

**ACCO 440 - ADVANCED TAXATION
JMSB
WINTER 2015 - LECTURE NOTES**

[Important Note: due to the substantial changes to the ITA, previous versions of notes no longer reflect current material]

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Disclaimers:

The notes are not a substitute for the textbook nor do they purport to cover the entire material indicated in the course outline. Accordingly, the textbook along with the *Income Tax (Canada)* (the "Act" or "ITA") are the primary sources of reference for the course. For any discrepancy between the notes and the textbook, the textbook has precedence.

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LECTURES 1 and 2: Chapters 12 & 14 (Association section)
 Taxable Income and Tax Payable for Corporations

Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

OVERVIEW OF NET AND TAXABLE INCOME FOR CORPORATIONS

3(a) Total of:			
Subdivision a			+
▪ Income from each employment [Add: ss.5,6,7,Less: ss 8 ITA]			
Subdivision b			+
▪ Income from each business [ss. 9 - 20, 67, 78 ITA] Refer to ACCO 340 (i.e., Chapter 6 and next slide)			
Subdivision b			+
▪ Income from each property [ss.12 ITA] (i.e., Gross Dividends from other corporations – no Gross-up)			
Subdivision d			+
▪ Other sources [ss. 56 – 59.1 ITA]			
Subdivision c			
3(b) the total, if any, by which [<u>Only Positive Balances</u>]			
i) the total of:			
▪ Taxable Capital Gains (other than LPP) and		+	
▪ Taxable Net Gain (Gains less losses) from LPP		+	
<i>Exceeds</i>			
▪ Allowable Capital Losses	xx		
<i>Less:</i> Allowable Business Investment Losses	(xx)	-	+
Subdivision e		-	
3(c) deductions (if any) [Section 60 -66.8 ITA]			
		-	-
			+
3(d) total of [<u>Obligatory and not Discretionary</u>]			
▪ Loss from each employment		-	
▪ Loss from each business		-	
▪ Loss from each property		-	
▪ Allowable business investment loss		-	
		-	-
Net Income – Division B income			+
DIVISION C: Computation of Taxable Income			
Less : [In the following order]			
Deduct (Only applicable to corporations):			
▪ Dividends received [from taxable Cdn corp or from foreign affiliates – may be PART IV Tax] ¹			
▪ Charitable Donations[limited to 75% of net income]			
▪ 111 Deductible losses of other years [No specific order required]			
- Non Capital Losses [ie. Employment, Business, Property] & [Oldest Losses First]			
- Net Capital Losses [1/2 of (Capital Losses – Capital Gains) [Oldest Losses First]			
- Allowable Business Investment Losses			
- Regular Farm Losses			
- Restricted Farm Losses			
Taxable Income for Corporations – Division C income			+

¹ For foreign dividends, no deduction - unless foreign affiliate - and may claim FTC [see headings in notes]

1. RECONCILIATION SCHEDULE FOR BUSINESS INCOME

ACCOUNTING NET INCOME BEFORE TAXES	XXXX
<u>Add:</u>	
▪ Accounting Depreciation	
▪ Recapture of CCA	
▪ Tax reserves deducted in prior year	
▪ Accounting Losses	
▪ Accounting Scientific Research Expenditures	
▪ Accounting Warranty Expenses	
▪ Foreign Tax Paid	
▪ Taxable Capital Gains (1/2 of Capital Gains)	
▪ Accounting Income Tax Expense	
▪ Interest and Penalties paid for income tax purposes	
▪ Non-deductible automobile costs	
▪ ½ of meals and entertainments	
▪ Club dues and recreational facilities	
▪ Accounting Reserves	
▪ Political Contributions ²	
▪ Charitable Contributions ³	
▪ Accounting Write-Downs	+XXX
<u>Deduct:</u>	
▪ Allowable Capital Losses (1/2 of Capital Loss)	
▪ CCA	
▪ CEC	
▪ Terminal Losses	
▪ Current Year Tax Reserves	
▪ Accounting Gains	
▪ Tax Scientific Research Expenditures	
▪ Tax Warranty Reserves	
▪ Foreign Non-Business Tax Deduction	
▪ Allowable business losses	(-XXX)
NET INCOME FOR TAX PURPOSES	XXXX

² Not a deduction in arriving at Net Income for tax purposes

³ Not a deduction in arriving at Net Income for tax purposes

OVERVIEW OF TAXES PAYABLE FOR CORPORATIONS

Net Income for Tax Purposes – Division B	<u>\$ XXX</u>
(i.e., for corporations dividends are included in net income - property income - without gross-up)	
Less: Division C	
▪ Dividends received [from taxable Cdn corp or from foreign affiliates – may be PART IV Tax] ⁴	<u>\$ XXX</u>
▪ Charitable Donations [limited to 75% of net income]	<u>\$ XXX</u>
▪ 111 Deductible losses of other years [No specific order required]	<u>\$ XXX</u>
- Non Capital Losses [ie. Employment, Business, Property] & [Oldest Losses First]	
- Net Capital Losses [1/2 of (Capital Losses – Capital Gains) [Oldest Losses First]	
- Allowable Business Investment Losses	
- Regular Farm Losses	
- Restricted Farm Losses	
Taxable Income	<u>\$ XXX</u>
Base Amount of Part I Tax @ 38%	\$ XXX
Federal Tax Abatement @ 10% max	<u>(XXX)</u>
<i>Add:</i>	
Additional Refundable Tax (ART) on Investment Income - 6 2/3%	\$ XXX
<i>Deduct:</i>	
Non business FTC	(XXX)
Business FTC	<u>(XXX)</u>
Small business deduction – 17.00%	(XXX)
M&P – 13.00%	(XXX)
General rate reduction (GRR) – 13.00%	(XXX)
SR&ED ITCs	(XXX)
Part I tax payable	\$XXX
<i>Add:</i>	
Part IV tax (i.e., for dividends)	XXX
<i>Deduct:</i>	
Dividend refund	(XXX)
Sub-total: Net Federal Tax Payable	XXX
<i>Add:</i>	
Provincial Tax per Regulation 400	\$ XXX
Total Tax Payable	\$ XXX

⁴ For foreign dividends, no deduction included on a gross basis and may claim FTC [see headings in notes]

1.1. Ordering of Deductions and Use of Losses

No specific order required between general categories of losses. Planning Point - Use Charitable Donations First (i.e., 5 year carry forward) followed by losses that will expire first

*Non Capital Losses [i.e., Employment, Business, Property] & [Oldest Losses First – subsection 111(3)]
 Expiry: 20 years*

*Net Capital Losses [Capital Losses – Capital Gains] [Oldest Losses First – subsection 111(3)]
 No Restriction*

*Allowable Business Investment Losses
 Non Capital Loss for first 10 years and reverts to net capital loss*

*Regular Farm Losses and Restricted Farm Losses
 Expiry 20 years*

1.2. Composition of Loss Balances & Carry Over of a Corporation to other years - 111(8)

Net Capital Losses	
Step 1: Aggregate of Capital losses in the year	XXXX
Step 2: Deduct ABILs	(XXXX)
Step 3: Apply only to extent of Capital Gains	(XXXX)
Step 4: Add unused ABIL for the 10 th preceding year	XXXX
Balance: Excess of Losses that may be carried over to other years	XXXX

Non Capital Losses A-D, where: A=E-F		
-Employment losses in the year	XXXX	
-Business losses in the year	XXXX	
-Property losses in the year	XXXX	
- Net capital loss carry over deducted in the calculation of Taxable Income for the year (i.e., limited/capped of to the taxable capital gains for the year)	XXXX	
-Dividends received from taxable Canadian corporations and deducted in the year.	<u>XXXX</u>	
Total Variable E	XXXX	XXXX
Less - Variable F - ITA 3(c)		(XXXX)
Less - Variable D - Farm Loss for the year		(XXXX)
Excess of Losses that may be carried over to other years		XXXX

