a corporation, as a form of business organization?

   A. Partners may be able to reduce their personal income taxes if the business has losses in the start-up years.
   B. Higher salaries can be paid to family members and claimed as an expense.
   C. Creditors cannot seize a partner's personal assets to cover business obligations.
   D. Partners will be able to defer taxes on income that is left within the partnership.

6. Jesse and Harold decide to form a partnership. They believe that this arrangement will have the following advantages:

   1. They may be able to reduce their personal income taxes during the start-up years.

   2. They may be able to split income with family members who are employed by the business.

   3. They may be able to realize a tax deferral on their business income.

   4. They will have limited personal liability for the debts of the business.

All of these statements are correct except:

A. 1 and 3.
B. 2 only.
C. 3 and 4.
D. 1 and 2.

Partnership Income, Losses And Tax Credits

7. Noel is a member of a partnership that had a Net Income For Tax Purposes of $304,000 during the current year. His share of this income is $152,000. During this year, Noel received monthly salary checks from the partnership that totalled $104,000. At the end of the year, the partnership distributed bonuses of $60,000 to each of the partners. How much income from the partnership should Noel report for the current year?

   A. $104,000.
   B. $152,000.
   C. $164,000.
   D. $316,000.

8. Jean Dubois has a 40 percent interest in a partnership. During the current year the partnership had accounting income of $123,000. In determining this figure, the following items were deducted:

   - Partner salaries of $42,000.
   - Interest on capital contributions of $11,000.
   - Charitable contributions of $3,000.
   - Salaries to Jean's spouse of $12,000 (she does the accounting for the partnership).
   - Personal expenses of the partners of $17,000.

   What is the amount of partnership income that Jean should report in his tax return for the current year?

   A. $49,200
   B. $83,200
   C. $78,400
   D. $71,600

9. Martin Aggerwal has a 30 percent interest in a partnership. During the current year, the partnership realized capital gains of $42,000, received non-eligible dividends of $15,000, and made charitable donations of $6,000. Which of the following statements is correct?

   A. Martin will report taxable capital gains of $6,300, will have a federal dividend tax credit of $750, and a charitable donations tax credit of $513.60.
   B. Martin will report taxable capital gains of $12,600, will have a federal dividend tax credit of $750, and a charitable donations tax credit of $513.60.
   C. Martin will report taxable capital gains of $6,300, will have a federal dividend tax credit of $2,500, and a charitable donations tax credit of $513.60.
   D. Martin will report taxable capital gains of $6,300, will have a federal dividend tax credit of $750, and a charitable donations tax credit of $522.00.

10. The Bartlo Partnership has income for the year ending December 31, 2010 of $490,000. As per the partnership agreement, this amount has been determined under generally accepted accounting principles. The agreement also calls for each of the two partners to have an equal share in this income. The following amounts are included in the calculation of this income figure:

- Non-eligible dividends received of $32,000
- Gains on the sale of shares of $96,000
- Charitable donations of $12,000
- Amortization on equipment of $49,000 (equal to CCA)

The two partners will each have Taxable Income for the 2010 taxation year of:

A. $227,000.
B. $225,000.
C. $231,000.
D. $245,000.

Partnership Interest

11. Joe Conners is a member of a partnership with a December 31 year end. Joe's share of the 2010 partnership allocations was as follows:

- Business Loss of $25,000.
- Charitable Donations of $1,000.

Joe took drawings totalling $10,000 from the partnership during 2010. Joe's adjusted cost base (ACB) at January 1, 2010 was $59,000. What is the ACB of Joe's partnership interest at January 1, 2011?

A. $23,000.
B. $24,000.
C. $25,000.
D. $33,000.

12. Ms. Sarah McLean has a 50 percent interest in a partnership that was acquired on January 1, 2010 at a cost of $40,000. The partnership's Net Income For Tax Purposes for the taxation year ending December 31, 2010 was $60,000, a figure that included a CCA deduction of $36,000. The 2010 income figure also included taxable capital gains of $10,000. During 2010, Ms. McLean withdrew $15,000 from the partnership. The adjusted cost base of Ms. McLean's partnership interest at January 1, 2011 is:

A. $60,000.
B. $83,000.
C. $65,000.
D. $88,000.

13. Karen would like to calculate the adjusted cost base of her partnership interest. She should include all of the following factors in her calculations except:

A. The original cost of her partnership interest.
B. Her share of the grossed up dividends received by the partnership.
C. Her share of the business income for the preceding year.
D. The amount of cash that she withdrew from the business that year.

TIF PROBLEM EIGHTEEN - 4
Partnerships - Exam Exercises

Exam Exercise Eighteen - 1 (Partnership Interest And Salaries)

The Vision Partnership (VP) is involved in advertising. The spouses of both partners do some work for VP. VP determines that its accounting net income for the current year is $164,500. In arriving at that amount, the following deductions were made:

Interest On Partner Loan To VP	$ 2,200
Interest On Partners' Capital Accounts	6,150
Salaries To Partners	42,000
Salaries To Partners' Spouses	
(Based On Fair Value Of Services)	19,000

Determine the amount of partnership income that would be allocated to the partners for tax purposes.

Exam Exercise Eighteen - 2 (Partnership Deductions)

Determine whether the following expenditures are deductible in determining the partnership income to be allocated to partners:

A. CCA on partnership property.
B. Donations to registered Canadian charities.
C. Taxes paid on foreign source income.
D. Drawings made by partners from the partnership.

Exam Exercise Eighteen - 3 (Partnership Income)

The XYZ Partnership calculates a net accounting loss of $164,680 for the current year. In determining that loss, the following amounts were included:

- $36,800 of charitable contributions were deducted.
- $18,400 of personal expenditures for one of the partners were deducted.
- $27,600 of rental expenses were not deducted because they relate to a lease of business premises from one of the partners.

Determine the income or loss for XYZ for income tax purposes for the current year.

Exam Exercise Eighteen - 4 (Partnership Income Allocation)

Paul Grund and Martin Land formed the Partin Partnership to provide renovation services. Paul contributed the capital to buy the tools needed for operations and Martin is doing most of the physical labour. They have agreed that Martin will be allocated $32,000 from the partnership each year, regardless of profits realized. Paul and Martin will share equally in the remainder of the profit or loss. In the current year, the partnership has Net Income of $49,500. Determine how the partnership income should be allocated between Paul and Martin.

Exam Exercise Eighteen - 5 (Admission Of A Partner)

Natasha and Felicia are equal partners in the Natty Partnership. On April 30, 2010, Natasha and Felicia's partnership capital account balances are $148,800 each. This amount is also equal to the adjusted cost base of their partnership interests. Kyra is admitted as an equal partner on April 30, 2010, and pays $124,000 to each of Natasha and Felicia. Calculate the tax effects of the partner admission for Natasha and Felicia and determine the capital account balances and adjusted cost base for each partner after the admission of Kyra.

Exam Exercise Eighteen - 6 (Adjusted Cost Base Of Partnership Interest)

On January 1, 2010, Rachel and Roberta form the Racherta Partnership. The partnership agreement provides Roberta with a 40 percent share of profits and losses. Roberta initially contributes $52,500 and makes a further contribution of $30,240 on May 15, 2010. She withdraws $16,800 on August 31, 2010. The Racherta Partnership has the following sources of income for the year ending December 31, 2010:

Capital Gain On Sale Of Shares	$ 48,720
Non-Eligible Dividends Received From Canadian Corporations	13,020
Net Business Income	196,140

Determine the adjusted cost base of Roberta's partnership interest on December 31, 2010, and at January 1, 2011. In addition, determine the amount that would be included in Roberta's 2010 Net Income For Tax Purposes as a consequence of her interest in the Racherta Partnership.

Exam Exercise Eighteen - 7 (Limited Partnership Losses)

During 2010, Blake Robson acquires an interest in a real estate limited partnership for $235,000, consisting of a cash payment of $62,000 along with the assumption of a loan of $173,000. The loan is payable in six years. The general partner has agreed to purchase Blake's interest at any time for $235,000, including the full assumption of the loan, without regard to the current value of the interest. For the current year, the limited partnership has allocated losses of $81,400 to Blake. How much of this loss is Blake entitled to claim as a deduction on his 2010 tax return? What is the amount of his limited partnership loss at the end of the year?

Exam Exercise Eighteen - 8 (Transfers From Partner To Partnership - No Rollover)

Martha Stuart is one of four partners in the Homemaker Partnership (HP). During the current year, Martha contributes a tract of land to the partnership. Martha acquired the land for $59,400 and, at the time of transfer, it is valued at $180,000. Martha does not use a rollover provision to make the transfer. Describe the tax consequences to Martha and HP in the following three situations:

A. No consideration is received from HP.
B. Martha receives $45,000 in cash from HP on the transfer.
C. Martha receives $201,600 in cash from HP on the transfer.

Exam Exercise Eighteen - 9 (Transfers From Partnership To Partners)

Lamar is one of 10 equal partners in the Trident Partnership. During the taxation year ending December 31, 2010, Trident distributes debenture bonds that were held for investment purposes to each of the partners. These bonds have an adjusted cost base of $567,750 and, at the time of transfer, they have a fair market value of $611,750. Lamar receives 10 percent of these bonds. At the time of the transfer, the adjusted cost base of Lamar's partnership interest is $75,800. What are the tax consequences to Trident and Lamar with respect to this distribution? Your answer should include the adjusted cost base of Lamar's partnership interest on both December 31, 2010 and January 1, 2011.

Exam Exercise Eighteen - 10 (Transfers From Partner To Partnership - Rollover)

Sol Marinara is one of four equal partners in the MSG Partnership. During the current year, Sol transfers land to the partnership as a capital contribution. He had acquired the land several years ago for $146,000. At the time of transfer, it is valued at $472,000. He would like to use any available rollover provision in order to minimize his current taxes. Assuming the appropriate rollover provision is used, what are the tax consequences of this transfer?

TIF PROBLEM EIGHTEEN - 5
Partnerships - Key Term Matching

The following five key terms are listed at the end of the Chapter 18, “Partnerships”.

A. Limited Liability Partnership

B. Specified Member

C. Canadian Partnership

D. Limited Partnership Loss

E. At-Risk Amount

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. A partnership that carries on all of its business only in Canada.
2. The excess of all losses allocated to a limited partner over his at-risk amount.
3. A partnership composed of at least one general partner and at least one limited partner.
4. A limited partner or a general partner who is not actively involved in partnership business activity.
5. A partnership, all of the members of which are residents of Canada at the time the term is relevant.
6. The amount a limited partner has invested in the partnership and could potentially lose to creditors.
7. The excess of losses allocated to a limited partner (other than farming or capital losses), over his at-risk amount.
8. A defined measure that limits the amount of deductions that can be flowed through to a limited partner.
9. A partnership, all of the members of which are legislatively specified professionals. The members of such partnerships are relieved of any personal liability arising from the wrongful or negligent action of their professional partners, as well as employees, agents, or representatives of the partnership who are conducting partnership business.
10. A limited partner or a general partner who is actively involved in partnership business activity.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM EIGHTEEN - 6
Partnership Income Allocation

Sally and Rose Leung are sisters and veterinarians. They specialize in treating dogs suffering from depression and personality disorders. As Sally is the older and more experienced practitioner, the partnership agreement calls for her to receive a salary of $45,000 per year, with remaining profits split equally between the two sisters.

