Chapter One Test Item File Solutions

TIF Solution One - 1

1. There are a number of possibilities here. They include:

- Progressive rates increase the complexity of the system.
- Progressive rates are unfair to individuals with highly variable income streams.
- Progressive rates are unfair to single income family units.
- Progressive rates lead to pressure for various types of tax concessions.
- Progressive rates discourage high income individuals from making additional efforts.
- Progressive rates encourage tax evasion.

2. While the sales tax rate is the same for all individuals without regard to their income level, lower income individuals normally spend a higher percentage of their total income. Since the sales tax is levied on the amounts spent, this means that the sales tax paid by lower income individuals represents a larger percentage of their income. As a consequence, they are generally considered to be regressive in nature.

3. There are many examples that could be used here. The text divides them into resource allocation (e.g., public health care), distribution effects (e.g., federal GST credit), stabilization effects (e.g., deficit reduction), and fiscal federalism (e.g., allocations to various levels of government).

4. Horizontal equity is achieved when taxpayers in similar economic circumstances are subject to similar levels of taxation. Vertical equity is achieved when taxpayers in different economic circumstances are subject to taxes in a different manner.

5. The child benefit system is designed to assist families with children. It would appear that the government is encouraging people to have children. The fact that the benefits are reduced as income increases suggests that it is also designed to assist lower income families care for these children.

6. For individuals and inter vivos trusts, the taxation year is equal to the calendar year. In contrast, corporations and testamentary trusts can use a fiscal period. A fiscal period can end on any date, with the only constraint being that it cannot exceed 53 weeks for a corporation.

7. The circumstances that would result in a non-resident person having to pay income taxes in Canada are as follows:

    - The non-resident person earns employment income in Canada.
    - The non-resident person carried on a business in Canada.
    - The non-resident person has a gain on the disposal of a taxable Canadian property.

8. The components of Net Income For Tax Purposes are employment income, business and property income, net taxable capital gains, other sources of income, and other deductions from income.

9. The phrase "the amount, if any" is used throughout the *Income Tax Act* to indicate that only positive amounts should be considered. In the context of ITA 3(b), the requirement that negative amounts be ignored, in effect, prevents the deduction of allowable capital losses in excess of taxable capital gains in the determination of Net Income For Tax Purposes.

10. Tax avoidance is a form of tax planning in which the taxpayer, through means that are within the boundaries of tax legislation, arranges his affairs in a manner that allows him to receive benefits without the payment of taxes. Tax planning to achieve tax deferral involves either the delayed recognition of income, or the accelerated recognition of deductions. The payment of tax is delayed, as opposed to permanently avoided.

11. Income splitting involves efforts to share the total income accruing to an individual with family members or other related parties. It will only benefit a taxpayer who is in a high tax bracket in those circumstances where there are family members or other related parties who are in lower tax brackets.

12. The basic type of tax planning that is involved in Registered Retirement Savings Plans is tax deferral — a tax savings results from making contributions that will have to be paid back at a later point in time. There may also be an element of avoidance in that, after retirement, an individual may be in a lower tax bracket than he was during his working years. If this is the case, there will be an absolute reduction in taxes. (This assumes that the basic rate structure is unchanged.)

TIF Solution One - 2

1. True. A value added tax is a tax levied on the increase in value of a commodity or service that has been created by the taxpayer's stage of the production or distribution cycle.

2. False. Only individuals, corporations, and trusts are taxable entities for income tax purposes.

3. True. Partnerships engaged in commercial activity are taxable entities for GST purposes.

4. False. In general, provincial taxes are based on a specified percentage of federal taxable income.

5. False. The federal government collects taxes for Ontario.

6. True. Even if the rate is the same on all transactions, it will be a higher rate on the taxable income of lower income individuals because they spend a larger percentage of their income.

7. False. Progressive rates discourage both employment and investment, thereby limiting economic growth.

8. True. Tax expenditures are less costly to administer than direct funding programs.

9. True. Part I of the *Income Tax Act* is the largest and the most important part.

10. False. The citation ITA 61(4)(b)(ii) would be read Section 61, Subsection 4, Paragraph b, Subparagraph ii.

11. True. An income tax is payable for each taxation year on the Taxable Income of every person resident in Canada at any time in the year.

12. True. While individuals and inter vivos trusts must use a calendar taxation year, other taxpayers can choose to use this period as their taxation year.

TIF Solution One - 3

1. C. Walters and Walters, a group of CMAs operating as a partnership.

2. D. Each province can establish rules for determining the Taxable Income of individuals.

3. B. A progressive rate system provides greater stability in the context of changing economic conditions.

4. A. It is more costly to administer tax expenditures as opposed to program spending.

5. B. Inelasticity.

6. C. Simplicity.

7. A. Neutrality.

8. D. Horizontal equity.

9. D All Parts of the *Income Tax Act* contain at least one Section.

10. B. Interpretation Bulletins.

11. C. Dominion Tax Cases.

12. C. Unreported revenues from business transactions.

13. B. The Income Tax Regulations.

14. D When there is a conflict between the Canadian *Income Tax Act* and an international agreement, the terms of the Canadian *Income Tax Act* prevail.

15. C. Business losses can be netted against employment income in determining the positive amounts to be included under ITA 3(a) and 3(b).

16. D. Tax avoidance.

17. B. Tax deferral.

TIF Solution One - 4

Exam Exercise Solution One - 1

She is not correct. Under ITA 2(3) she would be subject to Canadian taxes on employment income earned in Canada, but not on her U.S. employment income.

Exam Exercise Solution One - 2

Ms. Nexus' Net Income For Tax Purposes would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income	$66,000	
Interest Income	10,250	$76,250
Income Under ITA 3(b):		
Taxable Capital Gains	$13,500	
Allowable Capital Loss	(24,000)	Nil
Balance From ITA 3(a) And (b)		$76,250
ITA 3(c) Deductions:		
Spousal Support		(14,000)
RRSP Contributions		(3,000)
Balance From ITA 3(c)		$59,250
Deductions Under ITA 3(d):		
Net Rental Losses		(6,750)
Business Loss		(28,000)
Net Income For Tax Purposes		$24,500

She has an unused allowable capital loss carry over of $10,500 ($24,000 - $13,500).

Exam Exercise Solution One - 3

This transaction clearly involves tax deferral, in that the contribution will be deductible and the earnings on the contribution will accumulate on a tax free basis. However, all of these amounts will be taxable when they are withdrawn from the plan. There may also be tax avoidance. This will happen if the individual is taxed at a lower rate when the funds become taxable.

Exam Exercise Solution One - 4

Natasha is involved in income splitting, tax deferral, and possibly tax avoidance. She is getting the deduction from Taxable Income now and her spouse will be taxed on the income in the future. The tax deferral occurs as the contribution is currently deductible and the earnings on the contribution will accumulate on a tax free basis. However, all of these amounts will be taxable when they are withdrawn from the plan. Tax avoidance will occur if her spouse is taxed at a lower rate than is currently applicable to Natasha when the funds become taxable to him.

Exam Exercise Solution One - 5

This transaction involves income splitting. It would appear that her daughter is in a lower tax bracket than Mrs. Theil. This means that the income on the Canada Savings Bonds will be taxed at a lower rate than would be the case if the bonds remained in Mrs. Theil's hands.

TIF Solution One - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 5 (not 2)

B. 6 (not 4)

C. 3 (not 1)

TIF Solution One - 6

Case A

The Case A solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	$17,000	
Net Rental Income	8,500	$25,500
Income Under ITA 3(b):		
Taxable Capital Gains	$17,400	
Allowable Capital Losses	(19,200)	Nil
Balance From ITA 3(a) And (b)		$25,500
Subdivision e Deductions		(6,300)
Balance From ITA 3(c)		$19,200
Deduction Under ITA 3(d):		
Business Loss		(12,300)
Net Income For Tax Purposes (Division B Income)		$ 6,900

In this Case, Ms. Burke has an unused allowable capital loss carryover of $1,800 ($17,400 - $19,200). The lottery winnings are not subject to tax.

Case B

The Case B solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	$42,100	
Interest Income	8,200	$50,300
Income Under ITA 3(b):		
Taxable Capital Gains	$22,400	
Allowable Capital Losses	(19,200)	3,200
Balance From ITA 3(a) And (b)		$53,500
Subdivision e Deductions		(4,200)
Balance From ITA 3(c)		$49,300
Unincorporated Business Loss		(51,000)
Net Income For Tax Purposes (Division B Income)		Nil

In this Case, Ms. Burke's Net Income For Tax Purposes (Division B income) is nil. There would be an unused business loss carry over of $1,700 ($49,300 - $51,000).

TIF Solution One - 7

Case A

The Case A solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	$50,000	
Interest Income	12,000	$62,000
Income Under ITA 3(b):		
Taxable Capital Gains	$95,000	
Allowable Capital Losses	(73,000)	22,000
Balance From ITA 3(a) And (b)		$84,000
Subdivision e Deductions		(8,000)
Balance From ITA 3(c)		$76,000
Deductions Under ITA 3(d):		
Business Loss		(23,000)
Net Rental Loss		(5,000)
Net Income For Tax Purposes (Division B Income)		$48,000

In this Case, Mr. Dorne has no carry overs available.

Case B

The Case B solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	$45,000	
Net Rental Income	23,000	$68,000
Income Under ITA 3(b):		
Taxable Capital Gains	$25,000	
Allowable Capital Losses	(46,000)	Nil
Balance From ITA 3(a) And (b)		$68,000
Subdivision e Deductions		(10,500)
Balance From ITA 3(c)		$57,500
Deduction Under ITA 3(d):		
Business Loss		(51,000)
Net Income For Tax Purposes (Division B Income)		$ 6,500

In this Case, Mr. Dorne has a carry over of unused allowable capital losses in the amount of $21,000 ($46,000 - $25,000). The lottery prize is not considered to be income for tax purposes.

Chapter Two Test Item File Solutions

TIF Solution Two - 1

1. For an employer to grant this request, the reason for the reduction must be documented in a reasonable fashion and it must be recurring. While there are other examples, the one mentioned in the text involves an individual with deductible spousal support payments.

2. The dates for remitting source deductions are dependent on the amount of source deductions involved. Currently, four categories are identified.

   Quarterly Remitters Businesses that have an average monthly withholding amount of less than $3,000 in either the first or the second preceding calendar year, have to remit withholdings on or before the 15th day of the month immediately following the end of each calendar quarter.

   Regular Remitters Employers with average monthly withholdings of less than $15,000 in the second preceding calendar year and who do not qualify as quarterly remitters, are required to remit on the 15th day of the month following the month in which the amounts were withheld.

   Accelerated Remitters - Threshold 1 Employers with average monthly withholdings of $15,000 to $49,999.99 for the second preceding calendar year are required to remit on a twice monthly basis. Payments are due on the 25th day of the month for remuneration paid during the first 15 days of the month, while payments due on the 10th day of the following month would be for remuneration paid during the remainder of the month.

   Accelerated Remitters - Threshold 2 Employer with average monthly withholdings of $50,000 or more for the second preceding calendar year are required to remit four times per month. The schedule requires payments to be made within three working days (holidays and weekends are excluded) of the 7th, 14th, 21st, and last days of each month. The payments would be for withholdings on remuneration paid during the periods ending on those dates.

3. Individuals are required to make instalment payments if their net tax owing is greater than $3,000 ($1,800 in Quebec) in the current year and in either of the two preceding years. An alternative approach would be to indicate when instalments are not required. The statement here would be that instalments are not required when the net tax owing for the current year, or for each of the two preceding years, does not exceed $3,000.

4. An individual can choose from three different methods in determining their instalment payments:

   Method 1 The instalments could be based on one-quarter of the estimated net tax owing for the current year.

   Method 2 The instalments could be based on one-quarter of the net tax owing for the previous year.

   Method 3 The first two instalments could be based on one-quarter of the net tax owing for the second previous year, with the third and fourth instalments based on one-half of the net of the net tax owing for the previous year, less the sum of the first two instalments paid.

5. She should file the return on the due date, regardless of whether she has the funds to pay the balance owing. Whether or not she files, she will have to pay interest on the balance owing. However, if she delays filing until early July, she will not only have to pay the

non-deductible interest, she will also be subject to an immediate penalty of 5 percent of the balance owing, plus an additional 1 percent per complete month for the period from April 30, for a total penalty of 7 percent.

If, within the last three years, there has been another late filing of her return, the penalty can double to an immediate 10 percent, plus 2 percent per month. The monthly penalty will be assessed for a maximum of 20 months.

6. Corporations are generally required to make either monthly or quarterly instalment payments throughout their taxation year. The only exception to this is when the estimated taxes payable for the current year, or the taxes paid in the preceding year, are less than $3,000.

7. A corporation that is not a small CCPC can choose from three different methods in determining their instalment payments:

   Method 1 The instalments can be based on one-twelfth of the estimated taxes payable for the current taxation year.

   Method 2 The instalments can be based on one-twelfth of the taxes payable for the previous taxation year.

   Method 3 The first two instalments can be based on one-twelfth of the taxes payable for the second previous year. The remaining 10 instalments will then be based on one-tenth of the taxes payable for the previous taxation year, less the amounts paid in the first two instalments.

8. A corporation that is a small CCPC can choose from three different methods in determining their instalment payments.

   Method 1 The instalments can be based on one-fourth of the estimated taxes payable for the current taxation year.

   Method 2 The instalments can be based on one-fourth of the taxes payable for the previous taxation year.

   Method 3 The first instalment can be based on one-fourth of the taxes payable for the second previous year. The remaining three instalments will then be based on one-third of the taxes payable for the previous taxation year, less the amount paid in the first instalment.

9. The general and informal procedures differ as follows:

   - Under the informal procedures, the tax involved must be less than $12,000, or the loss in question is less than $24,000.
   - Under the informal procedures, an individual can represent himself, or be represented by someone other than a lawyer (e.g., an accountant).
   - Under the informal procedures, the taxpayer cannot be assessed court costs.
   - Under the informal procedures, if the taxpayer loses, there is no appeal to a higher court.
   - Informal procedures usually resolve a dispute much more quickly than the general procedures.

10. If the client has debt on which he is paying non-deductible interest (e.g., interest on non-business credit cards), you should determine the applicable rates. If he is paying at a rate in excess of the rate he will be charged on deficient instalments (i.e., the prescribed rate plus 4 percent), he might consider paying down the debt in lieu of making instalment payments. Alternatively, if the rate that he is paying on the personal debt is lower, he should make an effort to pay his instalments. The excess penalty under ITA 163.1 would also have to be taken into consideration if the instalment payments are large.

TIF Solution Two - 2

1. False. The deficiency must be recurring, not just for a particular year.

2. False. There are two filing due dates for individuals. April 30 or, for individuals earning business income, June 15.

3. True.

4. True.

5. False. The acceptable approach is to use one-quarter of the net tax owing for the current year.

6. False. The interest rate applicable on refunds to individuals is 2 percentage points less than the interest rate on amounts owing to the CRA.

7. False. There is no penalty for late payment of taxes. The penalty is for late filing of a return.

8. True.

9. False. Corporations, other than some CCPCs, must pay the balance of tax owing no later than two months after the end of their fiscal year.

10. True.

TIF Solution Two - 3

1. C. If an individual has disposed of a capital property during the year, they are required to file an income tax return, even if no tax is payable.

2. B. John must file a tax return on or before June 15, 2011.

3. B. April 30, 2011.

4. C. August 1, 2011.

5. A. The final tax return of individuals who die between January 1 and October 31 must be filed no later than April 30 of the following year. The 6-month filing extension provided by ITA 150(1)(b) only applies where an individual dies between November 1 of the year and April 30 of the following year.

6. E. Nil. The late filing penalty amounts to 5 percent of the tax that was unpaid at the filing due date. Since Ms. Deveco has paid more than her net tax owing by April 30 2011, there are no penalties or interest.

7. C. $1,875 ($7,500 ÷ 4).

8. B. $3,750 ($15,000 ÷ 4).

9. A. Jane White, who received a one-time bonus of $60,000 last year and, because her employer had not deducted enough tax, found herself with net tax owing of $8,200.

10. D. If Larry has as much income in 2011 as he had in 2010, he will have to pay instalments during 2011.

11. E. Six months after the fiscal year end.

12. D. The return would be due on May 31, 2011, six months after the taxation year end.

13. D. The penalty would be 5 percent of the tax unpaid at the date the return was due to be filed, plus 1 percent per month for three months, a total of 8 percent. This amounts to $200 [(8%)($2,500)].

14. B. Its preceding year's taxes payable of $13,200, divided by twelve months.

15. B. The only correct approach listed is to pay monthly instalments equal to 1/12th of the current year's estimated tax liability.

16. A. Monthly, based on the estimated tax for the current year.

17. E. For individuals and testamentary trusts, the notice of objection must be filed before the later of 90 days from the date of mailing of the notice of assessment or reassessment, one year from the filing due date for the return under assessment or reassessment.

18. C. Her notice of objection is due the later of one year after the due day for the return (April 30, 2012), and 90 days after the day of mailing the notice of assessment (July 18, 2011).

19. D. It must be filed no later than 90 days after the notice of assessment was mailed.

TIF Solution Two - 4

Exam Exercise Solution Two - 1

While Mr. Brown's 2010 tax return does not have to be filed until June 15, 2011, his tax liability must be paid by April 30, 2011 in order to avoid the assessment of interest.

Exam Exercise Solution Two - 2

Mr. Klause's 2010 tax return must be filed by the later of six months after the date of his death and his normal filing date. Given that his income is from an unincorporated business, his normal filing date for the 2010 return would be June 15, 2011. However, the later date is September 1, 2011, six months after the date of his death.

Exam Exercise Solution Two - 3

As the net tax owing for the current year and one of the two preceding years exceeds $3,000, she is required to make instalment payments. The best alternative for instalment payments would be to use the current year estimate. This would result in required instalment payments of $900 ($3,600 ÷ 4) to be paid on March 15, June 15, September 15, and December 15. If the estimated taxes payable are below actual taxes payable for 2010, instalment interest may be charged.

Exam Exercise Solution Two - 4

The net tax owing is $11,000 ($56,000 - $45,000) in 2008, $3,000 ($49,000 - $46,000) in 2009, and $20,000 ($65,000 - $45,000) in 2010. As the net tax owing exceeds $3,000 in 2008 and 2010, instalments are required. The Instalment Reminder will have March 15 and June 15 instalments of $2,750 each ($11,000 ÷ 4). There would be no further instalments required for 2010 as his net tax owing for 2009 is only $3,000 and he would already have paid $5,500 [(2)($2,750)].

The best alternative for instalment payments would be to use the prior year option. This would result in required instalment payments of $750 ($3,000 ÷ 4) to be paid on March 15, June 15, September 15, and December 15.

Exam Exercise Solution Two - 5

Given the size of her net tax owing, ITA 163.1 will not be applicable and there will be no penalties for late instalments. However, a penalty of 8 percent of taxes payable will be assessed for filing three complete months late (5 percent, plus 1 percent per month). If, in one of the three preceding taxation years she has committed a similar offence, the penalty could be 16 percent (10 percent, plus 2 percent per month). Interest on deficient instalments, the balance owing, and the penalties at the regular rate plus 4 percent would also be assessed.

Exam Exercise Solution Two - 6

Not Small CCPC The first two instalments would be based on the second preceding year and would be $5,958.33 each ($71,500 ÷ 12). The remaining 10 instalments would be based on the preceding year, less the $11,916 paid in the first two instalments. The amount would be $8,168.33 [($93,600 - $11,916.66) ÷ 10]. The instalments would be due on the last day of each month in 2010.

Small CCPC In this case, the first instalment would be based on the second preceding year and would be $17,875 ($71,500 ÷ 4). The remaining 3 instalments would be based on the preceding year, less the $17,875 paid for the first instalment. The amount would be $25,241.66 [$93,600 - $17,875) ÷ 3]. The instalments would be due on the last days of March, June, September, and December, 2010.

Exam Exercise Solution Two - 7

Not Small CCPC The minimum instalments would be based on the estimated taxes payable for 2010. The amount would be $4,358.33 ($52,300 ÷ 12). The instalments would be due on the last day of each month in 2010. Note that, if the estimate for 2010 is too low, interest will be assessed on the deficiency.

Small CCPC In this case, all four instalments would be based on the estimated taxes payable for 2010. The amount would be $13,075 ($52,300 ÷ 4). The instalments would be due on the last days of March, June, September, and December, 2010.

Exam Exercise Solution Two - 8

Grange Inc.'s tax return must be filed six months after its year end, on September 30, 2010. As it is a CCPC that claims the small business deduction, and its Taxable Income for the preceding taxation year did not exceed $500,000, the final tax payment is due three months after the year end. This would be June 30, 2010.

Exam Exercise Solution Two - 9

Lawnco Inc.'s tax return is due six months after its year end, on July 31, 2010. Unless Lawnco is able to claim the small business deduction, the final tax payment must be made two months after the year end, on March 31, 2010. If it is eligible for the small business deduction, it can defer the final payment for an additional month, to April 30, 2010, provided their Taxable Income for the preceding taxation year did not exceed $500,000.

Exam Exercise Solution Two - 10

A notice of objection must be filed by the later of:

- 90 days after the date of mailing of the reassessment (September 30, 2012); or
- one year after the due date for filing the return that is being reassessed (April 30, 2012).

The later of these two dates is September 30, 2012.

TIF Solution Two - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 4 (not 1)

B. 7 (not 5)

C. 9 (not 6)

D. 3 (not 10)

E. 2 (not 8)

TIF Solution Two - 6

Part A

Ms. Birch would be required to make instalment payments during 2010, as her net tax owing for 2010 is estimated to be in excess of $3,000 and, in addition, her net tax owing in one of the two preceding years (2009) is in excess of $3,000.

Part B

Instalments will be due on March 15, June 15, September 15, and December 15 of 2010. The three alternative payment schedules can be described as follows:

One The first two instalments could be based on the second preceding year. This amount would be $375 [($23,000 - $21,500) ÷ 4]. The remaining two instalments would be based on the preceding year, less the amount of the first two instalments. This amount would be $5,625 {[$27,000 - $15,000 - (2)($375)] ÷ 2}. This is the calculation that would be used by the CRA for her instalment reminders and the instalments would total $12,000.

Two The instalments can be based on the 2009 figures. This would give four equal instalments of $3,000 [($27,000 - $15,000) ÷ 4] that total $12,000.

Three The instalments can be based on the 2010 estimates which gives net tax owing of $3,200 ($21,200 - $18,000). This would give four equal instalments of $800 [($21,200 - $18,000) ÷ 4].

Alternative three is the best alternative, as the instalments will total $3,200.

Under both alternatives one and two, the instalments will equal the prior year's net tax owing of $12,000 which results in a significant overpayment of taxes. No interest will be paid on this overpayment.

Part C

The answer here will depend on Ms. Birch's other debt obligations. If she fails to make the instalment payments she will be charged non-deductible interest at the prescribed rate plus 4 percent. However, if she has other debt with non-deductible interest, unpaid credit card balances for example, the rate on this debt may be higher than the rate charged on deficient instalments. This would mean that there would be an advantage in paying off this alternative debt, rather than making the instalment payments.

TIF Solution Two - 7

Case A

1. The individual's net tax owing is $6,300 ($93,000 - $86,700) in 2008 and $3,300 ($82,500 - $79,200) in 2010. As the net tax owing exceeds $3,000 in the current year and one of the two preceding years, instalments are required.

2. The three alternatives would be:

- Quarterly instalments of $825 ($3,300 ÷ 4) based on the current year estimate.
- Quarterly instalments of Nil based on the first preceding year.
- Two quarterly instalments of $1,575 ($6,300 ÷ 4) based on the second preceding year. No further instalments will be required.

3. The best alternative would be quarterly instalments of nil, based on the first preceding year.

Case B

1. The individual's net tax owing is $1,500 ($93,000 - $91,500) in 2008, $9,300 ($108,000 - $98,700) in 2009, and $4,200 ($82,500 - $78,300) in 2010. As the net tax owing exceeds $3,000 in the current year and one of the two preceding years, instalments are required.

2. The three alternatives would be:

- Quarterly instalments of $1,050 ($4,200 ÷ 4) based on the current year estimate.
- Quarterly instalments of $2,325 ($9,300 ÷ 4) based on the first preceding year.
- Two quarterly instalments of $375 ($1,500 ÷ 4) based on the second preceding year, followed by two instalments of $4,275 {[$9,300 - (2)($375)] ÷ 2}.

3. The best alternative would be quarterly instalments of $1,050, for a total of $4,200. This is much lower than the total of $9,300 required under the other two alternatives.

   The instalments are due on March 15, June, 15, September 15, and December 15.

Case C

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required.

2. The three acceptable alternatives would be as follows:

- Quarterly instalments of $20,625 ($82,500 ÷ 4) based on the current year estimate.
- Quarterly instalments of $27,000 ($108,000 ÷ 4) based on the first preceding year.
- One quarterly instalment of $23,250 ($93,000 ÷ 4) based on the second preceding year, followed by three instalments of $28,250 [($108,000 - $23,250) ÷ 3], a total of $108,000.

3. The best alternative would be quarterly instalments of $20,625, for a total of $82,500.

   The instalments are due on March 31, June 30, September 30, and December 31.

Case D

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required.
2. The three acceptable alternatives would be as follows:
   - Monthly instalments of $6,875 ($82,500 ÷ 12 based on the current year estimate.
   - Monthly instalments of $9,000 ($108,000 ÷ 12) based on the first preceding year.
   - Two monthly instalment of $6,508.33 ($78,100 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $9,498.33 {[$108,000 - (2)($6,508.33) ÷ 10]}, a total of $108,000.
3. The best alternative would be monthly instalments of $6,875, for total payments of $82,500.

The instalments would be due on the last day of each month, beginning in January, 2010.

Chapter Three Test Item File Solutions

TIF Solution Three - 1

1. The ability to use a bonus arrangement to defer tax on employment income is based on the fact that, while business income is accrual based, employment income is on a cash basis. This means that the business can deduct the bonus at the time a commitment is made to make the payment, but the employee will not be taxed on it until it is received. If the bonus is declared in one year and paid in the following year, this provides a one year deferral to the employee. Note, however, the bonus must be paid within 180 days of the year end of the employer. If it is not paid within this period, the employer will not be able to deduct the bonus until it is paid.

2. As presented in the text, the major factors and their descriptions are as follows:

   Control In an employer/employee relationship, the employer usually controls, directly or indirectly, the way the work is done and the work methods used. The employer assigns specific tasks that define the real framework within which the work is to be done.

   Ownership Of Tools And Equipment In an employer/employee relationship, the employer usually supplies the equipment and tools required by the employee. In addition, the employer covers the following costs related to their use: repairs, insurance, transport, rental, and operations (e.g., fuel).

   In some trades, however, it is customary for employees to supply their own tools. This is generally the case for garage mechanics, painters, and carpenters. Similarly, employed computer scientists, architects, and surveyors sometimes supply their own software and instruments.

   Ability To Subcontract Or Hire Assistants If the individual must personally perform the services, he is likely to be considered an employee. Alternatively, if the individual can hire assistants, with the payer having no control over the identity of the assistants, the individual is likely to be considered self-employed.

   Financial Risk In general, employees will not have any financial risks associated with their work. In contrast, self-employed individuals can have risk and can incur losses. Responsibility for fixed monthly costs is a good indicator that an individual is self-employed.

   Responsibility For Investment And Management If the individual has no capital investment in the business and no presence in management, he is likely to be considered an employee. Alternatively, if the individual has made an investment and is active in managing the business, he should be considered self-employed.

   Opportunity For Profit In an employer/employee relationship, the employer alone normally assumes the risk of loss. The employer also usually covers operating costs, which may include office expenses, employee wages and benefits, insurance premiums, and delivery and shipping costs. The employee does not assume any financial risk, and is entitled to his full salary or wages regardless of the financial health of the business.

   The income of an employee paid by the piece, or on commission, does not depend on the profits or losses of the employer's business. The employee is paid the same per unit amount no matter how many pieces the employer requires him to produce or sell.

3. The importance of this distinction largely relates to the deductibility of expenses. The number and types of expenses which can be deducted against employment income are very limited. In contrast, if an individual is classified as self-employed, revenues generated will be treated as business income, thereby opening the door to a much wider range of expense deductions. An additional point here is that, if the individual is considered to be an employee, his/her employer will have to withhold income taxes, Canada Pension Plan contributions, and Employment Insurance premiums. This would not be the case if the individual was an independent contractor.

   An independent contractor is responsible for quarterly tax instalments, if necessary, and for both the employer's and employee's portions of CPP contributions. Such individuals may or may not have to make EI contributions, depending on whether they elect to participate in this program.

4. Salary is considered to be the basic benchmark because it is fully deductible to the employer and fully taxable to the employee. Given this, there is no tax benefit to be gained by any form of employee compensation that has these same characteristics.

