

ACCO 440/2 A and BB

ADVANCED TAXATION

COURSE NOTES

LECTURES 1 to 3

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LECTURE 1

(TEXTBOOK: CHAPTER 12)

TAXABLE INCOME AND TAX - CORPORATIONS DIVISION C

Net income for tax purposes \$ xxxx

LESS:

1. **Donations:**

- Charitable donations, ITA 110.1(1)(a) (xxxx)
- Gifts to Canada or province & cultural property,
ITA 110.1(1)(b) & (c) (xxxx)

2. **Dividends:**

- Dividends received from Canadian Corps., ITA 112 (xxxx)
- Dividends (not all) received from foreign affiliates, ITA 113 (xxxx)
- Foreign portfolio dividends are not deductible, but
can claim a foreign tax credit

3. **Loss carry overs** from subsequent or prior taxation years

- Non-Capital Loss, ITA 111(1)(a) (xxxx)
- Net Capital Loss, ITA 111(1)(b) (xxxx)
- Restricted Farm Loss, ITA 111(1)(c) (xxxx)
- Farm Loss, ITA 111(1)(d) (xxxx)

TAXABLE INCOME \$ xxxx

DONATIONS

- Registered charities: Max 75% of N.I. (net income)
- Excess carry forward c/f (carry forward) up to 5 years (no carry back)

DIVIDENDS

- Net Income calculation:
 - Include dividends received (not grossed up) from taxable Canadian corporations **and** from foreign corporations
- Taxable Income calculation:
 - Deduct the amount of dividends previously included in net income from taxable Canadian corporations and some foreign affiliate dividends
 - No similar deduction for foreign portfolio dividends. Instead, a FTC (foreign tax credit) will be allowed (to be covered later).

Dividends on Shares Sold For Loss (Stop Loss Rules)

- Special rule when dividends have been received by a corporation and the shares are subsequently sold at a loss.
- The loss must be reduced by all dividends received in the past

Example On June 30, 2015, Brian Company acquires 1,000 shares of Leader Company, a public company, at a cost of \$20 per share. On July 1, 2015, the Leader Company declares and pays its regular \$3 per share dividend. Because this dividend had been anticipated by the market, the price of the Leader Company stock falls \$3 per share to \$17 per share. On July 15, 2015, Brian Company sells all of its Leader Company shares at a price of \$17 per share.

Analysis In the absence of a special rule, the preceding situation would provide very favourable results for Brian Company. They would have received \$3,000 in dividends which, because of the deduction for intercorporate dividends, would not be included in their Taxable Income. In addition, they would have a potentially deductible capital loss of \$3,000 on the disposition of the shares.

- Stop-Loss rule apply if:
 1. The corporation owned the shares for less than 365 daysor
 2. The corporation and related persons own > 5 percent of class of shares paying the dividend

LOSS CARRY OVERS:

NON-CAPITAL LOSS - ITA 111(8)

- This is not the negative result of income from all sources, less deductions allowed.

Example During 2015, Marco Inc. has net taxable capital gains of \$30,000 [(1/2)(\$60,000)], dividends of \$25,000 received from taxable Canadian corporations, and a net business loss of \$60,000. The Company also has a net capital loss carry forward of \$50,000 [(1/2)(\$100,000)].

Analysis Using the ITA 3 rules for calculating Net Income For Tax Purposes, the result would be as follows:

ITA 3(a)	Dividends Received	\$25,000
ITA 3(b)	Net Taxable Capital Gains	30,000
ITA 3(c)	Subtotal	\$55,000
ITA 3(d)	Net Business Loss	(60,000)
<u>Net Income For Tax Purposes And Taxable Income</u>		<u>Nil</u>

12-25. From an intuitive point of view, it would appear that the non-capital loss for the year is \$5,000, the ITA 3(c) subtotal less the net business loss. Further, as Net Income is nil, it appears that none of the net capital loss carry forward can be deducted, despite the \$30,000 taxable capital gain. In addition, it does not appear that the Company will get any benefit from the potential deduction of the \$25,000 in dividends that were received during the year. Fortunately, the ITA 111(8) definition of non-capital loss solves both of these problems.

Non-capital loss calculation:

All losses + dividend deductions + loss carry overs:	
\$60,000 + \$25,000 + \$30,000* =	\$115,000
All income (ITA 3(c) balance): \$25,000 + \$30,000 =	<u>(55,000)</u>
Non-capital loss for the year	<u>\$ 60,000</u>

*The net capital loss carry forward deduction is limited to \$30,000, the amount of taxable capital gains realized during the year. This leaves a net capital loss carry forward of \$20,000 (\$50,000 - \$30,000).