For 2010, the Income Statement in the accounting records for the partnership is as follows:

Sally And Rose Leung
Partnership Income Statement
Year Ending December 31, 2010

Revenues		$625,000
Non-Eligible Dividends Received From Canadian Corporations		8,000
Gain On Sale Of Shares Of Canadian Public Corporations		14,000
Total Revenues		$647,000
Expenses:		
Salary To Sally	($ 45,000)	
Salaries To Staff	(29,000)	
Office Rent	(62,000)	
Office Supplies	(5,000)	
CCA On Office Equipment	(17,000)	
Charitable Donations	(12,000)	
Drawings By Sally	(198,000)	
Drawings By Rose	(203,000)	(571,000)
Net Income (Accounting Values)		$ 76,000

The Revenues include the December 31 balance of work-in-process of $115,000. The corresponding balance as at the previous December 31 year end was $83,000, and this amount was included in the accounting revenues for that year. While the Leung sisters have chosen to include work-in-process as a revenue in their accounting statements, they have elected under ITA 34 to exclude these amounts from their Net Income For Tax Purposes.

Required:

A. Calculate the minimum Net Business Income for the partnership for 2010.

B. Indicate the amount that will be added to each sister's Net Income For Tax Purposes as a result of belonging to the partnership during 2010.

C. Indicate any credits against Tax Payable that will be available to each of the sisters as a result of belonging to the partnership during 2010.

TIF PROBLEM EIGHTEEN - 7
Withdrawal Of A Partner

On March 1, 2008, John Smith, Larry Colt, and Sam Wesson form a partnership to provide management consulting services. The partners each contribute $185,000 and agree that all income and losses are to be shared equally. The fiscal year for the partnership is established to end on December 31.

For the period March 1, 2008 to December 31, 2010, the following information is available:

1. The partnership earned net business income of $312,000.
2. The partnership realized a capital gain of $33,000 (this amount is not included in the net business income figure).
3. The partnership made a number of charitable donations during the period. The total amount involved was $21,000, and this total was allocated equally to each of the three partners (this amount is not included in the net business income figure).
4. During this period, Sam Wesson made withdrawals from the partnership totaling $84,000.
5. Additional capital was required to expand the operations of the office and, as a consequence, each partner contributed an additional $23,000 in cash.

Sam Wesson decided to withdraw from the partnership effective January 1, 2011. After some negotiations, the other partners agreed to pay him $326,000 in cash for his interest in the partnership. The payment is made on February 1, 2011. Sam Wesson incurred legal and accounting fees in conjunction with this transaction totaling $2,200.

Required: Calculate Sam Wesson's gain or loss on the disposition of his partnership interest. Explain how this amount, and any other amounts related to the partnership, will be taxed in his hands.

Chapter Nineteen Test Item File Problems

TIF PROBLEM NINETEEN - 1
Trusts - Essay Questions

1. The three types of persons who are associated with a trust are usually described as the settlor, the trustee, and the beneficiary. Briefly describe the role of these persons with respect to the trust.

2. In order for a trust to exist, three characteristics must be established with certainty. What are these three characteristics?

3. Briefly describe two non-tax reasons for using a trust.

4. What is the difference between an inter vivos trust and a testamentary trust? Explain briefly how Tax Payable is calculated for these two types of trusts.

5. What is a qualifying spousal trust? What is the major tax advantage associated with a trust being classified as a qualifying spousal trust? Briefly describe two non-tax reasons for using a qualifying spousal trust.

6. What conditions must be satisfied in order for a trust to qualify as an alter ego trust? Briefly describe the income tax and non-income tax reasons for using an alter ego trust.

7. What are the tax consequences associated with a transfer of trust assets to a capital beneficiary?

8. A trust will normally deduct all amounts that are paid or payable to a beneficiary. However, under ITA 104(13.1), it can designate certain amounts that have been paid as "not to have become paid or payable in the year". This will result in the trust having to include these amounts in its Taxable Income. Why would a trust make such a designation?

9. On January 15 of the current year, Mr. George Barret was killed in an automobile accident while driving home from work. His will specified that his substantial investment portfolio of high yield bonds should be placed in a trust. Under the trust agreement, his wife, Mrs. Joan Barret, is to receive 40 percent of the trust's income, while the remaining income is to be used for the expenses of Mr. Barret's adult children. The trustees have discretion to pay tuition fees, medical expenses, and other specified amounts for the benefit of the children. Any remaining income is to be left in the trust to accumulate for the children. Briefly describe the manner in which the income earned by the trust will be taxed.

10. Briefly describe how Tax Payable is calculated for a SIFT trust.

TIF PROBLEM NINETEEN - 2
Trusts - True Or False

1. The three essential characteristics of a trust are certainty of:
   - the identity of the property to be placed in the trust;
   - an intent on the part of the settlor to create a trust; and
   - the basis for allocating the trust income to the beneficiaries.

   True or False?

2. The *Income Tax Act* uses the terms trust and estate interchangeably.

   True or False?

3. An alter ego trust can be either an inter vivos trust or a testamentary trust.

   True or False?

4. To qualify as a spousal trust, the settlor's spouse must be entitled to receive all of the income of the trust arising before his or her death.

   True or False?

5. In a discretionary trust, the trustees have discretion as to the amounts of income or capital to be distributed to individual beneficiaries, but do not have discretion as to the timing of the distributions.

   True or False?

6. In general, both testamentary and inter vivos trusts will pay income taxes on any income that is not paid or payable to beneficiaries.

   True or False?

7. The preferred beneficiary election allows income to be taxed in that beneficiary's hands, even though it remains in the trust. This election can be made for any individual under 18 years of age.

   True or False?

8. Income that is flowed through a trust retains its tax characteristics (e.g., a dividend earned by the trust can be allocated to a beneficiary as a dividend).

   True or False?

9. The Tax Payable of an inter vivos trust will be calculated using the same schedule of progressive rates that applies to individuals.

   True or False?

10. If capital property is transferred to a qualifying spousal trust, there will be no gain or loss on the transfer, any income earned on the property will be attributed back to the settlor, but capital gains on a disposition of the property by the trust will not be attributed back to the settlor.

    True or False?

11. A SIFT trust is resident in Canada, has trust units that are publicly traded, and holds at least one non-portfolio investment.

True or False?

12. The income from non-portfolio properties of a SIFT trust will be taxed at the maximum 29 percent federal rate that is applicable to individuals.

True or False?

TIF PROBLEM NINETEEN - 3
Trusts - Multiple Choice

Basic Concepts

1. Which of the following is not required for the successful establishment of a trust?

   A. The settlor must clearly intend to create a trust.
   B. The individual beneficiaries must be named.
   C. The property to be held in the trust must be known with certainty.
   D. There must be an actual transfer of property to the trust.

2. A testamentary trust is one that is established at the time of an individual's death. Which of the following statements is correct with respect to testamentary trusts?

   A. The taxation year of the trust must be the calendar year.
   B. The trust return is due 90 days after the trust's year end.
   C. All of the income of the trust will be taxed at the highest federal rate of 29 percent.
   D. The trust will not be eligible for a dividend tax credit on dividends received and retained in the trust.

Trust Income

3. Which of the following amounts will not be included in the determination of Net Income For Tax Purposes of a trust?

   A. Retained income which has been allocated to a preferred beneficiary of the trust.
   B. Amounts paid or payable to a beneficiary of the trust.
   C. The difference between the fair market value and the cost of assets transferred to a capital beneficiary.
   D. Amounts that have been paid to a beneficiary but have been designated not to have been paid.

4. Which of the following items cannot be allocated to beneficiaries of a trust?

   A. Losses incurred on the disposition of trust capital property.
   B. Gains resulting from the disposition of trust capital property.
   C. Recapture of CCA on the disposition of trust depreciable assets.
   D. All of the above.
   E. A and C above.

5. Upon his death three years ago, Mr. Allen's will provided for the creation of a trust. The will required that any income distributed by the trust be allocated 50 percent to his wife, and 12.5 percent to each of his four children. During 2010, the trust had the following income and expense:

Eligible Dividends From Canadian Corporations	$20,000
Interest From Canadian Sources	10,000
Interest Expense On Money Borrowed To Acquire Shares	1,000

   For 2010, the beneficiaries and the trustees jointly agreed that all income received by the trust, except for $5,000 of the interest, would be paid to the beneficiaries. What is the taxable income attributable to Mrs. Allen for the year from the trust?

   A. $12,000.
   B. $12,500.
   C. $16,400.
   D. $15,000.
   E. $14,400.

Tax Planning

6. Which of the following statements is not correct?

   A. A trust can be used to administer assets for beneficiaries with limited asset management experience.
   B. A trust can be used to ensure that assets are ultimately delivered to the intended beneficiaries.
   C. A trust can be used to avoid the income attribution rules applicable to a spouse.
   D. A trust can be used to protect assets from creditors.

7. When an individual dies, there is a deemed disposition of certain types of property. This would include property held by one type of trust for which the deceased taxpayer was a settlor. That type of trust is:

   A. A discretionary trust.
   B. A testamentary trust.
   C. A joint spousal or common-law partner trust.
   D. An alter ego trust.

8. Which one of the following statements with respect to a qualifying spousal trust is not correct?

   A. The transferor's spouse must be entitled to receive all of the income of the trust arising before the spouse's death.
   B. The settlor must be 65 years of age or older.
   C. No person other than the spouse may receive or benefit from any of the income or capital of the trust, prior to the death of the spouse.
   D. A spousal trust can be a non-discretionary trust.

9. Which one of the following statements with respect to an alter ego trust is correct?

   A. An alter ego trust can be either an inter vivos trust or a testamentary trust.
   B. For the settlor, the proceeds of disposition for property transferred to the trust will be equal to the fair market value of the assets at the time of transfer.
   C. Any resident individual can settle an alter ego trust.
   D. When assets are transferred out of an alter ego trust to anyone other than the settlor, the proceeds of disposition to the trust will be the fair market value of the assets transferred.

10. An individual settled a trust in favour of his minor children. The property transferred to the trust for no consideration included securities on which there were accrued capital gains. Which one of the following statements is not correct with respect to inter vivos trusts?