5. Examples involving tax deferral include contributions to RPPs and bonus arrangements that are paid within 180 days of the employer's year end. Examples involving tax avoidance include payments for private health care, discounts on the employer's goods or services, and non-cash gifts under $500.

6. While there may be other possibilities, the tax planning suggestions that were included in the text are as follows:

   Return The Keys As the car will be considered to be available for the employee's use unless the keys are returned to the employer, the vehicle and its keys should be left with the employer during significant periods when the employee is not using it. This procedure can substantially reduce the taxable benefit to the employee and, in general, will not have any effect on the amounts that can be deducted for the car by the employer.

   Record Keeping In the absence of detailed records, an employee can be charged with the full standby charge and 100 percent personal usage. To avoid this, it is essential that records be kept of both employment related and personal kilometers driven and of the actual number of days that the car was available for personal use.

   Leasing Vs. Buying In most cases, a lower taxable benefit will result when the employer leases the car rather than purchases it. One adverse aspect of leasing arrangements should be noted. Lease payments are made up of a combination of both interest and principal payments on the car. As the taxable benefit is based on the total lease payment, the interest portion becomes, in effect, a part of the taxable benefit.

   Minimizing The Standby Charge This can be accomplished in a variety of ways including longer lease terms, lower trade-in values for old vehicles in purchase situations, larger deposits on leases, and the use of higher residual values in leasing arrangements. Note that refundable deposits in excess of $1,000 on leases can reduce the deductible lease costs.

   Cars Costing More Than $30,000 With the taxable benefit to the employee based on the full cost of the car and any portion of the cost in excess of $30,000 not being deductible to the employer, it is difficult to imagine situations in which it would make economic sense for a profit oriented employer to provide any employee with a luxury car. As the taxable benefit to the employee is based on the actual cost of the car, while

the deductible amount is limited to $30,000, a situation is created in which the employee is paying taxes on an amount which can be considerably larger than the amount that is deductible to the employer.

Employee Owned Automobile The alternative to the employer provided automobile is to have the employer compensate the employee for using his own automobile. In many cases, this may be preferable to providing an automobile. For example, in those situations where business use is less than 50 percent, the provision of an automobile to an employee will result in a benefit assessment for the full standby charge. If business use were 45 percent, for example, it is almost certain that the amount assessed will exceed the actual benefit associated with 55 percent personal use of the vehicle. If, alternatively, the employee is compensated for using his own personal vehicle, there may be no taxable benefit.

7. From the point of view of the employer, the full amount of any monthly allowance will be deductible. With respect to the use of a milage allowance, there are prescribed limits on the deduction. (These are discussed in Chapter 6.)

   From the point of view of the employee, the monthly allowance will have to be included in his employment income for the year. Given this, he can then deduct his actual costs of using his automobile (an appropriate percentage of interest, CCA, and operating costs). Alternatively, if he receives a per kilometer allowance, he can simply ignore it. It will not be included in the T4 issued by his employer and, given this, he will not be able to deduct his actual costs.

8. Interest is calculated on the loan using the prescribed rate. From this calculated amount, amounts of interest paid by the taxpayer would be subtracted. Any resulting positive amount would be the taxable benefit.

9. While this treatment is very favourable for the employee, it does not appear to satisfy the tax policy goal of fairness. Even when a stock option is not in-the-money, it clearly has value. This is based on the fact that it allows the holder to participate in any appreciation in stock value without investing any funds or being exposed to any downside risk. This means that, if no income inclusion is recorded when stock options are issued to an employee, he is receiving a benefit that is not subject to tax.

10. If the issuing corporation is a publicly traded Canadian company, the deduction is only available when the option price is equal to or greater than the fair market value of the shares at the time the options were issued.

    If the issuing corporation is a Canadian controlled private corporation, the deduction is available if the shares are held for two years, without regard to whether the option price was above or below the fair market value of the shares at the time the options were issued. However, if the shares are not held for two years, the availability of the deduction is subject to the same condition that is applicable to public companies. That is, the option price must be equal to or greater than the fair market value of the shares at the time they were issued.

11. **Part A** ITA 8(1)(f) indicates that four conditions must be met before the deduction of expenses for salespersons will be allowed. These are as follows:

    1. The salesperson must be required by his/her employer to pay his/her own expenses. This must be supported by form T2200 signed by the employer.
    2. The salesperson must be ordinarily required to carry on his/her duties away from the employer's place of business.
    3. The salesperson must not receive an allowance that is not included in income.

4. The salesperson must receive at least part of his/her remuneration in the form of commissions.

Part B ITA 8(1)(h) indicates that any employee can deduct travel expenses, with meals and entertainment subject to the 50 percent limit, provided three conditions are met. These are as follows:

1. The person must be required by his/her employer to pay his/her own travel costs. This must be supported by Form T2200 signed by the employer.
2. The person must be ordinarily required to carry on his/her duties away from the employer's place of business.
3. The person must not receive an allowance that is not included in income.

TIF Solution Three - 2

1. False. Employment income is the salary, wages, and other remuneration, including gratuities, that are received by an individual during the year.

2. True.

3. False. Independent contractors have to make a double contribution to CPP.

4. True.

5. False. Such payments are a taxable benefit for employees.

6. True.

7. True.

8. True. Her taxable benefit from the loan is $200 for the year. Her use for only nine months is irrelevant.

9. False. Her taxable benefit is $195 [(2%)(9/12)($10,000)] + [(2%)(3/12)($9,000)].

10. False. There would be no minimum standby charge as the company does not own the car.

TIF Solution Three - 3

1. A. Veronica earns business income and Jonathon earns employment income. Veronica will be able to deduct more expenses than Jonathon.

2. A. Reimbursement of moving expenses.

3. B. Low rent housing.

4. C. A 20 percent discount on the employer's merchandise is not considered a taxable benefit unless the employee is permitted to purchase the item below the employer's cost.

5. A. The allowance is not taxable to the employee.

6. A. In B, group disability is not a taxable benefit. In C, subsidized meals in employer's facilities do not create a taxable benefit. In D, dental insurance is not a taxable benefit.

7. A. A dental plan plus a leased automobile that would be used only for personal travel by the employee.

8. G. $3,240.

   Standby charge = [(12)(2%)($20,000)(9,000/20,004)] = $2,160
   Operating costs - Lesser Of:
   • [(9,000)($0.24)] = $2,160
   • [(1/2)($2,160)] = $1,080

   Total of $2,160 and $1,080 = $3,240

9. C. $1,800.

   Standby charge = [(2/3)(12)($500)(11/12)(6,000/18,337)] = $1,200
   Operating costs - Lesser Of:
   • [(6,000)($0.24)] = $1,440
   • [(1/2)($1,200)] = $600

   Total of $1,200 and $600 = $1,800

10. I. $3,959.

   Standby charge = [(10)(2%)($20,000)(11,000/16,670)] = $2,639
   Operating costs - Lesser Of:
   • [(11,000)($0.24)] = $2,640
   • [(1/2)($2,639]) = $1,320

   Total of $2,639 and $1,320 = $3,959

11. A. $1,150.
   Standby charge = [(2/3)(12)($500)(11/12)(7,500/18,337)] = $1,500
   Operating costs - Lesser Of:
   • [(7,500)($0.24)] = $1,800
   • [(1/2)($1,500)] = $750

   Total of $1,500 and $750, less $1,100 = $1,150

12. C. The minimum taxable benefit that Mr. Brown must include in his employment income for the use of this vehicle in 2010 is $3,401 [(2%)(12)($31,500)(9,000/20,004)], plus $1,701 [(1/2)($3,401)], a total of $5,102.

13. B. $960 [(2%)(12)($40,000)(2,000/20,004)].

14. C. Some allowances are taxable, but reimbursements are never taxable.

15. C. $670.68 {[$80,000][(61/365)(4% - 2%) + (184/365)(3% - 2%)]}.

16. C. An increase of $4,187.50. This would be calculated as follows:

Employment Income [($31.50 - $22.00)(500)]	$4,750.00
Deduction Under ITA 110(1)(d)	(2,375.00)
Taxable Capital Gain [($38.75 - $31.50)(500)(1/2)]	1,812.50
Net Addition To Taxable Income	$4,187.50

17. B. The increase in Taxable Income is $3,000 [(1,000)($26 - $20) - (1/2)(1,000)($26 - $20)] in the year of sale.

18. D.

Employment Income [(10,000)($6 - $3)]	$30,000
Deduction Under ITA 110(1)(d.1)	(15,000)
Taxable Capital Gain [(10,000)($7 - $6)(1/2)]	5,000
Net Addition To Taxable Income	$20,000

Since the Company is a Canadian controlled private corporation, this amount is taken into income at the time the shares are disposed of. He is eligible for the stock option deduction, even though the fair market value of the share was greater than the option price at the time of issue, as the shares were held for at least two years.

19. C. The adjusted cost base of the shares is $60,000 ($6 per share).

20. D. An increase in employment income of $1,000 [($17 - $15)(500)]. No deduction is available as the fair market value was greater than the option price when the options were granted.

21. B. A taxable capital gain of $1,750 [($24 - $17)(500)(1/2)].

22. B. If John claims under ITA 8(1)(f) as a commission salesperson, the total eligible expenses would be $16,000 (one-half of the meals and entertainment of $14,000, plus 90 percent of the driving costs of $10,000). However, under this provision he would be limited to his $5,000 in 2010 commission income. The alternative that would maximize his deduction would be to use ITA 8(1)(h.1). While he could not deduct the meals and entertainment costs under this provision, his deduction would not be limited to his commission income. This would allow a deduction of $9,000 (90 percent of the driving costs of $10,000).

23. D. Must receive all remuneration in commissions.

TIF Solution Three - 4

Exam Exercise Solution Three - 1

The bonus will be taxed in Ms. Connely's hands in the year of receipt. This means that it will be included in her 2010 tax return. With respect to Connely Ltd., the bonus is not payable until more than 180 days after their year end. As a consequence, they will not be able to deduct the bonus in the year ending August 31, 2009. It will be deducted in the year ending August 31, 2010.

Exam Exercise Solution Three - 2

Mr. Lamarche's taxable benefit would be $5,539, the $5,275 cost of the tickets, plus the additional $264 in GST.

Exam Exercise Solution Three - 3

Rounded to the nearest whole number, 268 days results in 9 months of availability. Further, Ms. Nestor's employment use is over 50 percent, entitling her to a reduction in the basic standby charge. Given these factors, the standby charge would be calculated as follows:

[(2%)(9)($54,000 + $7,020)(5,000/15,003)] = $3,660

The 15,003 in this calculation is 9 months at 1,667 per month. The operating cost benefit would be $1,200 [(5,000)($0.24)], resulting in a total taxable benefit of $4,860 ($3,660 + $1,200). Note that, while Ms. Nestor could have used the alternative calculation of the operating cost benefit, the result would have been $1,830 [(1/2)($3,660)], a significantly higher figure than the $1,200 used here.

Exam Exercise Solution Three - 4

Rounded to the nearest whole number, 310 days results in 10 months of availability. As Mr. Warren's employment related use is more than 50 percent, he is eligible for a reduction in the basic standby charge. However, as his personal usage exceeds 16,670 kilometers [(1,667)(10)] the reduction is equal to nil. Given these factors, the standby charge would be calculated as follows:

[(2/3)(12)($791)(10/12)] = $5,273

Using the prescribed rate, the operating cost benefit would be $4,320 [(18,000)($0.24)]. However, Mr. Warren's employment kilometers are more than 50 percent of the total and, as a consequence, he can calculate the operating cost benefit as one-half the standby charge. This amount would be $2,637 [(1/2)($5,273)]. This lower amount would be used, resulting in a total taxable benefit of $7,910 ($5,273 + $2,637).

Exam Exercise Solution Three - 5

As the car allowance is not based on kilometers, Mr. Jackson will have to include the $4,200 allowance that was received from his employer in his employment income. He can deduct the employment related portion of his actual automobile costs against this amount. This would be $2,630 [($8,623)(8,150/26,720)]. The net inclusion would be $1,570 ($4,200 - $2,630).

Exam Exercise Solution Three - 6

As her employer contributes to the plan, the $6,940 in benefits received during the year will be included in her employment income. This will be reduced by the $648 in non-deductible contributions that she made during 2009 and 2010, leaving a net inclusion of $6,292.

Exam Exercise Solution Three - 7

The ITA 80.4(1) benefit is calculated as follows:

The Lesser Of:	
• [($135,000)(5%)(1/4) + ($135,000)(6%)(1/4) + ($135,000)(4%)(2/4)] = $6,413	
• [($135,000)(5%)] = $6,750	$6,413
Less Interest Payment [($135,000)(3.1%)]	(4,185)
Net Benefit	$2,228

As this is a home purchase loan, the annual benefit cannot exceed the benefit that would result from applying the 5 percent rate that was in effect when the loan was made. Note that the 5 percent rate is not compared to the prescribed rate on a quarter-by-quarter basis, but on an annual basis. The lower figure of $6,413 would then be reduced by the $4,185 in interest paid.

Exam Exercise Solution Three - 8

In the absence of the interest free loan, the employee would borrow $240,000 at 5 percent, requiring an annual interest payment of $12,000. The after tax cash outflow associated with the employer providing sufficient additional salary to carry this loan would be calculated as follows:

Required Salary [$12,000 ÷ (1 - 0.44)]	$21,429
Corporate Tax Savings From Deducting Salary [($21,429)(33.7%)]	(7,222)
Employer's After Tax Cash Flow - Additional Salary	$14,207

Alternatively, if the loan is provided, the employee will have a taxable benefit of $7,200 [(3%)($240,000)], resulting in taxes payable of $3,168 [(44%)($7,200)]. To make this situation comparable to the straight salary alternative, the employer will have to provide the employee with both the loan amount and sufficient additional salary to pay the taxes on the imputed interest benefit. The amount of this additional salary would be $5,657 [$3,168 ÷ (1 - 0.44)]. The employer's after tax cash flow associated with providing the additional salary and the loan amount would be calculated as follows:

Required Salary [$3,168 ÷ (1.00 - .44)]	$ 5,657
Corporate Tax Savings From Deducting Salary [($5,657)(33.7%)]	(1,906)
After Tax Cost Of Salary	$ 3,751
Employer's Lost Earnings [(8.2%)(1 - 0.337)($240,000)]	13,048
Employer's After Tax Cash Flow - Loan	$16,799

Given these results, providing the additional salary appears to be the better alternative.

Exam Exercise Solution Three - 9

The employment income inclusion is $22,000 [(1,000)($45 - $23)]. There would also be a deduction under ITA 110(1)(d) equal to $11,000. However, this does not affect net employment income.

Exam Exercise Solution Three - 10

For options to buy shares of a Canadian controlled private corporation, no employment income benefit is included until the shares are sold. As a result, the exercise of the stock options does not affect her employment income for 2010.

Exam Exercise Solution Three - 11

The effect of these transactions would be calculated as follows:

Employment Income [(1,000)($18.50 - $13.25)]	$5,250
Taxable Capital Gain [(1/2)(1,000)($19.75 - $18.50)]	625
Increase In Net Income For Tax Purposes	$5,875
Deduction Under ITA 110(1)(d) [(1/2)($5,250)]	(2,625)
Increase In Taxable Income	$3,250

Exam Exercise Solution Three - 12

The increase in Net Income For Tax Purposes and Taxable Income resulting from the exercise of the options in 2010 would be calculated as follows:

Fair Market Value At Exercise [(4,000)($82)]	$328,000
Cost of Shares [(4,000)($54)]	(216,000)
Employment Income Inclusion = **Increase In Net Income For Tax Purposes**	**$112,000**
Deduction Under ITA 110(1)(d) [(1/2)($112,000)]	(56,000)
Increase In Taxable Income	**$ 56,000**

When the shares are sold in 2011, Mr. Savage will have a taxable capital gain of $30,000 [(1/2)(4,000)($97 - $82)]. This will be both the increase in Net Income For Tax Purposes and the increase in Taxable Income.

Exam Exercise Solution Three - 13

As Mr. Savage's employer is a Canadian controlled private corporation, the exercise of the options has no effect on his Taxable Income in 2010.

When the shares are sold in 2011, the total increase in Net Income For Tax Purposes and Taxable Income is calculated as follows:

Fair Market Value At Exercise [(4,000)($82)]		$328,000
Cost of Shares [(4,000)($54)]		(216,000)
Employment Income Inclusion		$112,000
Proceeds Of Disposition [(4,000)($97)]	$388,000	
Adjusted Cost Base [(4,000)($82)]	(328,000)	
Capital Gain	$ 60,000	
Inclusion Rate	1/2	30,000
Increase In Net Income For Tax Purposes		**$142,000**
Deduction Under ITA 110(1)(d) [(1/2)($112,000)]		(56,000)
Deduction Under ITA 110(1)(d.1)		N/A
Increase In Taxable Income		**$ 86,000**

As the option price was greater than the fair market value of the shares at the time of issue, he is allowed the deduction under ITA 110(1)(d). If this had not been the case, although Mr. Savage's employer is a Canadian controlled private company, he would not have been able to make this deduction under ITA 110(1)(d.1) as he did not hold the shares for the required two years.

Exam Exercise Solution Three - 14

Her potential deduction is $19,900 [$6,150 + (1/2)($8,850) + $9,325]. However, this total exceeds her commission income and cannot be deducted under ITA 8(1)(f). If she deducts under ITA 8(1)(h) there is no limit on this total. The problem here is that she cannot deduct the advertising or entertainment costs under this Paragraph. Further, she cannot make any deduction under ITA 8(1)(h) if she makes any deduction under ITA 8(1)(f).

As the travel costs that are deductible under ITA 8(1)(h) exceed the ITA 8(1)(f) ceiling of $9,200 in commission income, her maximum deduction is the $9,325 in travel costs under ITA 8(1)(h).

Exam Exercise Solution Three - 15

As Doug Evans receives a portion of his income in the form of commissions, all of the $11,250 in listed expenses are potentially deductible under ITA 8(1)(f) (advertising and travel) and 8(1)(j) (CCA and interest on van). However, if he makes the deduction under ITA 8(1)(f), his expenses other than CCA and interest on the car, are limited to $6,250, the amount of his commission income. As a result, he can deduct $8,750 ($6,250 + $1,875 + $625).

Alternatively, he can deduct all of the expenses except the advertising and promotion costs under ITA 8(1)(h) and (h.1). As these deductions are not limited by commissions or total employment income, he will be able to deduct a total of $10,000 ($7,500 + $1,875 + $625). Note that, if he uses ITA 8(1)(h) and ITA 8(1)(h.1), he cannot use ITA 8(1)(f) to deduct the advertising and promotion costs of $1,250. Therefore, his maximum deduction is $10,000 and his minimum net employment income is $57,500 ($67,500 - $10,000).

TIF Solution Three - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 8 (not 1)

B. 2 (not 4)

C. 10 (not 6)

D. 9 (not 5)

E. 7 (not 3)

TIF Solution Three - 6

Case A

The required information under the assumption that Merlin Industries Ltd. is a Canadian controlled private corporation is as follows:

- Year Of Granting - No tax effect.
- Year Of Exercise - No tax effect.
- Year Of Sale - The tax effects would be as follows:

Fair Market Value At Exercise [(200,000)($22)]	$4,400,000
Cost of Shares [(200,000)($15)]	(3,000,000)
Employment Benefit	$1,400,000
Taxable Capital Gain [(200,000)($28 - $22)(1/2)]	600,000
Increase In Net Income For Tax Purposes	$2,000,000
Deduction Under ITA 110(1)(d) [(1/2)($1,400,000)]	(700,000)
Increase In Taxable Income	$1,300,000

Case B

As the option price at the time of the grant is less than the fair market value of the shares on that date, no deduction is available under ITA 110(1)(d). Further, as Ms. Bytech has not held the shares for two years, no deduction is available under ITA 110 (1)(d.1). Given this, the required information under the assumption that Merlin Industries Ltd. is a Canadian controlled private corporation is as follows:

- Year Of Granting - No tax effect.
- Year Of Exercise - No tax effect.
- Year Of Sale - The tax effects would be as follows:

Fair Market Value At Exercise [(200,000)($22)]	$4,400,000
Cost of Shares [(200,000)($15)]	(3,000,000)
Employment Benefit	$1,400,000
Taxable Capital Gain [(200,000)($28 - $22)(1/2)]	600,000
Increase In Net Income For Tax Purposes And Taxable Income	$2,000,000

Case C

The required information under the assumption that Merlin Industries Ltd. is a Canadian public company is as follows:

- Year Of Granting - No tax effect.
- Year Of Exercise - The tax effects would be as follows:

Fair Market Value At Exercise [(200,000)($22)]	$4,400,000
Cost of Shares [(200,000)($15)]	(3,000,000)
Employment Benefit = Increase In Net Income For Tax Purposes	$1,400,000
Deduction Under ITA 110(1)(d) [($1,400,000)(1/2)]	(700,000)
Increase In Taxable Income	$ 700,000

- Year Of Sale - There would be a taxable capital gain of $600,000 [(200,000)($28 - $22)(1/2)]. This would increase both Net Income For Tax Purposes and Taxable Income by $600,000.

Case D

As the option price at the time of the grant is less than the fair market value of the shares on that date, no deduction is available under ITA 110(1)(d). Further, as Merlin Industries Ltd. is a public company, no deduction could have been available under ITA 110 (1)(d.1). Given this, the required information is as follows:

- Year Of Granting - No tax effect.
- Year Of Exercise - There would be an employment income inclusion of $1,400,000 [(200,000)($22 - $15)]. This would increase both Net Income For Tax Purposes and Taxable Income by $1,400,000.
- Year Of Sale - There would be a taxable capital gain of $600,000 [(200,000)($28 - $22)(1/2)]. This would increase both Net Income For Tax Purposes and Taxable Income by $600,000.

TIF Solution Three - 7

Mr. Kern's net employment income for the year would be calculated as follows:

Gross Salary	$67,600
Registered Pension Plan Contributions	(1,800)
Contributions To Group Disability Plan	Nil
Automobile Benefit (Note One)	857
Disability Insurance Benefit (Note Two)	1,300
Professional Dues	(1,233)
Stock Option Benefit [($83 - $75)(200)]	1,600
Net Employment Income	$68,324

Note One Based on the fact that Mr. Kern's employment related usage is more than 50 percent of total usage, the automobile benefit is calculated as follows:

Standby Charge [(2/3)(12)($815 - $89)(9/12)(3,000/15,003)]	$ 871
Operating Cost Benefit - Lesser Of:	
• [(3,000)($0.24)] = $720	
• [(1/2)($871)] = $436	436
Total Before Payments	$1,307
Payments For Personal Use [($50)(9)]	(450)
Taxable Benefit	$ 857

Note Two The $1,650 in benefits received must be included in income as Mr. Kern's employer has contributed to the plan. However, this benefit is reduced by the $350 [(2)($175)] in total contributions that he has made in 2009 and 2010.

Note Three Other items and the reasons for their exclusion would be as follows:

- The CPP and EI amounts generate tax credits, but are not deductible.
- The contributions to the group disability plan are not deductible, but can be applied against taxable benefits received under the plan. The employer's contributions to this plan are not a taxable benefit.
- Any income tax withheld is not deductible.
- Although Mr. Kern would qualify for the deduction of one-half of the stock option benefit under ITA 110(1)(d), it is a deduction from Taxable Income and would not affect the calculation of net employment income.

TIF Solution Three - 8

Mrs. Smiles' net employment income for the year would be calculated as follows:

Gross Salary	$53,000
Commissions	34,500
Registered Pension Plan Contributions	(3,200)
Contributions To Group Disability Plan (Note One)	Nil
Disability Insurance Benefit (Note One)	2,178
Automobile Benefit (Note Two)	1,222
Loan Benefit (Note Three)	252
Stock Option Benefit (Note Four)	Nil
Reimbursed Travel Costs (Note Five)	Nil
Net Employment Income	$87,952

Note One The contributions to the group disability plan are not deductible, but can be applied against the $2,650 received under the plan during the year. The employer's contributions to this plan are not a taxable benefit. The $2,650 in benefits received must be included in income as Mrs. Smiles' employer has contributed to the plan. However, this benefit can be reduced by the $472 [(2)($236)] in total contributions that she has made in 2009 and 2010.

Note Two Based on the fact that Mrs. Smiles' employment related usage is more than 50 percent, the automobile benefit is calculated as follows:

Standby Charge [(2/3)(12)($1,220 - $127)(10/12)(4,000/16,670)]	$1,748
Operating Cost Benefit - Lesser Of:	
• [(4,000)($0.24)] = $960	
• [(1/2)($1,748)] = $874	874
Total Before Payments	$2,622
Payments For Personal Use	(1,400)
Taxable Benefit	$1,222

Note Three The benefit on the low interest loan would be calculated as follows:

[($50,000)(2% - 1%)(184 ÷ 365)] = $252

Or

[($50,000)(2% - 1%)(2/4)] = $250

Note Four As a Canadian controlled private corporation is involved and she is still holding the shares, Mrs. Smiles does not recognize an employment income inclusion in 2010.

Note Five Since all of her travel and entertainment costs were reimbursed based on actual receipts, there is no effect on her income. Her employer will have to apply the 50 percent limit on meals and entertainment to the reimbursed costs.

TIF Solution Three - 9

Mr. Jones' net employment income would be calculated as follows:

Salary			$25,800
Taxable Benefit From Fishing Trip			2,450
Commission Income			
Sales Commissions		$47,700	
Deductions:			
Airline Tickets	($2,350)		
Office Supplies	(415)		
Client Entertainment [(50%)($1,750)]	(875)		
CCA (Note 1)	(2,520)		
Operating Costs (Note 2)	(5,040)	(11,200)	36,500
Net Employment Income			$64,750

Notes:

1. The deductible capital cost allowance on the car would be calculated as follows:

Full Capital Cost Allowance	$ 3,600
Employment Related Usage Proportion (35,000/50,000)	70%
Deductible Amount	$ 2,520

2. As the car was used 30 percent on personal matters, only 70 percent of the $7,200 in operating costs would be deductible.

3. The laptop computer is a capital expenditure and is not deductible as an expense. Since an employee cannot deduct CCA except for an automobile, musical instrument, or aircraft, the purchase of the laptop computer would not have any effect on either employment income or taxes payable.

4. The payment for Blue Cross would be eligible for the medical expenses tax credit, but would not be deductible in the calculation of net employment income. The life insurance premiums would not have any effect on either employment income or taxes payable.

5. Discounts for employees on merchandise normally sold by an employer are not generally considered to be a taxable benefit.

Chapter Four Test Item File Solutions

TIF Solution Four - 1

1. The home relocation loan deduction is available where an individual has, as a result of employment, received an interest free or low interest loan to acquire a dwelling for the purpose of relocating at least 40 kilometers closer to his work location. The amount of the deduction is the lesser of:
   - The amount of the loan related benefit that was included in the individual's employment income.
   - Interest calculated at the prescribed rate on a $25,000 loan.

2. An individual is assessed for income taxes for the entire taxation (calendar) year by the province in which he resides on December 31 of that year. Which province assesses income tax is a very important tax planning issue. Maximum provincial rates vary from 10 percent to 19.25 percent. In addition, the value of the personal tax credits varies between the provinces. Clearly, what province an individual is taxed in can make a great deal of difference with respect to the amount of income taxes that will be paid.

3. An individual's spouse is a person to whom that individual is legally married. Depending on the province, legal marriage may be limited to couples of opposite sex or, alternatively, open to persons of the same sex. A common-law partner is an individual who is not a spouse and who cohabits in a conjugal relationship with the taxpayer and (a) has so cohabited with the taxpayer for a continuous period of at least one year, or (b) is a parent of a child of whom the taxpayer is a parent. Without regard to the province, common-law partners may be of either the same sex or of the opposite sex.

4. In order to claim this deduction, the taxpayer must be a person who is unmarried, does not have a common-law partner, or is separated. The claim must be for an individual who is living with the taxpayer in a self-contained domestic establishment. Further, the dependant has to be under 18 at any time during the year, the taxpayer's parent or grandparent, or mentally or physically infirm. The dependent must be related by blood, marriage, common-law partnership or adoption, and must be wholly dependent on the taxpayer for support. Note that, except in the case of the taxpayer's child, the dependant must be a resident of Canada.

5. In general, both credits require the qualifying individual to be mentally or physically infirm. The first factor that must be considered is whether the dependant lives with the taxpayer in the taxpayer's self-contained domestic establishment. If the dependant does not live with the taxpayer, the caregiver credit is not available.

   If the dependant lives with the taxpayer, the next factor relates to eligibility. To qualify for the caregiver credit, the individual must be mentally or physically infirm unless the dependant is a parent or grandparent over the age of 64.

   If the dependant qualifies for both credits, ITA 118(4)(d) indicates that, if a taxpayer is entitled to the caregiver credit for a particular individual, that individual is deemed not to be a dependant for purposes of the infirm dependant over 17 credit. In these circumstances, the infirm dependant credit cannot be used.