- Unused loss can be carry back (c/b) 3 years or c/f 20 years (7 years for taxation years ending before March 23, 2004, 10 years for tax years ending before 2006), against income from all sources

NET CAPITAL LOSS - ITA 111(8)

- Basically = Excess of allowable capital losses over taxable capital gain
- Only deductible against taxable capital gains
- Can be carried back 3 years and carried forward indefinitely

ORDERING OF DEDUCTIONS

Dividends must be deducted first. Afterwards:

Rule of Thumb

- Deduct most restricted first

Two types of restrictions:

1. Type of Income item can be deducted against

- Restricted farm losses can only be used against farm income
- Net C.L only against T.C.G

2. The number of years the item can be carried over

- Donations: C/F period just 5 years, so use before 20 year C/F of other items

- As non-capital losses and farm losses can be C/F up to 20 years against any source of income, only use them first if they are getting close to expiry

GOALS OF THE CORPORATE TAX SYSTEM

1. Raise revenues
2. Competitive with other countries
3. Incentives for small business
4. Incentives for certain business activities
 - E.g. Scientific research and investment tax credits (ITCs)
Active vs. inactive income
5. Incentives for certain regions
 - E.g. Investment tax credits
6. Integration
 - For an individual, income earned through a corporation should bear the same tax rate as if the income was earned directly

**2015 COMPUTATION OF TAX
CORPORATIONS**

PART I TAX:

BASIC TAX RATE 123(1) 38% x Taxable Income (T.I.)	\$ XXXX
LESS FEDERAL ABATEMENT 124(1) 10% x T.I. *	(XXXX)
LESS GENERAL RATE REDUCTION 13% **	(XXXX)
or	
LESS MFG & PROCESSING (M&P) CREDIT 13% ***	(XXXX)
LESS SMALL BUSINESS DEDUCTION 125(1) 17% ***	(XXXX)
LESS FOREIGN TAX CREDIT (FTC) - NON BUSINESS ***	(XXXX)
LESS FOREIGN TAX CREDIT (FTC) - BUSINESS ***	(XXXX)
LESS INVESTMENT TAX CREDIT (ITC) *****	(XXXX)
PLUS ADDITIONAL REFUNDABLE TAX (ART) 123.3 (6 2/3%)***** <u>XXXX</u>	
PART I TAX	\$ XXXX
PLUS PART IV TAX (on dividends received by private corporations)	XXXX
LESS DIVIDEND REFUND (Private corporations only)	<u>(XXXX)</u>
NET FEDERAL TAX PAYABLE	\$ <u>XXXX</u>

- * Generally on Taxable Income earned in Canada
- ** Income that is not eligible for SBD, M&P, or AII
- *** See Lecture 2 for calculation
- **** See Lecture 3 for calculation
- ***** See Lecture 4 for calculation

BASIC TAX RATE

- The basic tax rate for all corporations is 38%

FEDERAL ABATEMENT - 10% DEDUCTION

- Purpose: As the provinces and territories all charge corporate tax, the 38% federal tax rate is reduced by 10%, but only if the income is earned in a province or territory.
- Example:
XYZ Corporation carries on 100% of its business in Quebec. XYZ Corporation earned \$100,000 this year. Compute its federal tax abatement?

Answer:

Federal tax: 38% x \$100,000	\$38,000
Federal tax abatement: 10% x \$100,000	<u>(10,000)</u>
Net federal tax	<u>\$28,000</u>

- If income is earned in a foreign country, there is no 10% abatement on this income.
- Example:
ABC Corporation carries on business in both Quebec and the US. Assume 80% of its income is allocated to Quebec, the remaining 20% was earned in the US. ABC Corporation earned \$100,000 this year. What is its federal tax abatement?

Answer:

Federal tax: 38% x \$100,000	\$38,000
Federal tax abatement: 10% x \$100,000 x 80%	<u>(8,000)</u>
Net federal tax	<u>\$30,000</u>

PROVINCIAL ALLOCATION OF INCOME

- Added to the corporate taxes are the provincial and territorial taxes. Each province and territory has its own corporate tax. The tax rates range from 1% to 16%, depending on the province and type of income earned. You are not responsible to know the provincial tax rates (for example, Figure 12-3 in your text).
- Taxable income allocated to a province depends on whether there is a Permanent Establishment (P.E.) in a province
- Definition of P.E. **Regulation 400(2)**
 - A fixed place of business in a particular province: can include an office, a branch or division, a factory, warehouse...
- Where only one P.E. no allocation amongst provinces necessary
- Where income earned in several provinces then must allocate Taxable Income (T.I.) to each province since provincial taxes have to be paid to each province based on this allocation
 - Basis of allocation: Average of % of Gross Revenue and % of Salaries and wages of each province
 - Exclude property income not used in the main business from Gross Revenue
- See example on the next page.

Example The Linford Company has permanent establishments in Alberta, Manitoba, and Ontario. The Company's Taxable Income for the current year totaled \$100,000, with gross revenues of \$1,000,000 and salaries and wages of \$500,000.