    A. Any income and capital gains earned by the trust and allocated to the beneficiaries will be attributed back to the individual.
    B. The individual will have to recognize the accrued capital gains on the securities at the time of their transfer to the trust.
    C. The income in the trust will be taxed at the maximum 29 percent rate applicable to individuals.
    D. The trust will not be taxed on income that is distributed to the children during the year.

SIFT Organizations

11. Which of the following would not be a non-portfolio property of a SIFT trust?

    A. Holdings of resource property with a fair market value that exceeds 50 percent of the equity value of the trust.
    B. A property that is used for carrying on a business in Canada.
    C. A holding of 100 percent of the shares of Vida Ltd.
    D. A holding of 100 shares of Royal Bank of Canada.

12. A SIFT partnership has taxable income from non-portfolio properties of $500,000 for 2010. It has no other source of income. Which of the following statements is not correct?

    A. Income allocated to the partnership unitholders will not be eligible for dividend gross up and tax credit procedures.
    B. The SIFT partnership will pay federal taxes of $90,000.
    C. The SIFT partnership will be deemed to have received a dividend from a taxable Canadian corporation equal to the difference between $500,000 and the taxes paid.
    D. All of the income allocated to the partnership unitholders will be treated as dividends eligible for gross up and tax credit procedures.

TIF PROBLEM NINETEEN - 4
Trusts - Exam Exercises

Exam Exercise Nineteen - 1 (Establishing A Trust)

In each of the following Cases, an individual is attempting to establish a trust. For each of these Cases, indicate whether the attempt has been successful. Explain your conclusion.

Case A Martin Falk has signed an agreement that specifies the property that he will transfer to a trustee at the end of the current year. The income from the trust will be distributed to his friend of several years, Lola Lamour.

Case B Martha Stuart transfers property to a trustee, specifying that the income from the property should be distributed to prison inmates in Virginia.

Case C Joan Morgan sends a cheque to her son, indicating that the money should be used for the education of her grandchildren.

Exam Exercise Nineteen - 2 (Basic Taxation Of Trusts)

On January 1, 2009 , Jerry Fallen transfers debt securities with a fair market value of $570,000 to a newly established inter vivos trust for which his 22 year old son, James, is the only beneficiary. The cost of these securities to Jerry was $520,000. During 2010 , the securities earn and receive interest of $32,000, all of which is distributed to James.

On January 1, 2011, the securities are transferred to James in satisfaction of his capital interest in the trust. At this time, the fair market value of the securities has increased to $615,000. James sells all of the securities for $615,000 on January 3, 2011.

Indicate the tax consequences for Jerry, James, and the trust, in each of the years 2010 and 2011.

Exam Exercise Nineteen - 3 (Transfers To Common-Law Partner Trusts)

Larry died late this year, and bequeathed a portfolio of equity securities to a qualifying common-law partner trust created in his will. Larry is survived by his common-law partner, David who is to receive the securities from the trust three years after Larry's death if they have not been sold. The portfolio, which had an adjusted cost base of $420,000, was valued at $723,000 on the date of his death.

Determine the tax consequences of the transfer, including the adjusted cost base of the portfolio in the trust and in David's hands if it is transferred.

Exam Exercise Nineteen - 4 (Transfers To Trusts)

An individual has property with a cost of $2,100 and a current fair market value of $2,500. Seven Scenarios are presented for the transfer of this property to a trust. For each Scenario, indicate the tax consequences to the settlor at the time of transfer, as well as the adjusted cost base of the property within the trust.

Scenario 1: Transfer by settlor to inter vivos trust for adult child.
Scenario 2: Transfer by settlor to inter vivos trust for minor child.
Scenario 3: Transfer to testamentary trust for friend.
Scenario 4: Transfer to inter vivos qualifying spousal trust.
Scenario 5: Transfer to testamentary qualifying spousal trust.
Scenario 6: Transfer to joint common-law partner trust.
Scenario 7: Transfer to alter ego trust.

Exam Exercise Nineteen - 5 (Spousal Trusts And Income Allocation)

Five years ago, a depreciable asset was transferred from Mark's estate to a qualifying spousal trust created on his death. The asset, which cost $224,000, had a UCC of $147,200 at the time of transfer. At the time of Mark's death, the asset had a fair market value of $262,400. Since then, the trust has claimed CCA of $19,200. At the end of the current year, the trust sold the asset to an arm's length party for $243,200.

Determine the tax consequences of the transfer of the asset to the spousal trust and of the disposition of the asset by the trust. Determine the maximum amount of trust income that can be allocated to Mark's spouse from the sale.

Exam Exercise Nineteen - 6 (Flow Through To Beneficiaries)

During the year ending December 31, 2010, the Renaud family trust received eligible dividends from publicly traded Canadian corporations in the amount of $367,000. In addition, it received non-eligible dividends from the family owned Canadian controlled private corporation in the amount of $108,000. Its only other source of 2010 income was a capital gain of $47,000 on a disposition of investments in publicly traded equity securities.

The only beneficiary of the trust is the family's 23 year old daughter, Francine Renaud. During 2010, $210,000 of the dividends from public companies, all of the dividends from the family's private company, and all of the $47,000 capital gain were distributed to Francine.

Indicate the tax effects of these transactions on the 2010 Net Income For Tax Purposes for both the trust and for Francine. In addition, calculate the federal dividend tax credit available to both the trust and Francine for 2010.

Exam Exercise Nineteen - 7 (Inter Vivos Trusts - Tax Payable)

The sole income receipt for 2010 of an inter vivos trust is $38,000 in non-eligible dividends received from a private Canadian corporation. The only beneficiary of the trust is the adult son of the settlor. The beneficiary was paid $24,500 from the dividend income, which also was his sole income for the year. He has no personal tax credits other than his basic personal tax credit.

Calculate the Taxable Income and federal Tax Payable for 2010 for both the trust and for the beneficiary.

Exam Exercise Nineteen - 8 (Income Attribution)

Last year, Martine Brown transferred to a family trust, for no consideration, bonds that pay interest of $108,000 per annum. The beneficiaries of the trust are Martine's spouse, Michael, and their two children, Rachel (16 years old) and Dirk (22 years old). The trust income and capital gains are allocated equally, and are payable to each beneficiary during the year. Total interest income earned by the trust during the year was $108,000. As well, a taxable capital gain of $18,000 was realized on the trust's disposition of one of the bonds that Martine Brown transferred into the trust. The trust designated $6,000 of the taxable capital gain as payable to each beneficiary.

Determine the Taxable Income allocations to each beneficiary and any effect these allocations have on the Taxable Income of Martine.

Exam Exercise Nineteen - 9 (Income Attribution)

In 2009, Devon Jenkins transferred to a family trust, for no consideration, publicly traded stocks that pay eligible dividends of $72,900 during the year ending December 31, 2010. The beneficiaries of the trust are Devon's spouse, Connie, and their two children, Marvin (16 years old) and Diane (22 years old). During 2010, the trust income and capital gains are allocated equally, and are payable to each beneficiary during the year. In addition to the dividends, there was a 2010 disposition of shares held by the trust that resulted in a taxable capital gain of $8,100. The trust designated $2,700 of the taxable capital gain as payable to each beneficiary.

Determine the Taxable Income allocations to each beneficiary and any effect these allocations have on the Taxable Income of Devon.

Exam Exercise Nineteen - 10 (Sale Of A Capital Interest)

The Barton family trust was established when Mrs. Barton transferred publicly traded securities with a cost of $187,000 and a fair market value of $312,000 into the trust. The beneficiaries of the trust are Mrs. Barton's two daughters, Sarah, aged 25, and Mary, aged 27. They have an equal interest in the income and capital of the trust.

At the beginning of the current year, Mary sells her capital interest in the trust to Sarah. There have been no capital distributions from the trust. At the time of the sale, the fair market value of the securities in the trust is $409,000. Based on this, the transfer price for the capital interest is $204,500 [(1/2)($409,000)].

Determine the tax consequences of this transaction to each of the sisters.

Exam Exercise Nineteen - 11 (Family Trusts)

Fred Kemper is holding debt securities which produce interest income of $150,000 per year. He has other sources of income in excess of $300,000.

He has three sons who are triplets. They are all 25 years old and currently have no income that is subject to tax. Their only tax credit is the basic personal credit.

Determine the savings in federal taxes that could be achieved by transferring the debt securities to a family trust with the triplets as equal income beneficiaries. The trust will be required to distribute all of its income on an annual basis.

TIF PROBLEM NINETEEN - 5
Trusts - Key Term Matching

The following five key terms are listed at the end of Chapter 19, "Trusts And Estate Planning".

A. Spousal Or Common-Law Partner Trust

B. Personal Trust

C. Settlor

D. Reversionary Trust

E. Testamentary Trust

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. A trust agreement under which the property held by the trustee can revert to the settlor.
2. An individual who gives property to a specified group of beneficiaries.
3. An inter vivos or testamentary trust that has an individual's spouse or common-law partner as a beneficiary.
4. A trust that is created by the will of an individual.
5. A testamentary or inter vivos trust in which no beneficial interest was acquired for consideration paid to the trust, or to a person who contributed property to the trust.
6. A trust in which all of the beneficiaries are individuals.
7. An inter vivos trust established by an individual aged 65 years or more, subject to the conditions that the individual and his/her spouse or common-law partner must be entitled to all of the trust's income during their lifetimes, and the individual and his spouse or common-law partner must be the only individuals who can access the capital of the trust during his/her lifetime.
8. A trust that arises on, and as a consequence of, the death of an individual.
9. A trust agreement under which the property held by the trustee must revert to the settlor.
10. An individual who creates a trust by contributing property to be managed and administered by a trustee for the beneficiaries.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM NINETEEN - 6
Inter Vivos Trusts - Taxable Income And Tax Payable

Last year, Mr. Jerry Hall established an inter vivos trust for his 22 year old son, Mark Hall. The trust agreement leaves to the discretion of the trustees the portion of each type of the trust's income that will be distributed each year. During the year ending December 31, 2010, the following amounts of income were earned by the assets in the trust:

Interest From Canadian Sources	$ 18,500
Capital Gains	43,000
Eligible Dividends Received From Canadian Corporations	32,000
Net Rental Income (After CCA Deduction Of $4,300)	19,500
Total Trust Income	$113,000

During 2010, the trustees distributed all of the interest to Mark, as well as 80 percent of the capital gains, dividends, and net rental income.

Mark is a full time student for 12 months during 2010 and his tuition for the year was $12,500. He has no other source of income during this year.

Required: Calculate Taxable Income and federal Tax Payable for the year ending December 31, 2010, for both the trust and for Mark. In addition, comment on whether it was advantageous for the trustees to leave 20 percent of the capital gains, dividends, and net rental income in the trust.