6. The likely reason is the belief that limiting this tax credit to the low federal rate of 15 percent would discourage large donations by high income individuals. Stated alternatively, it appears that policy makers believed that the use of the high 29 percent rate was necessary in order to encourage high tax bracket individuals to continue making significant donations.

7. In general, the medical expense credit should be claimed by the lower income spouse. This is because the amount of medical expenses must be reduced by the lesser of $2,024 and 3 percent of the individual's income. This figure will generally be lower for the lower income spouse. Exceptions to this general rule are:
   - If both spouses have income such that 3 percent exceeds the $2,024 threshold, it does not matter which spouse claims the credit.
   - If the lower income spouse does not have sufficient Tax Payable to use the medical expense tax credit, it should be claimed by the higher income spouse.

8. The credits that can be transferred to a spouse or common-law partner are the:
   - age credit,
   - disability credit,
   - pension income credit,
   - tuition fee credit,
   - education credit, and
   - textbook credit.

9. Non-refundable tax credits can only be used against the individual's Tax Payable (or in some cases, transferred to another individual). Alternatively, if a credit is refundable, the government will pay the individual for any amount of the credit that cannot be applied against Tax Payable. If the individual has no Tax Payable, the entire amount of the credit will be paid to the individual.

10. For 2010, the OAS clawback claims 15 percent of each dollar of income in excess of $66,733. At this income level, the individual is already subject to a federal marginal tax rate of 22 percent. In effect, the clawback represents an additional 15 percentage points of taxation, resulting in an overall federal rate of 37 percent. When combined with an average provincial rate, this pushes the overall rate for these individuals to well over 50 percent.

TIF Solution Four - 2

1. False. They are included in Net Income For Tax Purposes and deducted in the determination of Taxable Income.

2. True.

3. False. Provincial income taxes are calculated as a percent of Taxable Income.

4. False. Not all of the base figures are indexed (e.g., the pension income credit base) and the charitable donations credit can be at 29 percent.

5. True. While the credit is usually only available for a resident related dependant, an exception is made for the child of an individual.

6. True. ITA 118(8) specifically excludes Canada Pension Plan payments from eligibility for this credit.

7. True. This will avoid double counting the 3 percent of income limit.

8. False. The combined transfer is limited to $5,000 multiplied by the appropriate percentage.

9. False. She is eligible for a federal political contributions tax credit of $350 [(3/4)($400) + (1/2)($100)].

10. False. The federal political contributions tax credit is deductible against federal Tax Payable.

TIF Solution Four - 3

1. E. No change. This would be calculated as follows:

Employment Income Benefit [($50,000)(4% - 3%)(6/12)]	$250
Home Relocation Deduction - Lesser Of:	
• [($25,000)(4%)(6/12)] = $500	
• Benefit = $250	(250)
Net Addition To Taxable Income	$ Nil

2. A. The benefit on a home purchase loan is based on the lesser of the prescribed rate at the time of the advance and the prescribed rate at the time the loan is outstanding, in this case, 5 percent. A deduction from Taxable Income equal to the benefit on up to $25,000 ($1,250 in this case) is available for a "home relocation loan." Therefore, the increase in Mr. Jones' Taxable Income in 2010 due to this loan is $8,750 [($200,000)(5%) - $1,250].

3. D. Pension income amount.

4. B. They reduce tax by the same amount regardless of a taxpayer's marginal tax rate.

5. C. The child must be a resident of Canada.

6. C. A person may claim 75% of his or her Net Income For Tax Purposes in charitable donations for a single year ($90,000 in this case). The donation credit is 15% of the first $200, plus 29% of the excess, for a total of $26,072.

7. C. Only expenses in excess of a specified amount are eligible for a tax credit.

8. D. All of the above.

9. D. The EI and CPP credits.

10. B. Contributions made to a candidate at the time of a federal general election are eligible.

11. C. Net Income $35,000, Taxable Income $25,000.

TIF Solution Four - 4

Exam Exercise Solution Four - 1

The effect of this loan on Ms. Rossi's Taxable Income would be calculated as follows:

Employee Benefit [($78,000)(5% - 1%)]	$3,120
Housing Loan Deduction [($25,000)(5%)]	(1,250)
Addition To Taxable Income	$1,870

Exam Exercise Solution Four - 2

The required Tax Payable would be calculated as follows:

Federal Tax Payable:	
On First $40,970	$6,146
On Next $12,205 ($53,175 - $40,970) At 22 Percent	2,685
Federal Tax Payable Before Credits	$8,831

Exam Exercise Solution Four - 3

The required amount would be calculated as follows:

Basic Personal Amount	$ 10,382
Spousal ($10,382 - $5,800)	4,582
Credit Base	$14,964
Rate	15%
Total Credits	$ 2,245

Exam Exercise Solution Four - 4

Gerrard would be entitled to a caregiver tax credit in the amount of $532 {[15%][$4,223 - ($15,100 - $14,422)]}.

Exam Exercise Solution Four - 5

Margo would be entitled to an infirm dependant over 17 tax credit in the amount of $550 {[15%][$4,223 - ($6,550 - $5,992)]}. She could not claim the caregiver credit as her son does not live with her.

Exam Exercise Solution Four - 6

As Ms. Cox is eligible for the eligible dependant credit, she could not take the caregiver tax credit. Given this she would first determine the amount of the eligible dependant credit as follows:

(15%)($10,382 - $7,675) = $406

As her father's income is below the $14,422 threshold for the caregiver credit, in the absence of ITA 118(4)(c), she would have been eligible for $633, the full amount of the caregiver credit. This means that she will have an additional credit under ITA 118(1)(e) of $227 ($633 - $406). The combination of the eligible dependant credit and the ITA 118(1)(e) credit totals $633, the maximum caregiver credit.

Exam Exercise Solution Four - 7

ITA 118(4)(d) indicates that, if a taxpayer is entitled to the caregiver credit for a particular individual, the taxpayer cannot claim the infirm dependant over 17 credit for that individual. As her investment income is below the income threshold for the caregiver tax credit, the caregiver tax credit for Toshiro's daughter would be calculated as follows:

[(15%)($4,223 - Nil)] = $633

Exam Exercise Solution Four - 8

His tax credits would be as follows:

Basic Personal Amount	$ 10,382
Amount For An Eligible Dependant (Daughter)	10,382
Child (Son)	2,101
Credit Base	$22,865
Rate	15%
Total Credits	$ 3,430

As Mr. Foret is entitled to claim his daughter as an eligible dependant, he cannot take the caregiver or infirm dependant over 17 tax credit for her. He does not have the option to claim his son as an eligible dependant and claim the caregiver credit for his daughter. Since he is entitled to claim her as an eligible dependant, he cannot claim the caregiver credit instead.

Exam Exercise Solution Four - 9

Ms. Burns' age credit would be $649 {[15%][$6,446 - (15%)($46,642 - $32,506)]}.

Exam Exercise Solution Four - 10

The adoption expenses tax credit would be calculated as follows:

Cost Of Second France Trip	$ 6,280
French Orphanage Fee	1,759
Canadian Adoption Agency Fee	5,600
Legal Fees	3,250
Total Eligible Expenses	$16,889

The first trip to France is not eligible for the credit as it was incurred before the adoption period. While the additional medical expenses will likely be available for a medical expenses tax credit, they are not eligible for the adoption expenses credit.

Since the employer reimbursement is a taxable benefit and included in employment income, it does not reduce the total eligible adoption expenses.

As the total eligible expenses exceed the maximum of $10,975, the credit is limited to $1,646 [(15%)($10,975)].

Exam Exercise Solution Four - 11

The credit base for 2010 would be limited to $52,800 [(75%)($70,400)]. However, he chooses to claim $15,000, leaving a carry forward of $105,000 ($120,000 - $15,000). The resulting credit would be:

$200 At 15 Percent	$ 30
$14,800 ($15,000 - $200) At 29 Percent	4,292
Total Credit	$4,322

As his income for 2011 is unchanged from 2010, the limit would be the same $52,800 [(75%)($70,400)]. Charitable donations can be carried forward for up to 5 years. As a result, the final year to claim any unused portion of his 2010 donation would be 2015.

Exam Exercise Solution Four - 12

The required calculation is as follows:

Amount B Expenses For Samuel And Spouse	$2,842
Amount C	
Lesser Of:	
• [(3%)($125,000)] = $3,750	
• 2010 Threshold Amount = $2,024	(2,024)
Subtotal	$ 818
Amount D	
Son - Lesser Of:	
• [$7,780 - (3%)($8,675)]* = $7,520	
• Absolute Limit = $10,000	7,520
Allowable Amount Of Medical Expenses	$8,338
Amount A The Appropriate Rate	15%
Medical Expense Tax Credit	$1,251

* [(3%)($8,675)] = $260, less than the $2,024 limit.

Exam Exercise Solution Four - 13

The regular medical expense credit would be calculated as follows:

Medical Expenses	$10,325
Lesser Of:	
• [(3%)($28,248)] = $847	
• 2010 Threshold Amount = $2,024	(847)
Allowable Amount Of Medical Expenses	$ 9,478

The refundable supplement would be calculated as follows:

Lesser Of:	
• $1,074 (2010 Maximum)	
• [(25%)($9,478)] = $2,370	$1,074
Reduction [(5%)($28,248 - $23,775)]	(224)
Refundable Medical Expense Supplement	$ 850

Mr. Mackey's total Tax Payable would be calculated as follows:

Tax Payable Before Credits [(15%)($28,248)]		$4,237
Non-Refundable Credits:		
Basic	$ 10,382	
Common-Law Partner	10,382	
Allowable Medical Expenses	9,478	
Total	$30,242	
Rate	15%	(4,536)
Tax Before Refundable Supplement		Nil
Refundable Supplement		(850)
Tax Payable (Refund)		($ 850)

Exam Exercise Solution Four - 14

Lorraine has sufficient other medical expenses to exceed the 3 percent threshold. Her income is too high to qualify for the refundable medical expense supplement. As Marie has no income, the regular disability credit can be transferred to Lorraine. However, as Marie is over 17, the disability supplement is not available.

In addition to the disability credit, Lorraine will be able to take the caregiver credit, as well as a credit for all of Marie's medical expenses since they are less than the $10,000 maximum. The total credits related to Marie would be as follows:

Disability - Regular Amount	$ 7,239
Caregiver	4,223
Marie's Medical Expenses - Lesser Of:	
• ($9,850 - Nil) = $9,850	
• Absolute Limit = $10,000	9,850
Total Credit Base	$21,312
Rate	15%
Total Credits Related To Marie	$ 3,197

Exam Exercise Solution Four - 15

Mr. Balmer's education related tax credits would be calculated as follows:

Tuition Amount:		
Total	$4,100	
Ineligible Ancillary Fees ($415 - $250)	(165)	$3,935
Education Amount:		
Full Time [(5)($400)]		2,000
Part Time [(3)($120)]		360
Textbook Amount:		
Full Time [(5)($65)]		325
Part Time [(3)($20)]		60
Interest On Student Loan		417
Total Credit Base		$7,097
Rate		15%
Total Available Credits		$1,065

Exam Exercise Solution Four - 16

The available education related credits for the year could be calculated as follows:

Tuition Amount	$ 5,650
Education Amount [(10)($400)]	4,000
Textbook Amount [(10)($65)]	650
Education Related Amounts From Current Year	$10,300
Rate	15%
Education Related Credits From Current Year	$ 1,545
Carry Forward Credit	525
Total Available Education Related Credits	$ 2,070

The alternative calculation approach that is used in the tax return would be as follows:

Education Related Amounts From Current Year (Preceding Calculation)	$10,300
Carry Forward Amount	3,500
Total Available Education Related Amounts	$13,800
Rate	15%
Total Available Education Related Credits	$ 2,070

Karl's Tax Payable before deducting education related credits would be $3,640 [(15%)($34,650 - $10,382)]. This is more than sufficient to absorb the available education related credits and, as a consequence, there would be no carry forward of credits.

Exam Exercise Solution Four - 17

The available education related credits for the year would be calculated as follows:

Tuition Amount	$26,800
Education And Textbook Amounts [(9)($400 + $65)]	4,185
Available Education Related Amounts (Maximum Transfer = $5,000)	$30,985
Rate	15%
Available Education Related Credits (Maximum Transfer = $750)	$ 4,648

Income Tax Act Approach The $750 maximum transfer of education related credits must be reduced by Betty's Tax Payable $210 [(15%)($11,785 - $10,382)]. This will leave a maximum transfer of $540 ($750 - $210) and a carry forward credit of $3,898 ($4,648 - $210 - $540).

Tax Return Approach The $5,000 maximum transfer of education related amounts must be reduced by $1,403 ($11,785 - $10,382), the excess of Betty's Taxable Income over her basic personal amount. This results in a maximum transfer of $3,597 ($5,000 - $1,403) and would leave a carry forward of $25,985 ($30,985 - $1,403 - $3,597). This would give the same $3,898 [($25,985)(15%)] credit as under the alternative calculation.

Exam Exercise Solution Four - 18

Her tax credits would be calculated as follows:

Basic Personal Amount	$ 10,382
Spousal Amount	10,382
Age [$6,446 - (15%)($53,500 - $32,506)]	3,297
Pension Income	2,000
Spousal Age Transfer	6,446
Spousal Tuition, Education, And Textbook Transfer - Lesser Of:	
• $5,000	
• [$3,450 + ($400)(3 Months) + ($65)(3 Months)] = $4,845	4,845
Credit Base	$37,352
Rate	15%
Total Credits	$ 5,603

Exam Exercise Solution Four - 19

Mr. Dion's $500 credit would be calculated as follows:

	Contributions	Credit Rate	Tax Credit
First	$400	3/4	$300
Next	350	1/2	175
Remaining	76	1/3	25
Maximum Credit	$826		$500

Exam Exercise Solution Four - 20

The credit will be $690 [(15%)($4,600)]. As her acquisition is less than the $5,000 maximum, the full cost is eligible for the 15 percent federal credit.

Exam Exercise Solution Four - 21

Mr. Clemens' income before deducting either the EI or OAS repayment would be calculated as follows:

Net Employment Income	$57,200
EI Benefits	9,460
OAS Benefits	6,200
Income Before Deductions	$72,860

Dealing first with the EI repayment, Mr. Clemens would have to repay $2,838 [(30%)($9,460)], which is the lesser of 30 percent of the EI benefits received and $5,658 [(30%)($72,860 - $54,000)]. The $54,000 is based on 1.25 times the maximum insurable earnings for 2010 of $43,200.

Using this deduction, the clawback of the OAS payments would be $493 [(15%)($72,860 - $2,838 - $66,733)]. As a result, his Net Income For Tax Purposes would be as follows:

Income Before Deductions	$72,860
ITA 60(v.1) Deduction (EI)	(2,838)
ITA 60(w) Deduction (OAS)	(493)
Net Income For Tax Purposes	$69,529

TIF Solution Four - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 9 (not 7)

B. 5 (not 1)

C. 3 (not 6)

D. 10 (not 2)

E. 8 (not 4)

TIF Solution Four - 6

The amount of the personal tax credits would be as follows:

1. **Mr. Hanson** will qualify for the following credit:

Basic Personal Amount	$10,382
Total Credit Base	$10,382
Rate	15%
Total Credits	$ 1,557

While his mother appears to be dependent, she is not a resident of Canada. The only non-residents who qualify for personal credits are a spouse and children. To be eligible for the caregiver credit, Mr. Hanson's mother would have to reside with him.

2. **Mr. Johnson** will qualify for the following credit:

Basic Personal Amount	$10,382
Spousal	Nil
EI (Maximum)	747
CPP (Maximum)	2,163
Canada Employment	1,051
Total Credit Base	$14,343
Rate	15%
Total Credits	$ 2,151

His wife's income will have to be considered for the entire year and, with her having a total of $30,000 ($27,500 + $2,500), the spousal credit will be eliminated.

3. **Mr. Massey** will qualify for the following credits:

Basic Personal Amount	$10,382
Spousal	10,382
Child [(2)($2,101)]	4,202
Total Credit Base	$24,966
Rate	15%
Total Credits	$ 3,745

4. **Mr. Jones** will qualify for the following credits:

Basic Personal Amount	$10,382
Spousal ($10,382 - $1,200)	9,182
Total Credit Base	$19,564
Rate	15%
Total Credits	$ 2,935

There is no personal tax credit available for his son.

5. **Ms. Morrison** will qualify for the following credits:

Basic Personal Amount	$10,382
Eligible Dependant (Either Child)	10,382
Child [(2)($2,101)]	4,202
Total Credit Base	$24,966
Rate	15%
Total Credits	$ 3,745

6. **Mr. Bagley** will qualify for the following credits:

Basic Personal Amount	$10,382
Spousal	10,382
Age	6,446
Pension	2,000
Spouse's Disability	7,239
Total Credit Base	$36,449
Rate	15%
Total Credits	$ 5,467

As Mr. Bagley's Net Income For Tax Purposes is less than $32,506, there will be no reduction in his age credit.

TIF Solution Four - 7

Mr. Kern's net employment income for the year would be calculated as follows:

Gross Salary	$67,600
Registered Pension Plan Contributions	(1,800)
Contributions To Group Disability Plan	Nil
Automobile Benefit (Note One)	857
Disability Insurance Benefit (Note Two)	1,300
Professional Dues	(1,233)
Stock Option Benefit [($83 - $75)(200)]	1,600
Net Employment Income	$68,324

Note One Based on the fact that Mr. Kern's employment related usage is more than 50 percent of total usage, the automobile benefit is calculated as follows:

Standby Charge [(2/3)(12)($815 - $89)(9/12)(3,000/15,003)]	$ 871
Operating Cost Benefit - Lesser Of:	
• [(3,000)($0.24)] = $720	
• [(1/2)($871)] = $436	436
Total Before Payments	$1,307
Payments For Personal Use [($50)(9)]	(450)
Taxable Benefit	$ 857

Note Two The $1,650 in benefits received must be included in income as Mr. Kern's employer has contributed to the plan. However, this benefit is reduced by the $350 [(2)($175)] in total contributions that he has made in 2009 and 2010.

Taxable Income

Taxable Income would be calculated as follows:

Net Income For Tax Purposes (Net Employment Income)	$68,324
Stock Option Deduction [(1/2)($1,600)]	(800)
Taxable Income	$67,524

Tax Payable

Tax Payable would be calculated as follows:

Tax On First $40,970		$ 6,146
Tax On Next $26,554 ($67,524 - $40,970) At 22 Percent		5,842
Federal Tax Before Credits		$11,988
Basic Personal Amount	($10,382)	
Spousal ($10,382 - $3,660)	(6,722)	
EI	(747)	
CPP	(2,163)	
Canada Employment	(1,051)	
Medical Expenses (Note Three)	(3,933)	
Transfer Of Tuition, Education and Textbook (Note Four)	(5,000)	
Credit Base	($29,998)	
Rate	15%	(4,500)
Charitable Donations [(15%)($200) + (29%)($500 - $200)]		(117)
Net Federal Tax		$ 7,371
Federal Amounts Withheld During Year		(11,200)
Federal Tax Payable (Refund)		($ 3,829)

Note Three The allowable medical expenses would be calculated as follows:

Samuel And Spouse Medical Expenses ($2,100 + $770)	$2,870
Lesser Of:	
• [(3%)($68,324)] = $2,050	
• 2010 Threshold Amount = $2,024	(2,024)
David's Medical Expense - Lesser Of:	
• $3,260 - (3%)($5,780) = $3,087	
• Absolute Limit = $10,000	3,087
Allowable Medical Expenses	$3,933

Note Four The transfer from David is as follows:

Tuition Fees	$ 6,700
Base For Education Credit [(8 Months)($400)]	3,200
Base For Textbook Credit [(8 Months)($65)]	520
Total Amount Available	$10,420
Maximum Transfer	(5,000)
Carry Forward (For David's Use Only)	$ 5,420

David's Tax Payable is completely eliminated by his basic personal credit. He can transfer a maximum of $5,000 of his education, tuition and textbook amounts to his father. The remaining $5,420 can be carried forward indefinitely, but must be used by David.

TIF Solution Four - 8

Part A

Ms. Van Horne's minimum Net Income For Tax Purposes would be calculated as follows:

Salary	$126,000
Add:	
Commissions	32,000
Bonus [(1/2)($25,000)]	12,500
Employer's Life Insurance Contribution	550
Automobile Benefit (Note 1)	2,237
Stock Option Benefit (Note 2)	30,000
Deduct:	
RPP Contributions	(7,400)
Employment Related Expenses (Note 3)	(17,700)
Net Income For Tax Purposes	$178,187

Note 1 The automobile benefit would be calculated as follows:

Standby Charge [(2/3)(12)($728 - $50)(11/12)(5,500 ÷ 18,337)]	$1,491
Operating Cost Benefit - Lesser Of:	
• [(1/2)($1,491)] = $746	
• [($0.24)(5,500)] = $1,320	746
Total Benefits	$2,237

As Ms. Van Horne's employment related use was more than 50 percent, there is a reduction in the standby charge and she can use the alternative calculation of the operating cost benefit.

Note 2 The employment income inclusion resulting from the exercise of the stock option is $30,000 [(5,000)($31 - $25)]. Subsequent to the March 4, 2010 budget, no amount of this total can be deferred.

Note 3 As Ms. Van Horne's commission income was $32,000, her deductible expenses are not limited by this constraint. They are calculated as follows:

Advertising	$5,600
Entertainment [(1/2)($9,000)]	4,500
Meals (reimbursed)	Nil
Hotels [(1/2)($8,400)]	4,200
Airline Tickets	3,400
Deductible Expenses	$17,700

Part B

Ms. Van Horne's minimum Taxable Income would be calculated as follows:

Net Income For Tax Purposes	$178,187
Stock Option Deduction [(1/2)($30,000)]	(15,000)
Taxable Income	$163,187

Part C

Based on the Taxable Income calculated in Part B, Ms. Van Horne's Tax Payable would be calculated as follows:

Tax On First $127,021		$26,880
Tax On Next $36,166 ($163,187 - $127,021) At 29 Percent		10,488
Tax Before Credits		$37,368
Credits:		
Basic Personal Amount	($10,382)	
Eligible Dependant - Son [($10,382 - $2,500)]	(7,882)	
Child [(2)($2,101)]	(4,202)	
Caregiver (Note 4)	(4,223)	
EI Premiums	(747)	
CPP Contributions	(2,163)	
Canada Employment	(1,051)	
Monthly Transit Passes [($45)(2)(9)]	(810)	
Transfer Of Tuition, Education and Textbook (Note 5)	(5,000)	
Medical Expenses (Note 6)	(4,006)	
Credit Base	($40,466)	
Rate	15%	(6,070)
Charitable Donations (Note 7)		(494)
Political Contributions (Note 8)		(525)
Federal Tax Payable		$30,279

Note 4 The father's income is below the threshold for the caregiver credit. This means that Ms. Van Horne can claim the full amount of the caregiver credit.

Note 5 The transfer from her daughter is as follows:

Tuition Fees	$ 7,000
Base For Education Credit [(8 Months)($400)]	3,200
Base For Textbook Credit [(8 Months)($65)]	520
Total Amount Available	$10,720
Maximum Transfer	(5,000)
Carry Forward (For Daughter's Use Only)	$ 5,720

Her daughter's Tax Payable is completely eliminated by her basic personal credit. She can transfer a maximum of $5,000 of her education, tuition and textbook amounts to her mother. The remaining $5,720 can be carried forward indefinitely, but must be used by her daughter.

Note 6 The base for Ms. Van Horne's medical expense credit can be calculated as follows:

Ms. Van Horne And Her Children ($850 + $1,480)	$2,330
Lesser Of:	
• [(3%)($178,187)] = $5,346	
• 2010 Threshold Amount = $2,024	(2,024)
Father's Medical Expenses - Lesser Of:	
• [$3,940 - (3%)($8,000)] = $3,700	
• Absolute Limit = $10,000	3,700
Allowable Medical Costs	$4,006

Note 7 The donations credit is equal to $494 [(15%)($200) + (29%)($1,800 - $200)].

Note 8 The credit for the $900 in political contributions is calculated as follows:

Three-Quarters Of First $400	$300
One-Half Of Next $350	175
One-Third Of Next $150 ($900 - $400 - $350)	50
Total Credit	$525

Chapter Five Test Item File Solutions

TIF Solution Five - 1

1. The capital cost of an asset for tax purposes would, in many cases, contain all of the same costs that were recorded for accounting purposes. However, there may be differences and some of them are caused by the factors described below:

   Automobiles Costing More Than $30,000 For tax purposes, the deductible cost of automobiles is limited to $30,000, exclusive of GST/HST/PST. For accounting purposes, there is no similar restriction and the capital cost would be the acquisition cost.

   Government Assistance Under the provisions of ITA 13(7.1), government grants to assist in the acquisition of capital assets must be deducted from the capital cost of the assets acquired. Under Section 3800 of the *CICA Handbook,* such assistance can either be deducted as per the tax procedures or treated as a deferred charge.

   Capitalization Of Interest While the *CICA Handbook* says little on the question of capitalizing the interest cost on money borrowed to acquire assets, it is uncommon for such amounts to be included in accounting asset values. In contrast, ITA 21 allows an election to capitalize interest costs if a taxpayer so desires.

   Property Acquired In Non-Arm's Length Transactions When an asset is acquired in a non-arm's length transaction, the general provisions of the *Income Tax Act* require that it be recorded at its fair market value without regard to the actual transfer price used. For accounting purposes, the transfer price would be used and, if that amount was different than the fair market value, a significant difference between the accounting and tax values could arise.

2. The basic similarity between amortization and CCA procedures is that both are directed towards allocating the cost of a depreciable asset to periods of time subsequent to the year in which the asset is acquired. Even here, however, we find a difference. Amortization procedures require that this allocation period be the useful life of the asset. In contrast, CCA procedures often use periods that are longer or shorter than the life of the asset. For example, CCA procedures allocate the cost of some Class 12 assets to one year, even though the assets last considerably longer. Alternatively, the period of write-off for Class 8 assets is infinite.

   The objectives of amortization and CCA procedures are different in that amortization procedures attempt to match amortization expense with the related revenues in order to present fairly the results of operations of the enterprise. In contrast, CCA is usually calculated in such a fashion as to minimize Tax Payable.

   As far as methods are concerned, CCA procedures are limited to the use of straight line or declining balance methods with the added complication of the first year one-half rules. Which of these methods is to be used is specified for various types of assets in the *Income Tax Regulations*. In contrast, amortization calculations can use a much wider range of methods and, in addition, the accountant has complete discretion as to the choice of methods for particular types of assets.

   A final difference is in the application of the methods chosen. The CCA rules determine the maximum amount that will be allowed as a deduction for each class. If an enterprise wishes to minimize a business loss by taking less or no CCA in a particular period, there is no prohibition against deducting less than the maximum CCA. In contrast, accounting amortization must determine the amount to be deducted on a consistent basis from year to year, without being influenced by the level of income being experienced by the enterprise.

3. Mistakes in allocating assets to the appropriate CCA class can result in the unnecessary payment of additional tax. For example, if a $100,000 asset is allocated to Class 1 (4 percent declining balance CCA) when it should have been allocated to Class 43 (30 percent declining balance CCA), the CCA deduction would be $4,000 as opposed to the $30,000 that would have been available if the appropriate class had been used.

4. The CCA rate applicable to a particular type of asset can be changed by either changing the rate for the class where the type of asset is allocated, or by allocating that type of asset to a different class that has the desired new rate. In general, the latter approach is preferable for two reasons:

   - As most classes contain a variety of asset types, changing the rate for the class will change the rate for assets other than the type on which the rate change is desired.
   - Changing the rate for the class will require the new rate to be used on all of the assets in the class, including assets that were acquired prior to the change. This type of retroactive change is thought by many to be unfair, in that taxpayers made various economic decisions based on the applicability of the old rate.

5. In years in which a taxpayer deducts less than maximum CCA, the CCA that is deducted should usually be taken from the class or classes with the lowest rates. The reason for this is that taking the deduction from a low rate class will leave a larger balance(s) in high rate classes. As a consequence, the application of these higher rates will result in a larger maximum CCA deduction in future years. An exception to this rule could be appropriate if Class 10.1 is available as there is no recapture for Class 10.1.

6. The procedures to be used under generally accepted accounting principles are straightforward. The net book value of the individual asset being retired is compared to the sale proceeds. If the sale proceeds exceed the net book value, a gain is recorded. Alternatively, if the sale proceeds are less than the net book value, a loss is included in the current year's income.

   The tax procedures involve a more complex range of outcomes. In general, the proceeds of disposition, up to a maximum of the capital cost of the asset, will be deducted from the CCA class for the asset involved (note that, unlike the situation in the accounting records, tax procedures generally focus on a class of assets, rather than on individual assets). If the proceeds do not exceed the capital cost, if the asset is not the last asset in its class, and if the deduction of the proceeds does not create a negative balance in the class, the retirement's only tax effect will be the reduction of future CCA resulting from a lower UCC balance after the disposition. However, there are several other possibilities that can be described as follows:

   Proceeds Exceed Capital Cost If the proceeds exceed the capital cost of the asset, the excess will be a capital gain, one-half of which will be a taxable capital gain.