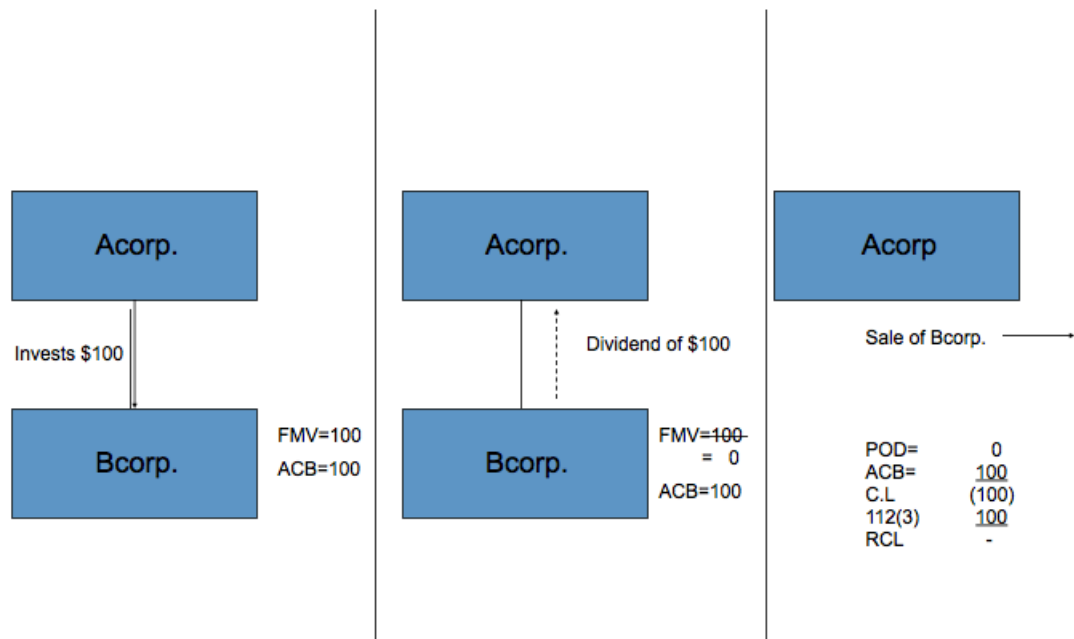
1.3. Corporation selling shares of another corporation at a loss: Subsection 112(3) and (3.01)

Reduce loss – other than 84(3) deemed dividends (to be reviewed in subsequent material) - on disposition of share by a corporation by all deductible inter-corporate section 112 dividends if (i.e., 5/365 Rule):

- the corporation owned the share for less than 365 days (i.e., less than one year)
 - or -
- the corporation and persons with whom the corporation was not dealing at arm's length owns more than 5 percent of the outstanding shares of any class of stock of the corporation.

Inversely stated, there will be no reduction if the share is owned for ≥ 365 days **and** owned $\leq 5\%$ of any class.

112(3) - Illustration



1.4. Individual selling shares of corporation at a loss: Subsection 112(3) and (3.01)

Parallel rule for individuals. However, the loss on the sale of shares is only reduced to the extent of the capital dividends (CDA) (i.e., non taxable dividends) received by the individual.

Note: Simply put, reduce loss of any taxpayer by any non-taxable dividend received (i.e., for individuals - CDA/83(2) dividends and for corporations - inter-co deductible dividends per section 112).

1.5. Determining Income Allocated to the Provinces - Permanent Establishments

Definition - Regulation 400(2):

Taxable income earned in a province will occur if there is a permanent establishment.

Physical Place of Business – Regulation 400(2)(a):

- an office
- a branch
- a factory
- a workshop
- a warehouse

If no physical location – Regulation 400(2)(b):

A corporation carries on business through an employee or agent, established in a particular place, who has either:

- general authority to contract for his employer or principal; or
- who has a stock of merchandise owned by his employer or principal from which he regularly fills orders which he receives,

Computation - Regulation 402(3):

Step # 1:

$$\frac{1}{2} \times \left[\frac{\text{Gross Revenues earned in a Province}}{\text{Total Gross Revenue}^5} + \frac{\text{Salaries in attributable to a Province}}{\text{Total Salaries}} \right]$$

Step # 2:

Result in step # 1 multiplied by Taxable Income of a corporation

⁵ Exclude interest on bonds, debentures or mortgages, dividends, or rentals or royalties from property that is not used in connection with the principal business operations of the corporation.

1.6. Rates of Tax

1.6.1. Overview - Part I Overview - Part I

Corporate taxation is based on two factors:

i. Type of Corporation:

a. Private Corporation – 89(1)

- Resident in Canada [See Appendix A] and not controlled by one or more public corporations

b. Public Corporations – 89(1)

- Resident in Canada and shares listed on a Cdn prescribed stock exchange per section 3200 (i.e., Montreal, Toronto, Vancouver, Winnipeg or Alberta); or

- Qualify as a public corporation by election or designation. The corporation must comply with the prescribed conditions listed in subsection 4800(1) of the Regulations.

- A corporation may also elect (Form T2067), or be designated, not to be a public corporation if it meets the prescribed conditions listed in subsection 4800(2) of the Regulations.

c. Canadian Controlled Private Corporation – 125(7) and 248(1)

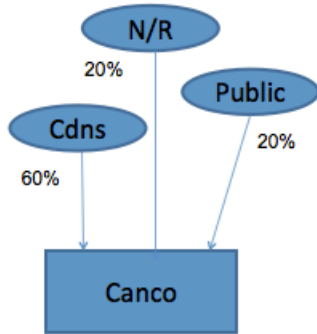
Criteria # 1: Resident in Canada

Criteria # 2: Incorporated in Canada, or resident in Canada throughout the period commencing June 18, 1971 and ending at that time

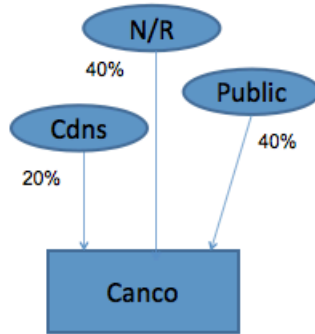
Criteria # 3: A private Canadian corporation must not be controlled:

- by one or more non-residents,
- by one or more public companies [defined in subsection 89(1) as a corporation resident in Canada whose shares are listed on a Cdn Stock exchange],
- by a combination thereof.

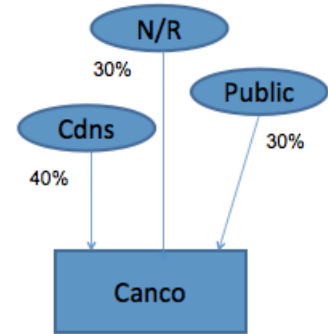
Corp. Status



CCPC



Non-CCPC



Non-CCPC

ii. Type of Income

a. Active Business Income (ABI) – defined in section 125 as income other than from a specified investment business or a personal service business:

Rates - ABI (CCPC)

Base Rate	38.00 %	38.00 %
Less: Abatement	(10.00)%	(10.00)%
Less: SBD - Up to Business Limit	(17.00)%	-
Less: GRR – Over Business Limit		(13.00)%
Tax Rate	11.00%	15.00 %

Specified Investment Business (SIB) - defined in section 125:

Principal purpose is to derive income from property (i.e., interest, dividends, rents, and royalties).

Rates - SIB Rates:

Base Rate	38.00 %
Less: Abatement	(10.00)%
Less: SBD	-
Less: GRR	-
Plus: ART	6.70 %
Tax Rate	34.70 %

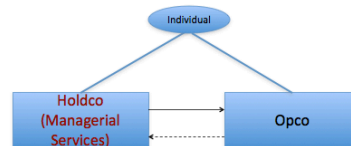
It does not include a business carried on by the corporation in the year where

- a. the corporation employs in the business throughout the year more than five full-time employees
- or -
- b. an associated corporations provides - in the course of carrying on an active business - managerial, administrative, financial, maintenance or other similar services to the corporation in the year

- and -

the corporation could reasonably be expected to require more than five full-time employees if those services had not been rendered;

**Paragraph (b) of SIB definition –
Illustration**



Note: Opco would have employed more than 5 employees but does not as Holdco (an associated corporation) provides services that would have otherwise been done by Opco's own employees

Personal service business (PSB) – defined in section 125:

A business of providing services where

- a. an individual who performs services on behalf of the corporation (an “incorporated employee”)

- or -

- b. any person related to the incorporated employee

is a specified shareholder of the corporation [10% or more] and the incorporated employee would reasonably be regarded as an officer or employee of the person to whom or to which the services were provided but for the existence of the corporation, unless

- c. the corporation employs in the business throughout the year more than five full-time employees, or
- d. the amount paid or payable to the corporation in the year for the services is received or receivable by it from a corporation with which it was associated in the year

Note: As a result, income from a PSB is not eligible for the SBD (material to follow) preferential rates. Accordingly, income from PSB will be eligible for the GRR (i.e., note that according to the October 31, 2011 draft proposals by the Department of Finance, PSB will not longer be able to avail itself of the GRR and will be taxed effectively at 28%).