TIF PROBLEM NINETEEN - 7
Testamentary Trusts - Taxable Income And Tax Payable

On March 3, 2010, Ms. Denise Lord died at her home in Victoria. Under the terms of her will, all of her property is transferred to a testamentary trust. This trust will have a fiscal year that ends on December 31, and the trust agreement contains the following provisions:

- Twenty percent of the income is to be paid to her 43 year old son, Richard Lord.
- Forty percent of the income is to be paid to her 38 year old daughter, Joan Lord.
- The remaining income will be retained by the trust. While this income can be distributed at the discretion of the trustees, there were no distributions prior to December 31, 2010.

Neither of her children have any income other than income from the trust.

Between March 3 and December 31, 2010, the following income and expense amounts were recorded by the trust:

Eligible Dividends Received From Canadian Corporations		$ 58,000
U.S. Source Interest ($13,000, Net Of 10 Percent Withholding Tax)		11,700
Net Rental Income:		
Rental Revenues	$158,000	
Rental Expenses Other Than CCA	(31,000)	
CCA Claimed	(51,000)	76,000
Total Income		$145,700

Required:

A. Determine the Taxable Income for the trust and each beneficiary for 2010.

B. Calculate the total federal Tax Payable for the trust for 2010.

Chapter Twenty Test Item File Problems

TIF PROBLEM TWENTY - 1
International Income - Essay Questions

1. When an individual leaves Canada, the CRA may take the position that he has retained his residence status. What are the primary factors that the CRA will consider in determining whether such an individual has, in fact, ceased to be a Canadian resident?

2. Are enterprises that are incorporated in Canada always considered to be resident in Canada? Explain your conclusion.

3. List three factors that would be considered in the determination of whether or not an individual is a resident of Canada.

4. One of your friends is leaving Canada and would like to know when he will no longer be considered a Canadian resident. Briefly explain the rules related to terminating an individual's status as a Canadian resident.

5. When a person emigrates from Canada, there is no deemed disposition/reacquisition of their Canadian real estate holdings. However, ITA 128.1(4)(d) allows a taxpayer to elect to have a deemed disposition/reacquisition of real estate at the time of their departure. Why would an individual wish to make this election? Briefly explain your conclusion.

6. When an individual immigrates to Canada, there is a deemed disposition/reacquisition at fair market value of most of their capital property. Briefly explain why this is an important provision for most individuals.

7. Explain why dividends received by individuals from non-resident corporations do not usually receive the same gross up and tax credit treatment that is accorded to dividends received from taxable Canadian corporations.

8. Summarize the taxation of the income of controlled and non-controlled foreign affiliates.

9. What is a Foreign Investment Entity (FIE)? What are the tax consequences associated with investments in FIEs by Canadian residents?

10. Clarkson Equipment Ltd. is a manufacturer of construction equipment that is used throughout the world. The factory is located in Windsor, Ontario and the majority of its manufacturing operations take place at that location. In the current year, the Company negotiated a very significant contract with an African country with which Canada has a comprehensive tax treaty. The contract requires not only the provision of the Company's equipment, but instruction and training of the operators as well. Given the magnitude of this contract, Clarkson is considering establishing a subsidiary in the African country to carry out the terms of the agreement. Compare the Canadian tax treatment of income earned if the contract was handled through the Canadian head office with the tax treatment if a non-resident subsidiary is used to carry out the contract.

TIF PROBLEM TWENTY - 2
International Income - True Or False

1. If an individual leaves Canada, the three most significant factors in determining whether he has ceased to be a resident are:
   - Whether he continues to own a dwelling in Canada.
   - Whether he is accompanied by his spouse or common-law partner.
   - Whether he maintains social ties in Canada.

   True or False?

2. If an individual returns to Canada after an absence of less than two years, IT-221R3 indicates that, in general, he will be considered to have retained Canadian residency during his absence.

   True or False?

3. A part year resident for the current year is an individual who either establishes residency in Canada during the current year or, alternatively, terminates residency in Canada during the current year.

   True or False?

4. A sojourner is any individual who has been present in Canada for 183 consecutive days in one year.

   True or False?

5. Children of members of the Canadian armed forces are considered to be Canadian residents, without regard to where they actually live.

   True or False?

6. A corporation must be incorporated in Canada and have its mind and management located in Canada in order to be a Canadian resident.

   True or False?

7. For residents of countries with which Canada has a tax treaty, the international tax treaty overrides the Canadian *Income Tax Act*.

   True or False?

8. In general, if a non-resident individual earns employment income in Canada, he will be subject to Canadian taxation on that income.

   True or False?

9. In general, if a non-resident earns income from mining in Canada, it is not subject to taxation in Canada.

   True or False?

10. Under the Canada/U.S. tax treaty, if a Canadian resident earns employment income in the U.S. that is $10,000 or less in U.S. dollars, then the income is taxable only in Canada.

    True or False?

11. If a U.S. corporation owns a storage facility in Canada, this will be considered a permanent establishment for purposes of determining which country will tax business income.

True or False?

12. Under ITA 2(3), gains resulting from the disposition of any capital property in Canada by a non-resident will be subject to Canadian income tax.

True or False?

13. A non-resident earning rental income on property in Canada can either pay Part XIII tax or, alternatively, elect to be taxed under Part I.

True or False?

14. All Canadian interest that is earned by non-residents is subject to Part XIII tax.

True or False?

15. While Canadian dividends paid to U.S. residents are subject to Part XIII tax, the Canada/U.S. tax treaty serves to reduce this rate from the statutory rate of 25 percent.

True or False?

16. When an individual immigrates to Canada, there is a deemed disposition/reacquisition at fair market value of most of their capital property.

True or False?

17. When an individual emigrates from Canada, there are no immediate tax consequences, provided the individual sells his residence, is accompanied by his spouse or common-law partner and children, and establishes residence in another country.

True or False?

18. A non-resident entity is defined as a corporation that was formed or organized under the laws of a country other than Canada.

True or False?

19. A non-resident corporation is defined as a foreign affiliate of a Canadian taxpayer, if that taxpayer has an equity percentage of at least 1 percent.

True or False?

20. An entity would be a controlled foreign affiliate of a Canadian taxpayer if it is a a foreign affiliate of the taxpayer that would, at that time, be controlled by the taxpayer if the taxpayer owned all of the shares of the capital stock of the foreign affiliate that are owned at that time by persons who do not deal at arm's length with the taxpayer.

True or False?

TIF PROBLEM TWENTY - 3
International Income - Multiple Choice

Determination Of Residence

1. Which of the following entities is not liable for paying Canadian income tax?

   A. Sam Jackle, a Canadian citizen who has lived in Barbados for the last fifteen years.
   B. Marian Jones, a U.S. citizen who lives in Buffalo, New York, but is employed in Fort Erie, Ontario.
   C. Baron Inc., a corporation that was incorporated in Manitoba in 1977.
   D. Marston Ltd., a U.S. corporation that employs a large sales force to sell its products in Ontario.

2. Ms. Floot has been out of Canada for several years. She is presumed to be a non-resident as long as certain tests are met. Indicate the condition that does not have to be met.

   A. She did not leave a spouse or other dependants in Canada.
   B. She does not return to Canada on a regular or frequent basis.
   C. She did not leave personal property or social ties in Canada.
   D. She did not leave taxable Canadian property in Canada.
   E. She did establish permanent residence in another jurisdiction.

3. In which of the following situations is the person considered a non-resident of Canada, in 2010, for income tax purposes?

   A. James Arder, a recently qualified CA, based in Montreal, accepted a transfer to an office in Sydney, Australia for the period May 1, 2010 to August 31, 2010. James is not married and had lived at his parent's house in Montreal.
   B. Karen Cotin, a computer programmer, had been employed by ABC Systems Ltd. in Toronto. In 2009, she accepted a minimum two-year contract with CS Services Inc. in London, England. Her position with CS Services Inc. started October 1, 2009. Before moving to England, where she will join her fiance, Karen terminated the lease on her apartment in Toronto and sold her car.
   C. N Limited was incorporated in Canada in 1990 and, until May 2009, its manufacturing plant was located in Mississauga, Ontario. In May 2009, it moved all of its operations, including the manufacturing plant, to North Carolina, U.S.A.
   D. B. Bath, a member of the Canadian Armed Forces, who was stationed in Lahr, Germany from September 1, 2008 to February 1, 2011.

4. The directors of Lartch Inc. have always met where the directors reside. Based on this fact, for income tax purposes, Lartch Inc. will not be resident in Canada if the Company was:

   A. incorporated in Canada in 1963 and all of its directors are Canadian residents.
   B. incorporated in the U.S. in 1970 and all of its directors are Canadian residents.
   C. incorporated in Canada in 1972 and all of its directors are U.S. residents.
   D. incorporated in the U.S. in 1965 and all of its directors are U.S. residents.

5. All of the following statements are true, except:

   A. Canadian residents must report their worldwide income for tax purposes.
   B. If an individual is a resident of Canada for part of the calendar year, that individual only has to report his worldwide income during the period of residency for Canadian tax purposes.
   C. An individual who immigrates to Canada during the year is a resident of Canada for tax purposes for the full calendar year.
   D. An individual can be a resident of Canada for tax purposes, even if she is not a Canadian citizen.

6. Alex is a U.S. citizen who commutes each day to Canada for employment purposes. Bob is a U.S. citizen who lives in Canada during the week for employment purposes, but returns to the U.S. on weekends to the house he shares with his wife and children. Charles is a Canadian citizen who lived in Toronto until March of last year, at which time he left for a four year aid mission in Africa under an agreement with the Canadian International Development Agency. Dick is a Canadian citizen who goes to school in the U.S. for eight months of each year but returns to Canada to live with his parents each summer. Of these individuals, who would be a resident or deemed resident of Canada for tax purposes this year?

   A. Alex, Bob and Charles.
   B. Bob, Charles and Dick.
   C. Bob and Charles.
   D. Alex and Dick.

7. With respect to the residency of an individual, which of the following statements is not correct?

   A. To be a resident for tax purposes, an individual must be a Canadian citizen.
   B. If an individual leaves or enters Canada during the current year, he will be considered a part-year resident for tax purposes.
   C. An individual is a Canadian resident for tax purposes if his principal residential ties are in Canada.
   D. An individual is considered to be a Canadian resident for tax purposes if he visits for more than 183 days in a calendar year.

8. Which of the following corporations would not be considered resident in Canada for tax purposes?

   A. Dontar Inc. was incorporated in Manitoba on April 5, 1965 and has carried on business in Canada since that date.
   B. Linco Ltd. was incorporated in Ontario on April 4, 1975 and, until the end of 1996, carried on business in Canada. At that time, all of the management and operations of the Company moved to the southern United States.
   C. Norad Inc. was incorporated in New York state on March 1, 1985 and, until the end of 1993, carried on business in Canada. At that time, all of the management and operations of the Company moved to the southern United States.
   D. Rio Amgal Inc. was incorporated in Montana on September 3, 2001. While the Company has operations in both Canada and the U.S., the directors live in Calgary. As a consequence, all director's meetings are held in that city.