   Last Asset In The Class If the asset retired is the last asset in the class and subsequent to the deduction of the proceeds of sale there is still a UCC balance in the class, this amount is a terminal loss and must be deducted in the year of the retirement.

   Negative Balance In The Class If the deduction of the proceeds creates a negative balance in a class at the end of the taxation year, regardless of whether the asset was the last asset in the class, the deficiency is referred to as recapture of CCA. The entire amount must be included in the current year's Taxable Income, a process that will restore the UCC balance for the class to nil.

7. If the photocopier is allocated to either the aggregate Class 8 or a separate Class 8, it will be subject to CCA at a 20 percent rate, even if its expected life is very short (e.g., two or three years). The difference is that, if it is disposed of for a value that is significantly less than its cost less CCA to the disposal date, putting the photocopier in a separate Class 8 will allow the taxpayer to deduct a terminal loss on the disposition. Alternatively, if it is allocated to the aggregate Class 8, it is likely that other assets will remain in the aggregate Class 8 and/or a new photocopier will be added to the class prior to the end of the year. This means that, despite an economic loss on the disposition of the photocopier, no terminal loss can be recognized for tax purposes.

8. As defined in IT-123R6, eligible capital property consists of intangible capital property which neither qualifies for capital cost allowance, nor is deductible in the year of its acquisition. Examples would include goodwill, purchased customer lists, the cost of licenses with unlimited lives, expenses of incorporation, and the cost of certain government rights.

TIF Solution Five - 2

1. True. Capital cost allowance is analogous to the accounting term amortization and allocates the cost of the capital asset to current and subsequent taxation years.

2. True. Undepreciated capital cost is decreased by government assistance received to acquire assets and increased by acquisitions of depreciable assets.

3. False. The method for calculating capital cost allowance for each class is specified in the *Income Tax Regulations*.

4. False. The maximum CCA for its fiscal year ending June 30, 2010 is [($50,000)(20%)(1/2)(181/365)] = $2,479.

5. True. If the patent is left in Class 44, it will be subject to 25 percent declining balance CCA. Alternatively, in Class 14, it can be written off on a straight-line basis over its legal life. If the patent is near the end of its life, this will provide larger deductions than the 25 percent rate applicable to Class 44.

6. False. The election should be used when the photocopiers are retired after relatively short periods as it provides for recognition of the terminal losses which would arise in such situations.

7. True. Recapture of CCA occurs when there is a negative balance in the class at the end of the year.

8. False. Cumulative eligible capital is amortized at a maximum rate of 7 percent, calculated on a declining balance basis.

9. False. The maximum CEC amount that can be deducted for tax purposes for the year is [($60,000)(3/4)(7%)] = $3,150. The half-year rule does not apply.

TIF Solution Five - 3

1. Solutions for the various parts of Question 1 are as follows:

Part A E. $18,000 [20%][$80,000 + (1/2)($20,000)].

Part B J. $60,800 [$80,000 - $4,000 - (20%)($80,000 - $4,000)].

Part C C. $13,000 [(20%)($80,000 - $15,000)].

Part D I. $52,000 [$80,000 - $15,000 - (20%)($80,000 - $15,000)].

Part E A. $10,000 [(20%)($80,000 - $90,000 + $60,000)].

Part F P. Recapture of $10,000.

Part G R. $10,000 terminal loss.

Part H V. $10,000 capital gain.

Part I F. $19,000 [20%][$80,000 - $70,000 + $100,000 - (1/2)($100,000 - $70,000)].

Part J O. $91,000 ($80,000 - $70,000 + $100,000 - $19,000 CCA).

2. C. All of the items would be included in the capital cost except C, fire and theft insurance paid for coverage of the asset. Such amounts would be considered a deductible item in the taxation year covered by the policy.

3. C. To minimize the subsequent year's taxes, the business should claim maximum CCA on Class 8 and Class 12. This will give a $5,000 unused business loss that can be carried forward to the subsequent year.

4. A. The maximum is limited to the lesser of cost divided by the initial lease term plus one renewal ($45,000 ÷ 4), and cost divided by five years ($45,000 ÷ 5). The resulting $9,000 is subject to the first year rules, giving a maximum deduction of $4,500.

5. B. $396, the franchise is Class 14 [($70,000 ÷ 15)(31/365)].

6. D. $125,000 x 4% = $5,000. The half-year rule does not apply to an acquisition from a non-arm's length party provided that the property was depreciable property of the prior owner for at least 364 days prior to the transfer. As well, properties transferred between non-arm's length persons retain the CCA class in which they were included by the vendor.

7. B. The equipment falls under Class 8, with CCA of 20%. Taking into account the half-year rule and the short fiscal year, the CCA is $1,336.99 [($40,000)(20%)(1/2)(122/365)].

8. A. Robert has recapture of $44,000 [($320,000 - $80,000) - $196,000]. The capital gain on the sale of the total property is $200,000 which makes D wrong.

9. A. Sherry has a terminal loss of $8,000 ($168,000 - $160,000).

10. A. All of the items would be considered to be eligible capital expenditures except A, the cost of fines and penalties.

TIF Solution Five - 4

Exam Exercise Solution Five - 1

CCA should have been $43,700 [($437,000)(1/2)(20%)]. The amount recorded was $8,740 [($437,000)(1/2)(4%)]. This error understated deductions and overstated income by $34,960 ($43,700 - $8,740).

Exam Exercise Solution Five - 2

The maximum 2010 CCA of $139,875 and the January 1, 2011 UCC balance of $339,625 would be calculated as follows:

January 1, 2010 UCC Balance		$453,000
Add: Additions	$63,200	
Deduct: Dispositions	(36,700)	26,500
Deduct: One-Half Net Additions [(1/2)($26,500)]		(13,250)
CCA Base		$466,250
CCA [(30%)($466,250)]		(139,875)
Add: One-Half Net Additions		13,250
January 1, 2011 UCC Balance		$339,625

Exam Exercise Solution Five - 3

The maximum CCA for the year is $9,431.51 [(30%)($150,000)(1/2)(153/365)].

Exam Exercise Solution Five - 4

Following the rule that, when less than the maximum CCA is to be deducted, the amounts deducted should be taken from the Class(es) with the lowest rates, the required calculations would be as follows:

Required Total		$40,000
Maximum CCA - Class 1 [(4%)($475,000)]	($19,000)	
Maximum CCA - Class 8 [(20%)($95,000)]	(19,000)	(38,000)
Required Balance		$ 2,000

As they are both 30 percent declining balance classes, the remaining $2,000 could be taken from either Class 10 or Class 10.1. It would be advisable to use Class 10.1, as recapture is not recorded for this class. In addition, if the Class 10.1 vehicle is going to be disposed of in the near future, it could be better tax planning to take the maximum CCA for Class 10.1 of $7,800 [(30%)($26,000)] and reduce the Class 8 CCA to $13,200 ($40,000 - $7,800 - $19,000). Since there is no recapture for Class 10.1, this could increase future deductions of the other classes. Whether this would be advantageous would depend on the anticipated proceeds of disposition.

Exam Exercise Solution Five - 5

The lesser of the asset's cost ($7,500) and the proceeds from its disposition ($7,950) will be subtracted from the UCC of the class. This results in fully taxable recapture of CCA of $77 ($7,423 - $7,500). The recapture of $77 is also added to the UCC balance resulting in a January 1, 2011 UCC balance of nil. While there will also be a taxable capital gain of $225 [(1/2)($7,950 - $7,500)], this amount is not part of net business income.

Exam Exercise Solution Five - 6

As there is a positive balance in the class at the end of the year, but no remaining assets, there would be a fully deductible terminal loss of $14,972 ($56,472 - $41,500). The terminal loss of $14,972 is also deducted from the UCC balance resulting in a January 1, 2011 UCC balance of nil.

Exam Exercise Solution Five - 7

Photocopiers would be included in Class 8, a 20 percent declining balance class. The following table compares the CCA if no election is made with the results if the separate class election is made.

	No Election 5 Copiers	With Election 2 Copiers	With Election 3 Copiers
January Acquisitions @ $5,500	$27,500	$11,000	$16,500
Dispositions	(4,000)	(4,000)	N/A
Terminal Loss		$ 7,000	
December Acquisitions @ $6,000	12,000	$12,000	
One-Half Net Additions	(17,750)	(6,000)	(8,250)
Base Amount For CCA Claim	$17,750	$ 6,000	$ 8,250
Class 8 CCA Rate	20%	20%	20%
CCA	$ 3,550	$ 1,200	$ 1,650

If no election is made, there will be a deduction for CCA of $3,550. Alternatively, if each machine is allocated to a separate class, there will be a deduction for CCA of $2,850 ($1,200 + $1,650). In addition, there will be a terminal loss of $7,000. The use of the election increases the total deductible amount by $6,300 ($2,850 + $7,000 - $3,550).

Exam Exercise Solution Five - 8

The income inclusion can be calculated as follows:

	CEC Balance	CEC Deductions
2008 CEC Addition [(3/4)($123,000)]	$92,250	
CEC Amount At 7 Percent	(6,458)	$ 6,458
Balance January 1, 2009	$85,792	
CEC Amount At 7 Percent	(6,005)	6,005
Balance January 1, 2010	$79,787	
Proceeds From Sale [(3/4)($118,200)]	(88,650)	
Balance After Sale	($ 8,863)	$12,463

The negative balance in the CEC account after the sale is less than the total of the CEC deductions in the past two years ($12,463). As a result, the entire $8,863 will be included in income in 2010.

TIF Solution Five - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 8 (not 5)

B. 7 (not 4)

C. 10 (not 2)

D. 6 (not 9)

E. 3 (not 1)

TIF Solution Five - 6

Part A

The maximum CCA for 2008, 2009, and 2010, would be calculated as in the following schedules:

2008	Class 1 6 Percent*	Class 10 30 Percent	Class 8 20 Percent
Opening Balance	Nil	Nil	Nil
Additions	$180,000	$150,000	$48,000
One-Half Net Additions	(90,000)	(75,000)	(24,000)
CCA Base	$ 90,000	$ 75,000	$24,000
Maximum CCA [(275 ÷ 365) For Short Fiscal Period]	(4,068)	(16,952)	(3,616)
One-Half Net Additions	90,000	75,000	24,000
January 1, 2009 UCC	$175,932	$133,048	$44,384

*As the Class 1 building is being used 100 percent for non-residential purposes, it would qualify for the additional 2 percent CCA allowance.

The total maximum CCA for 2008 would be $24,636.

2009	Class 1 6 Percent	Class 10 30 Percent	Class 8 20 Percent
Beginning UCC	$175,932	$133,048	$44,384
Additions	Nil	72,000	Nil
Dispositions - Lesser Of:			
Capital Cost = $75,000			
Proceeds = $42,000	Nil	(42,000)	Nil
One-Half Net Additions	Nil	(15,000)	Nil
CCA Base	$175,932	$148,048	$44,384
Maximum CCA	(10,556)	(44,414)	(8,877)
One-Half Net Additions	Nil	15,000	Nil
January 1, 2010 UCC	$165,376	$118,634	$35,507

The total maximum CCA for 2009 would be $63,847.

2010	Class 1 6 Percent	Class 10 30 Percent	Class 10.1 30 Percent	Class 8 20 Percent
Beginning UCC	$165,376	$118,634	Nil	$35,507
Additions (Class Maximum)	Nil	Nil	$30,000	Nil
Dispositions - Lesser Of:				
Capital Cost = $25,000				
Proceeds = $27,000	Nil	(25,000)	Nil	Nil
One-Half Net Additions	Nil	Nil	(15,000)	Nil
Balance	$165,376	$ 93,634	$15,000	$35,507
Maximum CCA	(9,923)	(28,090)	(4,500)	(7,101)
One-Half Net Additions	Nil	Nil	15,000	Nil
January 1, 2011 UCC	$155,453	$ 65,544	$25,500	$28,406

The total maximum CCA for 2010 would be $49,614.

Part B

The tax effects of the unusual events would be as follows:

Theft Of Equipment This is, in effect, a disposition with nil proceeds. There will be no immediate tax effect as the equipment is not the last asset in the class.

Insurance Deductible The $7,770 in insurance proceeds would be included in income [ITA 12(1)(f)], and the full repair expenses of $8,270 would be a deductible expense. This results in the $500 in repairs that were not covered under the Company's insurance policy being deducted as a repair or maintenance charge.

Car Sale As the car was sold for $2,000 more than its capital cost, there would be a capital gain of $2,000, resulting in a taxable capital gain of $1,000 [(1/2)($2,000)]. However, as there is still a balance in the class at the end of the year, no recapture would be recorded.

TIF Solution Five - 7

Part A

The required calculation of the maximum CCA is as follows:

	Class 1	Class 8	Class 10
Opening Balance	$2,597,000	$718,000	$524,000
Additions	Nil	Nil	374,000
Proceeds Of Disposition	Nil	Nil	(234,000)
One-Half Net Additions	Nil	Nil	(70,000)
CCA Base	$2,597,000	$718,000	$594,000
CCA Rate	4%	20%	30%
Maximum CCA	$ 103,880	$143,600	$178,200

This gives a maximum amount for CCA of $425,680 for the taxation year.

Part B

Since the Company only has Net and Taxable Income before CCA of $328,000 and the problem states that loss carry overs should not be considered, maximum CCA would not be deducted as this would produce a loss. Only $328,000 in CCA should be taken in order to reduce the Taxable Income to nil.

Given that the CCA deduction is limited to $328,000, it would normally be deducted in the class or classes with the lowest rates. This would leave the unused amounts in classes with higher rates which, in turn, would maximize the amount that could be deducted in the first profitable years. Taking this approach, the $328,000 would be deducted as follows:

Class 1 (Maximum Available)	$103,880
Class 8 (Maximum Available)	143,600
Class 10 (Required Balance)	80,520
Total CCA	$328,000

This CCA deduction would reduce Taxable Income to nil.

TIF Solution Five - 8

Furniture - Class 8

The tax consequences of the sale of furniture can be analyzed as follows:

Opening UCC Balance	$24,000
Dispositions - Lesser Of:	
• Capital Cost = $52,000	
• Proceeds Of Disposition = $36,000	(36,000)
Recaptured CCA	($12,000)

There would be no Class 8 CCA for 2010 as the CCA base is nil. The recapture would be added back to the Class 8 UCC, resulting in a January 1, 2011 Class 8 UCC of nil.

Old Buildings - Class 1

CCA on the old Class 1 Buildings would be calculated as follows:

Opening UCC Balance	$562,000
Dispositions - Lesser Of:	
• Capital Cost = $135,000 ($335,000 - $200,000)	
• Proceeds Of Disposition = $152,000 ($352,000 - $200,000)	(135,000)
Amount Subject To CCA	$427,000
2010 CCA [(4%)($427,000)]	(17,080)
January 1, 2011 UCC Balance	$409,920

In addition, the sale of the building would result in a taxable capital gain that would be calculated as follows:

Proceeds Of Disposition ($352,000 - $200,000)	$152,000
Capital Cost ($335,000 - $200,000)	(135,000)
Capital Gain	$ 17,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 8,500

New Building - Class 1

As the new building is used 100 percent for non-residential purposes and has been allocated to a separate Class 1, it is eligible for CCA at a 6 percent rate. The required calculations are as follows:

Capital Cost ($325,000 - $75,000)	$250,000
One-Half Net Additions	(125,000)
Amount Subject To CCA	$125,000
2010 CCA [(6%)($125,000)]	(7,500)
One-Half Net Additions	125,000
January 1, 2011 UCC Balance	$242,500

Automobiles

The tax consequences of the sale of the automobiles can be analyzed as follows:

Opening UCC Balance	$220,000
Dispositions - Lesser Of:	
• Capital Cost = $315,000	
• Proceeds Of Disposition = $185,000	(185,000)
Terminal Loss	$ 35,000

This terminal loss must be deducted in calculating net business income for the year ending December 31, 2010. As a consequence, there will be no Class 10 CCA for the year. The terminal loss will be deducted from the UCC for Class 10, leaving a January 1, 2011 balance of nil.

Summary Of The Results

The maximum CCA for the year ending December 31, 2010 and the January 1, 2011 UCC balances can be summarized as follows:

	Maximum CCA	UCC
Class 8	Nil	Nil
Class 1	$17,080	$409,920
Class 1 (Separate Class)	7,500	242,500
Class 10	Nil	Nil

In addition, the following income effects resulted from the information provided in the problem:

Recapture On Class 8 Assets	$12,000
Taxable Capital Gain On Class 1 Building [(1/2)($17,000)]	8,500
Terminal Loss On Class 10 Assets	(35,000)
Total Deduction	($14,500)

TIF Solution Five - 9

Sale Of Equipment

The tax consequences of the sale of equipment can be analyzed as follows:

Opening UCC Balance	$ 2,100
Dispositions - Lesser Of:	
• Capital Cost = $26,000	
• Proceeds Of Disposition = $21,000	(21,000)
Recaptured CCA	($18,900)

There would be no Class 8 CCA for this year as the CCA base is nil. The recapture would be added back to the Class 8 UCC, resulting in a January 1, 2011 Class 8 UCC of nil. The sale of the equipment would increase Net Income For Tax Purposes of Vance Enterprises by $18,900.

Sale Of Buildings

The tax consequences of the sale of buildings can be analyzed as follows:

Opening UCC Balance	$205,000
Dispositions - Lesser Of:	
• Capital Cost = $250,000	
• Proceeds Of Disposition = $262,000	
($342,000 - $80,000)	(250,000)
Recaptured CCA	($ 45,000)

There would be no Class 1 CCA for this year as the CCA base is nil. The recapture would be added back to the Class 1 UCC, resulting in a January 1, 2011 Class 1 UCC of nil.

The sale of the buildings would result in a taxable capital gain that would be calculated as follows:

Proceeds Of Disposition ($342,000 - $80,000)	$262,000
Capital Cost	(250,000)
Capital Gain	$ 12,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 6,000

The sale of the buildings would increase Net Income For Tax Purposes of Vance Enterprises by $51,000 ($45,000 + $6,000). As the adjusted cost base of the land is equal to the proceeds of disposition, there is no gain on the disposition of the land.

Leasehold Improvements

The leasehold improvements must be included in Class 13 and are subject to straight line write-off over the life of the lease. However, the minimum life that may be used is five years, resulting in a 2010 CCA deduction of $3,900 [(1/2)($39,000/5)] and a January 1, 2011 Class 13 UCC of $35,100.

Sale Of Automobile

The tax consequences of the sale of the automobile can be analyzed as follows:

Opening UCC Balance	$10,200
Dispositions - Lesser Of:	
• Capital Cost = $20,500	
• Proceeds Of Disposition = $8,900	(8,900)
Terminal Loss	$ 1,300

Since the capital cost of the automobile is less than $30,000, the automobile is not a Class 10.1 asset. This terminal loss must be deducted in the year ending December 31, 2010. As a consequence, there will be no Class 10 CCA for the year. The terminal loss will be deducted from the UCC for Class 10, leaving a January 1, 2011 balance of nil.

In addition, Ms. Vance would have to report a taxable benefit related to the personal use of the automobile during the year.

Sale Of Goodwill

The tax consequences of the sale of the goodwill can be analyzed as follows:

Proceeds [(3/4)($110,000)]	$82,500
Tax Cost	Nil
Unadjusted Income Inclusion	$82,500
Conversion Factor [(1/2) ÷ (3/4)]	2/3
Income Inclusion [(1/2)($110,000)]	$55,000

To the extent that Ms. Vance has deducted amounts under ITA 20(1)(b), this negative balance must be included in income in full. However, it does not appear that Vance Enterprises has made any such deductions. As a consequence, the full amount will be adjusted to the current capital gains inclusion rate of one-half, resulting in an income inclusion of $55,000 [(1/2)($110,000 - Nil)].

Summary Of The Results

The maximum CCA for the year ending December 31, 2010 and the January 1, 2011 UCC balances can be summarized as follows:

	Maximum CCA	UCC
Class 8	Nil	Nil
Class 1	Nil	Nil
Class 13	$3,900	35,100
Class 10	Nil	Nil

In addition, the following income effects resulted from the information provided in the problem:

Recapture On Class 8 Assets	$ 18,900
Recapture On Class 1 Assets	45,000
Taxable Capital Gain On Class 1 Assets [(1/2)($12,000)]	6,000
Terminal Loss On Class 10 Assets	(1,300)
Income Inclusion From Sale Of Goodwill	55,000
Total Inclusion	$123,600

TIF Solution Five - 10

The tax consequences for the three years 2008 through 2010 are calculated as follows:

	CEC Balance	CEC Deductions
2008 Additions To CEC		
[(3/4)($150,000 + $225,000 + $180,000)]	$416,250	
2008 CEC Deduction [($416,250)(7%)]	(29,138)	$29,138
CEC Balance - January 1, 2009	$387,112	
Disposition [(3/4)($82,000)]	(61,500)	
Subtotal	$325,612	
2009 CEC Deduction [($325,612)(7%)]	(22,793)	22,793
CEC Balance - January 1, 2010	$302,819	
Dispositions [(3/4)($210,000 + $283,000)]	(369,750)	
Balance After Sale	($ 66,931)	$51,931

As can be seen in the preceding table, $51,931 of the negative balance reflects CEC deductions that have been made in previous years. This full amount will have to be included in 2010 income. The remaining $15,000 ($66,931 - $51,931) reflects three-quarters of the $20,000 [($82,000 + $210,000 + $283,000) - ($150,000 + $225,000 + $180,000)] total gain on the dispositions. This will have to be converted to the one-half capital gains inclusion rate by multiplying by two-thirds. The result is $10,000 [(2/3)($15,000)].

Note that this is half of the total gains on the disposition of the goodwill [(1/2)($20,000)].

This gives a total 2010 income inclusion of $61,931 ($51,931 + $10,000).

Chapter Six Test Item File Solutions

TIF Solution Six - 1

1. For assets used in a business, the income produced while they are being held would be classified as business income. When they are sold, the result would be a capital gain or capital loss, provided they are non-depreciable. In the case of depreciable assets, the results could be a capital gain, recapture, or a terminal loss.

   For assets acquired as investments, the income while they are held would be property income, including rents, interest, and dividends. When they are sold, the result would be a capital gain or capital loss, provided they are non-depreciable. In the case of depreciable assets, the results could be a capital gain, recapture, or a terminal loss.

   For assets acquired for resale, there would generally be no income while they are held. However, when they are sold the result would be business income or loss.

2. The sale of inventory results in business income or loss, whereas the sale of non-depreciable capital property results in a capital gain or capital loss. (Subdivision b vs. c). With respect to the sale of inventories, 100 percent of any gain or loss will be included in, or deducted from, Net Income For Tax Purposes. In contrast, only one-half of any gain or loss on the sale of a non-depreciable capital asset will be included in, or deducted, from Net Income For Tax Purposes. The other important difference is that, while a loss on the sale of inventories can be deducted against any type of income, an allowable capital loss on the sale of a capital asset can only be deducted against taxable capital gains.

3. There are many items that could be listed here. The required four could be selected from differences:

   - between CCA and amortization expense,
   - in the treatment of warranty costs,
   - in the treatment of pension costs,
   - in the treatment of business meals and entertainment,
   - in the treatment of capital gains,
   - in the treatment of automobile costs, and
   - in the treatment of scientific research and experimental development costs.

   At a more conceptual level, there are also differences in the treatment of unreasonable expenditures and non-arms' length transactions.

4. The text lists four areas of difference. Any two of the following would serve to answer the question.

   - **CCA Calculations** When property income is being earned, the deduction of capital cost allowance (CCA) cannot be used to create or increase a net loss for the period. In addition, when property income is being earned by individuals, there is no requirement for a pro rata CCA reduction to reflect a short fiscal period. If business income is being earned, CCA can be used to create a loss. However, CCA deductions must be prorated for short fiscal periods.
   - **Attribution Rules** When property income is being earned, the income attribution rules (see Chapter 10) are applicable. This is not the case when business income is being earned.
   - **Earned Income Calculations** Property income is not included in the determination of earned income, either with respect to RRSP contributions or the limit on child care cost deductions. Business income is included in these figures.

- **Expense Deductions** Certain expenses can be deducted against business income, but not property income. These include write-offs of cumulative eligible capital and travel expenses. In contrast, for individuals, there is a deduction for foreign taxes on property income in excess of 15 percent that is not available against foreign business income.

5. A current year reserve is a deduction in the calculation of net business income. As this system is applied in tax work, only those reserves that are specified in the *Income Tax Act* can be deducted in the calculation of net business income. The other aspect of the system is that any reserve that is deducted in the determination of net business income in the current tax year, must be added back to net business income in the following year.

6. Although there are other reserves in the *Income Tax Act*, the three reserves that are given attention in the text are:

- reserve for doubtful debts;
- reserve for undelivered goods and services; and
- reserve for unpaid amounts.

7. Under GAAP, the bad debt expense for the current year is determined by estimating the amount of year end receivables that are expected to be uncollectible. The expense for the current year will be equal to this amount, plus any debit balance left in the allowance for bad debts at the end of the year or, alternatively, less any credit balance in the allowance for bad debts at the end of the year.

   Under the *Income Tax Act*, the deduction for bad debts will be determined as follows:

   - Add the actual amount of accounts that were written off during the current period.
   - Add the reserve that reflects the estimate of end of period accounts that are expected to be uncollectible.
   - Subtract the reserve that was deducted at the end of the previous period.

8. Some of the items that might be listed here include:

- Must be incurred to produce income.
- No capital expenditures.
- No personal living expenditures.
- No recreational facilities or club dues.
- No political contributions.
- No expenses of a personal services business.
- No interest or property taxes on vacant land.
- No soft costs.
- No prepaid expenses.

9. All employees can deduct a pro rata share of maintenance and utilities. In addition, employees who receive a portion of their income in the form of sales commissions can deduct a pro rata share of property taxes and house insurance. The self-employed individual can deduct all of the preceding items and, in addition, can deduct a pro rata share of both mortgage interest and capital cost allowance.

10. A typical example of the application of ITA 67 would be a payment to a non-arm's length party that could not be justified by the services rendered by that person. For example, a business paying a $100,000 salary to a spouse or child who does no work in the business.

11. The text describes the following exceptions, any three of which would satisfy the requirements of the question:

- Long-haul truck drivers can deduct more than 50 percent of these costs. They can deduct 75 percent for 2010 and 80 percent for years subsequent to 2010.
- The costs incurred by hotels and restaurants in providing meals and entertainment to their clients are fully deductible.
- Meals and entertainment expenses relating to a fund raising event for a registered charity are fully deductible.
- Where the taxpayer is compensated by someone else for the cost of food, beverages, or entertainment, the amounts will be fully deductible against this compensation.
- When amounts are paid for meals or entertainment for employees and, either the payments create a taxable benefit for the employee, or the amounts do not create a taxable benefit because they are being provided at a remote work location, the amounts are fully deductible to the employer.
- When amounts are incurred by an employer for food, beverages, or entertainment that is generally available to all individuals employed by the taxpayer, the amounts are fully deductible. (Maximum of six such special events per year.)
- Meals included in the price of airline, bus, and rail tickets are viewed by the government as immaterial. The food component of the ticket price is deemed to be nil.

12. There are two limits. CCA is limited to a maximum capital cost of $30,000. In addition, if the automobile is financed, interest costs are limited to $10 per day.

13. For tax purposes, inventories can be valued at either market or, alternatively, lower of cost and market.

14. The three categories and their situation with respect to the use of farm losses can be described as follows:

    Hobby Farmers These are individuals who farm on a part-time basis, but have no reasonable expectation of a profit. None of their losses are deductible.

    Part Time Farmers These are individuals who farm on a part-time basis and have a reasonable expectation of profit. They can deduct the first $2,500 of their farm loss, plus one-half of the next $12,500 of their farm loss, against any source of income.

    Full Time Farmers These are individuals who farm on a full-time basis. The full amount of their losses can be deducted against any other source of income.

15. The sale of the assets of a business in its entirety is a capital transaction. This means that any gains and losses from the sale of the assets will, in the absence of a special provision, be treated as capital gains and losses. As there is no possibility of a gain on the sale of accounts receivable, this means that any loss that arises will, in the absence of the ITA 22 election, be treated as a capital loss. This is unfortunate in that only one-half of such losses will be deductible.

    With respect to the purchaser of the receivables, he would be unable to claim any reserves for doubtful debts or deduct any amounts written off as bad debts with respect to those receivables. If the amount actually collected differs from the purchaser's cost, the difference will be treated as a capital gain or loss.

    Fortunately, the ITA 22 election allows the sale of accounts receivable to be treated as a business transaction, resulting in full deductibility for any loss that arises on the disposition. The election also means that, for the purchaser, any difference between the cost of the receivables and the amount collected will be treated as fully deductible or taxable business income. Note, however, that a joint election must be filed by both the purchaser and the vendor. ITA 22 does not automatically apply.