PSB Rates:

	Before Draft Proposal	Once Legislative Amendment Passed
Base Rate	38.00 %	38.00 %
Less: Abatement	(10.00)%	(10.00)%
Less: SBD	-	-
Less: GRR	(13.00)%	-
Tax Rate	15.00 %	28.00 %

Furthermore, deductions are prohibited per paragraph 18(1)(p) thereby limiting the deductions as an employee per section 8 (see ACCO 340 employee vs self employed lecture). In addition to the section 8 employee expenditures, the following deductions are permitted per paragraph 18(1)(p) for a PSB:

- salary, wages and other remuneration paid to the incorporated employee;
- cost to the corporation of any benefit and allowance paid to the incorporated employee;
- legal expenses incurred by the PSB in collecting amounts owed to it for services rendered

Income deemed to be Active Business Income (ABI)

Incidental Property Income

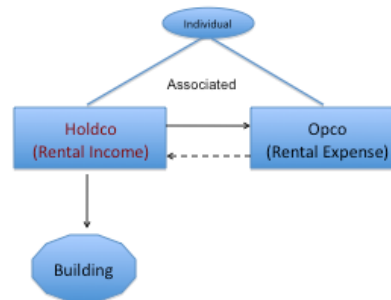
Incidental Property Income earned by a corporation engaged in an active business [i.e., Interest from temporary cash balances or temporary rentals of excess space].

Deemed Active Business Income- Paragraph 129(6)(b)

A corporation derives income from holding property, and the income is received from an associated company [to be visited later on] that deducted the amounts in computing active business income, paragraph 129(6)(b) deems the income to be active business income to the recipient.

Rental Income for Holdco and rental deduction to Opco – deemed ABI

**129(6)
 Deemed Active Business Income**



Rates - ABI (CCPC)

Base Rate	38.00 %	38.00 %
Less: Abatement	(10.00)%	(10.00)%
Less: SBD - Up to Business Limit	(17.00)%	-
Less: GRR - Over Business Limit		(13.00)%
Tax Rate	11.00%	15.00 %

b. Investment Income – defined in subsection 129(4) of the Act:

Aggregate Investment Income (AII)* - subsection 129(4):

-Taxable capital gains *in excess of* allowable capital losses, including those carried forward from other years and deducted in the year

Add:

-Income from property (*other than* deductible dividend income), net of outlays and expenses made to earn that income

Minus:

-All losses from an income source that is property

*Note: Includes Foreign Investment Income as generally not deductible

Aggregate Investment Income – Tabular Format:

Net Taxable Capital Gains (i.e.. TCG-ACL)	XXX
Net Capital Loss c/b or c/f and deducted (i.e., division C)	(XXX)
Net Income from Property (Other than deductible dividends – section 112)*	XXX
Aggregate Investment Income (AII)	XXX

1.6.2.Part I Tax Rates

ITA Provision	Components of Tax	Active Business Income Small Business Deduction - up to 500,000	Active Business Income over SBD limit other than M&P	M&P Income over SBD limit	Investment Income
Subsection 123(1)	Corporate Tax Rate	38.00%	38.00%	38.00%	38.00%
Subsection 124(1)	<i>Less:</i> Federal Abatement	- 10.00%	- 10.00%	- 10.00%	- 10.00%
Subsection 125(1)	<i>Less:</i> Small Business Deduction	- 17.00%	N/A	N/A	N/A
Section 125.1	<i>Less:</i> M&P Deduction	N/A	N/A	-13.00%	N/A
Subsection 123.4(2)	<i>Less:</i> General Rate Reduction	N/A	- 13.00%	N/A	N/A
Section 123.3	<i>Add:</i> Additional Refundable Tax	N/A	N/A	N/A	+6.70% (Rounded)
		11.00%	15.00%	15.00%	34.70%

Federal Abatement: Subsection 124(1) provides a reduction of 10 percentage points in the federal tax and is only applicable to income earned in a Canadian jurisdiction (i.e., need a permanent establishment). When a corporation has foreign operations, less than 100 percent of its income will be allocated to the various provinces and is allocated as follows:

$$10\% \times \frac{\text{Taxable Income Earned in all Cdn Provinces}}{\text{Total Taxable Income}}$$

Note: Foreign source property (investment) income is generally admissible for the federal abatement as the permanent establishment is in Canada and not in the foreign jurisdiction as there is no fixed place of business abroad (i.e., no business as it is property income).

Small Business Deduction (SBD): The SBD is calculated as 17% of the least of the following 3 amounts for CCPC's [**only available to CCPCs**] :

- Canadian Net Active business income (CNABI); XXX
- Taxable income *less:* XXX
 1. 100/28 times the non-business FTC calculated without consideration of the ART or GRR (XXX)
 2. 4.0 times the business FTC calculated without consideration of the GRR (XXX)
XXX
- Business Limit (BL): \$500,000
less: Allocation of BL⁶ (XXX)
 Revised Business Limit (RBL) XXX
less: LCR: RBL x ([Capital of previous year - \$10M] x .225%) /11,250 (XXX)
 XXX XXX

Note: If less than a year, prorate based on weeks.

⁶ Where the CCPC is associated [see Appendix B & C and Chapter 14] with another CCPC at any time in the year sharing [in a portion agreed by the corporations per subsection 125(3) otherwise nil per subsection 125(2)]

Additional Refundable Tax (ART) - [only applicable to CCPCs]:

The tax is levied at 6 2/3% of the *lesser* of:

1. Aggregate Investment Income (AII)		XXXX
2. Taxable Income	XXXX	
Deduct: Amount Eligible for SBD	(XXXX)	
	XXXX	XXXX

Manufacturing and Processing (M&P) (i.e., short version only):

The M&P deduction is 13.00 percent of the lesser of:

1. M & P Profits As Per ITR 5200 (To be provided)	XXXX
Deduct: Amount Eligible for SBD	(XXXX)
	XXXX
2. Taxable Income	XXXX
Deduct:	
- Amount Eligible For The SBD	(XXXX)
- 4.0 times Foreign Business Tax Credit	(XXXX)
- AII	(XXXX)
	XXXX

General Rate Reduction (GRR): Being only applicable to Full Rate Taxable Income, this rate reduction does not apply to income that has otherwise enjoyed the benefit of either the SBD, the M&P tax credits or any tax that is refundable (i.e., AII through ART – see above):

The GRR deduction is 13.00 percent of:

Taxable Income	XXXX
Deduct:	
- Amount Eligible for SBD (<u>only applicable to CCPCs</u>)	(XXXX)
- Amount Eligible for M&P	(XXXX)
- Amount Eligible for AII (<u>only applicable to CCPCs</u>)	(XXXX)
Amount	XXXX

Legislative Developments: As stated previously, income from a PSB is presently eligible for the GRR. However, according to the October 31, 2011 proposals by the Department of Finance, PSB will not longer be able to avail itself of the GRR and will be taxed effectively at 28% (i.e., 38% base - 10% federal where income is fully taxable in Cdn provinces).

1.6.3. Foreign Tax Credits – Section 126

- Available where income is derived abroad and foreign taxes are paid.
- One set of rules for business income
- Another set of rules for non-business income.
- The foreign tax credit must be calculated on a country-by-country basis.

Non Business Income

Lesser of:

1. Non Foreign Business Income Tax Paid to a Foreign Country
[no 15% limit for corporations]
2. Net Foreign Non Business Income x Tax Otherwise Payable
Adjusted Division B Net Income

Where:

Adjusted Division B Net Income:

Division B Income [i.e., Net income]
Less: Losses Deducted under subsection 111(1)(b)
[i.e., Net Capital Losses]
Less: Dividends deducted under section 112
Less: Dividends deducted under section 113 [F.A]

Tax Otherwise Payable:

Base Amount of Tax [i.e., 38%]
Add: ART
Less: Federal Abatement
Less: General Rate Reduction

Business Income

Lesser of:

1. Foreign Business Income Tax Paid to a Foreign Country
Plus: any unused foreign tax credits of that country for the ten (10) years before, and the three years after this year
2. Tax Otherwise Payable less FTC on non-business income
3. Net Foreign Business Income x Tax Otherwise Payable
Net Income

Where:

Adjusted Division B Net Income:

Division B Income [i.e., Net income]
Less: Losses Deducted under subsection 111(1)(b)
[i.e., Net Capital Losses]
Less: Dividends deducted under section 112
Less: Dividends deducted under section 113 [F.A]

Tax Otherwise Payable:

Base Amount of Tax [i.e., 38%]
Less: General Rate Reduction

Note:

If balance can not be used in the year, it can be carried over to the 3 preceding years and the following 10 years.

Note:

- A. Circularity Issues involving interaction of SBD, ART and FTC's:
 - Circularity issues arise for two reasons; basic federal tax for FTC purposes includes GRR and basic federal tax also requires determining the SBD which, in turn, is contingent on ascertaining FTC.
- B. Remedial Steps:
 1. For purposes of SBD only - calculate Non-Business FTC without ART and GRR; calculate Business FTC without GRR;
 2. After determining SBD based on Step 1, determine ART and GRR
 3. Calculate actual Non-Business FTC and business FTC after performing previous steps.
Note: See Self Study Problem Thirteen-6 (i.e., particularly item (D)) on p.653 and 654 of the textbook
- C. Textbook Problems:
Generally, problems will assume that foreign tax withheld is equal to the FTC.