9. Which of the following factors would not be relevant under the Canada/U.S. tax treaty tie-breaker rules for determining the residence of an individual?

   A. The country in which the individual earns business income.
   B. The country in which the individual is a citizen.
   C. The country in which the individual has a permanent home available to him.
   D. The country in which the individual has a habitual abode.

10. Which of the following is not a factor in determining whether an individual has ceased to be a Canadian resident?

    A. The individual's spouse and dependent children have left Canada.
    B. The individual is no longer physically present in Canada.
    C. The individual has become a resident of another country.
    D. The individual has given up his Canadian citizenship in order to become a citizen of another country.

Taxation Of Non-Residents

11. Mike O'Shea, a resident of Ireland, has owned a Canadian rental property for several years. The property is located in Alberta and, during the current year, it was sold for an amount that resulted in a significant capital gain. Which of the following statements is correct with respect to the gain?

    A. Mr. O'Shea is not a Canadian resident and, as a consequence, will not be taxed on this gain.
    B. Mr. O'Shea will be assessed for a withholding tax under Part XIII of the *Income Tax Act*.
    C. Mr. O'Shea will be subject to Canadian Part I tax.
    D. Mr. O'Shea will be subject to Canadian Part I tax as well as Part XIII tax.

12. Many types of income are subject to withholding tax under Part XIII of the *Income Tax Act*. Which of the following would not be subject to this withholding tax when paid to a non-resident individual? Ignore any tax treaty provisions that might be applicable.

    A. A withdrawal from a RRIF by a former resident of Canada.
    B. A deferred bonus from a former employer who is resident in Canada.
    C. Interest on Government of Canada bonds.
    D. Dividends received from a CCPC.

13. Certain types of Canadian income earned by non-residents is not taxed under Part I of the *Income Tax Act*. Which of the following types of income would be eligible for this treatment? Ignore any tax treaty implications that might be applicable.

    A. Income from the sale of Canadian real estate.
    B. Interest on a GIC issued by a Canadian bank.
    C. Income resulting from the exercise of options on the stock of a Canadian public company.
    D. Recapture resulting from the sale of a Canadian business property.

14. Merivale is an American corporation with operations throughout the United States. In addition to its U.S. operations, it has a sales office in Calgary. Canadian employees who work out of this sales office take orders for the company's products. The orders are filled from a warehouse in Montana.

    A. Merivale is not subject to Canadian tax because it is not incorporated in Canada.
    B. Merivale is not subject to Canadian tax because the orders are not filled from a Canadian warehouse.
    C. Merivale is not subject to Canadian tax because the mind and management of the company is not in Canada.
    D. Merivale is subject to Canadian tax on the income that is earned by the Calgary office.

15. A non-resident individual owns a rental property in Canada. Which of the following statements is correct?

    A. The gross rents are subject to withholding under Part XIII of the *Income Tax Act*. However, the taxpayer can elect to file a Canadian tax return which will include the net rental income.
    B. The net rental income is subject to withholding under Part XIII of the *Income Tax Act*. However, the taxpayer can elect to file a Canadian tax return which will include the gross rents.
    C. The taxpayer must file a Canadian tax return which includes the net rental income.
    D. The net rents are subject to withholding under Part XIII of the *Income Tax Act*.

Immigration And Emigration

16. Mr. Winsome is a Canadian citizen and has been resident in Canada for the past 35 years. His company has offered him a position with its Australian branch, which Mr. Winsome has accepted. The position is a transfer and Mr. Winsome plans to remain in Australia for the rest of his life. Given the temperate climate in Australia, he thinks it will be a good country to retire in. Mr. Winsome has the following assets in Canada on December 15, 2010, the date of his departure from Canada:

	As At December 15, 2010	
	FMV	ACB
Shares in Bell Canada, a public company	$10,000	$ 7,000
Shares in TNX Co., a private company	8,000	5,000
Mutual Funds	10,000	10,000
Sailboat (that he is shipping to Australia)	15,000	18,000

He sold all of his other assets.

Which of the following is correct?

A. Mr. Winsome will be deemed to have disposed of his mutual funds, sailboat, TNX Co. shares and Bell Canada shares on December 15, 2010.
B. Mr. Winsome can elect to defer the gain on the Bell Canada shares until they are sold, only if security acceptable to the CRA is provided.
C. Mr. Winsome can elect to have a deemed disposition of the Bell Canada shares on December 15, 2010, only if security acceptable to the CRA is provided.
D. None of the above.

17. When an individual departs from Canada, there is a deemed disposition of several types of property. Which of the following properties would not be subject to this deemed disposition rule?

    A. A large painting by a well known Canadian artist.
    B. Land and building that is being used as a rental property.
    C. Shares of a CCPC involved in earning active business.
    D. Shares of a CCPC that is used to hold investments.

18. Because of his distaste for Canadian winters, Rob Johnston has emigrated from Canada to Florida. At the time of his departure, his RRSP held assets with a fair market value of $1,500,000. Which of the following statements is correct?

    A. There will be a deemed disposition of all of these assets at the time of Rob's departure from Canada.
    B. There will be no tax consequences at the time of departure. However, any withdrawals from the plan after his departure will be subject to Canadian Part I tax.
    C. There will be no tax consequences at the time of departure. However, any withdrawals from the plan after his departure will be subject to Canadian Part XIII tax.
    D. Part XIII tax will have to be paid at the time of departure, but there will be no further taxation assessed on withdrawals from the plan.

19. Joan Bias, a U.S. citizen, established Canadian residency in 2007. At the time she entered Canada, she owned shares in a U.S. company that had an adjusted cost base of $150,000 and a fair market value $210,000. During 2010, she sold these shares for $170,000. Which of the following reflects the tax consequence of this sale?

    A. There would be a taxable capital gain of $20,000.
    B. There would be an allowable capital loss of $20,000.
    C. There would be a taxable capital gain of $10,000.
    D. There would be a business investment loss of $40,000.

Taxation Of Foreign Source Income

20. Last year, Maria Antonelli immigrated to Canada from Italy. However, she continues to be a partner in the family business which is located in Sicily. It is the policy of the partnership to distribute 100 percent of its income to the partners. Which of the following is the correct treatment of her share of the partnership income?

    A. The amount received, net of Italian taxes, will be taxable in Canada.
    B. The amount will be taxed only in Italy.
    C. The gross amount received, prior to the deduction of any Italian taxes withheld, will be taxable in Canada. No consideration will be given in Maria's Canadian tax return for the Italian taxes paid.
    D. The gross amount received, prior to the deduction of any Italian taxes withheld, will be taxable in Canada. Maria will receive a Canadian tax credit for the Italian taxes paid.

21. Which of the following conditions are required in order for a resident Canadian corporation to be able to deduct dividends from a non-resident corporation?

    A. The dividend must be paid out of active business income.
    B. The active business income must be earned in a country with which Canada has a tax treaty or has entered into a tax exchange information agreement.
    C. The non-resident corporation must be a foreign affiliate.
    D. All of the above.

22. Which of the following statements with respect to foreign investment entities (FIEs) is incorrect?

    A. An FIE is also a non-resident entity.
    B. Investors in some FIEs must include in income an amount based on the designated cost of the investment, without regard to the earnings of the FIE.
    C. A controlled foreign affiliate is considered to be an FIE unless otherwise elected.
    D. Investors in an FIE that is widely traded on a prescribed foreign stock exchange are not required to include in income an amount based on the designated cost of the investment.

TIF PROBLEM TWENTY - 4
International Income - Exam Exercises

Exam Exercise Twenty - 1 (Residential Ties)

At the end of the current year, Michael Resner departed from Canada. He was accompanied by his common-law partner and their children, as well as what personal property he had not sold. Due to the intent of his neighbour to start a pig farm, he was unable to sell his residence at a satisfactory price. However, he was able to rent it for a period of two years. He also retained his membership in the Certified General Accountants Association of Alberta. After his departure, would he still be considered a Canadian resident for tax purposes? Explain your conclusion.

Exam Exercise Twenty - 2 (Temporary Absences)

Mary is a Canadian citizen who is employed by a corporation operating in Canada and the U.S. While she has worked for many years in the Canadian office of this organization, she agreed to transfer to the corporation's U.S. head office in New York City. Before leaving, she disposed of her residence and other personal property that she did not wish to move. She canceled her Saskatchewan driver's licence and health care card, and closed all of her Canadian banking and brokerage accounts.

Because her boyfriend remained in Regina, she found herself flying back to Canada at least once a month. After two years, she concluded that between the high cost of living in New York City and the travel required to maintain the relationship with her boyfriend, she would return to Canada. Would Mary be considered a Canadian resident during the two years that she was absent from Canada? Explain your conclusion.

Exam Exercise Twenty - 3 (Part Year Residence)

Melissa is a Canadian citizen who has been employed in Vancouver for the last five years. She has accepted a new position in the United States and, as of March 15 of the current year, flies to New Mexico to assume her responsibilities. (She has been granted a green card to enable her to work in the U.S.) Her husband remains behind with the children until July 1, after the end of their school year. On that date, they fly to New Mexico to join Melissa. Their residence is sold on August 1 of the current year, at which time a moving company picks up their furniture and other personal possessions. The moving company delivers these possessions to their new house in New Mexico on August 15. Explain how Melissa will be taxed in Canada during the current year.

Exam Exercise Twenty - 4 (Individual Residency)

Mary Sothor is the Canadian ambassador to Tanzania. She was a resident of Canada immediately prior to her appointment as ambassador. Living with her in Tanzania's capital city are her husband and two children. Her husband was born in Canada and was a Canadian resident at the time of their marriage. He is exempt from Tanzanian taxation because he is the spouse of a foreign diplomat. Her 25 year old son was born in Canada and works for a Tanzanian company. His income exceeds $30,000 annually. Her 16 year old son was born in Kenya and is a full time student with no income of his own. Which of these individuals would be considered Canadian residents for tax purposes? Explain your conclusions.

Exam Exercise Twenty - 5 (Individual Residency)

Ms. Sharon Washton was born 26 years ago in Bahn, Germany. She is the daughter of a Canadian High Commissioner serving in that country. Her father still holds this position. However, Ms. Washton is now working in Prague, Czechoslovakia. The only income that she earns in the year is from her Prague marketing job and is subject to taxes in Czechoslovakia. She has never visited Canada. Determine the residency status of Sharon Washton.

Exam Exercise Twenty - 6 (Corporate Residency)
Nixon Inc. was incorporated as an Ontario corporation in 2003. However, since 2006, all of the Company's business has been carried on outside of Canada. Determine the residency status of Nixon Inc.