TIF Solution Six - 2

1. False. There are a number of differences between the business income and property income rules.

2. True. While taxpayers cannot deduct losses on personal use property, any gains will be subject to tax.

3. False. The deduction of CCA cannot be used to create a property income loss. It can be used to create a business loss.

4. False. The fact that an asset is held for a long period of time would indicate that any gain on its disposition should be treated as a capital gain.

5. True.

6. False. While they cannot be deducted for tax purposes, they can be deducted under GAAP.

7. False. A reserve can only be deducted if it is specified in the *Income Tax Act*.

8. True. While the procedures are somewhat different, the results are the same.

9. False. If the home office is the individual's principal place of business, it does not have to be used exclusively to produce income.

10. True. The specific provision in ITA 20(1)(aa) overrides the more general provision in ITA 18(1)(b) which prohibits the deduction of capital expenditures.

11. False. For the hobby farmer, no losses are deductible.

12. True. Inventories can be valued at aggregate market, which can mean replacement cost or net realizable value.

13. False. The gain will be treated as business income without any election being made by the taxpayer.

14. True.

TIF Solution Six - 3

1. B. Business income is not subject to the income attribution rules.

2. E. Whether the transaction resulted in a gain or loss.

3. C. Jerry has business income of $26,350.

4. A. In determining whether a disposition is capital or business in nature, the number and frequency of transactions is taken into account.

5. D. Included in income when the cash is received. However, the business will be able to deduct a reserve for goods or services to be delivered in the future.

6. C. $13,000 ($12,000 - $12,500 + $1,500 - $14,000)

7. E. None of the above. No reserve is allowable under ITA 20(1)(n) as the entire proceeds are due within two years after the sale.

8. D. Both A and B.

9. C. $33,000 ($25,000 + $8,000).

10. D. Jon can deduct a pro rata share of operating costs, utilities, property taxes, mortgage interest and CCA.

11. A. $18,800 [($30,000)(85%)(30%) + (365)($10) + $7,500]

12. A. Last-In, First-Out.

13. A. This $11,000 would have to be written off over five years on a straight-line basis.

14. B. Financing costs may be deducted on a straight-line basis over a five-year period. However, if the debt is repaid in full without any new debt being incurred, the undeducted balance of financing costs may be deducted immediately.

15. A. Interest and property taxes on vacant land can be deducted to the extent of incidental income produced by the property. In this case the incidental income was $200 ($1,000 - $800). This allows for the deduction of $200 of the interest and property taxes, leaving a balance of $4,100 ($4,000 + $300 - $200) to be added to the adjusted cost base of the land. The result is a total adjusted cost base of $154,100 ($150,000 + $4,100). The 2009 income is nil ($1,000 - $800 - $200) and the 2010 loss is $29,100 ($125,000 - $154,100).

16. D. $85,000 ($50,000 + $30,000 + $5,000). The salaries cannot be deducted because they are not paid within 180 days of the Company's year end.

TIF Solution Six - 4

Exam Exercise Solution Six - 1

Provided that he can demonstrate that his intent was to operate the building as a rental property, the gain should qualify as a capital gain. The fact that the offer was unsolicited would support this conclusion.

Exam Exercise Solution Six - 2

The net decrease for the year will be $4,300 calculated as follows:

Add: 2009 Reserve For Tax Purposes		$3,400
Deduct:		
2010 Actual Write-Offs	($3,600)	
2010 Reserve For Tax Purposes	(4,100)	(7,700)
2010 Net Deduction For Tax Purposes		($4,300)

Exam Exercise Solution Six - 3

The total inclusion would be calculated as follows:

Cash Sales	$71,200
Accounts Receivable	22,450
Reserve For Undelivered Services	(7,100)
Reserve For Doubtful Accounts	(650)
Total Increase	$85,900

Exam Exercise Solution Six - 4

As some of the proceeds are not receivable for more than two years, a reserve can be deducted under ITA 20(1)(n). The maximum reserve, based on the gross profit of $216,000, and the net business income, for each of the five years would be as follows:

	Income From Sale
2010 Reserve = [(100%)($216,000)] = $216,000	Nil
2011 Reserve = [(75%)($216,000)] = $162,000	$54,000
2012 Reserve = [(50%)($216,000)] = $108,000	108,000
2013 Reserve = Nil	32,500
2014 Reserve = Nil	Nil

As December 31, 2013 is more than 36 months after the sale was made, no reserve can be deducted for 2013 or 2014. Note that the previous year's reserve is added to income before deducting the new reserve.

Exam Exercise Solution Six - 5

As Mr. Roundtree owns 29 percent of the common shares, he is clearly a specified shareholder under ITA 18(5). His relevant equity balance would be $1,359,000 [(29%)($2,100,000) + (100%)($750,000)]. Given this, the disallowed interest would be calculated as follows:

Total Interest Paid To Mr. Roundtree [(7%)($5,250,000)]	$367,500
Maximum Deductible Interest [(7%)(2)($1,359,000)]	(190,260)
Disallowed Interest	$177,240

Exam Exercise Solution Six - 6

The following home office costs would be deductible in each of the three scenarios:

	Part A	Part B	Part C
Utilities	$3,200	$ 3,200	$ 3,200
Maintenance And Repairs	3,800	3,800	3,800
Property Taxes	Nil	6,400	6,400
House Insurance	Nil	1,800	1,800
Interest On Mortgage	Nil	Nil	6,200
House CCA	Nil	Nil	15,000
Subtotal	$7,000	$15,200	$36,400
Percentage	30%	30%	30%
Subtotal	$2,100	$ 4,560	$10,920
Employment/Business Related			
Long Distance Charges (100%)	780	780	780
Supplies	675	675	675
Maximum Deduction	$3,555	$ 6,015	$12,375

Exam Exercise Solution Six - 7

The base amount for the CCA calculation is limited to the Class 10.1 maximum of $30,000. As a result, the amounts that can be deducted by Mr. Roddle in his tax return are as follows:

Capital Cost Allowance [(30%)(1/2)($30,000)]	$4,500
Interest Costs - Lesser Of:	
• Amount Paid = $1,575	
• [($10)(92 Days)] = $920	920
Total Deduction	$5,420

Exam Exercise Solution Six - 8

The amount she can deduct is limited to $1,148, the least of:

- $1,724 [($862)(2)];
- $1,627 [($800)(61/30)]; and
- $1,148 {[$1,724][$30,000 ÷ (85%)($53,000)]}.

Exam Exercise Solution Six - 9

For tax purposes, the lease would be treated as an operating lease, with the deduction being based only on the lease payments. Under GAAP, the lease would have to be treated as a purchase (capitalized). This is because the lease term is more than 75 percent of the asset's expected useful life. This means that the accounting deductions would be for amortization on the capitalized asset and interest costs on the associated liability.

Exam Exercise Solution Six - 10

Ms. Futon appears to be a part-time farmer with a reasonable expectation of a profit and, as a consequence, her farm losses will be deductible on a restricted basis. The amount she can deduct for the current year will be $7,875 [$2,500 + (1/2)($13,250 - $2,500)]. As the question refers to the amount that can be deducted from her current year's Net Income For Tax Purposes, the calculation of the loss carry over is not required.

Exam Exercise Solution Six - 11

Ms. Vickers' income for the current year under the three alternatives would be as follows:

Cash Basis The cash basis income would be $242,200 ($41,400 + $48,700 + $152,100).

Billed Basis The billed basis income would be $212,700 ($41,400 + $171,300).

Accrual Basis The accrual basis income would be $206,350.

Exam Exercise Solution Six - 12

The tax effect would be a net deduction of $610 [$4,800 - ($87,560 - $82,150)].

TIF Solution Six - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 6 (not 10)

B. 4 (not 5)

C. 8 (not 3)

D. 1 (not 7)

E. 9 (not 2)

TIF Solution Six - 6

The Net Income For Tax Purposes of Swindex Inc. for the year, ignoring CCA, would be calculated as follows:

Accounting Income Before Taxes		$ 950,000
Additions:		
Bond Discount Amortization	$ 500	
Interest On Tax Instalments	1,700	
Reserve For Inventory Declines	96,300	
Amortization Expense	36,500	
Charitable Donations (Note 1)	19,100	
Prepaid Advertising [(1/2)($15,000)]	7,500	
Appraisal Fees (Note 2)	3,800	165,400
		$1,115,400
Deduction:		
Landscaping Costs		(5,200)
Net Income For Tax Purposes		$1,110,200

Note 1 The corporate charitable donations can be deducted in the calculation of Taxable Income, but are not deductible in the calculation of Net Income For Tax Purposes.

Note 2 While the problem states that this item was deducted in the calculation of accounting income, this would not be in compliance with generally accepted accounting principles. Generally accepted accounting principles would require that the appraisal costs on the property to be sold be added to the cost of the relevant property. Regardless of the treatment accorded to this item in the accounting records of Swindex, it is clear that it could not be deducted for tax purposes.

Other Items Further explanation related to the items not included in the preceding calculation of Net Income For Tax Purposes are as follows:

Bond Interest The interest would be deductible as the bonds are a liability of the business.

Foreign Advertising Advertising in foreign periodicals is fully deductible provided the advertising is not directed at Canadians. Since the periodical is not distributed in Canada, these expenses would be deductible.

Hockey Sponsorship This would be deductible as a promotional expense.

Damages As the damages relate to a transaction that produces business income, they are considered a business expense.

Loss From Theft Losses of this type, unless they result from the activity of senior officers, are considered to be deductible as a normal cost of doing business.

TIF Solution Six - 7

The appropriate treatment for each of the listed items would be as follows:

1. Neither current nor future income taxes can be deducted in the calculation of Net Income For Tax Purposes. As a consequence, $123,000 would be added back to Net Income to arrive at the required tax figure.

2. Interest on late tax instalments is not deductible in the calculation of Net Income For Tax Purposes. As a consequence, $400 would be added back to Net Income to arrive at the required tax figure.

3. In the calculation of Net Income For Tax Purposes, amortization expense of $83,000 must be added back to accounting Net Income and CCA of $97,000 must replace it as the appropriate deduction for tax purposes.

4. The club dues of $2,500 are not deductible for tax purposes and must be added back to Net Income in the calculation of Net Income For Tax Purposes. In addition, 50 percent of the cost of entertaining clients would not be deductible. This means that the non-deductible portion of the $9,600 total would be $4,800. This amount would also be added back to Net Income in the calculation of Net Income For Tax Purposes.

5. The appropriate tax deduction for bad debts is $6,000 ($5,200 - $3,400 + $4,200). As only $5,200 was deducted in the accounting records, $800 ($6,000 - $5,200) must be deducted in the calculation of Net Income For Tax Purposes.

6. As this life insurance policy was required in order to obtain financing, the premiums would be deductible. No adjustment is required in the calculation of Net Income For Tax Purposes.

7. Provided that they are paid within 180 days of year end, bonuses are deductible when declared by a business. This means that the full amount would be deductible and no adjustment is required in the calculation of Net Income For Tax Purposes.

8. The bond discount amortization is not deductible for tax purposes. As a consequence, the $3,200 must be added back to Net Income in the calculation of Net Income For Tax Purposes.

9. While the landscaping costs were given the appropriate capitalization treatment for accounting purposes, ITA 20(1)(aa) specifically permits such costs to be deducted in the year in which they are paid. Therefore, a deduction of $27,000 will be required in the conversion of accounting Net Income to Net Income For Tax Purposes.

TIF Solution Six - 8

The calculation of Markham Ltd.'s Net Income For Tax Purposes would be as follows:

Accounting Net Income	$147,000
Additions:	
Amortization Expense (Income Statement)	156,000
Income Tax Expense (Income Statement)	129,000
Item 2 - Non-Deductible Meals And Entertainment (50% of $15,000)	7,500
Item 3 - Contributions To Registered Charities	3,700
Item 4 - Articles Of Incorporation Amendment Costs	6,000
Item 6 - Bond Discount Amortization	2,500
Item 7 - Golf Club Membership Fees	3,400
Item 8 - Taxable Capital Gain On Sale Of Building [(1/2)($562,000 - $500,000)]	31,000
Item 8 - Accounting Loss On Class 10 Assets	15,000
Item 9 - Interest On Late Income Tax Instalments	500
Subtotal	$501,600
Deductions:	
Item 1 - Landscaping Costs	(6,000)
Item 8 - Accounting Gain On Sale Of Building ($612,000 - $507,000)	(105,000)
Item 8 - Terminal Loss (Note One)	(8,000)
Capital Cost Allowance (Note One)	(154,060)
Write-Off Of CEC (Note Two)	(3,733)
Net Income For Tax Purposes	$224,807

Note One Maximum CCA and other related inclusions and deductions can be calculated as follows:

January 1, 2010 Class 1 Balance		$400,000
Addition ($683,000 - $60,000)	$623,000	
Disposition - Lesser Of:		
• Proceeds = $562,000		
• Capital Cost = $500,000	(500,000)	123,000
One-Half Net Additions		(61,500)
CCA Base		$461,500
CCA At 4 Percent		(18,460)
One-Half Net Additions		61,500
January 1, 2011 UCC Balance		$504,540

January 1, 2010 Class 8 Balance	$575,000
Additions	126,000
One-Half Net Additions	(63,000)
CCA Base	$638,000
CCA At 20 Percent	(127,600)
One-Half Net Additions	63,000
January 1, 2011 UCC Balance	$573,400

January 1, 2010 Class 10 Balance	$ 45,000
Disposition Proceeds	(37,000)
Balance After Disposition	$ 8,000
Terminal Loss	(8,000)
January 1, 2011 UCC Balance	Nil

January 1, 2010 Class 13 Balance	$68,000
CCA:	
2008 Expenditures ($50,000 ÷ 10 Years)	(5,000)
2009 Expenditures ($27,000 ÷ 9 Years)	(3,000)
January 1, 2011 UCC Balance	$60,000

Summary Of CCA Results The maximum 2010 CCA and January 1, 2011 UCC balances can be summarized as follows:

Class	Maximum CCA	UCC
Class 1	$ 18,460	$ 504,540
Class 8	127,600	573,400
Class 10 (Terminal Loss = $8,000)	Nil	Nil
Class 13	8,000	60,000
Total	$154,060	

Note Two The amortization of the cumulative eligible capital account can be calculated as follows:

2009 Additions [(3/4)($70,000)]	$52,500
2009 CEC Amount At 7 Percent	(3,675)
Opening Balance, 2010	$48,825
Current Year Additions [(3/4)($6,000 Legal Costs)]	4,500
Balance Before CEC Amount	53,325
CEC Amount At 7 Percent	(3,733)
January 1, 2011 CEC Balance (Not Required)	$49,592

Other Notes

- While there is a specific prohibition against the deduction of interest on late income tax instalments, there is no equivalent restriction on interest due to late municipal taxes, and it would appear that these amounts are deductible.
- As the old building is not a rental property, the new building can be added to the same Class 1 that contained the old building. If this were not the case, this transaction would have resulted in recapture of CCA on the disposition of the old building.

TIF Solution Six - 9

The Net Income For Tax Purposes of Voxit Inc., would be calculated as follows:

Accounting Income Before Taxes		$565,000
Additions:		
Current Income Tax Expense	$210,000	
Bond Discount Amortization	3,500	
Interest On Tax Instalments	1,250	
Reserve For Inventory Declines	12,600	
Amortization Expense	51,500	
Charitable Donations (Note One)	14,500	
Loss On The Sale Of Vehicles	36,200	
Appraisal Fees (Note Two)	2,600	332,150
Subtotal		$897,150
Deductions:		
Future Income Tax Benefit	($ 23,000)	
CCA (Note Three)	(88,302)	
Terminal Loss On Class 10	(30,968)	
Write-Off Of CEC (Note Four)	(630)	(142,900)
Net Income For Tax Purposes		$754,250

Note One The corporate charitable donations can be deducted in the calculation of Taxable Income, but are not deductible in the calculation of Net Income For Tax Purposes.

Note Two While the problem states that this item was deducted in the calculation of accounting income, this would not be in compliance with generally accepted accounting principles. Generally accepted accounting principles would require that the appraisal costs on the property to be sold be added to the cost of the relevant property. Regardless of the treatment accorded to this item in the accounting records of Voxit, it is clear that it could not be deducted for tax purposes.

Note Three The required CCA calculations would be as follows:

Class 1 [($325,236)(4%)]		$ 13,009
Class 8 Opening Balance		$226,964
Additions	$262,000	
Disposal - Lesser Of:		
• Proceeds = $189,000		
• Cost = $275,000	(189,000)	73,000
One-Half Net Addition		(36,500)
CCA Base		$263,464
Rate		20%
Class 8 CCA		$ 52,693
Class 13 ($36,400 ÷ 14)		$ 2,600
Class 52 (100% write-off)		$ 20,000
Total CCA ($13,009 + $52,693 + $2,600 + $20,000)		$ 88,302

Note that the January 1 Class 13 balance shows that less than the maximum CCA for this class has been claimed in the past.

Class 10 - Terminal Loss ($56,500 - $87,468)	($30,968)

Note Four The required CEC calculation would be as follows:

CEC Deduction [(3/4)($55,000 - $43,000)(7%)]	$630

Notes On Excluded Items

- The cost of sponsoring the local soccer team is deductible for both tax and accounting purposes.
- The cost of theft by employees who are not officers of the Company is deductible.

Chapter Seven Test Item File Solutions

TIF Solution Seven - 1

1. Corporations are required to recognize revenue on a full accrual basis, including all amounts receivable at the end of a taxation year. In contrast, individuals can use either cash or accrual accounting. However, either method is limited by the requirement under ITA 12(4) that interest be recognized on each anniversary date of the debt instrument. This, in effect, is a modified version of accrual accounting.

2. If the debt issuer is in the money lending business, the premium will have to be taken into income when the bonds are issued. For most other taxpayers, the premium will be treated as a tax free capital receipt, with no further tax consequences at the maturity of the bond. If, however, it appears that the bonds were deliberately priced to create a premium, the premium will have to be amortized as a reduction in interest expense over the life of the bonds.

3. Over the life of the bond, no recognition is given to the fact that the bond sold at a discount. The amount of interest that will be deducted will be based entirely on the coupon or stated rate. When the bonds are paid off at maturity, the difference between the discounted value and the maturity amount will be deductible as a loss. Provided the bonds are sold for not less than 97 percent of their face value and have an effective yield that does not exceed 4/3 of the stated yield, the loss will be a fully deductible business loss. Otherwise, it must be treated as a capital loss, only one-half of which is deductible against taxable capital gains.

4. The friend is incorrect. This is a prescribed debt obligation as described in ITR 7000(1)(a). Interest will have to be accrued each year using the yield that equates the cost of the obligation with the present value of the maturity amount (in this case it is 10 percent). No part of the difference between the cost and the maturity amount will receive capital gains treatment.

5. These rules were created to deal with situations where an investment which has been financed with debt is sold for proceeds that are less than the debt. If all of the proceeds are used to pay off the related debt, a debt balance will remain. In the absence of special rules, interest on this remaining debt would not be deductible because it cannot be linked to an income producing asset. However, ITA 20.1(1) indicates that the remaining debt is deemed to be used for income producing purposes, thereby allowing the taxpayer to deduct the interest on this balance.

6. The goal here is to ensure that the individual is not able to escape recapture when he disposes of the property. Rental properties often have a fair market value that exceeds their UCC. If each such asset is in a separate CCA class, when the asset is sold and the proceeds of disposition are subtracted from the UCC, the result will be a negative balance that must be taken into income. If the property was not allocated to a separate CCA class, this result could be avoided by simply acquiring another rental property and adding its cost to the CCA class. As recapture only arises if there is a negative balance at the end of the period, there would be no recapture if this addition eliminates the deficit in the CCA class.

7. As discussed in IT-533, for an amount to be characterized as interest, three characteristics must be present:

   - The payment must accrue on a continuous basis.
   - It must be calculated with reference to a principal sum.
   - It must be compensation for the use of that principal sum.

   Dividend payments are also compensation for the use of a principal sum and, in some cases (preferred shares), they are calculated with reference to some stated amount. Given this, the most reliable distinguishing feature is that dividends do not accrue on a continuous basis. They arise only when they are declared by the management of the company.

8. The concept of integration is the idea that an individual should pay the same amount of taxes on a given income source, without regard to whether it is received directly and taxed only once or, alternatively, channeled through a corporation. In this latter case, the income would be taxed twice — once at the corporate level and again in the hands of the individual. If integration works, the amount of taxes that would be paid by the individual receiving the income directly would be the same as the combined corporate and personal taxes that would be assessed if a corporation was used.

9. For eligible dividends, the gross up and tax credit procedures require that the dividends received be grossed up by 44 percent. The federal credit against tax payable is calculated as 10/17 of the amount of the gross up.

   For non-eligible dividends, the procedures require that the dividends received be grossed up by 25 percent. The federal credit against tax payable is calculated as two-thirds of the amount of the gross up.

10. The adjusted cost base of income trust units at the time they are acquired is equal to their cost. As the units are held by the investor there are two types of adjustments to this value:

    - The adjusted cost base will be reduced by any return of capital that is included in the distributions that are received by the investor.

    - In those cases where the investor has chosen to reinvest distributions, the adjusted cost base will be increased by the amounts reinvested. As new units will be issued, this addition, when combined with the new total units, will create an new average cost for individual units.

TIF Solution Seven - 2

1. True. Corporations must use the full accrual approach.

2. False. When an issuer deliberately prices a bond issue to create a premium, IT-533 requires that this premium be amortized as a reduction in the deductible amount of interest.

3. True. IT-533 makes it clear that the indirect use of the money is not relevant to the question of deductibility.

4. False. IT-533 indicates that there is a presumption that common shares will pay dividends unless the securities have contractual terms that make such payments impossible.

5. False. He can claim a rental loss in the current year of $800. The loss cannot be increased with CCA.

6. True. All of these calculations will produce the correct result.

7. False. The return of capital is subtracted from the adjusted cost base of the units.

8. True While mutual funds are usually organized as trusts, they can also be organized as corporations.

9. True. Even though no assets are received, investors will have to pay taxes on stock dividends equal to the increase in the PUC of the shares issued on the stock dividend.

10. False. The full pre-tax amount must be included in the Net Income For Tax Purposes of the Canadian resident. The amount withheld will be treated as a credit against Tax Payable or a combination of credit and deduction.

TIF Solution Seven - 3

1. i. A. The accrual method.
   ii. D. The receivable method.
   iii. E. Not allowed method (interest would have to be accrued on the September 30, 2009 anniversary of the loan).
   iv. E. Not allowed method (interest would have to be accrued on the September 30, 2009 anniversary of the loan).

2. C. The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a capital loss in year 10 of $100,000, only one-half of which will be deductible.

3. D. The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and there will be no tax consequences at maturity.

4. C. It must be paid on a regular, periodic basis.

5. D. Jon will have to recognize nil in 2010 and $12,000 in 2011.

6. B. $16,000 ($43,000 - $27,000).

7. C. $11,844.

Taxes on the grossed up eligible dividends [(144%)($16,000)(29% + 17.5%)]	$10,714
Dividend tax credit [($7,200)(10/17 + 31%)]	(6,324)
Net Taxes	$ 4,390

   This gives after tax retention on $16,000 of dividends received of $11,610.

8. D. $23,040 [(2%)($800,000)(144%)].

9. A. $58.21 [($720,000 + $60,000 - $18,000) ÷ (12,000 + 1,090.91)]

10. B. $6,275 [(29%)($50,000 - $2,500) - $7,500]. The credit is limited to $7,500, 15 percent of the foreign non-business income. The remaining $2,500 of the withholding is used as a deduction from Net Income For Tax Purposes.

TIF Solution Seven - 4

Exam Exercise Solution Seven - 1

In each of the years 2010 through 2015, Latkin would have a deduction for interest of $25,000 [($1,250,000)(2%)]. When the bonds are retired in 2015, there would also be a loss of $100,000 ($1,250,000 - $1,150,000). The loss would have to be treated as a capital loss as the bonds are sold for less than 97 percent of their maturity amount. In addition, the four-thirds test is not met since the effective rate of 3.5 percent is more than four-thirds of the coupon rate [(2%)(4/3) = 2.7%]. This means that only one-half, or $50,000, would be deductible and this allowable amount could only be deducted against taxable capital gains. The total deduction for the six year period would be $200,000 [($25,000)(6) + (1/2)($1,250,000 - $1,150,000)].

For accounting purposes, interest expense would be $41,667 in each of the six years. This is made up of the annual payment of $25,000, plus amortization of the discount of $16,667 ($100,000 ÷ 6). Note that the total for the six year period would be $250,000 [(6)($41,667)], $50,000 more than could be deducted for tax purposes.

Exam Exercise Solution Seven - 2

The tax consequences under each of the three assumptions would be as follows:

Money Lender In this case, there would be an income inclusion of $250,000 ($1,750,000 - $1,500,000) in the current year. The interest deduction for the year would be $210,000 [(14%)($1,500,000)].

No Deliberate Premium In this case, the premium would have no immediate tax consequences and there would be no tax consequences when the bonds mature. The interest deduction for the year would be $210,000 [(14%)($1,500,000)]. Given that the bonds are paid off for less than the proceeds from their issuance, this result provides the issuer of the bonds with a tax free capital receipt of $250,000.

Deliberate Premium In this case, the premium would be amortized at the rate of $31,250 per year ($250,000 ÷ 8). This means the interest deduction for the year would be $178,750 ($210,000 - $31,250).

Exam Exercise Solution Seven - 3

The total interest to be recorded on the investment is $33,600 [($80,000)(7%)(6 years)]. It will be allocated as follows: 2010 - nil, 2011 - $5,600, 2012 - $5,600, 2013 - $7,000, 2014 - $4,200, 2015 - $5,600, and 2016 - $5,600.

As no anniversary date occurred and no interest was received during 2010, no interest will have to be included in Mr. Leiner's 2010 tax return.

In 2011, the first anniversary date occurs on May 31 and this requires the recognition of $5,600 [(7%)($80,000)] of interest.

In 2012, the second anniversary date occurs and this requires the recognition of an additional $5,600 of interest.

In 2013, the third anniversary date requires the recognition of $5,600 and, in addition, a $18,200 [(7%)($80,000)(3.25 Years)] payment is received. As $16,800 [(3)($5,600)] of this amount has been accrued on the three anniversary dates, only $1,400 of this amount will be added to income. This gives a total for the year 2013 of $7,000 ($5,600 + $1,400).

In 2014, the anniversary date will require recognition of $5,600. However, only $4,200 of this amount will be included as $1,400 was recognized in 2013.

In 2015, $5,600 will be recognized on the anniversary date.

In 2016, a payment of $15,400 [(2.75)($5,600)] will be received. As $9,800 ($4,200 + $5,600) of the amount received has been recorded on the 2014 and 2015 anniversary dates, the total for 2016 will be $5,600 ($15,400 - $9,800).

Exam Exercise Solution Seven - 4

With respect to the maturity amount, the interest income to be included in the purchaser's tax return would be calculated as follows:

Year	Initial Balance	Interest At 10%	Closing Balance
2010	$206,612	$20,661	$227,273
2011	227,273	22,727	250,000
2012	250,000	25,000	275,000

Calculations of interest income with respect to the coupon payments are as follows:

Year	Initial Balance	Interest At 10%	Cash Received	Closing Balance
2010	$68,388	$6,839	($27,500)	$47,727
2011	47,727	4,773	(27,500)	25,000
2012	25,000	2,500	(27,500)	Nil

Exam Exercise Solution Seven - 5

Mrs. White will have to include the full $4,000 received. However, under ITA 20(14) she is eligible for a deduction of $1,333 [($2,000)(4/6)], reflecting the interest that was accrued on the bonds at the time of her purchase. The net amount that will be included in her tax return is $2,667.

Exam Exercise Solution Seven - 6

As the improvements will be added to his CCA base, his maximum available CCA on the rental property is $6,660 [(4%)(1/2)($423,000 - $132,000 + $42,000)]. However, the maximum CCA that he can deduct will be limited by his net rental income before CCA. This amount is $4,500 ($32,000 - $27,500).

Exam Exercise Solution Seven - 7

Federal and provincial Tax Payable on these dividends would be calculated as follows:

Non-Eligible Dividends Received	$5,600
Gross Up (25%)	1,400
Taxable Dividends	$7,000
Combined Federal/Provincial Tax Rate (22% + 10%)	32%
Tax Before Credit	$2,240
Dividend Tax Credit [(2/3 + 38%)($1,400)]	(1,465)
Tax Payable	$ 775

The after tax retention is $4,825 ($5,600 - $775). Note that to calculate this amount, the taxes are deducted from the dividends received and not the grossed up taxable dividends.

Exam Exercise Solution Seven - 8

Eligible Dividends Received	$23,500
Gross Up (44%)	10,340
Taxable Dividends	$33,840
Combined Federal/Provincial Tax Rate (29% + 14%)	43%
Tax Before Credit	$14,551
Dividend Tax Credit [(10/17 + 25%)($10,340)]	(8,667)
Tax Payable	$ 5,884

The after tax retention is $17,616 ($23,500 - $5,884). Note that to calculate this amount, the taxes are deducted from the dividends received and not the grossed up taxable dividends.