The following allocation of the gross revenues and the salaries and wages among the provinces occurred during the current year:

Province	Gross Revenues		Salaries And Wages	
	Amount	Percent	Amount	Percent
Alberta	\$ 250,000	25.0	\$100,000	20.0
Manitoba	400,000	40.0	200,000	40.0
Ontario	350,000	35.0	200,000	40.0
Totals	\$1,000,000	100.0	\$500,000	100.0

Analysis Using the average of the two percentages for each province, the Linford Company's Taxable Income would be allocated to the three provinces as follows:

Province	Average Percent	Taxable Income	Amount Allocated
Alberta	22.5	\$100,000	\$ 22,500
Manitoba	40.0	100,000	40,000
Ontario	37.5	100,000	37,500
Totals	100.0	N/A	\$100,000

LECTURE 2

(TEXTBOOK: CHAPTERS 12 AND 11)

COMPUTATION OF TAX FOR CORPORATIONS

SMALL BUSINESS DEDUCTION (SBD) - ITA 125(1), 125(7)

- Additional 17% tax deduction for CCPCs (Canadian Controlled Private Corporations) for active business income carried on in Canada

-Formula:

17% of least of:

- 1) Active business income (ABI) carried on in Canada (i.e. remove property income not used in the business)
- 2) Taxable income, less
 - $100/28$ x non-business Foreign Tax Credit (FTC)
 - 4 x business Foreign Tax Credit (FTC)
- 3) Annual Business Limit for the year (\$500,000), less any portion allocated to an associated company

Example A Canadian controlled private corporation has Taxable Income of \$130,000 for the year ending December 31, 2015. Of this amount, \$100,000 is active business income carried on in Canada. It also has a non-business FTC of \$2,800, and a business FTC of \$10,000 (assume 90% of the company's business is carried on in Canada). Determine the federal taxes payable.

Analysis:

Base amount of Part I Tax (38% x \$130,000) \$49,400

Less: Federal tax abatement (\$130,000 x 10% x 90%) (11,700)

Small business deduction:

17% of least of:

1. Active business income: \$100,000

2. Taxable income \$130,000

Less:

100/28 x \$2,800 = (10,000)

4 x \$10,000 = (40,000) \$80,000

3. Annual Business Limit \$500,000

The small business deduction (SBD) = 17% x \$80,000 = \$(13,600)

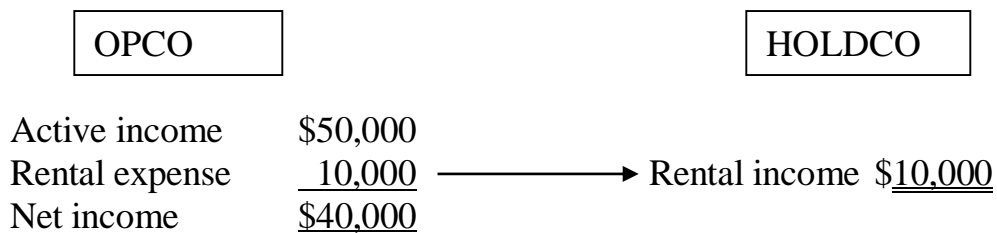
Federal Taxes Payable (before FTC, to be covered later) \$24,100

Active business income (ABI):

- Any business activity, including manufacturing, the sale of property (inventory) and the rendering of services
- Includes incidental property income and certain income from associated companies. See property income exceptions below.

Property Income:

- Active business income does not include income from property, such as interest, dividends, rents, and royalties
- Exception: Incidental property income is part of active business income E.g., interest on short term investments of temporary excess cash, short term rental of excess space, interest on overdue accounts receivable, etc.
- Exception for property income received from an associated corporation: If a corporation receives property income from an associated corporation, which deducted the amount in computing its ABI, then the income is deemed to be ABI to the recipient
- Example: Assume Opco and Holdco are associated.



The rental income earned by Holdco would be deemed to be active business income, and not property income.

Specified Investment Business (SIB):

- Active business income does not include income from a SIB, which is a business the principal purpose of which is to earn income from interest, dividends, rents, and royalties
- SIB income is included in property income
- SIB income will qualify as active business income if it employs > 5 full time employees in the business

Personal Services Business (PSB) and Personal Service Corporations:

- Active business income does not include income from a PSB
- PSB definition:
 - A corporation (often referred to as the incorporated employee) provides services to another person
 - If not for the corporation, the individual performing the services would be regarded as an employee of the other person
 - The individual owns $\geq 10\%$ of the corporation
- A PSB can only deduct the following expenses:
 - Salaries paid to the incorporated employee
 - Employment related expenses
- A PSB is not entitled to the SBD (Small Business Deduction) nor the GRR (General Rate Reduction, to be discussed later)
- If the corporation employs > 5 full time employees in the business, then the PSB income will qualify as active business income (can claim the SBD and GRR)

Professional Corporations

- Some provinces (not all) permit doctors, dentists, lawyers, accountants, veterinarians, and chiropractors to incorporate their practice.
- The income earned by these professional corporations is considered to be active business income and qualifies for the SBD.