LECTURE 3: Chapters 13 & 11

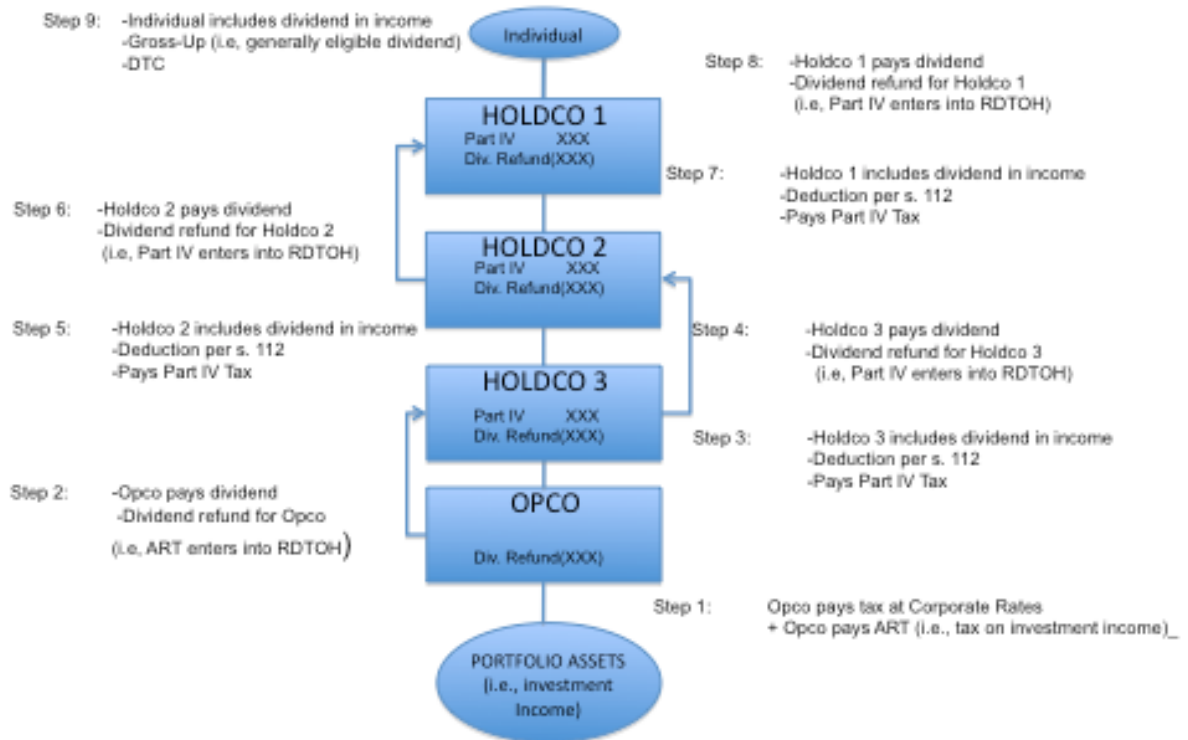
Taxation of Corporate Investment Income and Qualifying Property for \$400,000 CGD (i.e., \$375,000 pre-2014)

Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

2. Dividends Received by Corporations

2.1. Overview – Interaction of Different Provisions

The Big Picture - Interaction between 112, Part IV and Dividend Refund (i.e, to prevent deferral of investment income through corporations until ultimately paid to an individual)



2.2. Part I - Dividends Received

- Dividends received by a corporation are included in net income but are deducted under section 112 in arriving at taxable income..
- However, they may be subject to Part IV tax.

2.3. Part IV tax

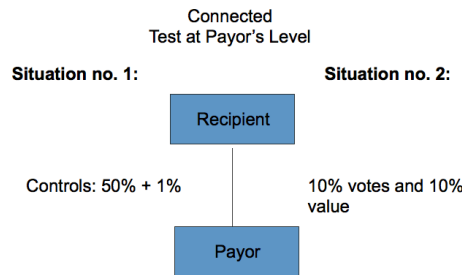
2.3.1. General

- The amount of Part IV tax is determined based on the concept of connected.
- Generally, applies to private corporations [i.e., does not matter if the corporation is Canadian controlled or not.]

2.3.2. Connected - Subsection 186(4)

Payor Corporation is connected with corporation who receives a dividend if:

- If the corporation who receives the dividend controls the payer corporation at that time;
- or -
- If the corporation who receives the dividend owned, at that time, more than 10% of the voting shares capital of the payor corporation **and** 10% of all issued shares



2.3.3. Taxation – Subsection 186(1)

2.3.3.1. If not connected [usually where dividend received from a public corp]

- $33 \frac{1}{3}\% \times \text{Dividends received}$

2.3.3.2. If connected – pro rata share of dividend refund of subsidiary (payer)

- $\frac{\text{Dividend Received by Corp}}{\text{Dividend Paid by Payor Corp}} \times \text{Payor's Dividend Refund}$

2.3.3.3. Reduction of Part IV Tax

- Reduce Part IV With Non-Capital Losses
- Not recommended as non-capital losses are usually a Permanent Reduction In Taxes. If NCL utilized, using an a tax attribute to Reduce Tax Payable That Would Ultimately Be Refunded [next topic]

2.4. Dividends Paid / Refundable System

2.4.1. Subsection 129(3) - Purpose of Dividend Refund:

- Establishes Part IV tax on dividends received by the Recipient co. [based on % of Payor’s dividend refund];
- When dividend paid by the Payor company, the dividend refund reimburses:
 - temporary tax on Investment Income (i.e., the 6 2/3% ART); and
 - Part IV tax to the Payor Company.

2.4.2. Defined in subsection 129(3) - Dividend Refund is the lesser of:

- 33 1/3% of dividends **paid [at the time when it was a private corporation]**;
- RDTOH Balance at the end of the year which is composed of:

(A) the refundable amount of Part I tax (Part I Refundable)
[Needs to be a CCPC throughout the year]

Least of:

(i)

Aggregate Investment Income		XXX
Rate	@ 26 2/3%	
Sub-Total		XXX
Deduct Excess of :		
- FNBTC	XXX	
- Over 9 1/3% Foreign Investment Income	(XXX)	
	XXX	(XXX)
129(3)(a)(i) Amount		XXX

(ii)

Taxable Income		XXX
Deduct :		
- Amount Eligible for SBD		(XXX)
- 100/35 FNBTC		(XXX)
- 4.0 BTC		(XXX)
		(XXX)
Total		XXX
Rate	@ 26 2/3%	
129(3)(a)(ii) Amount		XXX

(iii) tax payable under Part I

Plus:

(B) Part IV tax paid,

Plus:

(C) RDTOH at the end of the preceding year,
[Needs to be a private corporation at the end of the preceding year]

Minus:

(D) Dividend refund for the preceding year.
[Maxed/Capped at C above (RDTOH at the end of the preceding year)]

3. Integration

3.1. Theory - Concept

The theory of integration holds that the amount of income tax should be no different if the income (i.e., active income, passive income and capital gains) is earned via a corporation and subsequently paid per a dividend to a shareholder\individual versus if earned directly by an individual personally. The following components of the Canadian tax system are designed to ensure integration is achieved :

- the dividend tax gross up and dividend tax credit;
- section 112 inter-corporate dividend reduction;
- small business deduction [subsection 125(1)];
- Part IV tax;
- the dividend refund provisions [subsection 129(1)];
- the capital dividend account [subsection 83(2)];

3.2. Assumptions:

To provide virtually total integration, with the existing integration tools, the theory requires the application of the following tax rates:

Federal/Provincial Tax Rate On Corporations:

The corporate tax rate that will make integration work is contingent on the type of dividends:

- For eligible dividends (38 percent gross up), a 27.54 % corporate tax rate.
- For non-eligible dividends (18 percent gross up), a 15.25% corporate tax percent.

If the applicable rate is higher than these parameters, the use of a corporation will result in additional taxation.

Federal/Provincial Dividend Tax Credit:

For integration to be effective, the combined federal/provincial dividend tax credit must be equal to the gross up. The required 2014 provincial dividend tax credit that will make integration work is contingent on the type of dividends:

- For eligible dividends (38 percent gross up), the federal dividend tax credit is equal to 6/11 of the gross up. Accordingly, the provincial credit must be equal to 5/11 (45.5 percent) of the gross up.
- For non-eligible dividends (18 percent gross up), the federal dividend tax credit is equal to 13/18 of the gross up. Accordingly, the provincial credit must be equal to 5/18 of the gross up (27.8 percent).

If the combined federal/provincial dividend tax credit is below, the use of a corporation will result in additional taxation.

3.3. Achieving Integration for income in excess of SBD :

In reality, for income that is not eligible for the SBD, integration is not achieved as public corporations can not benefit from SBC.

As a result, the dividend tax gross-up has been revisited to achieve integration.