Exam Exercise Solution Seven - 9

Given the purchase price per unit is $10.40, the reinvestment will result in Mr. Bordy receiving 57.12 ($594 ÷ $10.40) additional units. This will leave him holding 2,257.12 units with an adjusted cost base of $18,524 ($17,930 + $594). His adjusted cost base per unit after the reinvestment is $8.21 ($18,524 ÷ 2,257.12).

Exam Exercise Solution Seven - 10

Part A If the foreign source income is non-business income, the withholding in excess of 15 percent is a deduction rather than a tax credit. This means that the total withholding of $5,940 will be divided into a credit of $4,050 [($27,000)(15%)] and a deduction of $1,890 [($27,000)(22% - 15%)]. Isaac's incremental Taxable Income will be $25,110 ($27,000 - $1,890) and his incremental Tax Payable will be $3,232 [($25,110)(29%) - $4,050].

Part B If the foreign source income is business income, all of the $5,940 withholding will be treated as a tax credit. This means that Isaac's incremental Taxable Income will be $27,000 and his incremental Tax Payable will be $1,890 [($27,000)(29%) - $5,940]. Note the significant reduction in Tax Payable when the full amount of withholding is treated as a credit, as opposed to part of it being treated as a deduction.

TIF Solution Seven - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 8 (not 5)

B. 10 (not 7)

C. 2 (not 9)

D. 6 (not 3)

E. 4 (not 1)

TIF Solution Seven - 6

Common Stock Investment

The Taxable Income inclusion would be calculated as follows:

Dividends [($2.25)(12,000)]	$27,000
Gross Up Of 44 Percent	11,880
Taxable Capital Gain [($49.50 - $48.50)(12,000)(1/2)]	6,000
Taxable Income	$44,880

The Tax Payable would be calculated as follows:

Taxable Income	$44,880
Combined Federal/Provincial Tax Rate (29% + 13%)	42%
Tax Before Dividend Tax Credit	$18,850
Dividend Tax Credit [(10/17 + 38%)($11,880)]	(11,503)
Tax Payable	$ 7,347

After tax cash retained would be $31,653 ($27,000 + $12,000 - $7,347).

Guaranteed Investment Certificate

The Taxable Income inclusion would be $40,740 [($582,000)(7%)].

The Tax Payable would be $17,111 [($40,740)(29% + 13%)].

After tax cash retained would be $23,629 ($40,740 - $17,111).

Discount Bond

The Taxable Income inclusion would be calculated as follows:

Interest [($600,000)(4%)]	$24,000
Taxable Capital Gain [($600,000 - $582,000)(1/2)]	9,000
Taxable Income	$33,000

The Tax Payable would be $13,860 [($33,000)(29% + 13%)].

After tax cash retained would be $28,140 ($24,000 + $18,000 - $13,860).

TIF Solution Seven - 7

Taxable Income And Tax Payable

The amount of taxable income and tax payable resulting from the two investments would be calculated as follows:

Pepcor Distribution [($2.75)(2,500)]	$6,875	
Return Of Capital [($0.75)(2,500)]	(1,875)	$ 5,000
Pickett Capital Gain [($2.00)(3,500)]	$7,000	
Non-Taxable One-Half	(3,500)	3,500
Pickett Eligible Dividends [($1.75)(3,500)]	$6,125	
Dividend Gross Up [(44%)($6,125)]	2,695	8,820
Pickett Return Of Capital [($.75)(3,500) = $2,625]		Nil
Taxable Income		$17,320
Tax Rate (29% + 13%)		42%
Tax Before Dividend Tax Credit		$ 7,274
Dividend Tax Credit [($2,695)(10/17 + 24%)]		(2,232)
Tax Payable		$ 5,042

Adjusted Cost Base - Pepcor

The reinvestment of the $6,875 distribution at $36.00 per unit would acquire an additional 190.97 units. After recognizing these changes, the adjusted cost base per unit would be as follows:

$34.37 [($87,500 - $1,875 + $6,875) ÷ (2,500 + 190.97)]

Adjusted Cost Base - Pickett

The reinvestment of the $15,750 [($4.50)(3,500)] distribution at $50.00 per unit would acquire an additional 315 units. After recognizing these changes, the adjusted cost base per unit would be as follows:

$52.98 [($189,000 + $15,750 - $2,625) ÷ (3,500 + 315)]

Chapter Eight Test Item File Solutions

TIF Solution Eight - 1

1. One explanation that is mentioned in the text is that such gains are incidental to the main activities of the business. However, the most important explanation is that these gains cannot be distributed to investors. Since they result from the disposition of assets that are required in the operations of the business, the funds resulting from their sale must be reinvested in the business in order to continue operations. Other possible factors are that such gains may only reflect the inflation in the prices of assets and the requirement that the gains be taxed favourably in order that Canada remain internationally competitive.

2. A superficial loss is one that relates to a sale of a capital asset that is reacquired within 30 days before, or 30 days after, the disposition. Such losses cannot be deducted at the time of the disposition. However, they are added to the adjusted cost base of the reacquired asset, thereby reducing any future gain on the disposition of that asset.

3. Possible answers here would include:
   - Sale of the capital asset. The proceeds of disposition here would be the sales price.
   - Expropriation by a government body. The proceeds of disposition here would be the amount of compensation paid by the government body.
   - Destruction through fire, flood, or other natural disasters. The proceeds of disposition here would be any insurance payments received.
   - Loss through theft. The proceeds of disposition here may be nil. However, if there is insurance coverage, any amount paid by the insurer would be the proceeds of disposition.
   - Deemed dispositions. The deemed proceeds of disposition here would be the amount specified in the *Income Tax Act*.

4. The maximum amount of the reserve in each year is the lesser of two figures. The first is the capital gain multiplied by the ratio of the proceeds not yet collected to the total proceeds of disposition. The second is the capital gain multiplied by a fraction which is 20 percent of the gain multiplied by, 4 less the number of preceding taxation years ending after the disposition.

5. When a combination of land and buildings is sold, there will often be a capital gain on the land component, only one-half of which will be included in the selling taxpayer's Net Income For Tax Purposes. If the fair market value of the building is less than its UCC balance and the building is the last asset in its class, there will be a terminal loss on the building. This terminal loss will be 100 percent deductible and can be used to offset the one-half of the capital gain on the land that was included in the taxpayer's Net Income For Tax Purposes. This will, of course, tempt taxpayers to allocate a larger amount of the total proceeds to the land and a correspondingly smaller amount of the total proceeds to the building. The special rule in ITA 13(21.1)(a) prevents this from happening by reducing the building proceeds to the point where any terminal loss will either be eliminated, or reduced to the point that it no longer offsets any capital gain on the land.

6. A transfer below fair market value would produce a reduced capital gain (increased capital loss) for the transferor. In the absence of ITA 69, the transferee would have a reduced adjusted cost base for the asset, resulting in an increased capital gain (reduced capital loss) for the transferee. The most logical reason for such a transfer would be that the transferor is in a higher tax bracket than the transferee.

7. The consideration should either be equal to the fair market value of the transferred property or nil (i.e., gift the property). If the transfer is made for consideration in excess of fair market value, the transferee's adjusted cost base will be limited to fair market value, resulting in the potential for double taxation of the difference between the fair market value and the transfer price. If the transfer is made for consideration that is less than fair market value, the transferor's proceeds will be deemed to be fair market value, again resulting in the potential for double taxation of the difference between the transfer price and the fair market value of the property.

8. Unless an election is made, a transfer to a spouse or common-law partner will be recorded at tax values. For non-depreciable property, this will be the adjusted cost base of the property. For depreciable property, this will be the UCC of the property. The original capital cost will also be retained by the transferee with the difference between this and the UCC being considered to be deemed CCA. In these circumstances, there will be no tax consequences for the transferor at the time of transfer. The transferor can elect out of this treatment in his tax return by including any gain, loss, or recapture that would result if the transfer were made at fair market value.

9. There are two differences. The first difference relates to the type of property that is eligible. The rules apply to involuntary dispositions where capital property is lost, stolen, destroyed, or expropriated, without regard to its type. If the disposition is voluntary, only real property is eligible. The second difference relates to the timing of the replacement. For involuntary dispositions, the taxpayer has two taxation years after the year of disposition to replace the property. When the disposition is voluntary, the time period is limited to one year.

10. If the fair market value of the personal use property exceeds its cost, there will be a capital gain resulting from the deemed disposition/reacquisition. As a capital gain is involved, only one-half of the gain would be taxable. Given this, it would not be appropriate to allow this amount to be fully deductible as CCA. As a consequence, the deductible amount only includes one-half of the difference between the fair market value of the asset and its cost.

11. This result can be avoided by electing under ITA 45(2) not to have a change in use. If this election is made, there will be no deemed disposition. In addition, the taxpayer can continue designating the property as his principal residence for up to four years after the change in use. The disadvantage of this election is that the taxpayer will not be able to claim CCA against the net rental income that is received.

12. While gains on personal use property are taxable, losses cannot be deducted. In addition, a special rule specifies that each property will have a minimum proceeds of disposition of $1,000 and a minimum adjusted cost base of $1,000. The treatment of listed personal property differs in that losses can be deducted. However, they can only be deducted against gains on listed personal property, not against other types of income including capital gains on other types of property. Listed personal property is also subject to the same rules as other personal use property with respect to minimum amounts for proceeds of disposition and adjusted cost base.

13. The unique tax planning feature that is available with capital gains and capital losses is that they can be recognized for tax purposes at the discretion of the taxpayer. This results from the fact that they are recognized when there is a disposition and, in most circumstances, the taxpayer decides when a disposition will occur.

TIF Solution Eight - 2

1. True. The gains may reflect higher prices for the assets the business needs.

2. True. Note that it would also be a superficial loss if an identical asset was acquired 30 days prior to the disposition.

3. False. The adjusted cost base of the shares would be equal to their average cost of $21.43 {[(250)($20) + (100)($25)] ÷ 350}. This means that the allowable capital loss would be $321.50 [($15.00 - $21.43)(100)(1/2)].

4. False. The reserve cannot be more than 80 percent of the total gain.

5. False. Rollover is a term that refers to a transfer of assets on a tax free basis.

6. True. The term arm's length can apply to transactions involving trusts, corporations, and individuals.

7. True. Johan's gain will be $1,000. However, his brother's adjusted cost base will be limited by ITA 69 to $1,500.

8. False. There will be no capital gain.

9. True. If it were a voluntary disposition, replacement would have to occur within one year.

10. False. The requirement for active business income is 90 percent or more.

11. True. There will always be a deemed disposition/reacquisition when there is a change in use.

12. False. There is a deemed disposition/reacquisition of most capital property, but there are types of property that are exempt.

13. False. If the beneficiary is a spouse or common-law partner, the disposition will be at tax values rather than fair market value.

14(a). True. If she bequeaths all of her assets to a spousal trust, her Taxable Income at death is nil.

14(b). False. If she bequeaths all of her assets to her daughter, Christine, her Taxable Income at death arising from the dispositions totals $38,875. This is comprised of a taxable capital gain of $4,500 [(1/2)($20,000 - $11,000)] on the stocks, a taxable capital gain on the building of $5,625 [(1/2)($110,000 - $98,750)], and recapture of $28,750 ($98,750 - $70,000) on the building.

14(c). True. Christine's Taxable Income arising from the sale is a taxable capital gain of $7,500 [(1/2)($125,000 - $110,000)]. Christine's adjusted cost base for the building is $110,000, the fair market value at the time of her mother's death.

15. False. Capital gains on a principal residence are taxable, but there is a formula available to reduce or eliminate the capital gain.

16. True. While losses on personal use property can, in general, not be deducted, an exception is made for those items that are listed personal property.

17(a). False. There is no capital gain on the transaction, since both the adjusted cost base and the proceeds of disposition are less than $1,000.

17(b). False. There is no allowable capital loss on the sale of personal use property.

17(c). True. The taxable capital gain on the transaction is $250, one-half of the $1,500 proceeds less the deemed cost of $1,000.

TIF Solution Eight - 3

1. D. Amounts paid to PD Company on the sale of inventories.

2. B. CCA taken in previous years.

3. B. $156,250 - The maximum reserve that can be claimed is the lesser of:
   - [($400,000 - $150,000)($250,000/$400,000)] = $156,250
   - [($400,000 - $150,000)(20%)(4 - 0)] = $200,000

4. B. $78,125 - The maximum reserve that can be claimed is the lesser of:
   - [($400,000 - $150,000)($125,000/$400,000)] = $78,125
   - [($400,000 - $150,000)(20%)(4 - 1)] = $150,000

5. C. $12,000 - The maximum reserve that can be claimed is the lesser of:
   - [($300,000 - $170,000 - $10,000)($280,000/$300,000)] = $112,000
   - [($300,000 - $170,000 - $10,000)(20%)(4 - 0)] = $96,000

   Taxable capital gain = [(1/2)($120,000 - $96,000)] = $12,000

6. D. John will have a taxable capital gain of $35,000 and the adjusted cost base of the land to his son will be $250,000.

7. C. John will have a taxable capital gain of $35,000 and the adjusted cost base of the land to his son will be $320,000.

8. D. Nil

9. B. $6,800 {[4%][1/2][$230,000 + (1/2)($450,000 - $230,000)]}

10. B. Land and building that is being used as a rental property.

11. D. Susan can elect to defer the recognition of any capital gain until she disposes of the house.

12. B. When Ms. Boisvert moved, she filed an election not to be deemed to have disposed of her residence. As a result, she could claim no CCA on the property, but she is able to designate it her principal residence for years in which she did not reside there. This is limited to four years when the residence is vacated due to a transfer by one's employer and the house is not reoccupied after that employment ceases.

    In the following formula, A is the number of years the property is designated a principal residence and B is the number of years the property was owned after 1971.

    Exempt portion of gain = {[Total capital gain][(1 + A) ÷ B]}
    = [$72,000][(1 + 12 + 4) ÷ 24] = $51,000

    Minimum capital gain = ($72,000 - $51,000) = $21,000

    Note that the election could have been extended for more than four years if Ms. Boisvert had returned to live in the property, prior to leaving the employer who required her to move.

13. B. $2,500 taxable capital gain on Home B.

    Home B owned 4 years (2007 to 2010)

    - 2007 and 2008 designated to Home A
    - 2009 and 2010 can be used for Home B

    In the following formula, A is the number of years the property is designated a principal residence and B is the number of years the property was owned after 1971.

    Exempt portion of gain = {[Total capital gain][(1 + A) ÷ B]}

    = [$200,000 - $180,000][(1 + 2)/4] = $15,000

    Taxable capital gain = [(1/2)($20,000 - $15,000)] = $2,500

14. C. $1,300 ($1,500 - $200)
    The net capital gain on listed personal property consisted of a $1,500 gain ($2,500 - $1,000) on the painting and a $200 loss ($1,000 - $1,200) on the stamp collection. There is no net capital gain on the personal use property as the outboard motor gain is eliminated by the $1,000 rule and the loss on the desk is not deductible.

15. C. An antique chair.

TIF Solution Eight - 4

Exam Exercise Solution Eight - 1

The capital cost of this Class 1 asset would be $2,725,000 ($4,200,000 - $375,000 - $1,100,000). Given this, the maximum CCA in this first year would $54,500 [(1/2)($2,725,000)(4%)]. As the property is not new, it does not qualify for the enhanced CCA rates.

Exam Exercise Solution Eight - 2

The total loss on the sale of 750 shares would be $5,813 [(750)($13.75 - $21.50)]. As he acquires 400 shares of identical property within 30 days of the sale, 53-1/3 percent (400/750) of the loss would be disallowed. This $3,100 [(53-1/3%)($5,813)] disallowed loss would be added to the adjusted cost base of the new shares. This gives a total adjusted cost base for the new shares of $7,960 [(400)($12.15) + $3,100], or $19.90 per share. The remaining capital loss of $2,713 ($5,813 - $3,100) will create an allowable capital loss of $1,357 [(1/2)($2,713)].

Exam Exercise Solution Eight - 3

The required adjustments would be as follows:

Add:	
Taxable Capital Gain [(1/2)($126,000 - $111,000)]	$ 7,500
Recapture ($111,000 - $103,000)	8,000
Deduct:	
Accounting Gain ($126,000 - $93,000)	(33,000)
Net Adjustment	($17,500)

Exam Exercise Solution Eight - 4

The average cost of the shares purchased in 2009 is $23.77 {[(700)($22.75) + (410)($25.50)] ÷ 1,110}. Given this, Mr. Park's taxable capital gain for 2009 is calculated as follows:

Proceeds Of Disposition [($26.45)(250)]	$6,612.50
Adjusted Cost Base [($23.77)(250)]	(5,942.50)
Capital Gain	$ 670.00
Inclusion Rate	1/2
Taxable Capital Gain	$ 335.00

When his 2010 purchase is added to the remaining balance, his average cost becomes $26.09 {[(860)($23.77) + (925)($28.25)] ÷ 1,785}. Given this, Mr. Park's taxable capital gain for 2010 is calculated as follows:

Proceeds Of Disposition [($30.75)(410)]	$12,607.50
Adjusted Cost Base [($26.09)(410)]	(10,696.90)
Capital Gain	$ 1,910.60
Inclusion Rate	1/2
Taxable Capital Gain	$ 955.30

Exam Exercise Solution Eight - 5

For 2009, there will be a taxable capital gain of $26,500 [(1/2)($279,000 - $226,000)]. During 2010, there will be an allowable capital loss of $2,200 [(1/2)($4,400)]. This allowable capital loss will only be deductible in 2010 against 2010 taxable capital gains. Any undeducted loss is subject to the carry over provisions described in Chapter 11.

Exam Exercise Solution Eight - 6

The capital gain on the property would be $59,800 ($172,300 - $112,500). As $139,300 of the proceeds remain uncollected, she could deduct a reserve equal to the lesser of:

- [($59,800)($139,300 ÷ $172,300)] $48,347
- [($59,800)(20%)(4 - 0)] $47,840

Deducting the lesser figure of $47,840 leaves a capital gain of $11,960. The addition to her Net Income For Tax Purposes is $5,980 [(1/2)($11,960)].

Exam Exercise Solution Eight - 7

For 2010, there will be an allowable capital loss of $8,000 [(1/2)($115,000 - $131,000)]. For 2011, there will be an allowable capital loss of $16,500 [(1/2)(Nil - $33,000)]. Both of these allowable capital losses will only be deductible against taxable capital gains.

Exam Exercise Solution Eight - 8

As the transfer is for $130,000, a value that is less than the fair market value of $175,000, ITA 69 deems the proceeds of disposition to be the fair market value. This means that Ms. Lox has a taxable capital gain of $12,500 [(1/2)($175,000 - $150,000)].

When her father sells the securities for $175,000, his adjusted cost base will be the $130,000 that he paid. This will result in a taxable capital gain of $22,500 [(1/2)($175,000 - $130,000).

Exam Exercise Solution Eight - 9

Ms. Lox will have a taxable capital gain of $30,000 [(1/2)($210,000 - $150,000)]. This is based on the actual proceeds of disposition.

As the transfer is for $210,000, a value that is more than the fair market value of $175,000, ITA 69 limits the father's adjusted cost base to the fair market value. This means that when he sells the securities for $175,000, he would have no gain or loss.

Exam Exercise Solution Eight - 10

ITA 73(1) Applies If Mr. Lionel does not elect out of ITA 73(1), the property will be transferred at the UCC of $107,000. There would be no tax consequences at the time of transfer.

While the spouse would receive the property with a UCC of $107,000, the capital cost of $160,000 would be retained, with the difference being considered deemed CCA. The $200,000 proceeds of disposition do not affect these results.

Elect Out Of ITA 73(1) Mr. Lionel can elect out of ITA 73(1) by including in his income a taxable capital gain of $20,000 [(1/2)($200,000 - $160,000)], as well as recapture of $53,000 ($160,000 - $107,000).

For capital gains purposes, the capital cost to the spouse would be $200,000. However, for CCA and recapture calculations, ITA 13(7)(e) would deem the capital cost to the spouse to be $180,000 [$160,000 + (1/2)($200,000 - $160,000)].

Exam Exercise Solution Eight - 11

Mr. Low When Mr. Low sells the asset for $132,000, the only tax consequence will be recapture of $68,500 ($63,500 - $132,000).

Mr. Low's Father As the transfer value is below the transferor's capital cost, ITA 13(7)(e) will deem the capital cost to Mr. Low's father to be equal to the old capital cost of $145,000, with the $13,000 excess over the transfer value of $132,000, being deemed CCA. This means when Mr. Low's father sells the asset for $135,000, he will subtract the lesser of the $135,000 proceeds of disposition and the $145,000 deemed capital cost from the UCC of $132,000. The result will be recapture of $3,000 ($132,000 - $135,000).

Exam Exercise Solution Eight - 12

With respect to the land, the $300,000 paid is between the $271,000 adjusted cost base floor and the $365,000 fair market value ceiling. Therefore, the proceeds of disposition would be $300,000, resulting in a taxable capital gain for Mrs. Wong of $14,500 [(1/2)($300,000 - $271,000)]. The $300,000 would also be the adjusted cost base for her son.

With respect to the barn, as there was no consideration given, the transfer would take place at the UCC floor of $90,000. There would be no tax consequences for Mrs. Wong. With respect to her son, he would assume a UCC value of $90,000. However, the old capital cost of $120,000 would be retained, with the $30,000 difference being treated as deemed CCA.

Exam Exercise Solution Eight - 13

As the replacement did not occur until 2010, Multi's 2009 tax return will include a taxable capital gain of $92,500 [(1/2)($1,000,000 - $815,000)], and recapture of $166,725 ($815,000 - $648,275). In 2010, these amounts can be removed from income and asset values through an amended return. The capital cost of the new building will be $890,000 [$1,075,000 - ($1,000,000 - $815,000)]. Its UCC will be $723,275 ($890,000 - $166,725).

These amounts are $75,000 more than the old capital cost and UCC. This reflects the $75,000 ($1,075,000 - $1,000,000) over and above the insurance proceeds that the Company spent on replacing the building.

Exam Exercise Solution Eight - 14

For the 2009 taxation year, the sale of the building will result in recapture of $850,000 ($1,100,000 - $250,000). There will be no capital gains for the year as the fair market value of the land is equal to its adjusted cost base, and the fair market value of the building is equal to its capital cost.

With the appropriate election under ITA 13(4), the recapture that was recorded in 2009 can be reversed through an amended return filed in 2010. However, this amount will have to be deducted from the UCC of the new property, resulting in a UCC of $550,000 ($1,400,000 - $850,000). The maximum CCA based on this value would be $11,000 [($550,000)(4%)(1/2)].

Exam Exercise Solution Eight - 15

The capital gain is $500,000 ($1,100,000 - $600,000) and the lesser of the proceeds of disposition and the cost of the replacement shares is the $940,000 cost of the replacement shares. Given this, the permitted deferral would be $427,273 [($500,000)($940,000 ÷ $1,100,000)]. This means that the adjusted cost base of the Quint Ltd. shares is $512,727 ($940,000 - $427,273).

Exam Exercise Solution Eight - 16

The cost of the building without the land is $120,000 ($142,000 - $22,000). Its fair market value on July 1, 2010 is $220,000 ($242,000 - $22,000). Given that the fair market value exceeds cost, and that the change in use is from personal to business, the UCC value will be $170,000 [$120,000 + (1/2)($220,000 - $120,000)]. The maximum CCA for 2010 will be $3,400 [(4%)(1/2)($170,000)]. As this is less than the $4,800 in net rental income, this full amount can be deducted. The first year rules are applicable as the property was not a depreciable property prior to the change in use. However, the short fiscal period rules do not apply to an individual earning property (rental) income.

Exam Exercise Solution Eight - 17

After removing the $20,000 value of the land, the cost of the building is $37,000 and the fair market value of the building at the time of conversion is $116,400. Given these values, Mr. Jordu will have a taxable capital gain of $39,700 [(1/2)($116,400 - $37,000)]. The adjusted cost base of the new rental property will be $116,400. However, its capital cost for UCC purposes will be $76,700 [$37,000 + (1/2)($116,400 - $37,000)]. Maximum CCA for 2010 will be $1,534 [(4%)(1/2)($76,700)]. The ability to deduct this full amount is conditional on its being less than net rental income before consideration of CCA.

Exam Exercise Solution Eight - 18

There would be a deemed disposition on his departure, leaving him liable for the taxes on a $13,000 [(1/2)($56,000 - $30,000)] taxable capital gain.

Exam Exercise Solution Eight - 19

With respect to the transfer to Linda, it would be transferred at its UCC of $74,000 [($148,000)($180,000 ÷ $360,000)]. This would result in no tax consequences on Mr. Norten's final tax return and would give Linda a UCC for the asset of $74,000. However, she would retain the old capital cost of $180,000.

The transfer to his daughter, Mary, would take place at the fair market value of $122,000. This means that the proceeds of disposition for the two trucks would be $196,000 ($74,000 + $122,000). That would result in recapture of $48,000 ($148,000 - $196,000) being included in Mr. Norten's final tax return. In this case, Mary would also retain her father's original capital cost of $180,000, but her UCC for the backhoe would be $122,000.

Exam Exercise Solution Eight - 20

The annual gain on the house is $6,417 [($263,000 - $186,000) ÷ 12 Years], while the annual gain on the cottage is $10,222 [($197,000 - $105,000) ÷ 9 Years]. Given these amounts, the years 2003 through 2010 should be allocated to the cottage. When these eight years are combined with the plus one in the numerator of the reduction formula, the gain on the cottage will be completely eliminated. This leaves the years 1999 through 2002 for the Calgary house, resulting in a gain reduction of $32,083 {[$77,000][(4 + 1) ÷ 12]}.

This will leave a minimum capital gain on the sale of the two properties of $44,917 ($92,000 - $92,000 + $77,000 - $32,083).

Exam Exercise Solution Eight - 21

The total capital gain on the two properties can be calculated as follows:

	City Home	Chalet
Sales Price	$214,000	$122,000
Adjusted Cost Base	(172,000)	(89,000)
Sales Commission At 6 Percent	(12,840)	(7,320)
Capital Gain	$ 29,160	$ 25,680

On an annualized basis, the gain on the city home is $2,083 ($29,160 ÷ 14). The corresponding figure on the chalet is $3,210 ($25,680 ÷ 8). Given these amounts, the years 2004 through 2010 should be allocated to the chalet. When these seven years are combined with the plus one in the numerator of the reduction formula, the gain on the chalet will be completely eliminated. This leaves the years 1997 through 2003 for the Vernon house, resulting in the following gain reduction:

Chalet: $25,680 {[$25,680][(7 + 1) ÷ 8]}

City Home: $16,663 {[$29,160][(7 + 1) ÷ 14]}

This will leave a minimum capital gain of $12,497 ($25,680 - $25,680 + $29,160 - $16,663).

Exam Exercise Solution Eight - 22

The results would be as follows:

Personal Use Property		
Gain On Collector Car [(1/2)($61,000 - $45,000)]		$ 8,000
Loss On Antique Furniture		Nil
Listed Personal Property		
Gain On Marble Sculpture		
[(1/2)($13,000 - $1,000)]	$6,000	
Loss On Stamp Collection		
[(1/2)($26,000 - $32,000)]	(3,000)	3,000
Net Taxable Capital Gain		$11,000

While the loss on the furniture is not deductible as it is personal use property, the loss on the stamp collection can be deducted against the gain on the marble sculpture because it is listed personal property. The adjusted cost base of the marble sculpture is deemed to be $1,000 using the $1,000 floor rule.

Exam Exercise Solution Eight - 23

There will be a capital gain of $5,610 {[(300)(B$85)(C$0.52)] - [(300)(B$51)(C$0.50)]} on the sale. None of this gain qualifies under ITA 39(2), so there would be no $200 exemption. Ms. Jacks' 2010 Net Income For Tax Purposes will include $2,805, or one-half, of this gain.

TIF Solution Eight - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 7 (not 2)

B. 9 (not 3)

C. 8 (not 6)

D. 4 (not 1)

E. 10 (not 5)

TIF Solution Eight - 6

The total cost of the shares purchased in 2000 and 2001 by Ms. Ho would be $4,212.50 [(200)($10.00) + (150)($14.75)]. This gives a weighted average cost for the 350 shares of $12.04 per share.