Management companies

- These companies provide management services, usually to unincorporated professionals
- Services usually include payroll, accounting and purchasing services, etc. A 15% mark-up is normally charged on the services
- The income earned by management companies qualifies as active business income and can claim the SBD

Elimination of the SBD for Large CCPCs

- The SBD is reduced for corporations whose capital is > \$10 million, and is completely eliminated when the capital is \geq \$15 million.

- Formula:

$$\text{Annual Business Limit Reduction} = A \times \frac{B}{\$11,250} \text{ where,}$$

A is the amount of the corporation's annual business limit for the year (\$500,000 or less if shared with associated corporations).

B is 0.225 percent (.00225) of the excess of, the previous year's total Taxable Capital Employed In Canada by the corporation and its associated companies, over \$10 million.

- Example: ABC Corporation has:

2015 Taxable income:	\$600,000
2015 Active business income	\$400,000
2014 Taxable capital employed in Canada	\$12,000,000

Reduction to Annual business limit:

$$\$500,000 \times \frac{.00225 \times (\$12,000,000 - 10,000,000)}{\$11,250} = \$240,000$$

Annual business limit: $\$500,000 - 240,000 = \underline{\underline{\$260,000}}$

MANUFACTURING AND PROCESSING CREDIT Sec 125.1

- General Rules
 - Tax credit
 - Only on M&P income
 - 13% reduction in tax payable
 - CCPCs cannot claim this deduction for income which qualifies for the small business deduction
 - If claim M&P credit, you do not also get 13% general rate reduction (you can take one or the other, but not both) so this credit is no longer relevant for federal tax purposes
 - Calculation is still relevant for computing provincial taxes for some provinces

- M & P Credit = 13% of the lesser of:
 - 1) M & P Profits - Amount eligible for SBD
 - 2) Taxable income - (Amount eligible for SBD + 4 x FTC Business + Aggregate Investment Income)

GENERAL RATE REDUCTION

The rules are different for the application to CCPCs and to non CCPCs

Application to non-CCPCs

- 13% x Full Rate Taxable Income.
- Full Rate Taxable Income for a non-CCPC =

Taxable income, less:

1. Income eligible for the Manufacturing & Processing deduction (or 100/13 of the M&P deduction)

Application to CCPCs

- 13% x Full Rate Taxable Income.
- Full Rate Taxable Income for a CCPC =

Taxable Income, less:

1. Income eligible for the Small Business Deduction
(or 100/17 of the SBD)
2. Income eligible for the Manufacturing & Processing deduction
(or 100/13 of the M&P deduction)
3. Aggregate Investment Income

Example For the year ending December 31, 2015, Zaptek Ltd., a CCPC, has \$200,000 in Taxable Income. This amount is made up entirely of active business income earned in Canada, none of which relates to M&P activity. Zaptek is associated with another company and, as per the agreement with that company, Zaptek is entitled to \$100,000 of the annual business limit.

Analysis The federal Tax Payable for Zaptek Ltd. would be calculated as follows:

Base Amount Of Part I Tax [(38%)($\$200,000$)]	\$76,000
Federal Tax Abatement [(10%)($\$200,000$)]	(20,000)
Small Business Deduction [(17%)($\$100,000$)]	(17,000)
General Rate Reduction [(13%)($\$200,000 - \$100,000$)]	(13,000)
<u>Federal Tax Payable</u>	<u>\$26,000</u>

12-149. The overall rate of federal tax in this example is 13 percent ($\$26,000 \div \$200,000$). This reflects a combination of a rate of 11% (38% - 10% - 17%) on the \$100,000 of income that was eligible for the small business deduction, and a rate of 15% (38% - 10% - 13%) on income that is not eligible for this deduction.

FOREIGN TAX CREDITS

Basic Concepts

- Gross pre-withholding tax amounts included in income
- Foreign tax credit allowed for withholding tax
- Withholding tax rates differ depending on the country

→ Non business FTC

Lesser of:

- 1) Foreign non-business taxes paid (no 15% limit for corporations)
- 2) $\frac{\text{Foreign non-business income}}{\text{Adjusted Division B Income}} \times \text{Part I taxes otherwise payable}$

→ Business FTC

Lesser of:

- 1) Foreign business taxes paid
- 2) $\frac{\text{Foreign business income}}{\text{Adjusted Division B income}} \times \text{Part I taxes otherwise payable}$
- 3) Part I tax otherwise payable - FTC on non-business income

Definitions:

■ **Adjusted Division B Income**

- Net Income, less following amounts deducted from net income
 - Net capital loss carry over
 - Canadian and foreign affiliate dividends

■ PART I Tax Otherwise Payable

<u>Tax Otherwise Payable Components</u>	<u>Non-Business</u>	<u>Business</u>
Base Amount Of Part I Tax (38%)	Yes	Yes
Plus: Additional Refundable Tax (ART) On Investment Income Of CCPC (See Chapter 13)	Yes	No
Minus: Federal Tax Abatement	Yes	No
Minus: General Rate Reduction	Yes	Yes

FTC Carry Over

If foreign taxes exceeds the FTC allowed for Canadian purposes, per above:

- Business FTC: The undeducted amount can be
 - Carried back 3 years
 - Carried forward 10 years

- Non business FTC
 - No carryover of unused amount
 - Excess can be deducted from net income under ITA 20(12)

Example Non-business FTC:

A Canadian controlled private corporation (CCPC) earns \$10,000 of interest from a US bank. There was a \$3,000 foreign withholding tax, with the net amount received of \$7,000. Adjusted Division B net income is \$100,000, with 80% allocated to a province, and tax otherwise payable is \$28,067.

Non business FTC:

Lesser of:

1. Foreign taxes: \$3,000

2. $\frac{\$ 10,000 \text{ Foreign income}}{\$100,000 \text{ Adj. Div. B income}} \times \$28,067 \text{ tax otherwise payable} = \underline{\$2,807}$

Result: \$2,807 allowed as a FTC against Part I Tax.

Example Business FTC:

Continuing the previous example, the company also earned \$20,000 from operating a gas station in the US. The company paid \$8,000 in taxes to the US on this income, and Tax Otherwise Payable for the business FTC is \$35,400.

Business FTC:

Lesser of:

1. Foreign taxes: \$8,000

2. $\frac{\$ 20,000 \text{ Foreign income}}{\$100,000 \text{ Adj. Div. B income}} \times \$35,400 \text{ tax otherwise payable} = \underline{\$7,080}$

3. \$18,500 Part I Tax less \$2,807 Non-business FTC = \$15,693

Result: \$7,080 allowed as a FTC against Part I Tax. The remaining \$920 can be carried back 3 years or carried forward 10 years.

LIFETIME CAPITAL GAINS DEDUCTION (CGD)

CGD on the disposition of:

- Qualified small business corporation shares (QSBC): \$813,600 CG limit
 - Qualified farm properties: \$1,000,000* CG limit
 - Qualified fishing properties: \$1,000,000* CG limit
- * Amount was \$500,000 prior to April 22, 2015

Note: The above amounts are cumulative.

Qualified Small Business Corporation Shares

To be eligible to claim the CGD on the disposition of QSBC shares, the corporation must meet the following 4 conditions:

- **SBC:**
 1. CCPC
 2. 90% or more of the FMV of assets used primarily to carry on an active business in Canada at the time the shares are sold
- **QSBC:**
 3. No unrelated party could have owned the corporation in the previous 24 months (so you can't purchase a corporation on speculation, sell it before two years, and claim the CGD)
 4. $\geq 50\%$ of the FMV assets used in active business in Canada during entire 2 year period.