3.4. Eligible Dividends and Non Eligible Dividends

3.4.1. General

In order to favour and promote integration for income not subject to the preferable rates [i.e., preferential income treatment is income that benefited from the SBD and investment income (e.g. RDTOH)], the dividend gross up rate and dividend tax credit have been revised to lessen the tax burden [i.e., double taxation] for shareholders receiving these dividends.

Designation – Subsection 89(14):

Corporation must now designate dividends as being eligible dividends based on the balance of certain pools. If no designation, can not pay an eligible dividend.

3.4.2. Non Eligible Dividends v. Eligible Dividends

Non - Eligible Dividends	Eligible Dividends
<p>Types of Income (i.e., Preferential) : - Income eligible to SBD; - Investment income that will be refunded</p> <p>Exception\Availability: CCPCs can Pay Eligible Dividend to Extent of GRIP (i.e., income taxed at high rates; meaning income other than above)</p>	<p>Types of Income: - Income not eligible for SBD;</p> <p>Exception\Restriction: Public Corps can not pay eligible dividends to extent of LRIP (i.e., income taxed at low rates)</p>
Gross Up : Multiply Dividend by 1.25*	Gross Up: Multiply Dividend by 1.38
Dividend Tax Credit: 13 1/3 % of Grossed Up Dividend	Dividend Tax Credit: 15.02% of Gross-Up

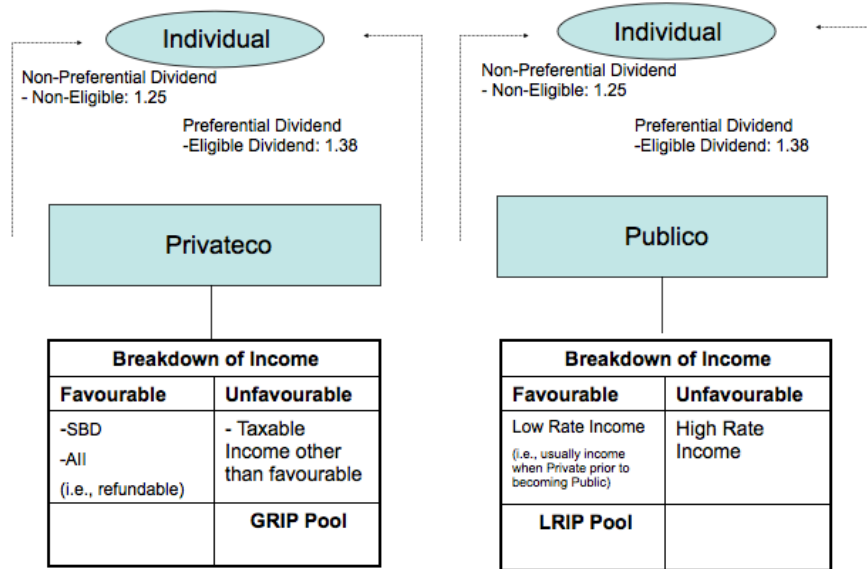
***Note for 2014:** Budget 2013 proposes to adjust the gross-up factor applicable to non-eligible dividends from 25 per cent to 18 per cent and the corresponding DTC from 2/3 of the gross-up amount to 13/18. Expressed as a percentage of the grossed-up amount of a non-eligible dividend, the effective rate of the DTC in respect of such a dividend will be 11.07 per cent.

This measure will apply to non-eligible dividends paid after 2013. The reason for this amendment is that the current DTC and gross-up factor applicable to non-eligible dividends overcompensate individuals for income taxes presumed to have been paid at the corporate level on active business income. As such, an individual who receives dividend income from a corporation is in a better tax position than if the individual had earned the income directly.

2013 and 2014:

		2013 Non Eligible Dividends	2014 Non Eligible Dividends	2013 and 2014 Eligible Dividends
A	Dividend	\$100,000	\$100,000	\$100,000
	Grossed Up Dividend	\$125,000	\$118,000	\$138,000
	Federal Tax @ 29%	\$ 36,250	\$ 34,220	\$ 40,020
	Provincial Tax @ 50% of Federal	\$ 18,125	\$ 17,110	\$ 20,010
B	Total Tax	\$ 54,375	\$ 51,330	\$ 60,030
	DTC – Federal [13 1/3% x 125,000] [11.00 % x 118,000] [15.02% x 138,000]	\$16,667	\$12,980	\$ 20,728
	DTC – Provincial	\$ 8,334	\$ 6,490	\$ 10,364
C	Total DTC	\$25,001	\$19,470	\$ 31,092
D=B-C	Taxes Payable	\$29,374	\$31,860	\$28,938
A-D	Net Cash Retained	\$70,626	\$68,140	\$71,062

GRIP and LRIP: The Big Picture



Availability for CCPCs: Extent of General Rate Income Pool (GRIP)

A CCPC can **distribute eligible dividends in the year** to the extent that its GRIP has a positive balance **at the end taxation year**. Simply stated, this essentially means it can pay eligible dividends for income taxed at full rates.

The GRIP includes:

$$\text{GRIP} = (C + [(72\%)(D - E - F)] + G + H - I) \text{ less } B$$

C = GRIP at end of preceding year

D = CCPC's Taxable Income for the year

E = Amount eligible for SBD for the year

F = Least of [i] Aggregate investment income for the year or [ii] Taxable Income

G = Eligible dividends received during the year by the CCPC

H = Adjustments for amalgamations and wind ups

I = Eligible dividends paid during the preceding year less EEDD made during the preceding year

B = Non-capital losses carried back and applied in the three preceding taxation years

Note: Balance can be negative

GRIP Balance At End of Previous Year		XXXX
Taxable Income	XXXX	
Income Eligible For SBD	(XXXX)	
Aggregate Investment Income	(XXXXX)	
Adjusted Taxable Income	XXXX	
Rate _ 72%	XXXX	
Eligible Dividends Received		XXXX
Eligible Dividends Designated in Previous Year		(XXXX)
GRIP At End of the Year		XXXX

Tax Treatment - After 2011

- 72%

Restrictions for Non – CCPCs: Low Rate Income Pool (LRIP)

A non-CCPC must pay non-eligible dividends [i.e., factor of 1.25 and DTC of 13.1/3% of grossed up dividends] before eligible dividends to the extent that it has a positive LRIP at the time.

Unlike GRIP, **LRIP is a point in time account** and cannot be negative. Therefore, if it is positive must clear by paying non-eligible dividend before can pay eligible dividend.

The LRIP balance at the end of the preceding year

$$\text{LRIP} = (A + B + C + D + E + F) - (G + H)$$

A = LRIP at end of preceding year of the Non-CCPC

B = Non-eligible dividends received by the non-CCPC for the year from a CCPC

C = Additions for corporate reorganizations

D = Adjustment if non-CCPC was a CCPC in some preceding year

E = Adjustment if non-CCPC was credit union in some preceding year

F = Adjustment if non-CCPC was investment company in some preceding year

G = Taxable dividends, other than eligible dividends paid during the year by the non-CCPC

H = EEDD of the non-CCPC during the year

Excessive Eligible Dividend Designation (EEDD) - Part III.I tax and Penalty

Occurrence for CCPC

- Where CCPCs designates eligible dividends that exceeds its GRIP at the end of the year

Occurrence for Non-CCPC

- Least of [i] Eligible Dividend Designated or [ii] LRIP balance at the time dividend is paid

Inadvertent Errors

- A 20 percent tax under part III.1 on excess designations

Advertent Errors

- 30 percent on the entire dividend [i.e., not just the EEDD].