Subsequent to the April, 2004 sale, Ms. Ho would be holding 275 (350 - 75) shares of Alcor with a total adjusted cost base of $3,311 [(275)($12.04)]. Starting from this balance, the total cost and weighted average cost of Ms. Ho's holding at the time of the July, 2010 sale would be calculated as follows:

April, 2004 Balance (Remaining 275 Shares)	$3,311.00
July, 2006 Purchase [(125)($13.50)]	1,687.50
October, 2008 Purchase [(180)($12.75)]	2,295.00
Total Cost	$7,293.50
Weighted Average Cost ($7,293.50 ÷ 580)	$12.58

Given the preceding, the July, 2010 sale would result in a taxable capital gain calculated as follows:

Proceeds Of Disposition [(200)($14.00)]	$2,800.00
Adjusted Cost Base [(200)($12.58)]	(2,516.00)
Capital Gain	$ 284.00
Inclusion Rate	1/2
Taxable Capital Gain	$ 142.00

TIF Solution Eight - 7

The capital gain on the two tracts of land would be calculated as follows:

	Tract A	Tract B
Proceeds Of Disposition	$127,000	$106,000
Adjusted Cost Base	(71,000)	(87,000)
Capital Gain	$ 56,000	$ 19,000

2009 Solution

The minimum taxable capital gain to be included in Ms. Helm's income for 2009 would be calculated as follows:

	Tract A	Tract B
Total Capital Gain	$ 56,000	$ 19,000
Maximum Reserve For 2009:		
[($56,000)(20%)(4)]	(44,800)	
[($19,000)($74,000 ÷ $106,000)]		(13,264)
Subtotal	$ 11,200	$ 5,736
Inclusion Rate	1/2	1/2
2009 Inclusion	$ 5,600	$ 2,868

For Tract A, the $17,000 collected was less than 20 percent of the total proceeds ($17,000/$127,000 ≈ 13 percent), resulting in the use of the 20 percent limiting formula from ITA 40(1)(a)(iii). For Tract B, the $32,000 collected was more than 20 percent of the total proceeds ($32,000/$106,000 ≈ 30 percent), resulting in the application of the fraction of the proceeds that remains uncollected.

2010 Solution

The minimum taxable capital gain to be included in Ms. Helm's income for 2010 would be calculated as follows:

	Tract A	Tract B
2009 Reserve	$ 44,800	$ 13,264
2010 Reserve:		
[($56,000)(20%)(3)]	(33,600)	
[($19,000)(20%)(3)]		(11,400)
Subtotal	$ 11,200	$ 1,864
Inclusion Rate	1/2	1/2
2010 Inclusion	$ 5,600	$ 932

For Tract A, the cumulative total amount collected on the principal at the end of 2010 is $42,000 ($17,000 + $25,000). As this is less than 40 percent ($42,000/$127,000 ≈ 33 percent) of the total proceeds of $127,000, the limiting formula must be used. The formula must also be used for Tract B, as the cumulative amount collected is below 40 percent ($32,000/$106,000 ≈ 30 percent).

TIF Solution Eight - 8

Case A

As the shares are sold to a non-arm's length party for less than their fair market value, ITA 69 is in effect, resulting in a deemed disposition at fair market value. This will result in a taxable capital gain of $103,000 [(1/2)($426,000 - $220,000)]. The adjusted cost base to her daughter will be the actual cost of $220,000.

Case B

Under ITA 69, a gift to a related party is treated as a deemed disposition at fair market value. This means that there will be a taxable capital gain of $103,000 [(1/2)($426,000 - $220,000)] for Ms. Wales. The adjusted cost base to her son, Jerry, will be the fair market value of $426,000.

Case C

Ms. Wales will have a taxable capital gain of $140,000 [(1/2)($500,000 - $220,000)]. However, because the non-arm's length sale was at a price in excess of fair market value, ITA 69 limits Jeff's adjusted cost base to the fair market value of $426,000.

Summary

These results can be summarized as follows:

	Taxable Capital Gain To Ms. Wales	ACB To Transferee
Case A	$103,000	$220,000
Case B	$103,000	$426,000
Case C	$140,000	$426,000

TIF Solution Eight - 9

Part A

As the insurance proceeds were equal to the capital cost of the building, there is no capital gain on the building. With respect to the furniture and fixtures, the insurance proceeds were less than the capital cost of the assets, again resulting in no capital gain. Given this, we can simply deduct the insurance proceeds from the UCC to arrive at the 2009 figures for recapture.

	Building	Furniture And Fixtures
UCC	$113,000	$152,000
Insurance Proceeds	(850,000)	(180,000)
Terminal Loss (Recapture Of CCA)	($737,000)	($ 28,000)

The total income inclusion for 2009 would be $765,000 ($737,000 + $28,000). The $737,000 and $28,000 would be added back to the relevant CCA classes, leaving each of them with a January 1, 2010 balance of nil.

Part B

For both types of assets, the replacement cost exceeded the amount of recapture recorded in 2009. Given this, the maximum amendment on the building would be the $737,000 in recapture that was recorded in 2009. Similarly, the maximum amendment on the furniture and fixtures would be the $28,000 that was recorded as recapture on that class in 2009.

The maximum 2010 CCA figures and the January 1, 2011 UCC would be based on the capital cost of the new assets, reduced by the amount of the amended recapture. The first year rules would be applicable to both classes. The relevant calculations would be as follows:

	Building	Furniture And Fixtures
UCC - January 1, 2010	Nil	Nil
Additions		
Building ($925,000 - $737,000)	$188,000	
Furniture And Fixtures		
($235,000 - $28,000)		$207,000
Deduct: One-Half Net Additions	(94,000)	(103,500)
CCA Base	$ 94,000	$103,500
CCA - Building [($94,000)(4%)]	(3,760)	
CCA - Class 8 [($103,500)(20%)]		(20,700)
Add: One-Half Net Additions	94,000	103,500
UCC - January 1, 2011	$184,240	$186,300

Part C

The rules for voluntary dispositions differ from those for involuntary dispositions in two ways:

- In the case of voluntary dispositions, in order to elect under ITA 13(4), the replacement must occur within the first taxation year after the disposition took place. With involuntary dispositions, the taxpayer has two years to replace the property. As Farnham Inc. replaced both types of assets in the year following the disposition, this constraint would not alter the Part B results.
- In the case of voluntary distributions, ITA 13(4) is only available on real property. This means that Farnham Inc. would not be able to make the ITA 13(4) election on the Class 8

assets. Because of this, there would be no amendment of the $28,000 in 2009 recapture that was recorded on these assets.

Since there was no amendment of the recapture on the Class 8 assets, the 2010 CCA on these assets would be $23,500 [($235,000)(1/2)(20%)], rather than the $20,700 that was recorded in Part B when the ITA 13(4) election was available. This would result in a January 1, 2011 UCC of $211,500 ($235,000 - $23,500). There would be no change from the Part B results in the CCA or the UCC of the building.

Part D

If the replacement cost had been $700,000 (less than the 2009 recapture), ITA 13(4) would not be able to reverse all of the recapture on the building. This is shown in the following calculation.

January 1, 2009 UCC Of Building		$113,000
Deduction:		
Lesser Of:		
• Proceeds Of Disposition = $850,000		
• Capital Cost = $850,000	$850,000	
Reduced By The Lesser Of:		
• Normal Recapture = $737,000		
• Replacement Cost = $700,000	(700,000)	(150,000)
Amended 2009 Recapture On Building		($ 37,000)

The amendment of 2009 recapture would be limited to $700,000, leaving a balance of $37,000 in the amended 2009 return. In addition it would leave the UCC of the new building at nil ($700,000 - $700,000). This means that the 2010 CCA on the building would be nil, as would be the January 1, 2011 UCC.

In terms of the economics of these calculations, the Company received insurance proceeds of $850,000, an amount that was $737,000 greater than the $113,000 UCC of the old building. Since it only reinvested $700,000 of this amount in the new building, the excess $37,000 will remain in 2009 income as recapture.

TIF Solution Eight - 10

Part A

Whether or not the expropriated assets are replaced, the Company will experience capital gains and recapture in 2009 as follows:

	Land	Building
Compensation Received	$130,000	$430,000
Adjusted Cost Base - Capital Cost	(88,000)	(290,000)
Capital Gains	$ 42,000	$140,000
Inclusion Rate	1/2	1/2
Taxable Capital Gains	$ 21,000	$ 70,000

Capital Cost	$290,000
UCC	(248,000)
Recapture Of CCA	$ 42,000

Part B

As the assets were replaced before the end of the second taxation year following the receipt of the expropriation proceeds, Janchek can use both ITA 44(1) and ITA 13(4) to modify these results. These changes will be implemented through an amended return.

Under ITA 44(1) the revised capital gain on the land would be nil, the lesser of:

- $42,000 as calculated in the preceding table; and
- Nil (there was no excess of the $130,000 proceeds of disposition for the old land over the $210,000 cost of its replacement).

Again under ITA 44(1), the revised capital gain on the building would be nil, the lesser of:

- $140,000 as calculated in the preceding table; and
- Nil (there was no excess of the $430,000 proceeds of disposition for the old building over the $840,000 cost of its replacement).

Under ITA 13(4), the revised recapture would be calculated as follows:

January 1, 2009 UCC Balance		$248,000
Deduction:		
Lesser Of:		
• Proceeds Of Disposition = $430,000		
• Capital Cost = $290,000	$290,000	
Reduced By The Lesser Of:		
• Normal Recapture = $42,000		
• Replacement Cost = $840,000	(42,000)	(248,000)
Recapture Of 2009 CCA (Amended)		Nil

Part C

Since Janchek decides to eliminate the capital gains and recapture by using the elections under ITA 44(1) and ITA 13(4), the deemed cost and UCC of the replacement properties would be as follows:

	Land	**Building**
Actual Cost Of Replacement Property	$210,000	$840,000
Capital Gain Deferred By Election	(42,000)	(140,000)
Deemed Cost Of Replacement Property	$168,000	$700,000

Deemed Capital Cost Of Building	$700,000
Recaptured CCA Deferred By Election	(42,000)
UCC	$658,000

With respect to the economic basis for these amounts, the $168,000 value for the land is equal to the adjusted cost base of the old land ($88,000), plus the additional $80,000 ($210,000 - $130,000) in funds paid by Janchek in excess of the expropriation proceeds.

The deemed cost of the replacement building is equal to the adjusted cost base of the expropriated building ($290,000), plus the additional $410,000 ($840,000 - $430,000) in funds invested by Janchek in excess of the expropriation proceeds.

The UCC for the new building is equal to the UCC of the old building ($248,000), plus the additional $410,000 ($840,000 - $430,000) in funds invested by Janchek in excess of the expropriation proceeds.

TIF Solution Eight - 11

Minimum Net Rental Income

Minimum net rental income for the year ending December 31, 2010 would be calculated as follows:

Rent [($1,900)(9)]		$17,100
Less:		
Property Taxes	($4,600)	
Insurance	(1,100)	
Maintenance And Operating Costs	(1,850)	
Mortgage Interest	(8,200)	(15,750)
Income Before CCA		$ 1,350
CCA (Note)		(1,350)
Net Rental Income		Nil

Note The maximum CCA would be calculated as follows:

Cost ($235,000 - $85,000)	$150,000
Bump Up {[1/2][($392,000 - $112,000) - ($235,000 - $85,000)]}	65,000
Capital Cost For CCA Purposes Only	$215,000
One-Half Net Additions	(107,500)
CCA Base	$107,500
Rate For Class 1	4%
Maximum CCA	$ 4,300

Since the problem requires that the minimum rental income (loss) be calculated, CCA has been deducted. While maximum CCA would be $4,300, a rental loss cannot be created through the deduction of CCA. As a consequence, the actual CCA deduction is limited to $1,350, the amount of net rental income before the deduction of CCA.

For individuals, since the calendar year is considered the fiscal year for property income purposes, there is no adjustment for a short fiscal period in the year of acquisition.

Additional Tax Consequences

As no election was made under ITA 45(2), the usual change in use procedures will be applicable. This will result in a taxable capital gain of $78,500 [(1/2)($392,000 - $235,000)]. As it appears that the property was Ms. Houston's only principal residence during all of the years that she owned the property, it is likely that this can eliminated through the use of the reduction formula in ITA 40(2)(b).

TIF Solution Eight - 12

Case A

Whenever a taxpayer dies, there is a deemed disposition of all of his property. If the transfer is to a spouse, the disposition is deemed to have taken place at the adjusted cost base of capital property other than depreciable property, and at the UCC of depreciable property. This would mean that there would be no immediate tax consequences associated with Mr. Cheever's death in this Case, unless fair market value elections are made, since all of the property is transferred to his spouse. Note, however, that on a subsequent disposition by Mr. Cheever's spouse, her tax base would be the same as Mr. Cheever's.

Case B

This Case is more complex and would follow the general rules applicable to transfers made at death to anyone other than a spouse. Such transfers, unless they involve farm property, will be deemed to have taken place at fair market value.

Farm Land In the case of farm land that is being used by the taxpayer or a member of his family, ITA 70(9) permits a tax free transfer of such property to a child. The deemed proceeds would be Mr. Cheever's adjusted cost base, resulting in no tax consequences for his estate. As you would expect, the adjusted cost base to Mr. Cheever's daughter, Mary, would be the same $525,000 that was deemed to be the proceeds of the disposition on Mr. Cheever's death.

Rental Property In the case of the rental property, the tax consequences to Mr. Cheever's estate would be as follows:

	Land	Building
Deemed Proceeds	$100,000	$870,000
Adjusted Cost Base	(100,000)	(450,000)
Capital Gain	Nil	$420,000
Inclusion Rate	N/A	1/2
Taxable Capital Gain	Nil	$210,000
Capital Cost ($550,000 - $100,000)		$450,000
UCC		(270,000)
Recaptured CCA		$180,000

Shares In the case of the Brazeway Dynamics shares and the shares of Cheever Inc., the deemed proceeds would be the fair market value and the tax consequences to Mr. Cheever's estate would be as follows:

	Brazeway Dynamics	Cheever Inc.
Deemed Proceeds	$425,000	$227,000
Adjusted Cost Base	(275,000)	(155,000)
Capital Gain	$150,000	$ 72,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 75,000	$ 36,000

This gives a total increase in Net Income For Tax Purposes for Mr. Cheever of $501,000 ($210,000 + $180,000 + $75,000 + $36,000).

Case C

With respect to the departure from Canada, ITA 128.1(4)(b) indicates that when a taxpayer ceases to be a resident of Canada, he is deemed to have disposed of all property except real property, property of a business carried on in Canada by an individual, and excluded personal property [a variety of items specified in ITA 128.1(9)]. This means that, of the property listed in the problem, only the rental property and the farm land would be exempt.

Given this, there would be a deemed disposition of both the Brazeway Dynamics shares and the Cheever Inc. shares. The results would be as follows:

	Brazeway Dynamics	**Cheever Inc.**
Deemed Proceeds	$425,000	$227,000
Adjusted Cost Base	(275,000)	(155,000)
Capital Gain	$150,000	$ 72,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 75,000	$ 36,000

This gives a total increase in Net Income For Tax Purposes of $111,000 ($75,000 + $36,000).

TIF Solution Eight - 13

During the period 1996 through 2010 (15 years), the condo experienced the larger capital gain as shown in the following table. To minimize the total capital gain, it should be designated the principal residence for 14 years. This will completely eliminate the capital gain as the exemption formula adds an additional year.

This will leave one year for the city home to be designated her principal residence.

The minimum taxable capital gain for 2010 would be calculated as follows:

	City Home	Condo
Estimated Proceeds Of Disposition	$325,000	$304,000
Adjusted Cost Base	(173,000)	(131,000)
Anticipated Selling Costs	(13,500)	(12,240)
Total Gain	$138,500	$160,760
Exemption:		
City Home [$138,500][(1 + 1) ÷ 15]	(18,467)	
Condo [$160,760][(14 + 1) ÷ 15]		(160,760)
Capital Gain	$120,033	Nil

This gives a total capital gain of $120,033 on the two properties and a taxable capital gain of $60,017 [(1/2)($120,033)].

TIF Solution Eight - 14

Case A

In this Case, the Federal Court Trials Division decided that the profit on the sale of the apartment building was a capital gain. They based their decision largely on the fact that it appeared that the **Intent** of the taxpayer was to operate the apartment building as an income producing property.

Case B

In this Case, the Minister Of National Revenue argued that because of the **Frequency Of Transactions**, the taxpayer was in the business of buying and selling cars and, as a consequence, profits on the sale of cars should be treated as business income. However, the taxpayer was successful in refuting the Minister's view by arguing that the **Nature Of The Transaction** was such that the assets should be viewed as capital assets and any resulting profits as capital gains (tax free at the time of this Case).

Case C

The gains on the various sales of residential property were ruled to be business income. The primary consideration in this Case seemed to be the **Relation Of The Transactions To The Regular Business** of the taxpayer. The work that was done on the residential properties was so closely related to the normal business activities of the interior designer that they should be considered as part of the income from that business.

Case D

The Tax Appeals Board concluded that the amounts involved were business income rather than capital gains. The **Nature Of The Transaction** seemed to be the primary consideration in this Case. The Board indicated that the transaction was no more than an ingeniously contrived scheme to pay sums of money for another ten years in return for the right to fill the doctors' prescriptions. Therefore, the amounts constituted income from their profession.

Case E

Here again, the Tax Appeals Board concluded that the amounts involved were not capital gains. In this Case, primary emphasis was placed on the fact that the **Company's Charter** was not limited to dairy farming, but allowed them to undertake such real estate transactions.

Case F

The profits on trading in racehorses were ruled as business income. The primary point made was the **Relation Of The Transactions To The Regular Business** of the taxpayer. There was also mention of the **Frequency Of The Transactions**.

Chapter Nine Test Item File Solutions

TIF Solution Nine - 1

1. A retiring allowance is an amount received, either on, or after retirement in recognition of long service or, alternatively, an amount received in respect of a loss of employment. The full amount of such allowances must be included in income in the year that it is received. While this is not part of the answer to the question as stated, you might note that, within specified limits, all or part of the allowance may be transferred to an RRSP and deducted in the calculation of Net Income For Tax Purposes.

2. A death benefit is the total of all amounts received by a taxpayer in a taxation year on or after the death of an employee in recognition of the employee's service in an office or employment. The definition of this benefit is stated in such a way that it does not include the first $10,000 of such payments. This means that they can, in effect, be received tax free.

3. They are included in Net Income For Tax Purposes because that figure is used in a variety of eligibility tests. For example, to get the full tax credit for an infirm dependant over 17, the dependant's income must be less than a threshold amount ($5,992 for 2010). Since the policy is to reduce this credit in proportion to the dependant's income in excess of that amount, it is important that all types of income be included in the Net Income For Tax Purposes calculation. To accomplish this goal, social assistance and workers' compensation payments are included in the calculation of Net Income For Tax Purposes and then deducted in the calculation of Taxable Income.

4. Deductibility of moving expenses is available to four categories of taxpayers. They are as follows:
   - Taxpayers who move to a new work location, either as employees or as independent contractors (a new work location may not involve a new employer).
   - Taxpayers who move in order to commence full time attendance at a post-secondary institution and receive income from the educational institution that increases their Net Income For Tax Purposes.
   - Taxpayers who move to a new work location after ceasing to be a full time student at a post-secondary institution.
   - An unemployed taxpayer who moves to a new location in Canada to take up employment at that new location.

5. An employer can compensate an employee for a loss on the sale of a home that was sold because of a required move. However, the tax free amount of compensation is limited to the first $15,000, plus one-half of any compensation in excess of $15,000. This means that one-half of any amount of compensation in excess of $15,000 will be treated as a taxable benefit to the employee.

6. An eligible child is defined in ITA 63(3) to include a child of the taxpayer, his spouse or common-law partner, or a child who is dependent on the taxpayer or his spouse or common-law partner and whose income does not exceed the basic personal credit amount ($10,382 for 2010). In addition, the child must be under 16 years of age at some time during the year or dependent on the taxpayer or his spouse by reason of physical or mental infirmity.

7. The specific conditions that must be met are set out in IT-530R as follows:

   - the amount is paid as alimony or an allowance for the maintenance of the spouse or common-law partner, or former spouse or common-law partner;
   - the spouses or common-law partners, or former spouses or common-law partners, are living apart at the time the payment is made and throughout the remainder of the year, and were separated pursuant to a divorce, judicial separation, or written separation agreement;
   - the amount is paid pursuant to a decree, order, or judgment of a competent tribunal or pursuant to a written agreement;
   - the recipient has discretionary use of the amount; and
   - the amount is payable on a periodic basis.

8. The answer here depends on how the annuity was acquired. If it was purchased with tax deferred funds (e.g., funds from an RRSP), the full amount of the annuity payment will be included in Net Income For Tax Purposes and there will be no offsetting deduction.

   Alternatively, if the annuity was purchased with after tax funds (e.g., funds from a bank account), the full amount of the payment will still be included in income. However, there will be an offsetting deduction to reflect the fact that part of the payment is a return of capital. The amount of the deduction will be based on the cost of the annuity, divided by total payments to be received under the annuity, with this fraction multiplied by the individual annuity payment.

9. The major advantages would include:

   - The fact that making contributions results in additional contributions being made by the government in the form of Canada Education Savings Grants.
   - The fact that earnings on the invested contributions are not taxed as they accrue, providing for tax free compounding while the funds are in the plan.
   - The fact that these plans allow parents to allocate income to their children without triggering the income attribution rules.
   - The probability that the funds will be received by an eligible student either with no taxes being assessed or, at worst, with taxes being assessed at the lowest federal rate.

   Note that, while having an RESP can result in eligibility for Canada Learning Bonds contributions, this is not part of the answer to this question because these contributions are not dependent on others making a contribution to the RESP.

10. In the Canada Learning Bonds program, the government will make contributions to an RESP for a child whose family qualifies for the National Child Benefit supplement. The contributions will be made in each year that the child's family qualifies for the supplement, beginning with the year that the child is born and ending in the year that the child reaches age 18. The first payment will be for $500, plus an additional $25 to help defray the costs of establishing an RESP for the child. Subsequent payments will be for $100 in each year that the family qualifies. Unlike Canada Education Savings Grants, there is no requirement that anyone else make contributions in order for the child to receive the Canada Learning Bonds contributions.

11. The non-taxable component of the current year's distribution from a RDSP is determined by multiplying the current year's payment by the ratio of the total contributions to the plan to the fair market value of the assets in the plan.

12. The major advantage of these plans is that the income earned by the assets in the plan is free of taxation. Similar to other registered savings plans is the fact that the earnings accumulate tax free as long as the assets are in the plan. Unlike plans where contributions are deductible (such as RRSPs) earnings are not subject to tax when they are withdrawn.

13. Unless an election is made, a transfer to a spouse or common-law partner will be recorded at tax values. For non-depreciable property, this will be the adjusted cost base of the property. For depreciable property, this will be the UCC of the property. The original capital cost will also be retained by the transferee with the difference between this and the UCC being considered to be deemed CCA. In these circumstances, there will be no tax consequences for the transferor at the time of transfer. The transferor can elect out of this treatment in his tax return by including any gain, loss, or recapture that would result if the transfer were made at fair market value.

14. The income attribution rules are applicable if all of the following conditions are present:

    - The transferor does not elect out of ITA 73(1).
    - The transferee does not provide consideration for the property that is equal to the fair market value of the property.
    - The income from the transferred property is either property income or capital gains. (The rules are not applicable to business income.)

15. If he gives the shares to his spouse and does not elect out of ITA 73(1), the shares will be transferred at their tax costs and there will be no tax consequences at the time of transfer. However, both dividends and any capital gain or loss resulting from a subsequent sale by the spouse will be attributed back to him.

    Alternatively, if the shares are gifted to the daughter, the transfer will take place at fair market value, resulting in a capital gain or loss at that time. Until the daughter reaches 18 years of age, any dividends paid on the shares will be attributed back to her father. However, if the daughter sells the shares, any resulting gain or loss (based on the fair market value at the time of transfer) will be taxed in the hands of the daughter.

16. There are a number of items listed in the text that could be mentioned here. They include:

    - Contributing to an RESP for his child.
    - Contributing to a spousal RRSP.
    - Contributing to a TFSA for his spouse.
    - Contributing to a TFSA for his child once the child is 18 years of age.
    - Since business income is being earned in the family unit, pay reasonable salaries to family members for activities that can be justified as business related.
    - If pension income is received, make use of the pension splitting provisions.
    - Giving assets with anticipated capital gains to the child rather than the spouse.
    - Loans at the prescribed rate if safe investments with higher returns are available.
    - Segregating funds from sources to which the income attribution rules do not apply (i.e. gifts and inheritances).
    - Keeping records which detail that the lower income family members' funds are being used for investment purposes, rather than for non-deductible expenditures such as household expenses.
    - Allowing family members to invest at the inception of any new business.

    Other factors might also be mentioned.

TIF Solution Nine - 2

1. False. She must include only $15,000 ($25,000 - $10,000) in income in the year of receipt.

2. True. While the entire amount must be included, a deduction is available for eligible amounts that are transferred to an RRSP.

3(i). True. His airfare from Prince George to Red Deer is a deductible moving cost.

3(ii). True. The $750 is a deductible moving cost.

3(iii). True. The total $1,800 in legal fees is a deductible moving cost.

3(iv). False. The $2,000 is not a deductible moving cost.

3(v). True. The $5,000 in real estate fees paid to sell their Prince George house is a deductible moving cost.

3(vi). False. There is a an unlimited carry forward for unused moving costs.

4. False. Sarah can deduct a maximum of $5,333 [(2/3)($8,000)].

5. False. An eligible child does not have to be under 16 at some time during the year if he or she is dependent on the taxpayer or his spouse or common-law partner by reason of physical or mental infirmity.

6. True. Imprisonment of the lower income spouse is one of the situations in which the higher income spouse is allowed to deduct child care costs.

7. True. The payments will be taxed in Jim's hands and will be deductible from Shirley's income. As there are no children, the amounts paid are spousal support.

8. True. If after tax funds are used, the capital element of the annuity payment can be deducted from the amount received. Alternatively, if RRSP funds are used, the entire annuity payment will be subject to tax, with no offsetting deduction for a capital element.

9. True.

10. True. While contributions are not deductible, earnings resulting from the investment of these contributions are not subject to tax until the funds are withdrawn from the plan.

11. True. There is no annual limit.

12. False. There is no tax on income withdrawn from a TFSA.

13. False. Any dividends declared on the securities will not be attributed to the father because his daughter is older than 17.

14. False. There will be no capital gain.

15. False. There is no income attribution for capital gains that are realized on assets that have been transferred to related minors.

TIF Solution Nine - 3

1. C. While a deduction can be made for transfers to an RRSP, 100 percent of the retiring allowance has to be included in income.

2. C. He cannot claim the 50 percent of the cost that was reimbursed. Further, the claim can only be made against employment income earned at the new location.

3. A. $8,800 [$5,000 + $2,000 + $750 + (15/30)($2,100)]. Legal fees are not deductible as Mr. Kumar did not own a house prior to moving; house hunting trips are not deductible; costs for temporary accommodation are limited to 15 days.

4. A. $8,500 ($102,000 ÷ 12). The deduction is limited to the income earned at the new location.

5. B. $16,300 ($1,200 + $12,000 + $100 + $200 + $2,800).

6. C. John's claim is limited to $5,950 [($175)(2)(17)].

7. E. None of the above.

8. D. $2,200 [($4,000 - $1,800)]. Deductible spousal support is limited to the $4,000 amount paid, less the required $1,800 for child support.

9. C. There is no limit on the amount of annual contributions that can be made. The limit is on the total amount that can be contributed for each beneficiary.

10. A. Contributions to the plan are deductible.

11. C. Earnings on assets in the plan will accumulate tax free.

12. D. Withdrawals of accumulated account earnings will be subject to tax.

13. C. $240 (compound interest does not attribute).

14. C. A growth fund that invests in corporations with a history of paying minimal dividends and earns its income primarily in the form of capital gains.

15. D. William's Net Income For Tax Purposes is $1,275.

Taxable Capital Gain On Disposition Of Global Inc. [($2,500 - $200)(1/2)]	$1,150
Allowable Capital Loss On Gift - TriStar Limited	Nil
Attribution Of Dividend	125
William's Net Income For Tax Purposes	$1,275

16. D. Hans must elect out of the ITA 73 rollover, Olga must pay consideration equal to fair market value, and the loan must bear interest to be paid within 30 days of the end of each year. Although the loan must bear interest at the prescribed rate or greater, there is no requirement that the rate be adjusted in future years.

17. D. Carmen faces a tax liability of $2,574 as a result of her capital gains.

18. C. The loan is interest free and made to Joan's 19 year old son.

19. A. The gift is to Sandy's long-time business partner.

TIF Solution Nine - 4

Exam Exercise Solution Nine - 1

Since he did not own a house in Halifax, he cannot deduct the $3,250 in costs associated with acquiring the new home in Moncton. Further, there is no provision for deducting the $650 cost of the house hunting trip to Moncton. However, these amounts can be paid for by his employer without creating a taxable benefit. This would use up $3,900 of the $6,000 that his employer is willing to pay, leaving $2,100 to be applied against other items.

These other items total $9,500 ($8,300 + $1,200). After the employer's $2,100 is applied against this total, $7,400 is left for Mr. Havlik to deduct. However, the deduction is limited to $6,625, the 2010 income at the new location. The remaining $775 can be carried forward and deducted against income earned at the new location in a subsequent year.