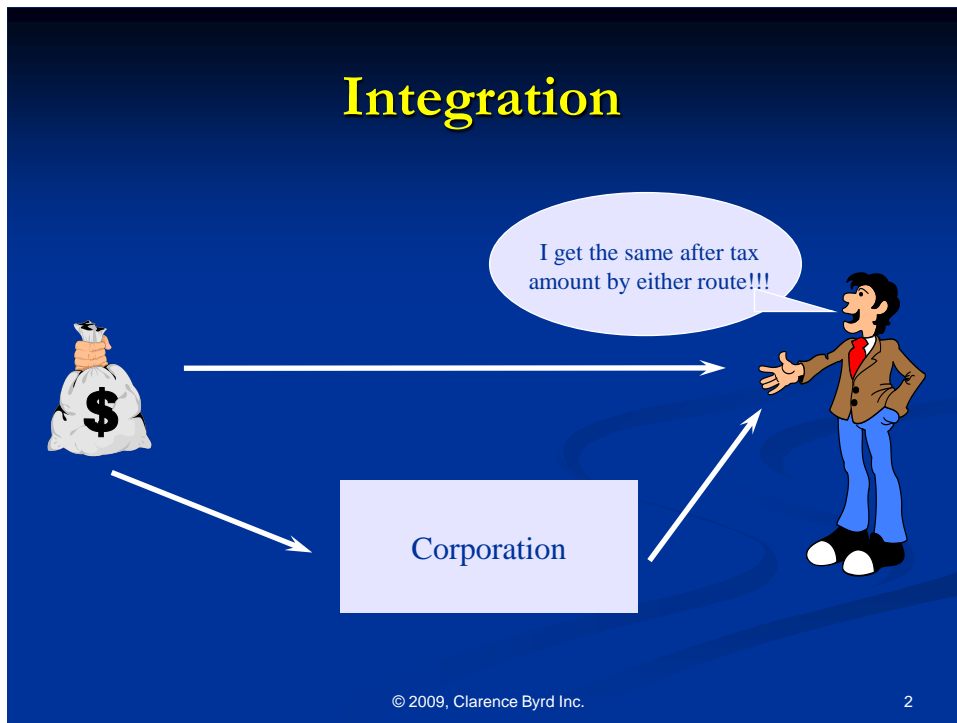
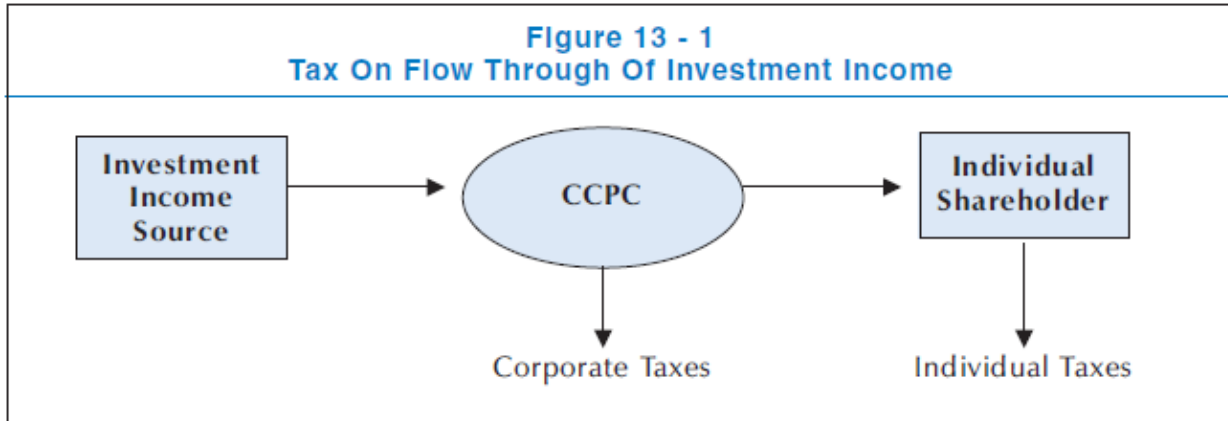
Purification:

- If the 90% rule noted above is not met at the time of sale, then the corporation can be purified.
- This would involve the selling of non-qualifying assets before the sale of the company, and:
 - Distributing the proceeds to the shareholders by way of dividends, or
 - Pay off company debts

LECTURE 3

(TEXTBOOK: CHAPTER 13)

TAXATION OF CORPORATE INVESTMENT INCOME INTEGRATION AND REFUNDABLE TAXES



The Integration concept: Income earned through a corporation should bear the same tax rate as if the income was earned directly.

Issue:

- Corporate taxes on investment income in CCPCs (38% -10% + 12% provincial taxes (estimate) = 40%) is less than individual taxes on investment income (about 45% for the top tax bracket).

Solution:

- An additional tax (6 2/3%) will apply to investment income (see AII below) at the corporate level for CCPCs. This tax will be refundable to the CCPC when it pays out dividends to its shareholders.

Aggregate Investment Income (AII):

- Includes:
 - Property income, both Canadian and foreign, (interest, rents, royalties)
 - Foreign portfolio dividends
 - Net taxable capital gains for the year, reduced by any net capital loss carryovers
- Excludes:
 - Canadian dividends deductible in computing Taxable Income
- **Remember: AII is not the same as Property income**

Additional Refundable Tax (ART) (CCPC only)

- 6 2/3% x lesser of:
 - 1) Aggregate Investment Income
 - 2) TI - amount eligible for SBD
- Note: ART is in addition to Part I taxes payable

Issue:

- Corporate taxes on investment income in CCPCs (38% -10% + 12% provincial taxes (estimate) plus ART 6 2/3% = 46 2/3%). If the income after taxes is paid out by way of dividend, the shareholder will pay taxes on the dividend (net of the dividend tax credit) at approximately 29 to 34% on a non-eligible dividend. The corporation tax and the tax on the dividend combined would be much greater than if the investment income were to be earned directly by the shareholder.

Solution:

- Refund part of the Part I taxes paid by a CCPC on its investment income when it pays out dividends to its shareholders.