Elections

- Can restore or remedy the situation. Corporations can elect to treat all or part of the excess designation as a separate non-eligible dividend [factor of 1.25 and DTC of 13 1/3% will therefore be applicable].
- Only applicable to inadvertent errors

Election not to be a CCPC – Subsection 89(11) to (13)

- Election Allows CCPCs to elect out of CCPC status for purposes of SBD, GRIP, LRIP and EEDD.
- Useful election for a CCPC that is an investment company and does not foresee to have any low-rate income (i.e., cannot claim SBD) as will not have to calculate GRIP. However, it will have to calculate LRIP

CCPC status – Becoming a CCPC/89(4) and Losing CCPC status/89(8):

- Deemed year end per 249(3.1) and need to determine GRIP (i.e., becoming a CCPC) and LRIP (i.e., becoming a Non-CCPC) \

Illustration: Integration - Theoretical Model: All sources of Income

Legend		ABI eligible for SBD	ABI in excess of SBD	Interest	Capital Gain	Eligible Dividends	Non-Eligible Dividends
Earned Directly:							
A	Amount Received	100,000	100,000	100,000	100,000	100,000	100,000
	Add: Gross-Up (25%)						25,000
	Gross-Up (38%)					38,000	
	Less: Non Taxable portion of CG (i.e., 50%)				50,000		
B	Taxable Income	100,000	100,000	100,000	50,000	138,000	125,000
Tax at Individual Level:							
	Amount Subject to Tax (@45%)	45,000	45,000	45,000	22,500	62,100	56,250
	Less: DTC Non-Eligible Dividend - (Fed. 2/3 + Prov. 1/3) of Gross-Up						25,000
	DTC Eligible Dividend - (Fed. 13/23 + Prov. 10/23) of Gross-Up					38,000	
C	Net Tax	45,000	45,000	45,000	22,500	24,100	31,250
D=(B-C)	Net Amount Retained at Individual's level	55,000	55,000	55,000	77,500	75,900	68,750
Earned via Corporation:							
	Amount Received	100,000	100,000	100,000	100,000	100,000	100,000
	Less: Non Taxable portion of CG (i.e., 50%)				50,000		
	Less: Inter-Corporate Deductible Dividends (i.e., ss.112(1))					100,000	100,000
E	Taxable Income:	100,000	100,000	100,000	50,000	0	0
Corporate Tax on ABI:							
	Federal Tax - SBD @ 12%	12,000					
	Federal Tax - In Excess of SBD @ 20%		20,000				
	Provincial Tax - SBD @ 8%	8,000					
	Provincial Tax - In Excess of SBD @ 9.078%		9,078				
Corporate Tax Investment Income:							
	Federal Tax @ 28%			28,000	14,000		
	ART @ 6 2/3%			6,667	3,333		
	Part IV - 33 1/3%					33,333	33,333
	Provincial Tax @ 12%			12,000	6,000		
F	Net Tax at Corporate Level:	20,000	29,078	46,667	23,333	33,333	33,333
G=(E-F)	Net Cash Available for Distribution	80,000	70,922	53,333	26,667	66,667	66,667
	Add: RDTOH			26,667	13,333	33,333	33,333
	Distributed to Individual (i.e., as a dividend)			80,000	40,000	100,000	100,000
	Add: Non Taxable portion of CG (i.e., 50%)				50,000		
H	Amount Received	80,000	70,922	80,000	90,000	100,000	100,000
	Add: Gross-Up (25%)	20,000		20,000	10,000		25,000
	Gross-Up (38%)		29,078			38,000	
I	Taxable Income	100,000	100,000	100,000	50,000	138,000	125,000
	Federal and Provincial Tax @45%	45,000	45,000	45,000	22,500	62,100	56,250
	Less: DTC Non-Eligible Dividend - Fed. 2/3 + Prov. 1/3	20,000		20,000	10,000		25,000
	DTC Eligible Dividend - Fed. 13/23 + 10/23		29,078			38,000	
J	Net Tax at Individual Level	25,000	15,922	25,000	12,500	24,100	31,250
K=(H-J)	Net Amount Retained	55,000	55,000	55,000	77,500	75,900	68,750

**Illustration:
 Integration - Tax Deferral Incidence of Retaining Income at Corporate Level**

	ABI eligible for SBD	ABI in excess of SBD	Interest	Capital Gain	Eligible Dividends	Non-Eligible Dividends
Earned Directly:						
Amount Received	100,000	100,000	100,000	100,000	100,000	100,000
Add: Gross-Up (25%)						25,000
Gross-Up (38%)					38,000	
Less: Non Taxable portion of CG (i.e., 50%)				50,000		
Taxable Income	100,000	100,000	100,000	50,000	138,000	125,000
Tax at Individual Level:						
Amount Subject to Tax (@45%)	45,000	45,000	45,000	22,500	62,100	56,250
Less: DTC Non-Eligible Dividend - (Fed. 2/3 + Prov. 1/3) of Gross-Up						25,000
DTC Eligible Dividend - (Fed. 13/23 + Prov. 10/23) of Gross-Up					38,000	
Net Tax	45,000	45,000	45,000	22,500	24,100	31,250
Net Amount Retained at Individual Level	55,000	55,000	55,000	77,500	75,900	68,750
Earned via Corporation:						
Amount Received	100,000	100,000	100,000	100,000	100,000	100,000
Less: Non Taxable portion of CG (i.e., 50%)				50,000		
Less: Inter-Corporate Deductible Dividends (i.e., ss.112(1))					100,000	100,000
Taxable Income:	100,000	100,000	100,000	50,000	0	0
Corporate Tax on ABI:						
Federal Tax - SBD @ 12%	12,000					
Federal Tax - In Excess of SBD @ 20%		20,000				
Provincial Tax - SBD @ 8%	8,000					
Provincial Tax - In Excess of SBD @ 9.078%		9,078				
Corporate Tax Investment Income:						
Federal Tax @ 28%			28,000	14,000		
ART @ 6 2/3%			6,667	3,333		
Part IV - 33 1/3%					33,333	33,333
Provincial Tax @ 12%			12,000	6,000		
Net Tax at Corporate Level:	20,000	29,078	46,667	23,333	33,333	33,333
Net Cash Available for Distribution	80,000	70,922	53,333	26,667	66,667	66,667
Add: CDA				50,000		
Net Amount Retained at Corporate Level	80,000	70,922	53,333	76,667	66,667	66,667
Tax Deferral Advantage (Cost) of Retaining Income in Corporation	25.00%	15.92%	-1.67%	-0.83%	-9.23%	-2.08%

4. Qualifying Property for \$400,000 CGD (\$375,000 pre-2014)/ Lifetime Capital Gains Deduction: - Section 110.6

3(a) Total of:			
Subdivision a			+
▪ Income from each employment [Add: ss.5,6,7,Less: ss 8 ITA]			
Subdivision b			+
▪ Income from each business [ss. 9 - 20, 67, 78 ITA]]			
Subdivision b			+
▪ Income from each property [ss.12 ITA]			
Subdivision d			+
▪ Other sources [ss. 56 – 59.1 ITA]			
Subdivision c			
3(b) the total, if any, by which [Only Positive Balances]			
i) the total of:			
▪ Taxable Capital Gains (other than LPP) and		+	
▪ Taxable Net Gain (Gains less losses) from LPP		+	
<i>Exceeds</i>			
▪ Allowable Capital Losses	xx		
<i>Less:</i> Allowable Business Investment Losses	(xx)	-	+
Subdivision e		-	
3(c) deductions (if any) [Section 60 -66.8 ITA]		-	-
			+
3(d) total of [Obligatory and not Discretionary]			
▪ Loss from each employment		-	
▪ Loss from each business		-	
▪ Loss from each property		-	
▪ Allowable business investment loss		-	
		-	-
Net Income – Division B income			+
DIVISION C: Computation of Taxable Income			
Less : [In the following order]			
▪ 110(1)(d), (d.1) Employee stock options			
▪ 110(1)(f) - Deductions for social assistance payments			
▪ 110.2 Retroactive Lump Sum Payments			
▪ 110.6 CGD [Available on CCPC shares - max \$400,000]			
▪ 110(1)(j), Home relocation loan			
▪ 111 Deductible losses of other years [No specific order required]			
- Non Capital Losses [ie. Employment, Business, Property] & [Oldest Losses First]			
- Net Capital Losses [1/2 of (Capital Losses – Capital Gains) [Oldest Losses First]			
- Allowable Business Investment Losses			
- Regular Farm Losses			
- Restricted Farm Losses			
▪ 110.7 Northern residents Deduction			
Taxable Income – Division C income			+

4.1. Eligibility:

A capital gain realized by an individual on the disposition of qualified small business corporation shares (QSBCS) may be eligible for a \$400,000 in capital gain deduction.

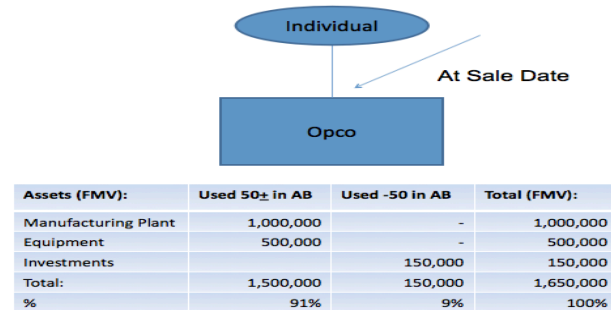
QSBCS are defined in subsection 110.6(1) as:

1. share capital in a small business corporation;

where:

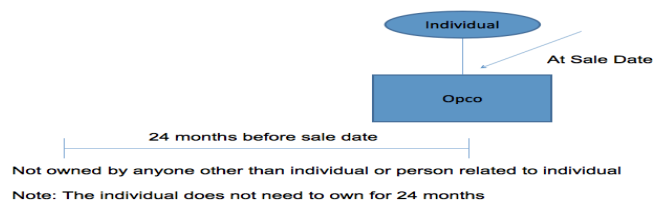
Defined in subsection 248(1): a CCPC, all or substantially all of the fair market value of the assets (90% or more according to CRA) of which are used principally (50% or more according to CRA) in an active business carried on in Canada by the corporation or a related corporation or shares/debt of other connected small business corporations or a combination of those two requirements.