Exam Exercise Twenty - 7 (Corporate Residency)
Wolfhowl Ltd. was incorporated in Banff, Alberta in 1961. Despite its Canadian charter, the Company has never carried on business in Canada. However, until 1971, all meetings of the Board of Directors were held in Banff. Since 1971, all directors' meetings have been held in Wyoming. Determine the residency status of Wolfhowl Ltd.

Exam Exercise Twenty - 8 (Non-Resident Liability For Tax)
Ms. Michelle Walker, a U.S. citizen, has Canadian employment income of $22,000 and U.S. employment income of $40,000 Canadian for the current year. The Canadian employment income is from a British Columbia company that can deduct the payments in its Canadian tax return. She lives in Seattle, Washington and is a resident of the United States for the entire year. Ms. Walker does not believe that she is subject to taxation in Canada. Is she correct? Explain your conclusion.

Exam Exercise Twenty - 9 (Non-Resident Employment Income In Canada)
In each of the following Cases, determine whether the employment income is taxable in Canada:

Case 1 Mary resides in the state of Maine. She accepted temporary employment as a clerk with a Canadian company in Quebec beginning August 1, 2010 and ending on December 31, 2010. The Canadian employer agreed to pay her $2,660 Canadian per month. Mary remained a non-resident of Canada throughout her Canadian employment.

Case 2 Assume the same facts as in Case 1, except the employer was resident in Maine and did not have a permanent establishment in Canada.

Case 3 Bill resides in Watertown, New York and has commuted daily to a full-time job in Kingston, Ontario for the last five years. In 2010, he spent 217 days at his job in Canada. He works for the municipality of Kingston and earned $53,000 Canadian in employment income. Bill is a U.S. resident throughout the year.

Exam Exercise Twenty - 10 (Carrying On A Business In Canada)
In each of the following Cases, determine whether, Rawlings Inc., a non-resident U.S. corporation, is taxable in Canada:

Case 1 Rawlings is the parent company of Delma Ltd., a company incorporated in British Columbia. Rawlings produces and sells small construction equipment, while Delma produces and sells hand tools. Rawlings sells pieces of equipment to Delma, who in turn sells them in Canada.

Case 2 Rawlings manufactures small construction equipment in the U.S. Rawlings ships pieces of equipment to a warehouse located in Winnipeg that they have rented on a seven year lease. Rawlings has employed an individual in Winnipeg to sell the equipment throughout central Canada. The employee, however, is not allowed to conclude contracts without approval by the U.S. office.

Case 3 Assume the same facts as in Case 2, except that the employee has the authority to conclude contracts on behalf of the employer.

Exam Exercise Twenty - 11 (Dispositions Of Taxable Canadian Property)

In each of the following Cases, determine whether the U.S. resident who is disposing of property is taxable in Canada on any gain resulting from the disposition.

Case 1 In 2005, Anne Mason acquired a condo in Canmore, Alberta that she rented to Canadian residents. She sold the condo in 2010 at a considerable gain. Anne never occupied the condo.

Case 2 Assume the same facts as in Case 1, except that Anne incorporates a private corporation under Alberta legislation which acquires the condo. Anne immediately sells the shares of the private company.

Case 3 Assume the same facts as in Case 2, except the corporation is created under Oregon state legislation.

Exam Exercise Twenty - 12 (Interest Payments To Non-Residents)

In each of the following Cases, determine whether the interest payments made to non-residents are subject to Part XIII withholding tax.

Case 1 Phillip, a resident of New Mexico, earned interest of $2,250 on Canada Savings Bonds in 2010.

Case 2 Marsha, a resident of Halifax, acquired a vacation property in California for personal purposes. The property is mortgaged with a U.S. bank. Marsha paid $16,500 in interest to the U.S. bank in 2010.

Case 3 Assume the same facts as in Case 2, except that Marsha had acquired the California condo in 2004 for cash. In 2010, she mortgages the property with a U.S. bank and uses the money to support a business she carries on in Halifax.

Exam Exercise Twenty - 13 (Rental Payments To Non-Residents)

In each of the following Cases, determine how the rental payments made to non-residents will be taxed by Canada.

Case 1 Carco is a U.S. corporation with worldwide rental facilities dedicated to automobile rentals. Carco has offices in New Brunswick, where it rents out small and medium sized vehicles.

Case 2 In 2007, Danielle Clark, a U.S. resident, acquired several cottages in Quebec that she rents out. In 2010, she rented the cottages to Canadian residents exclusively. Danielle received $46,000 in gross rents and estimates that expenses, including CCA, totaled $17,500.

Case 3 Assume the same facts as in Case 2, with one additional consideration. Danielle acquired four all terrain vehicles in 2008, which she rented to guests of the cottages for an additional cost. In 2010, she received $4,000 in gross rents and estimates all terrain vehicle related expenses of $2,500.

Exam Exercise Twenty - 14 (Relieving Double Taxation)

Shelley Burns is a Canadian resident living in Sudbury, Ontario. In 2010, she earns $23,000 of interest income from a foreign country with which Canada does not have a tax treaty. Income taxes of $2,300 were assessed and withheld at the source on that income. All amounts are in Canadian dollars. Assume that her marginal combined federal/provincial tax rate is 42 percent. Determine her after tax retention and overall tax rate.

Exam Exercise Twenty - 15 (Emigration)

Mr. Ryan Marchand owns publicly traded securities with an adjusted cost base of $30,000 and a fair market value of $56,000. During the current year, he permanently departs from Canada still owning the shares. What would be the tax consequences of his departure, if any, with respect to these securities?

Exam Exercise Twenty - 16 (Emigration)

Mrs. Lorna Rand owns a rental property in Calgary, Alberta with a cost of $175,000 and a fair market value of $315,000. The land values included in these figures are $52,000 and $70,000, respectively. The UCC of the building is $91,400. During the current year, Mrs. Rand permanently departs from Canada. What are the tax consequences of her departure with respect to this rental property?

Exam Exercise Twenty - 17 (Emigration)

Mr. Jordan Koch owns shares in a Canadian private company with an adjusted cost base of $115,000 and a fair market value of $240,000. In addition, he owns a rental property with a fair market value of $105,000 ($27,000 of this can be attributed to the land) and a cost of $200,000 ($55,000 of this can be attributed to the land). The UCC of the building is $121,000. During the current year, Mr. Koch permanently departs from Canada. Calculate the minimum Net Income For Tax Purposes that will result from his departure with respect to the shares and the rental property.

TIF PROBLEM TWENTY - 5
International Income - Key Term Matching

The following five key terms are listed at the end of Chapter 20, "International Issues In Taxation".

A. Foreign Accrual Property Income (FAPI)

B. Foreign Investment Entity

C. Controlled Foreign Affiliate

D. Deemed Resident

E. Part Year Resident

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. A foreign investment entity for which the taxpayer has a direct ownerships of a majority of the outstanding voting shares.
2. Income of a foreign investment entity from property (interest, dividends, rents, royalties), income from inactive businesses, taxable capital gains from properties not used in an active business, and income from an investment business, defined as a business the principal purpose of which is to earn property income.
3. A non-resident entity that is largely devoting its activities to the production of investment or property income.
4. A person who becomes resident of Canada during the year or, alternatively, a person who departs from Canada during the year and gives up their resident status. In either case, the person will be taxed on their worldwide income for the part of the year that they were considered to be a resident of Canada.
5. An individual, corporation, or trust that is considered to be a resident of Canada because of some factor other than physical presence in Canada.
6. Income of a controlled foreign affiliate from property (interest, dividends, rents, royalties), income from inactive businesses, taxable capital gains from properties not used in an active business, and income from an investment business, defined as a business the principal purpose of which is to earn property income.
7. An individual who either enters Canada during the year and becomes a resident or, alternatively, an individual who departs from Canada during the year and gives up their resident status. In either case, the individual will be taxed on their worldwide income for the part of the year that they were considered to be a resident of Canada.
8. A foreign affiliate of the taxpayer that would, at that time, be controlled by the taxpayer if the taxpayer owned all of the shares of the capital stock of the foreign affiliate that are owned at that time by persons who do not deal at arm's length with the taxpayer.
9. An individual who is considered a resident of Canada because of some factor other than physical presence in Canada.
10. A non-resident corporation that is largely devoting its activities to the production of investment or property income.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM TWENTY - 6
Residency Of Individuals And Corporations

Pertinent facts are given for a different individual or corporation in each of the Parts of this problem. For each Part, indicate whether or not this individual or corporation would be considered a Canadian resident for income tax purposes during the current year. Briefly explain your conclusion. Ignore any possible implications related to tax treaties.

Part A Dorothy is married to Jack, who is a member of the Canadian armed forces serving in Indonesia. Other than a brief visit to Jack's parents' home in Halifax, she has never been to Canada in her life. Because Jack is a member of the Canadian armed forces, neither he nor his wife is subject to taxation in Indonesia.

Part B Alice is a U.S. citizen living in Seattle, Washington. While she leaves many of her belongings at her parent's home in that city, she spends at least four days every week living with her boyfriend in Burnaby, British Columbia. They plan to be married at some future date.

Part C Berkly Management Inc. was incorporated in Alberta in 1963. Until 1986, its only director resided in that province. In that year, she permanently moved to Fresno, California.

Part D Lorris Ltd. was incorporated in Wisconsin in 1983. Until 1992, all of the directors of the corporation lived in Kenora, Ontario. During this period, all of the director's meetings were held in that city. In 1992, all of the directors moved to Green Bay, Wisconsin, where subsequent director's meetings were held.

Part E Last year, John transferred to the Cayman Islands office at the request of his Canadian employer. His three year employment contract calls for him to return to work in Canada after its completion. On his departure from Canada, he severed all residential ties with Canada.

Part F Millicent is a U.S. citizen who, until last year, had lived and worked in Canada as a landed immigrant for over 20 years. Last year, after winning $2 million in an Ontario lottery, she left Canada on a two year pleasure trip that will take her to virtually every country in the world. Her husband and children, all Canadian citizens, continue to live at the family home in Port Hope, Ontario.

TIF PROBLEM TWENTY - 7
Residency Of Individuals And Taxation Of Non-Residents

The following independent Cases describe situations in which income has been earned by an individual. In each of the Cases, indicate whether the income amounts described would be subject to Canadian taxation. Explain the basis for your conclusions. Ignore any possible implications related to tax treaties.

Case A Donald Plesser is a U.K. citizen who immigrated to Canada on July 1 of the current year. He immediately began employment as a retail clerk and, during the period July 1 through December 31, his employment income totaled $11,000. In addition, he has retained a large savings account in the U.K. Interest on this account, which was earned uniformly over the current year, totaled £11,000.