REFUNDABLE DIVIDEND TAX ON HAND (RDTOH) 129(3) FORMULA

1. Opening balance of RDTOH
 - + 2. Refundable portion of Part I taxes = Least of:
 - a) 26 2/3% of aggregate investment income for year
less
(Non Business FTC - 9 1/3% x foreign investment income)
 - b) 26 2/3% x Taxable income
less the total of:
 - amount eligible for SBD
 - 100/35 x Non-Business FTC
 - 4 x Business FTC
 - c) Part I Tax
 - + 3. Part IV Tax
 - 4. Dividend refund of prior year
- 1 + 2 + 3 - 4 = Ending balance of RDTOH

Part IV Tax (applies to all private corporations)

$1/3 \times$ Canadian dividends received from non-connected corporations

+ corporation's pro-rata share of the dividend refund received by a connected payor corporation

Definition of Connected corporation:

> 10% Ownership

Dividend refund =

Lesser of:

- 1) RDTOH ending balance
- 2) $1/3 \times$ Taxable dividends paid

Example Fortune Ltd. is a Canadian controlled private corporation. Based on the formula in ITR 402(3), 90 percent of the Company's income is earned in a province. The following information is available for the year ending December 31, 2015:

Canadian Source Investment Income (Includes \$25,000 In Taxable Capital Gains)	\$100,000
Gross Foreign Non-Business Income (15 Percent Withheld)	20,000
Gross Foreign Business Income (15 Percent Withheld)	10,000
Active Business Income (No Associated Companies)	150,000
Portfolio Dividends Received	30,000
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Net Income For Tax Purposes	\$310,000
Portfolio Dividends	(30,000)
Net Capital Loss Carry Forward Deducted	(15,000)
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Taxable Income	\$265,000
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RDTOH - December 31, 2014	\$110,000
Dividend Refund For 2014	20,000
Taxable Dividends Paid During 2015	40,000

Analysis The Part I Tax Payable would be calculated as follows:

Base Amount Of Part I Tax [(38%)(\\$265,000)]	\$100,700
Federal Tax Abatement [(10%)(90%)(\\$265,000)]	(23,850)
Small Business Deduction (Note 1)	(25,500)
ART (Note 2)	7,000
General Rate Reduction (Note 3)	(1,300)
Foreign Non-Business Tax Credit (Note 1)	(3,000)
Foreign Business Tax Credit (Note 1)	(1,500)
Part I Tax Payable	\$ 52,550

Note 1 In order to simplify the calculation of the small business deduction, the foreign tax credits are assumed to be equal to the amounts withheld (15 percent). Additional calculations would be required to support this conclusion.

The small business deduction would be equal to 17 percent of the least of:

1. Active Business Income	<u>\$150,000</u>
2. Taxable Income	\$265,000
Deduct:	
[(100/28)(\\$3,000 Foreign Non-Business Tax Credit)]	(10,714)
[(4)(\\$1,500 Foreign Business Tax Credit)]	(6,000)
Adjusted Taxable Income	\$248,286
3. Annual Business Limit	<u>\$500,000</u>

The small business deduction is \$25,500 [(17%)(\\$150,000)].

Note 2 Aggregate Investment Income is equal to \$105,000 (\$100,000 + \$20,000 - \$15,000). The \$7,000 Additional Refundable Tax (ART) is equal to the lesser of:

• [(6-2/3%)(\\$105,000)]	\$7,000
• [(6-2/3%)(\\$265,000 - \$150,000 SBD)]	\$7,667

Note 3 The general rate reduction would be calculated as follows:

Taxable Income	\$265,000
Amount Eligible For Small Business Deduction (Note 1)	(150,000)
Aggregate Investment Income	(105,000)
Full Rate Taxable Income (= Foreign Business Income)	\$ 10,000
Rate	13%
General Rate Reduction	\$ 1,300

13-117. Based on the preceding information, the refundable portion of Part I tax would be the least of the following three amounts:

26-2/3% Of Aggregate Investment Income		
[(26-2/3%)(\\$105,000)]		\$ 28,000
Deduct Excess Of:		
Foreign Non-Business Tax Credit	(\$3,000)	
Over 9-1/3% Of Foreign Investment		
Income [(9-1/3%)(\\$20,000)]	1,867	(1,133)
Amount Under ITA 129(3)(a)(i)		\$ 26,867

Taxable Income		\$265,000
Deduct:		
Amount Eligible For Small Business Deduction	(\$150,000)	
[(100/35)(\$3,000 Foreign Non-Business Tax Credit)]	(8,571)	
[(4)(\$1,500 Foreign Business Tax Credit)]	(6,000)	(164,571)
Total		\$100,429
Rate		26-2/3%
Amount Under ITA 129(3)(a)(ii)		\$ 26,781
Amount Under ITA 129(3)(a)(iii) = Part I Tax Payable		\$ 52,550

The refundable portion of Part I tax is equal to \$26,781, which is the least of the preceding three amounts.