Exam Exercise Solution Nine - 2

As Mr. Renaud is the low income spouse, he will have to take the deduction for child care costs. The deduction will be the least of the following amounts:

- The actual costs of $11,200.
- The annual limit of $15,000 [(1)($7,000) + (2)($4,000)].
- 2/3 of earned income, an amount of $8,000 (2/3 of the reported amount of $12,000).

The least of these three amounts is $8,000. Note that the universal child care benefit payments are not included in Mr. Renaud's earned income for this purpose.

Exam Exercise Solution Nine - 3

As the 21 year old child has a physical infirmity, he is an eligible child for purposes of deducting child care costs. While child care costs are normally deducted by the lower income spouse, the higher income spouse can make the deduction during periods when the lower income spouse is in prison. The amount that can be deducted, however, is limited to $175 per week in the case of the four year old and $100 per week for the other children. Given this, Mr. Anders' deduction is limited as shown in the following calculation:

	Mr. Anders	Mrs. Anders
Actual Payments [(50)($190)]	$ 9,500	$ 9,500
Annual Expense Limit [(1)($7,000) + (2)($4,000)]	$15,000	$15,000
2/3 Of Earned Income		
[(2/3)($69,000)]	$46,000	
[(2/3)($18,000)]		$12,000
Periodic Expense Limit [(6)($175)(1) + (6)($100)(2)]	$ 2,250	N/A

The least of the amounts for Mr. Anders is $2,250. The least of the amounts for Mrs. Anders is $9,500. Mrs. Anders' deduction would be reduced by the $2,250 deducted by Mr. Anders, leaving her with a deduction of $7,250. Note that the universal child care benefit payments are not included in Mrs. Anders' earned income.

Exam Exercise Solution Nine - 4

The total required child support is $8,400 [(7 Months)($1,200)] and Shannon's payments will be allocated to this requirement first. This means that $8,400 of her payments will not be deductible to her or taxable to Leon. The remaining $1,100 ($9,500 - $8,400) will be considered a payment towards spousal support and will be deductible to Shannon and taxable to Leon.

Exam Exercise Solution Nine - 5

A total of $12,060 [(3)($4,020)] in payments will be received from this annuity. The $4,020 will be included in her annual tax return. However, because the annuity was purchased with after tax funds, she is eligible for a deduction equal to $3,333 [($10,000 ÷ $12,060)($4,020)]. As a result, Ms. Brock's Net Income For Tax Purposes will increase by $687 ($4,020 - $3,333) each year.

Exam Exercise Solution Nine - 6

ITA 73(1) provides for a tax free rollover of capital property to a spouse. The tax consequences for Mr. and Mrs. Blue for the two years can be outlined as follows:

- 2009 for Mr. Blue - none.
- 2009 for Mrs. Blue - none.
- 2010 for Mr. Blue - none.
- 2010 for Mrs. Blue - Total income of $10,720. She would have taxable dividends of $5,184 and a taxable capital gain of $5,500 [(1/2)($53,000 - $42,000)] attributed to her.

Exam Exercise Solution Nine - 7

ITA 73(1) provides for a tax free rollover of capital property to a spouse. The tax consequences for Mr. and Mrs. London for the two years can be outlined as follows:

- 2009 for Mrs. London - none.
- 2009 for Mr. London - none.
- 2010 for Mrs. London - none.
- 2010 for Mr. London - total income of $12,116. He would have taxable dividends of $2,966 and a taxable capital gain of $9,150 [(1/2)($39,800 - $21,500)] attributed to him.

Exam Exercise Solution Nine - 8

There is no provision for a tax free transfer of shares to a child. The tax consequences for Tom and Patrick London for the two years can be outlined as follows:

- 2009 for Patrick - none.
- 2009 for Tom - a taxable capital gain of $6,850 [(1/2)($35,200 - $21,500)].
- 2010 for Patrick - a taxable capital gain of $2,300 [(1/2)($39,800 - $35,200)].
- 2010 for Tom - taxable dividends of $2,966 attributed to him.

Exam Exercise Solution Nine - 9

The tax consequences are as follows:

2009

- Mr. Cleroux has a taxable capital gain of $10,200 [(1/2)(400)($156 - $105)].
- His son has no tax consequences.
- His wife has no tax consequences.

2010

- Mr. Cleroux has taxable dividends of $6,480 [(400 + 600)($4.50)(144%)] attributed to him from his son and wife.
- Mr. Cleroux has a taxable capital gain of $11,100 [(1/2)(600)($142 - $105)] attributed to him from his wife.
- His son has an allowable capital loss of $2,800 [(1/2)(400)($142 - $156)].
- His wife has no tax consequences.

Exam Exercise Solution Nine - 10

Since Mrs. Lafarge does not elect out of ITA 73(1) by including a gain in her 2009 tax return, there will be no tax consequences for either Mr. or Mrs. Lafarge in 2009. In addition, because the transfer is a tax free rollover, the adjusted cost base of the bonds to Mr. Lafarge will be $119,000.

As the loan did not bear interest at market rates, all of the 2010 interest income on the bonds will be attributed to Mrs. Lafarge. In addition to the interest of $5,600, there would be a taxable capital gain of $7,500 [(1/2)($134,000 - $119,000)], which would also be attributed to Mrs. Lafarge. The total addition to Mrs. Lafarge's income for 2010 is $13,100 ($5,600 + $7,500). There will be no tax consequences for Mr. Lafarge in 2010.

TIF Solution Nine - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 8 (not 2)

B. 4 (not 9)

C. 6 (not 1)

D. 10 (not 3)

E. 7 (not 5)

TIF Solution Nine - 6

Mrs. Fortin

Generally, the spouse with the lower income must claim the deduction for child care expenses. However, under certain circumstances, for example if this spouse is hospitalized, the spouse with the higher income can claim the deduction for the period of hospitalization. Thus Mrs. Fortin can claim the least of the following:

	Case A	Case B
Actual Payments [($200)(48)]	$ 9,600	$ 9,600
2/3 Of Earned Income [(2/3)($63,000)]	$42,000	$42,000
Annual Expense Limit:		
Case A [(2)($7,000)]	$14,000	
Case B [(2)($7,000) + (1)($4,000)]		$18,000
Periodic Expense Limit:		
Case A [(2)($175)(6 weeks)]	$ 2,100	
Case B {[(2)($175)(6 weeks)] + [(1)($100)(6 weeks)]}		$ 2,700

In Case A, the least of these figures is $2,100, the Periodic Expense Limit. In Case B, the least of the figures is $2,700, also the Periodic Expense Limit.

Mr. Fortin

The calculations for Mr. Fortin are as follows:

	Case A	Case B
Actual Payments	$ 9,600	$ 9,600
2/3 Of Earned Income [(2/3)($8,000)]*	$ 5,333	$ 5,333
Annual Expense Limit:		
Case A [(2)($7,000)]	$14,000	
Case B [(2)($7,000) + (1)($4,000)]		$18,000

*The universal child care benefit payments are not included in Mr. Fortin's earned income for this purpose.

The lowest figure in both cases is $5,333, two-thirds of Mr. Fortin's earned income. Mr. Fortin's deduction for the current year will be reduced by the amount claimed by Mrs. Fortin. Mr. Fortin's deduction for the current year is $3,233 ($5,333 - $2,100) in Case A, and $2,633 ($5,333 - $2,700) in Case B.

TIF Solution Nine - 7

Summary Results

	Net Income For Tax Purposes		
	2009	2010	2011
Case A			
Mr. Tucker	Nil	$9,360	$33,000
Mrs. Tucker	Nil	Nil	Nil
Case B			
Mr. Tucker	Nil	$9,360	$33,000
Mrs. Tucker	Nil	Nil	Nil
Case C			
Mr. Tucker	$19,000	$9,360	$28,000
Mrs. Tucker	Nil	Nil	Nil
Case D			
Mr. Tucker	$19,000	$9,360	Nil
Doreen Tucker	Nil	Nil	$14,000
Case E			
Mr. Tucker	$19,000	Nil	Nil
Martin Tucker	Nil	$9,360	$14,000

The details of each Case are as follows:

Case A

With ITA 73(1) in effect, the December 31, 2009 transfer would be a deemed disposition at the adjusted cost base for the securities of $85,000. This means that Mr. Tucker would not record a capital gain at the time of the transfer and the adjusted cost base of the securities to Mrs. Tucker would be $85,000.

In 2010, the $9,360 in taxable dividends would be attributed back to Mr. Tucker and included in his Net Income For Tax Purposes for that year. He would claim the related dividend tax credit.

When Mrs. Tucker sells the securities, the 2011 taxable capital gain of $33,000 [(1/2)($151,000 - $85,000)] would also be attributed back to Mr. Tucker. This transfer would not affect Mrs. Tucker's Net Income For Tax Purposes in any of the three years under consideration.

Case B

With ITA 73(1) in effect, the December 31, 2009 transfer would still take place at the adjusted cost base of $85,000, and the resulting 2009, 2010, and 2011 results for both Mr. Tucker and Mrs. Tucker would be identical to Case A.

Case C

When a taxpayer elects out of ITA 73(1) and a transfer is made for consideration that is less than fair market value, the provisions of ITA 69(1) are applicable to the transferor. Under these provisions, if a taxpayer disposes of a property for less than its fair market value, the proceeds of disposition are deemed to be the fair market value amount. This will result in Mr. Tucker recording a 2009 taxable capital gain of $19,000 [(1/2)($123,000 - $85,000)].

As the transfer is for consideration that is less than the fair market value of the securities, the income attribution rules will be applicable, resulting in the 2010 taxable dividends of $9,360 being included in Mr. Tucker's 2010 Net Income For Tax Purposes. He would claim the related dividend tax credit.

Under the provisions of ITA 69, Mrs. Tucker's adjusted cost base for the shares will be the $95,000 price that she actually paid. As a consequence, when the shares are sold in 2011, the taxable capital gain would be $28,000 [(1/2)($151,000 - $95,000)]. This amount would be attributed back to Mr. Tucker and included in his 2011 Net Income For Tax Purposes.

Mr. Tucker's total taxable capital gain on these shares is $47,000 ($19,000 + $28,000). This is $14,000 more than the $33,000 taxable capital gain in Cases A and B. This $14,000 amount reflects the fact that, under ITA 69, there is double taxation of the difference between the $95,000 price paid by Mrs. Tucker for the securities and their $123,000 fair market value at that time.

Case D

Under ITA 69, a non-arm's length gift is deemed to be a disposition and acquisition to be recorded by both parties at fair market value. This means that Mr. Tucker would have to record a 2009 taxable capital gain of $19,000 [(1/2)($123,000 - $85,000)].

As a gift to a minor was involved, income attribution rules will apply and the 2010 taxable dividends of $9,360 will have to be included in the 2010 Net Income For Tax Purposes of Mr. Tucker. He would claim the related dividend tax credit.

However, the attribution rules do not apply to capital gains when the attribution results from a transfer to someone under 18 years of age. As a consequence, Doreen Tucker will include a taxable capital gain of $14,000 [(1/2)($151,000 - $123,000)] in her 2011 Net Income For Tax Purposes.

The transfer will have no effect on the 2009 and 2010 Net Income For Tax Purposes of Doreen Tucker, or on the 2011 Net Income For Tax Purposes of Mr. Tucker.

Case E

As the transfer is at fair market value, Mr. Tucker will have a taxable capital gain of $19,000 [(1/2)($123,000 - $85,000)] included in his 2009 Net Income For Tax Purposes. Martin's adjusted cost base for the securities will be $123,000, and the transfer will not affect his 2009 Net Income For Tax Purposes.

As Martin is not under 18 years of age, the attribution rules found in ITA 74.1(2) do not apply. As a consequence, the $9,360 in taxable dividends would be included in Martin's 2010 Net Income For Tax Purposes. He would claim the related dividend tax credit.

In addition, the taxable capital gain of $14,000 [(1/2)($151,000 - $123,000)] would be included in Martin's 2011 Net Income For Tax Purposes.

Chapter Ten Test Item File Solutions

TIF Solution Ten - 1

1. The major advantages can be described as follows:

    - Eligible contributions are fully deductible and provide an immediate reduction in Tax Payable.
    - While the contributions are invested in the plan, earnings on the investments accumulate on a tax free basis. (This would not provide any advantage with respect to contributions made to a defined benefit RPP.)
    - When the funds are withdrawn from the plan, the individual may be in a lower tax bracket than he was in when he made the contributions. When this is the case, there is tax avoidance in that the taxes saved on the deduction are greater than the taxes paid on the withdrawal.
    - The payments from an RPP or RRSP may be eligible for both the pension income tax credit and for pension income splitting.

2. The income earned by equity securities consists of dividends and capital gains, both of which receive tax treatment that, when earned outside an RRSP, is more favourable than that given to interest on debt securities. Specifically, only one-half of capital gains are subject to tax while, in the case of both eligible and non-eligible dividends, the gross up and tax credit procedure serves to significantly reduce the rate applicable to this type of income. In contrast, when accumulated dividends or capital gains are removed from an RRSP, the amounts are taxable at full personal rates, thereby eliminating any tax advantages associated with capital gains or dividends. For this reason, it makes sense to keep equity holdings outside of an RRSP and to allocate interest bearing debt securities to the RRSP.

3. The components of Earned Income for purposes of determining the RRSP Deduction Limit are as follows:

    - Employment income computed without the deduction of RPP contributions.
    - Royalties, provided the taxpayer is the author, inventor, or composer.
    - Taxable (deductible) support payments.
    - Supplementary unemployment benefits.
    - Business income (loss).
    - Income (loss) earned as an active partner.
    - Net rental income (loss).
    - CPP disability benefits.

4. In simplified terms, benefits earned in defined benefit plans are converted to a contribution-like number by multiplying the benefits earned by an individual by the number 9. The use of this approach does not take into consideration the fact that it would take a much larger contribution to provide $1 of benefits to a 64 year old individual who will retire in one year, than it would to provide $1 of benefits to a 20 year old individual who will not receive the benefit for 45 years. This would suggest that the approach used is systematically unfair to younger taxpayers.

5. There are several points to be made here:
    - Contributions that are more than $2,000 greater than the individual's unused deduction room should not be made as they attract a penalty of 1 percent per month.
    - Non-deductible contributions of $2,000 or less have the advantage of having the earnings resulting from their investment accumulate on a tax free basis.
    - The basic point for your friend, however, is that while he cannot deduct contributions in excess of his unused deduction room at the time the contributions are made, he can deduct them in any future period when deduction room becomes available. As a consequence, his basic point is really not valid.

6. When an individual reaches age 71, his RRSP must be collapsed. The basic alternatives for withdrawing the funds in the plan, along with the related tax consequences, are as follows:
    - The total amount of assets in the plan can simply be withdrawn. This alternative will result in the fair market value of all of the assets being included in the individual's income in the year of withdrawal.
    - The assets in the plan can be converted to cash and the proceeds used to purchase an annuity. There will be no immediate consequences associated with the purchase of the annuity. However, the subsequent payments will be included in full in the taxpayer's income as they are received.
    - The assets in the RRSP can be transferred to a RRIF. There are no tax consequences associated with this rollover. However, the taxpayer will have to make a minimum withdrawal from the RRIF in each subsequent year. The full amount of each withdrawal will be taxed in the year that it is received.

    These are not mutually exclusive choices. They can be used in combinations (e.g., one-half the funds to a RRIF, with the remaining one-half being used to purchase an annuity).

7. Contributions to a spousal plan are desirable when the individual's spouse or common-law partner is currently in a lower tax bracket and is expected to remain in that bracket. There are two advantages to making such contributions:
    - Income splitting. When the contributions are withdrawn they will be taxed at the spouse or common-law partner's lower tax rate.
    - In situations where the spouse or common-law partner has no other source of pension income, withdrawals from the spousal plan could be eligible for the pension income tax credit.

    Note that these results could also be achieved through the use of the provisions which allow for the splitting of pension income.

8. The basic considerations would be:
    - Whether the required funds could be acquired through a conventional mortgage.
    - What rate would be paid on conventional mortgage financing.
    - What rate is being earned on the investments in the plan.
    - The fact that the earnings lost while the funds are out of the plan can never be put back in the plan, resulting in a permanent loss of tax assisted savings.

9. DPSPs provide tax deferral in that employer contributions to these plans do not create a taxable benefit until they are withdrawn from the plan. There is further deferral in the fact that amounts earned on the DPSP investments accumulate tax free, with these amounts also not being taxed until they are withdrawn from the plan. In contrast, employer contributions to a PSP are treated as taxable benefits to the employees who receive them. In addition, amounts earned on the PSP's assets are taxed in the hands of the employees as they are earned. While there may be human resource or motivational reasons for using PSPs, the use of these plans does not provide any tax advantages to employees.

10. The basic differences are as follows:

    - RRIFs are only funded through a transfer from an RRSP or another RRIF. In contrast, the individual can make deductible contributions or transfer funds from another retirement savings plan (RRSP, RPP, DPSP) in order to get funds into an RRSP.
    - There is no requirement to make minimum annual withdrawals from an RRSP. In contrast, an individual must make a minimum withdrawal each year from a RRIF.
    - An individual can have a RRIF after the age of 71. They cannot have an RRSP after that age.

TIF Solution Ten - 2

1. True. In general, deferral is available as individuals can deduct contributions when they are made, are not taxed on amounts earned within the plan, and only pay taxes when amounts are withdrawn from the plan. Avoidance may also be available if the individual is in a lower tax bracket when taxable withdrawals are made than he was when the deductible contributions were made.

2. True. A pension plan that provides for a pension equal to 3 percent of an employee's average annual salary for each year of service is a defined benefit plan.

3. True. All of these items are components of Earned Income for RRSP purposes.

4. False. Only those undeductible contributions in excess of $2,000 are subject to the penalty.

5. True. Once a spouse or common-law partner has made a contribution, the plan is permanently designated a spousal RRSP.

6. True. The amounts must be repaid over 15 years, beginning in the second calendar year after withdrawal.

7. False. While the tax free withdrawal is conditional on being enrolled in a qualified educational program at a designated educational institution, there is no requirement that the funds be used for any particular purpose.

8. False. The employees' contributions have no effect on the deductibility of the employer's contributions. A maximum of $25,000 is deductible.

9. False. Contributions to DPSPs are not considered to be taxable benefits to employees.

10. False. The tax free transfer is limited to $2,000 per year of service with the employer prior to 1996, plus an additional $1,500 for each year of service prior to 1989 for which the employer's contributions to an RPP or a DPSP had not become vested at the time the retiring allowance is granted.

TIF Solution Ten - 3

1. B. The employer promises each employee a retirement benefit that is based on a contractually specified formula.

2. D. The employee's ultimate pension benefit is not affected by rates of return on the pension plan assets.

3. C. Direct investments in rental properties.

4(i). C. $580 [(18%)($40,000 - $16,000 + $7,000) - ($2,000 + $3,000)].

4(ii). E. $2,580 [(18%)($40,000 - $16,000 + $7,000) - $3,000].

4(iii). I. $5,580 [(18%)($40,000 - $16,000 + $7,000)].

4(iv). F. $3,580 [(18%)($40,000 - $16,000 + $7,000) - $2,000].

5. D. $12,360.

Unused RRSP Deduction Room carried forward from 2009:	
Lesser Of:	
• ($21,000 - $6,000) = $15,000	
• [(18%)($50,000) - $6,000] = $3,000	$ 3,000
Plus 2010 RRSP deduction room	
Lesser Of:	
• 2010 RRSP Dollar Limit = $22,000	
• [(18%)($52,000)] = $9,360	9,360
RRSP Deduction Limit	$12,360

6. A. Scholarships, resource royalties, and CPP retirement benefits do not form part of the Earned Income calculation for RRSP purposes.

7. D. Contributions made during the current year can be deducted in any subsequent year.

8. A. All amounts withdrawn must be repaid within 10 years of the year of withdrawal.

9. A. Eileen can deduct her contribution from her Net Income For Tax Purposes and her employer's contribution is not considered a taxable benefit.

10. C. Earnings accumulate within the RRIF on a tax free basis.

11. C. Profit Sharing Plan to Deferred Profit Sharing Plan.

12. C. The amount of the retiring allowance which Mr. Smith can transfer to his RRSP in the year he retires is $59,500 [(20)($2,000) + (13)($1,500)]. This is $2,000 per year prior to 1996, plus $1,500 per year prior to 1989 during which no employer contributions vested to a pension plan.

TIF Solution Ten - 4

Exam Exercise Solution Ten - 1

His Earned Income for RRSP purposes will be $61,550 ($78,300 + $2,400 - $6,750 - $12,400).

Exam Exercise Solution Ten - 2

The Pension Adjustment will be $6,900 ($2,600 + $1,700 + $2,600).

Exam Exercise Solution Ten - 3

The addition to her RRSP deduction room for 2010 is $7,830, the lesser of 18 percent of her Earned Income of $43,500, and the 2010 RRSP Dollar Limit of $22,000. At the end of the year, her Unused RRSP Deduction Room would be $7,730 ($5,100 + $7,830 - $5,200) and her undeducted contributions would be $1,800 ($7,000 - $5,200).

Exam Exercise Solution Ten - 4

The required calculations would be as follows:

Unused Deduction Room - End Of 2009	$11,120
Lesser Of:	
• 2010 RRSP Dollar Limit = $22,000	
• 18% Of 2009 Earned Income Of $73,920* = $13,306	13,306
Less 2009 PA	(6,000)
2010 RRSP Deduction Limit	$18,426
RRSP Deduction Is Lesser Of:	
• RRSP Deduction Limit = $18,426	
• Available Contributions = $19,275 ($6,275 + $13,000)	(18,426)
Unused Deduction Room - End Of 2010	Nil

*Earned Income = $5,720 - $15,000 + $80,200 + $3,000 (RPP)

Mrs. White's maximum RRSP deduction is $18,426. While she has no Unused RRSP Deduction Room, she has $849 ($19,275 - $18,426) in undeducted contributions that can be carried forward and deducted in a subsequent year in which there is sufficient RRSP deduction room.

Exam Exercise Solution Ten - 5

Mr. Parnell will have a $13,500 [(18%)($75,000)] addition to his deduction room in both 2009 and 2010. These amounts are 18 percent of his Earned Income for 2008 and 2009, and $13,500 is below the RRSP dollar limit for both 2009 and 2010. His 2010 Earned Income will affect his 2011 RRSP deduction room and is not relevant to this Exercise. As his 2009 contribution is $13,500, he will not be in excess of his deduction room and no penalty will be assessed. However, when he makes the May 1, 2010 contribution, he will be over his deduction room by $2,500 [$13,500 + $16,000 - ($13,500 + $13,500)]. A 1 percent per month penalty is applicable to amounts above $2,000. As a consequence, there will be a 2010 penalty of $40 [(1%)($2,500 - $2,000)(8)].

Exam Exercise Solution Ten - 6

As the withdrawal is prior to January 1, 2013, Mr. Peters will be responsible for the taxes on $3,500 ($1,500 + $2,000) of the withdrawal, the total of his contributions. The remaining $800 ($4,300 - $3,500) will be taxed in the hands of his spouse.

Exam Exercise Solution Ten - 7

Mr. Debon's minimum payment for 2010 would be $433 [(1/15)($15,000 - $8,500)]. Note that the voluntary payment that was made during 2009 did not reduce the fraction of the remaining balance that must be repaid in 2010. If he does not make this payment, the amount will be added to his 2010 Net Income For Tax Purposes and subtracted from his HBP balance. Without regard to whether or not he makes this $433 payment, his minimum payment for 2011 would again be $433 [(1/14)($15,000 - $8,500 - $433)].

Exam Exercise Solution Ten - 8

As the withdrawals are within the annual limit of $10,000 and the overall limit of $20,000, there will be no tax consequences associated with the withdrawals from Mr. Forsyth's RRSP.

The repayment period will begin in 2014, as this is the fifth year (the maximum delay) of his participation in the Lifelong Learning Plan. It did not begin earlier because he had at least three months of education tax credits in the years 2009 through 2013.

There are no tax consequences in 2014, as his designated repayment of $2,900 exceeds the required amount of $2,000 ($20,000 ÷ 10).

The required repayment for 2015 is $1,900 [($20,000 - $2,900) ÷ 9]. The shortfall in his payment of $400 ($1,900 - $1,500) will be included in his income for 2015. This illustrates the fact that excess payments in some years cannot be applied against shortfalls in subsequent years.

Exam Exercise Solution Ten - 9

There is no required withdrawal from the RRIF in 2010, as this is the year that it is established. For 2011, the minimum withdrawal is $61,364 [$1,350,000 ÷ (90 - 68)].

Exam Exercise Solution Ten - 10

If Mrs. Barth has worked for 27 years as of 2010, she must have started in 1984. Given this, she can rollover a total of $31,500 [($2,000)(12 Years Before 1996) + ($1,500)(5 Years Before 1989)]. The remaining $53,500 ($85,000 - $31,500) will be subject to tax in 2010.

TIF Solution Ten - 5

For each term there is both a 100 percent correct answer and an answer that is close. We have indicated the “close answer” in brackets. This would allow you to mix terms from various chapters if you wish to do so.

The correct definitions for each of the listed key terms are as follows:

A. 8 (not 4)

B. 6 (not 10)

C. 5 (not 1)

D. 9 (not 2)

E. 3 (not 7)

TIF Solution Ten - 6

Registered Pension Plan

All of the $2,500 contribution to his RPP in 2009 was deductible by Mr. Plate in 2009. Further, his employer's matching contribution was not considered a taxable benefit. However, these contributions created a Pension Adjustment (PA) of $5,000 that will affect the limit on his 2010 RRSP contribution. His 2010 RPP contribution of $2,800 will be deductible in 2010.

Registered Retirement Savings Plan

Mr. Plate's maximum RRSP deduction is based on the lesser of $22,000 and $9,360 [(18%)($52,000, his 2009 Earned Income)]. This would be reduced to $4,360 by the 2009 PA of $5,000. The remaining RRSP contribution of $640 ($5,000 - $4,360) would not be deductible in 2010, but could be carried forward for deduction in subsequent years when he has sufficient deduction room.

TIF Solution Ten - 7

Mr. Bornstein's 2009 Earned Income would be calculated as follows:

Salary	$51,450
Taxable Benefits	1,580
Gross Employment Income	$53,030
Less: Union Dues	(110)
Net Employment Income	$52,920
Business Income	3,925
Rental Loss	(10,750)
Spousal Support Received	2,520
Earned Income	$48,615

As Mr. Bornstein is not a member of an RPP or a DPSP during 2009, he would have no Pension Adjustment (PA) for that year. Given this, his RRSP Deduction Limit for 2010 would be calculated as follows:

Opening Unused RRSP Deduction Room	$ 900
Lesser Of:	
• 2010 RRSP Dollar Limit = $22,000	
• [(18%)($48,615)] = $8,751	8,751
RRSP Deduction Limit	$9,651

As the problem states that he deducts the maximum allowable contribution to his RRSP in 2010, his Unused RRSP Deduction Room at the end of 2010 is nil. Mr. Borenstein would have an undeducted RRSP contribution of $349 ($10,000 - $9,651) that can be deducted in a future year.

TIF Solution Ten - 8

Part A

Ms. Harcourt's net employment income for the year would be calculated as follows:

Gross Salary	$72,000
Registered Pension Plan Contributions	(4,200)
Union Dues	(360)
Free Bahamas Trip ($5,600 + $1,000)	6,600
Taxable Car Benefit (See Note)	17,976
Net Employment Income	$92,016

Note: The taxable benefit on the car would be calculated as follows:

Standby Charge [(2%)($59,890)(11)]	$13,176
Operating Cost Benefit [(20,000)($0.24)]	4,800
Total Benefit	$17,976

As Ms. Harcourt's employment related driving is less than 50 percent of the total, no reduction in the standby charge is available. This also means that she could not have based her operating cost benefit on 50 percent of the standby charge if it had been advantageous.

Other Notes

- The Canada Pension Plan and Employment Insurance premiums can be used for tax credits, but cannot be deducted from any source of income.
- Income taxes and the parking fees withheld cannot be deducted against income.
- Donations to the United Way create a tax credit for individuals but cannot be deducted from any source of income.
- In general, IT-470R indicates that discounts on an employer's merchandise do not generate a taxable benefit.

Part B

Ms. Harcourt's Earned Income for 2009, which is equal to her Earned Income for 2010, is as follows:

Net Employment Income (Part A)	$92,016
Registered Pension Plan Contributions	4,200
Net Rental Loss	(3,900)
Business Loss	(24,600)
Earned Income	$67,716

Her maximum deductible RRSP contribution for 2010 is as follows:

Unused Deduction Room - End Of 2009	$ 4,500
Lesser Of:	
• 2010 RRSP Dollar Limit = $22,000	
• 18% Of 2009 Earned Income Of $67,716 = $12,189	12,189
Less 2009 PA	(7,000)
Maximum Deductible RRSP Contribution	$ 9,689