Case B Uta Jurgens is the spouse of Colin Jurgens, a member of the Canadian armed forces stationed in Germany. Mrs. Jurgens is a German citizen and has never visited Canada. During the current year, she has employment income of €28,000. She is exempt from German taxation because she is the spouse of a member of the Canadian armed forces.

Case C Martin Downs is a U.S. citizen who lives in Detroit, Michigan. He is employed two days each week in Windsor, Ontario by a local landscaping business. During the current year, he is paid $15,000 (Canadian) for this work. In addition, he maintains a savings account at a bank in Windsor. This account earned interest of $1,500 during the current year.

Case D Sarah Mennan is a Canadian citizen who lives in Syracuse, New York. She works as an accountant in that city, and has professional income of $72,000. Ten years ago, she left her husband at the end of the second period of the final game of the Stanley Cup Playoffs. She departed from Canada the following day, and has vowed to never set foot in Canada again. She is divorced from her husband and has no assets in Canada, other than a small savings account on which she earned interest of $150 during the current year.

TIF PROBLEM TWENTY - 8
Residency After Departure From Canada

Mr. Desmond Morris has spent his entire working life with his current employer, the Alcorn Manufacturing Company. In his first years with the Company, he was located in Winnipeg, Manitoba as a production supervisor. More recently, he was transferred to the Company's Calgary based subsidiary, where he has served as a manufacturing vice president until the current year.

Early in the current year, Mr. Morris was asked to move to the United States by April 1 to oversee the construction of a new manufacturing operation in Sarasota, Florida. It is expected that when the facility is completed, Mr. Morris will remain as the senior vice president in charge of all of the Florida operations. He does not have any intention of returning to live in Canada during the foreseeable future.

On April 1, Mr. Morris left Canada. In preparation for his departure, he had taken care to sell his residence, dispose of most of his personal property, and resign from all memberships in social and professional clubs. However, because Mr. Morris and his wife had three school age dependent children, it was decided that they would remain in Canada until the end of the current school year. As a consequence, Mrs. Morris and the children did not leave Canada until June 30. Until their departure, they resided in a small furnished apartment, rented on a month to month basis.

Required For purposes of assessing Canadian income taxes, determine when Mr. Morris ceased to be a Canadian resident and the portion of his annual income which would be assessed for Canadian taxes. Explain your conclusions.

Chapter Twenty-One Test Item File Problems

TIF PROBLEM TWENTY-ONE - 1
GST/HST - Essay Questions

1. Explain the difference between an accounts-based value added tax and invoice-credit value added tax.

2. Give two examples of entities that would have to file a GST or HST return, but do not have to file an income tax return.

3. Under what circumstances would an entity choose to file a GST or HST return more frequently than required by the *Excise Tax Act*?

4. A person with taxable sales of less than $30,000 in the previous calendar year has asked your advice as to whether he should register for GST/HST purposes. What questions should you ask him about his business in order to give the appropriate advice?

5. Describe the GST/HST consequences related to the sale of:
   - fully taxable goods and services;
   - zero-rated goods and services; and
   - exempt goods and services.

6. How are input tax credits calculated when registrants purchase capital expenditures?

7. Certain qualifying registrants can use the Quick Method of accounting for GST/HST. What are the advantages of using this method?

8. Briefly describe the simplified method of accounting for input tax credits.

9. What is the "harmonized sales tax"?

TIF PROBLEM TWENTY-ONE - 2
GST/HST - True Or False

1. The GST is a commodity tax.

   True or False?

2. In general, transaction taxes are easy to administer and collect.

   True or False?

3. A major advantage of using a invoice-credit VAT system as opposed to an account-based VAT approach is that this approach does not rely on an accounting measurement of income.

   True or False?

4. One reason for using a single stage transaction tax as opposed to a multi-stage transaction tax is that it allows the government to accrue revenues at a faster pace.

   True or False?

5. Both the provision of exempt supplies and the provision of zero-rated supplies are excluded from the definition of commercial activity.

   True or False?

6. The amounts to be included in a GST/HST return are recorded on a cash, rather than an accrual basis.

   True or False?

7. In a retail business, input tax credits for merchandise are calculated on the amount of purchases, not on the amount of goods sold.

   True or False?

8. If an individual engages in a business activity that does not have a reasonable expectation of profit, he does not have to charge GST on his sales.

   True or False?

9. Providers of zero-rated goods are not allowed to claim input tax credits.

   True or False?

10. Providers of health care services and providers of financial services to Canadian residents do not charge GST on their sales.

    True or False?

TIF PROBLEM TWENTY-ONE - 3
GST/HST - Multiple Choice

General GST/HST

1. Which of the following is not correct?

   A. All persons engaged in a business must register with the CRA for GST purposes.
   B. A 'Quick Method' of calculating GST/HST is available to eligible small businesses.
   C. Long-term residential rents are exempt from GST.
   D. A 'Simplified Method' of calculating input tax credits is available to eligible small businesses.

Transaction Tax Concepts

2. Which of the following is not a transaction tax?

   A. The Manitoba 7 percent provincial sales tax.
   B. The federal gasoline tax.
   C. The tax for nightly use of camp sites in national parks.
   D. The federal GST.

GST/HST Registration

3. Marvin's Rooms is a new business which started on January 1, 2010. Its sales during its first four quarters of operation were as follows:

Quarter	Sales
1	$13,000
2	18,000
3	24,000
4	27,000

   On what date will Marvin's Rooms have to begin collecting GST?

   A. The date in the second quarter on which cumulative sales total $30,000.
   B. July 1, 2010.
   C. August 1, 2010.
   D. September 1, 2010.

Input Tax Credits

4. For vendors of taxable supplies who purchase goods for resale and make capital expenditures to be used in commercial activities, input tax credits can be claimed for GST/HST billed or paid on:

   A. capital expenditures and goods sold during the period.
   B. a portion of capital expenditures based on their estimated service life and goods purchased for resale during the period.
   C. capital expenditures and goods purchased for resale during the period.
   D. a portion of capital expenditures based on their estimated service life and goods sold during the period.
   E. goods purchased for resale during the period, but not capital expenditures.

5. Underwater World Ltd., is located in Alberta. Alberta does not participate in the HST program and does not have a provincial sales taxes. Among the purchases Underwater World Ltd. made during December were the following items:

Item	Price Before GST
New motor for Dinghy #1	$7,000
New snorkelling equipment (for charter trips)	400
Waterski club membership fee (for the president)	700
Membership to Waterways Ltd.	500

Waterways Ltd. carries supplies for charter boat operators and requires the payment of a membership to use their services. The input tax credits that Underwater World Ltd. can claim for the above items for December are:

A. $350.
B. $370.
C. $395.
D. $430.
E. None of the above.

GST/HST Remittances

6. Two university friends recently opened a bagel shop, BBBagel. The shop is located in the province of Alberta. Alberta does not participate in the HST program and does not have a provincial sales tax. They have asked you to calculate the GST remittance/refund for the first reporting period. Given the following information, what should the BBBagel Shop's GST remittance/refund be?

	Amount, Net Of GST And PST
Sales	$ 80,000
Equipment purchased	100,000
Supplies purchased	50,000
Wages paid	20,000
Rent paid	6,400

A. Nil, a refund of $3,820 will be claimed.
B. Nil, a refund of $3,500 will be claimed.
C. Nil, a refund of $4,820 will be claimed.
D. $180.

7. Joel Knight, a lawyer, is a sole practitioner in the province of Ontario. The HST rate in Ontario is 13 percent. Joel has requested that you advise him on what his HST remittance should be for the October to December quarter. Details of transactions, excluding applicable taxes, between October and December are:

Revenues	$30,000
Expenses:	
Salaries	$ 7,000
Proprietor's drawings	11,000
Office supplies	500
Rent	3,000

The HST that is to be remitted for the October to December quarter is:

A. $1,105.
B. $2,535.
C. $3,445.
D. $3,835.
E. None of the above.

8. Paddy's Cycle Shop operates in New Brunswick where the HST rate is 13 percent. A summary of the shop's transactions for the month of January is as follows::

Account	Amount, Net Of HST
Revenues	$300,000
Purchase of bicycles	150,000
Purchase of tires and other parts	18,500
Salaries	8,000
Premises rental	3,000

The HST that is to be remitted in respect of the above transactions is:

A. $15,665.
B. $16,055.
C. $16,705.
D. $17,095.
E. None of the above.

9. You are performing a review of a lawyer's books of account. The lawyer's office is in the province of Newfoundland where the HST rate is 13 percent. While you are in her office, she asks you to calculate how much her HST remittance should be. You are given the following information, which is net of HST paid.

Revenues	$325,000
Expenses:	
Salaries	$135,000
Stationery and supplies	5,000
Utilities - telephone and hydro	2,500
Rent	15,000

Based on the above transactions, the HST payable is:

A. $21,775.
B. $39,325.
C. $39,975.
D. $41,275.
E. None of the above.

Quick And Simplified Methods

10. With respect to the quick method of accounting for GST, which of the following statements is not correct?

    A. Registrants using this method charge GST at the usual 5 percent rate on fully taxable sales.
    B. This method can be used by businesses with annual GST included taxable sales of $200,000 or less.
    C. Capital expenditures are not tracked separately for purposes of determining input tax credits.
    D. Current expenditures are not tracked separately for purposes of determining input tax credits.

11. With respect to the simplified method of accounting for input tax credits in a province that does not participate in the HST program, which of the following statements is not correct?

    A. Total fully taxable inputs, with the exclusion of capital expenditures on real property, are multiplied by 5/105 to arrive at the input tax credit for the GST return.
    B. Capital expenditures are not tracked separately for purposes of determining input tax credits.
    C. Registrants using this method charge GST at the usual 5 percent rate on fully taxable sales.
    D. The method can be used by a business if the annual tax inclusive sales are $500,000 or less and annual GST taxable purchases are $2,000,000 or less.

Employee GST Rebate

12. A GST rebate is available to employees of a GST registrant located in a province that does not participate in the HST program. The calculation is based on a factor of 5/105 of:

    A. all taxable benefits received from their employer.
    B. all expenses deducted in the calculation of net employment income.
    C. all taxable benefits received from their employer and all expenses deducted in the calculation of net employment income.
    D. all eligible expenses for fully taxable supplies deducted in the calculation of net employment income, except for capital cost allowances.
    E. all eligible expenses for fully taxable supplies deducted in the calculation of net employment income, including capital cost allowances.

TIF PROBLEM TWENTY-ONE - 4
GST/HST - Exam Exercises

Exam Exercise Twenty-One - 1 (Alternative VAT Approaches)

During the current taxation period, Mackin Enterprises purchased merchandise for \$371,000. Merchandise sales during this period totalled \$476,000 and the cost of the merchandise sold was \$302,000. Ignoring all other costs incurred by Mackin and assuming a rate of 5 percent, how much tax would be paid by Mackin under an accounts-based VAT system and under an invoice-credit VAT system?