13-118. The Part IV tax would be \$10,000, one-third of the \$30,000 in portfolio dividends received. Given this, the balance in the RDTOH account at the end of the year is as follows:

RDTOH - End Of Preceding Year	\$110,000	
Less: Dividend Refund For Preceding Year (Given)	(20,000)	\$ 90,000
Refundable Portion Of Part I Tax	\$ 26,781	
Part IV Tax Payable [(33-1/3%)(30,000)]	10,000	36,781
RDTOH - December 31, 2015		\$126,781

13-119. The dividend refund for the year would be \$13,333, the lesser of:

- One-Third Of Taxable Dividends Paid ($\$40,000 \div 3$) = \$13,333
- RDTOH Balance - December 31, 2015 = \$126,781

13-120. Using the preceding information, the total federal Tax Payable for Fortune Ltd. is calculated as follows:

Part I Tax Payable	\$52,550
Part IV Tax Payable	10,000
Dividend Refund	(13,333)
Federal Tax Payable	\$49,217

13-122. The dividend refund for the year would be \$13,333, the lesser of:

- One-Third Of Taxable Dividends Paid ($\$40,000 \div 3$) = \$13,333
- RDTOH Balance - December 31, 2013 = \$126,781

13-123. Using the preceding information, the total federal Tax Payable for Fortune Ltd. is calculated as follows:

Part I Tax Payable	\$52,550
Part IV Tax Payable	10,000
Dividend Refund	(13,333)
Federal Tax Payable	\$49,217

Dividend Gross Up and Tax Credit for 2015

Non-Eligible Dividends

Dividend received	\$100,000
18% Gross up	<u>18,000</u>
Taxable dividend	<u>\$118,000</u>
Federal dividend tax credit (or DTC):	
(13/18 x gross up of 18,000)	
(13% x dividend received)	
(11.017% x grossed up dividend)	<u>\$13,000</u>

Eligible Dividends

Dividend received	\$100,000
38% Gross up	<u>38,000</u>
Taxable dividend	<u>\$138,000</u>
Federal dividend tax credit (DTC):	
(6/11 x gross up of \$38,000)	
(15.0198% x grossed up dividend)	
(20.727% x dividend received)	<u>\$20,727</u>

ELIGIBLE DIVIDENDS

History – Problems

1. 18% gross up and DTC (dividend tax credit) effectively eliminates most double tax for a CCPC earning income subject to the SBD (small business deduction) or refundable taxes (integration concept)
2. Double tax problem exists for income not subject to the SBD or refundable taxes, and for all income of public corps.
3. Corporations started to convert to income trusts

Solution

1. Eligible Dividends: Enhanced gross up (38%) and DTC (6/11) for dividends paid out of income not subject to the SBD or refundable taxes
2. Non-eligible dividends: Normal gross up (18%) and DTC (13/18) for dividends paid out of income subject to SBD or refundable taxes

Designation of eligible dividends

1. Paying corporation can designate a dividend as eligible by informing recipient
2. CCPC: If paid by a CCPC, must be paid out of the GRIP account

GRIP (General Rate Income Pool):

- + 72%(TI-SBD-AII)
- + Eligible dividends received
- Eligible dividends paid in the previous year

3. Public Corp: If paid by a non-CCPC (i.e., a public corporation, or other private), must first pay non-eligible dividends out of the LRIP account, if any, until there is a nil balance.

LRIP: (Low Rate Income Pool)

- + Non-eligible dividends received from a CCPC
- Dividends paid out of LRIP

4. Most companies in position to designate eligible dividends will do so.

Penalties:

1. If make an excessive designation, the entire dividend is still taxed as an eligible dividend to the recipient.

2. Part III.1 Tax on EEDD (Excessive Eligible Dividend Designation)

20% of excess if inadvertent

or

30% on entire dividend if deliberate

**SUMMARY OF 2015 FEDERAL CORPORATE TAX RATES FOR
DIFFERENT CORPORATIONS**

1. Public Corporation: 38% - 10% Fed. Abatement – 13% GRR = 15%
2. CCPC earning ABI: 38% - 10% Fed. Abatement – 17% SBD = 11%
3. CCPC earning property income: 38% - 10% Fed. Abatement
+ 6 2/3% ART = 34 2/3%
(less 26 2/3 % dividend refund when dividends are paid)
4. SIB: 38% - 10% Fed. Abatement + 6 2/3% ART = 34 2/3%
(less 26 2/3 % dividend refund when dividends are paid)
5. SIB with > 5 employees: 38% - 10% Fed. Abatement – 17% SBD = 11%
6. PSB: 38% - 10% Fed. Abatement (no SBD or GRR) = 28%
(and expenses limited to employee deductions)
7. PSB with > 5 employees: 38% - 10% Fed. Abatement – 17% SBD = 11%
8. Professional Corp. (CCPC): 38% - 10% Fed. Abatement – 17% SBD = 11%
9. Management Corp. (CCPC): 38% - 10% Fed. Abatement – 17% SBD = 11%