Determination Time Test - 90%+



2. the shares were not owned by anyone other than the individual or a related person or partnership throughout 24 months before the determination time;⁷

Holding Period Test



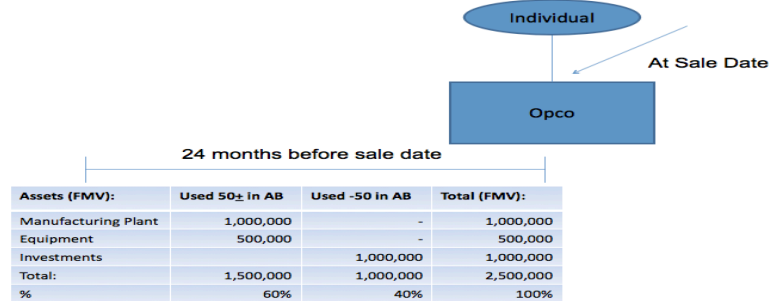
⁷ Per paragraph 110.6(14)(f), treasury shares issued by a corporation are deemed to have been owned immediately before their issue by a person not related to the owner of those new shares. Some exceptions to this rule are:

- they are issued as consideration for other shares (i.e., amalgamation)
- they are issued as stock dividends.

3. throughout those 24 months, more than 50% of the fair market value of the assets of the corporation were used principally in an active business carried on primarily in Canada by either the corporation or a related corporation.

Basic Asset Test

Determination Time Test = 50%+



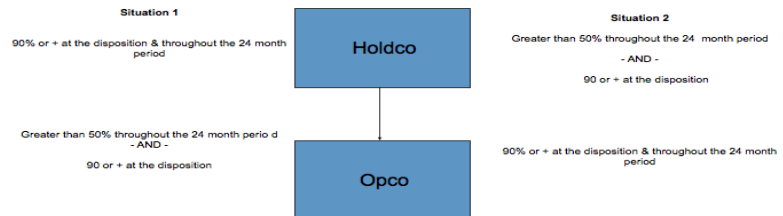
Modified Asset Test

If shares/debts of connected corporations [i.e., A two-tiered structure]

- throughout that part of the 24-month period preceding the disposition, such shares or debts were not owned by anyone other than the corporation or a person or partnership related to it

- and -

Modified Asset Test



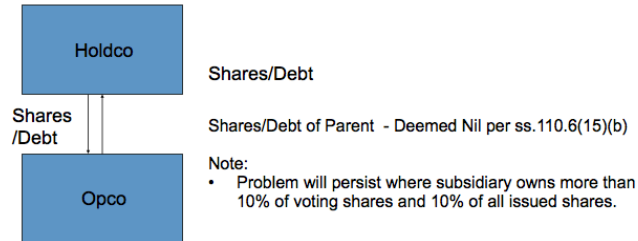
Note: All the following conditions must be met.

4.2. Circular Problems – Paragraph 110.6(15)(b)

If parent corporation holds shares/debts of a connected subsidiary and the subsidiary holds shares or debts of the parent corporation, this circular problem is eliminated as it establishes that the FMV of shares or debts of the parent corporation held by the subsidiary is nil.

Circular Problem – Connected

[Rule only applicable where payer corporation is controlled]

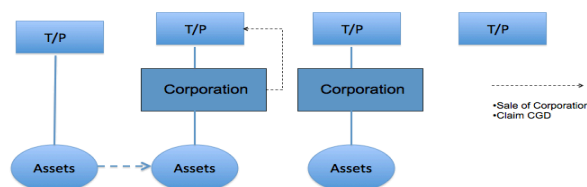


4.3. Planning Issues:

4.3.1. Selling an Unincorporated Business: Transfer Unincorporated business on rollover basis per section 85 to in order to claim CGD [no requirement that shares be held for 24 months. Rather, the requirement is that the shares were not owned by anyone other than the individual or a related person throughout the 24 months]

- Transfer on a tax free basis via section 85 [i.e., subsequent lesson] all the assets used in the business to a new corporation
- Sell shares and claim CGD;
- Shares will be considered capital property per section 54.2 of the Act [i.e., preserving capital gain treatment which is needed to claim CGD]

Planning 24 months



4.3.2. Planning Issues - Removing “unpure” assets (“Purification”):

Taxable Methods

- pay taxable dividends which trigger [i.e., eligible dividends first and, subsequently, non-eligible dividends] dividend refund where substantial RDTOH;
- pay taxable dividends [i.e., eligible dividends first and, subsequently, non-eligible dividends];
- pay out bonuses and salary
- Sell investment (bad) assets and buy active (good) assets

Non Taxable Methods

- Use cash on hand to pay liabilities
- Pay Capital Dividend
- Reduce PUC
- Spin out [i.e., section 55 – subsequent lesson] bad assets to a new corporation

4.4. Amount Available (i.e., simplified form where dispositions are only from qualified property)

Least of:		
(i) Capital Gains Deduction Available:		
Gross	750,000*	
Gross LCGD used in previous years	(XXX)	
Amount	XXX	
Multiply by ½ inclusion @1/2	XXX	
Amount Available	XXX	XXX
(ii) Annual Gains Limit:		
TCG qualified property	XXX	
Minus: ACL realized	(XXX)	
Minus: ABIL realized	(XXX)	
Minus: NCL carry overs deducted	(XXX)	
Amount Available	XXX	XXX
(iii) Cumulative Gains Limit:		
Annual Gains Limit	XXX	
Minus: CGD deducted in past	(XXX)	
Minus: CNIL		
(Invest. Exp – Invest. Inc.)	(XXX)	
Amount Available	XXX	XXX

*\$750,000 pre-2014

AMT Issues (i.e., ACCO 340 reminder - applicable where tax preference items - including “paper deductions” such as the CGD exceeds 40K: In order to mitigate any AMT impact with respect to the CGD, bifurcate/split gain over two years (i.e., December 31st, Year 1 and January 1st, Year 2)

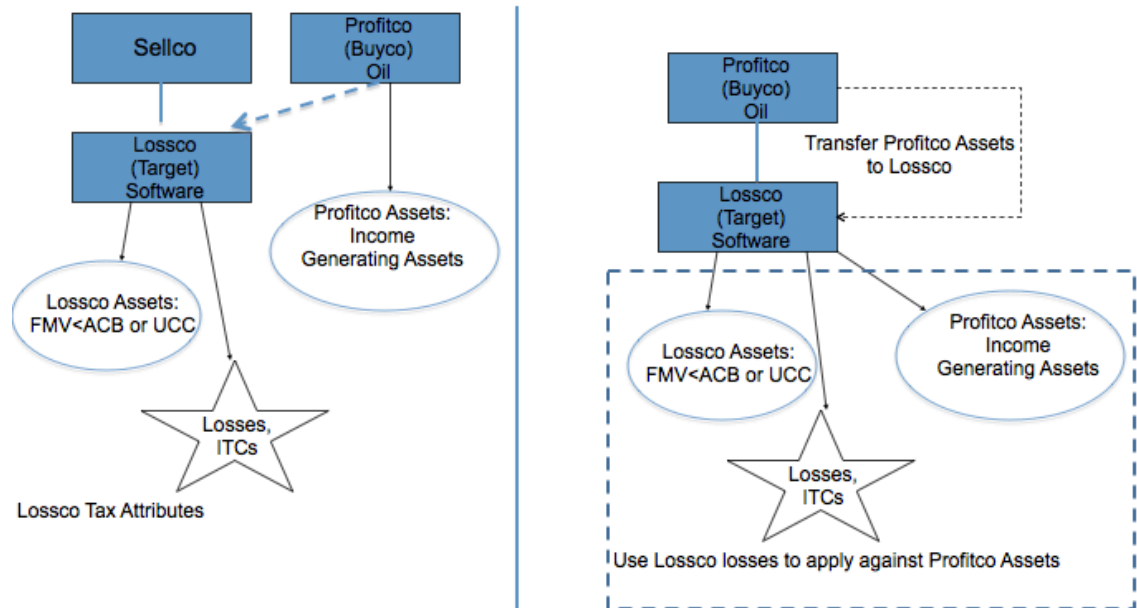
LECTURE 4: Chapter 14
 Other Issues in Corporate Taxation

Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

1. Acquisition of Control /Section 111 - The Purpose:

- To prevent Buyco, a profitable corporation, acquiring control of Lossco and sheltering its income by transferring its income generating assets to Lossco [through Lossco’s losses or by selling Lossco’s assets].