Exam Exercise Twenty-One - 2 (Requirement To Register)

Mr. Marcus Leblanc begins his business on January 1 of the current year. His quarterly sales of taxable items are as follows:

Calendar Quarter	Taxable Sales
One	\$14,000
Two	6,000
Three	33,000
Four	50,000

At what point in time will Mr. Leblanc have to begin collecting GST? At what point will he be required to register?

Exam Exercise Twenty-One - 3 (Requirement To Register)

Ms. Jesse Holt begins her business on January 1 of the current year. Her quarterly sales of fully taxable items are as follows:

Calendar Quarter	Taxable Sales
One	\$20,000
Two	2,000
Three	19,000
Four*	42,000

*Consists of a sale of \$28,000 on October 15 and a sale of \$14,000 on November 27.

At what point in time will Ms. Holt have to begin collecting GST? At what point will she be required to register?

Exam Exercise Twenty-One - 4 (Input Tax Credits)

Edleson Inc. is located in a province that does not participate in the HST program. During its current fiscal period, Edleson Inc. purchases an office building for \$1,450,000 (excluding GST), including a payment for the land of \$320,000. It spends an additional \$347,400 (excluding GST) for equipment to be used in the building. The building will be used 35 percent to produce fully taxable supplies and 65 percent for exempt supplies. The equipment will be used 42 percent for taxable supplies and 58 percent for exempt supplies. For accounting purposes, the building will be amortized over 30 years, while the equipment will be written off over 12 years.

Determine the input tax credits that Edleson Inc. can claim as a result of these capital expenditures.

Exam Exercise Twenty-One - 5 (GST Calculation)

Mr. Jack Morton works in the province of Alberta, a province that does not participate in the HST program. He is a management consultant who delivers services that are billed at a GST inclusive amount of $286,650 during the current year. Before the inclusion of any applicable GST, his expenses for the year are $18,000 for rent, $23,500 for clerical salaries, $5,000 for interest on a loan, and $3,000 for office supplies (purchases of these supplies totaled $4,500 for the year). In addition, he acquired office furniture at the beginning of the year for $32,000, plus GST of $1,600. The cost of this furniture is being expensed over 10 years at a rate of $3,200 per year.

Determine the net GST payable or refund for the year.

Exam Exercise Twenty-One - 6 (HST Calculation)

Ms. Mary Rivers works in the province of New Brunswick where the HST rate is 13 percent. She is a photographer who has billings of $136,000 during the current year. Rent for this period on her office and darkroom totals $29,450 and she pays an office assistant an annual salary of $21,300. Her capital expenditures during the period are for photographic equipment with a cost of $43,700 and computer hardware and software for $18,000. All amounts are before the addition of HST. She files her HST return on an annual basis and does not use the Quick Method.

Determine the net HST payable or refund for the year.

Exam Exercise Twenty-One - 7 (Quick Method)

Felicia's Frocks, an unincorporated retail business, operates solely in Newfoundland where the HST rate is 13 percent. The Quick Method rates are 4.4 percent for businesses that purchase goods for resale and 8.8 percent for service providers. During the first quarter of the year, the business has sales of fully taxable items in the amount of $42,300. Current expenses on which HST was paid amount to $37,800. In addition, capital expenditures during this period totaled $72,000. All of these amounts are before the inclusion of HST. The business has no activities other than the delivery of fully taxable merchandise.

Compare the HST payable (receivable) using the regular method applicable to GST/HST calculations with the amount that would be payable (receivable) using the Quick Method.

Exam Exercise Twenty-One - 8 (Quick Method)

Click Cameras operates in the province of Alberta which does not participate in the HST program. The Quick Method rates are 1.8 percent for businesses that purchase goods for resale and 3.6 percent for service providers. During the first quarter of the year, the business has taxable sales of $63,400. Current expenses on which the GST was paid total $26,275. Due to numerous burglaries, Click Cameras spends $44,900 on a sophisticated security system. All of these amounts are before the inclusion of GST. The system is being amortized over five years on a straight line basis. The store is used exclusively for the sale of taxable merchandise.

Compare the GST payable (receivable) using the regular method applicable to GST/HST calculations with the amount that would be payable (receivable) using the Quick Method.

Exam Exercise Twenty-One - 9 (Simplified Input Tax Credits)

Narston Ltd. operates in the province of Alberta which does not participate in the HST program and has no provincial sales tax. For the current year ending December 31, Narston Ltd. has GST inclusive sales of $472,500. It has purchases of merchandise and other current expenditures of $320,000 before the inclusion of GST. Capital expenditures consisted of real property in the amount of $85,000 and personal capital property in the amount of $23,000. These amounts are before the inclusion of GST.

Using the simplified method of accounting for input tax credits, calculate Narston's GST payable or refund for the current year.

TIF PROBLEM TWENTY-ONE - 5
GST/HST - Key Term Matching

The following five key terms are listed at the end of Chapter 21, "GST/HST".

A. Value Added Tax (VAT)

B. Input Tax Credit

C. Harmonized Sales Tax

D. Zero-Rated Goods And Services

E. Quick Method

The following list contains 10 potential definitions for the preceding key terms.
NOTE There is only **ONE** correct definition for each key term.

1. A method of determining GST/HST amounts payable or receivable that is available to businesses with annual GST/HST taxable sales, including those of associated businesses, of $200,000 or less. Specified percentages are applied to the GST/HST inclusive sales figures to determine the GST/HST payable or the refund. There is no separate tracking of input tax credits on either current expenditures or capital expenditures.
2. A provincial sales tax that is harmonized with the GST by being assessed on the same goods and services.
3. A tax assessed at each stage of the production/distribution process, based either on value added (account-based VAT) or the difference between costs and expenditures (invoice-credit VAT).
4. Goods and services that are taxable at a zero GST/HST rate. Registrants who sell such goods are not eligible for input tax credits.
5. An amount, claimable by a registrant, for GST/HST paid or payable on certain expenses such as Cost Of Goods Sold and Administrative Expense.
6. A method of determining GST/HST amounts payable or receivable that is available to businesses with annual GST/HST taxable sales, including those of associated businesses, of $200,000 or less. Specified percentages are applied to the GST/HST inclusive sales figures to determine the GST/HST payable or the refund. Input tax credits on capital expenditures are tracked separately.
7. Goods and services that are taxable at a zero GST/HST rate. Registrants who sell such goods and services are eligible for input tax credits.
8. A combined federal/provincial sales tax that is assessed on a base that is similar to that used for GST. The combined rate varies by province and currently ranges from 12 percent in British Columbia to 15 percent in Nova Scotia.
9. A tax based on the value added to a product at the final stage of distribution to the customer. It is generally based on some accounting measurement of income.
10. An amount, claimable by a registrant, for GST/HST paid or payable on goods or services that were acquired or imported for consumption, use, or supply in the course of the registrant's commercial activity.

Required: For each of the five key terms listed, indicate the number of the item that provides the **BEST** definition of that term. As only one definition is completely correct, please indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

TIF PROBLEM TWENTY-ONE - 6
HST Payable

Montagne Inc. is located in New Brunswick and carries on all of its business in that province. The HST rate in that province is 13 percent.

The Income Statement of Montagne Inc. for the current fiscal year ending December 31 is as follows (applicable HST has been excluded from all amounts):

Sales And Other Revenues		$823,000
Less Expenses:		
Cost Of Goods Sold	($478,000)	
Amortization Expense	(132,000)	
Salaries And Wages	(57,000)	
Interest Expense	(16,000)	
Other Operating Expenses	(32,000)	(715,000)
Income Before Taxes		$108,000
Less: Federal And Provincial Income Taxes		(23,000)
Net Income		$ 85,000

Montagne is an annual filer for HST purposes.

Other Information:

1. Sales And Other Revenues included $120,000 in exempt supplies and $116,000 in zero-rated supplies. The remaining sales were fully taxable for HST purposes.

2. All of the goods sold involved the provision of either fully taxable or zero-rated supplies. During the year, inventories of these goods decreased by $74,000. HST was paid on all goods that were purchased for resale during the year.

3. Capital expenditures for the year amounted to $1,200,000 before HST. HST was paid on all amounts. Of this total, $800,000 was for an office building that will be used 85 percent for the provision of fully taxable or zero-rated supplies. The remaining $400,000 was for equipment that will be used 27 percent in the provision of exempt supplies. HST was paid on the acquisition of all assets on which amortization is being taken during the year.

4. All of the Other Operating Expenses involved the acquisition of fully taxable supplies and were acquired to assist in the provision of fully taxable supplies.

5. Of the Salaries And Wages, 32 percent were paid to employees involved in providing exempt supplies.

Required: Calculate the net HST payable or refund that Montagne Inc. will remit or receive for the current year.

TIF PROBLEM TWENTY-ONE - 7
GST Payable Including Quick Method

Midvale Ltd. is located in Alberta and carries on all of its business in that province. Its business involves purchasing goods for resale. Alberta does not participate in the HST program and does not have a provincial sales tax. The Quick Method rates in Alberta are 1.8 percent for businesses that purchase goods for resale and 3.6 percent for service providers.

Midvale's Income Statement for the current fiscal year ending December 31 is as follows:

Sales		$175,000
Less Expenses:		
Cost Of Goods Sold	($104,000)	
Amortization Expense	(17,000)	
Salaries And Wages	(56,000)	
Interest Expense	(12,000)	
Other Operating Expenses	(8,000)	(197,000)
Income (Loss) Before Taxes		($ 22,000)
Income Taxes - Benefit		7,000
Net Income (Loss)		($ 15,000)

All of the above amounts have been calculated without the inclusion of GST. Midvale is an annual filer for GST purposes.

Other Information:

1. Of the Salaries And Wages, 32 percent were paid to employees involved in providing exempt supplies.
2. All of the Other Operating Expenses involved the acquisition of taxable supplies and these supplies were acquired to assist in the provision of taxable supplies.
3. All of the goods sold involved the provision of taxable supplies. During the year, inventories of these goods increased by $6,000.
4. Sales included $25,000 in exempt supplies and $23,000 in zero-rated supplies. The remaining sales were fully taxable for GST purposes.
5. Capital expenditures for the year amounted to $200,000 (before GST), with GST being paid on all amounts. Of this total, $50,000 was for equipment that will be used 52 percent in the provision of exempt supplies. The remaining $150,000 was for a building that will be used 22 percent for providing exempt supplies, 18 percent for providing zero-rated supplies, and 60 percent for providing fully taxable supplies.

Required: Calculate the net GST payable or refund that Midvale will remit or receive for the current year using:

A. the regular method applicable to GST calculations.
B. the Quick Method.