Conceptual – AC Rules to Prevent Loss Trading



1.1. Big Picture (i.e., see detailed mechanics further on in the notes)

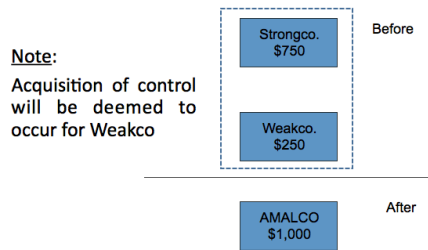
Net-Capital Losses		Non-Capital Losses	
Opening: Pre-Acquisition Balance (immediately before AOC)	XXX	Opening: Pre-Acquisition Balance (immediately before AOC)	XXX
Add: Write-downs of capital assets (i.e., write down capital assets with accrued losses and to the extent not absorbed by capital gains)	XXX	Add: Write-downs of inventory and any losses triggered by write-down of depreciable assets, ECE and A/R (i.e., to the extent not absorbed by income) (i.e., write down assets with accrued losses)	XXX
Less: Election to Trigger Capital Gain - 111(4)(e)	(XXX)	Less: Election to Trigger Recapture - 111(4)(e)	(XXX)
Balance: No carry forward or carry back after AOC	<u>XXX</u>	Balance: No carry forward or carry back after AOC unless REOP and same/similar business requirement	<u>XXX</u>

1.2. Control and Acquisition of Control (and not change of control)

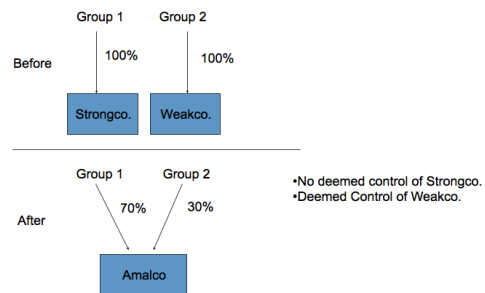
- Control not defined in the ITA;
- *De jure control* – more than 50% of votes and includes ultimate control through a chain of corporations;
- Paragraph 251(5)(b): If has right to acquire to shares, provision will deem to have acquired control if exercise of rights will result in *De jure control* [i.e., only applicable for CCPC purposes and section 251)
- Even though may not be actual legal control, there are provisions in subsection paragraphs 256(7)(b) and (c) that will, nonetheless, deem control to be acquired.
- For the rules outlined below to apply, there must be an acquisition of control and not a change of control [i.e., see Appendix D)

1.3. Illustrations of Deemed Control:

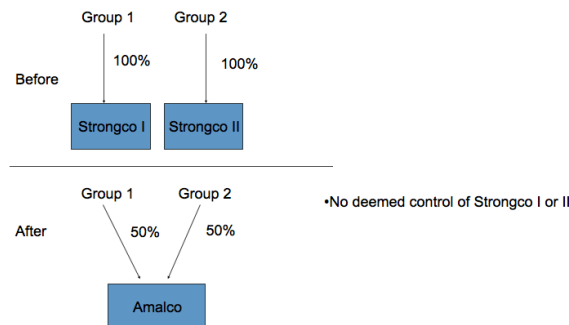
Acquisition on Control Subparagraph 256(7)(b)(iii)



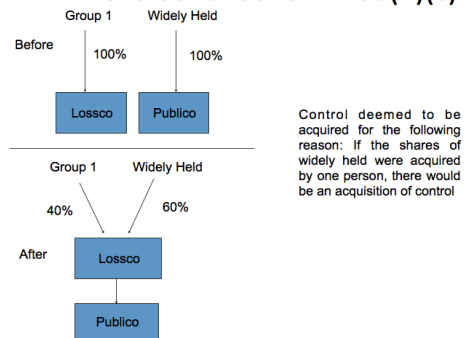
Clause – 256(7)(b)(iii)(B)



Clause – 256(7)(b)(iii)(B)



Reverse Takeover – 256(7)(c)



1.4. Control Not Acquired - Paragraph 256(7)(a): If immediately before acquisition of control, the acquirer was related to the particular corporation or to the buyer.

1.5. Anti-Avoidance: Subsection 256(8): If a taxpayer has right referred per paragraph 251(5)(b) and one of the main reasons was to avoid acquisition of control, will deem the person to control the shares where share have voting control

1.6. Detailed Mechanics

1.6.1. Effect on Accounts - If acquired by a non-related party, the following rules apply:

- Possible sharing of accounts such as SBD, M&P.
- Loss of SBD, MP, CDA, RDTOH where acquired by a Non-Resident

1.6.2. Timing of Acquisition of Control - Subsection 256(9): Deemed to have acquired at the commencement of the day regardless on when control truly acquired UNLESS election to specify time

1.7. Year End - Subsection 249(4) deems the taxation year to end immediately before the acquisition of control.

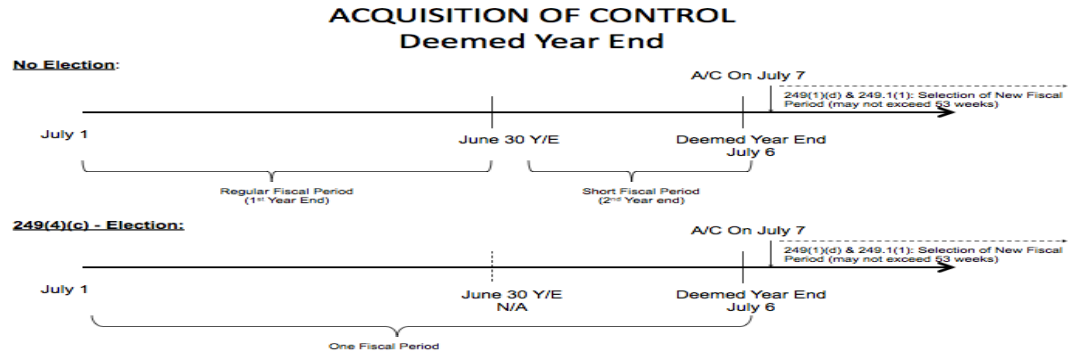
For example an acquisition of control on September 1, 2011, will result in a year end for the target corporation on August 31, 2011 unless elected otherwise.

1.8. Effect on Year End - Subsection 249(4)

New taxation year is deemed to have commenced at that time and may choose a new year end but it may not exceed 53 weeks. As a result, the following could occur:

- Additional financial statements and income tax returns for the stub year;
- Instalments may have to be paid sooner;
- Prorate CCA for new fiscal period;
- Shareholder Loans [i.e., 15(2) and 20(1)(j)] will have to be repaid sooner;
- Unpaid remuneration and amounts [i.e., section 78] will be accelerated;
- Losses carry-forward per section 111 will be affected [i.e., 1 less year due to additional stub year];
- R&D and ITCs pools will also be affected.

1.9. Election to extend normal Year End - If an acquisition of control of a corporation takes place within seven days after its usual/last fiscal year end, the taxpayer may elect to extend the normal year end until the time immediately before the acquisition date [paragraph 249(4)(c)]



1.10. Inventory - Subsection 10(1), 10(10) and Regulation 1801: Inventory and adventures in the nature of trade [subsection 10(10)] must be valued at the lower of cost or FMV resulting in the recognition of accrued inventory [i.e., may increase pre-acquisition non-capital loss balance]

Step 1: $ACB - FMV = Loss$
 Step 2: $New\ ACB = FMV$

Step 1	Step 2
ACB= 100	ACB after AOC = 20
FMV=(20)	FMV after AOC = 20
Loss= 80 * increases pre-acquisition non-capital loss balance	Note: No accrued loss

1.11. Donations and Gifts - Paragraph 110.1(1.2) restricts carry-forward of donations and gifts post acquisition of control.

1.12. Net Capital Losses - Paragraphs 111(4)(a) and (b) restricts the carry-forward of net capital losses [including Allowable Business Investment Losses and those triggered/accelerated by virtue of these A/C rules - i.e., accrued loss on non-depreciable property] before the acquisition of control and the carry-back of net capital losses realized after the acquisition of control.

1.13. Accrued Loss non Depreciable Property - Paragraph 111(4)(c) requires a recognition of accrued capital losses in the taxation year ending prior to the acquisition of control [i.e., may increase pre-acquisition net-capital loss balance above]

Step 1: $ACB - FMV = Loss$ [by virtue of paragraph 111(4)(d)]
 Step 2: $New\ ACB = FMV$

Step 1	Step 2
ACB= 100	ACB after AOC = 20
FMV=(20)	FMV after AOC = 20
Loss= 80 * increases pre-acquisition net-capital loss balance	Note: No accrued loss

1.14. Election to Trigger Gain/Recapture - Paragraph 111(4)(e):

Step 1: Disposition anywhere between FMV and ACB [Why: Select amount to offset against losses above]

Step 2: ACB: Reacquisition at POD determined in Step 1

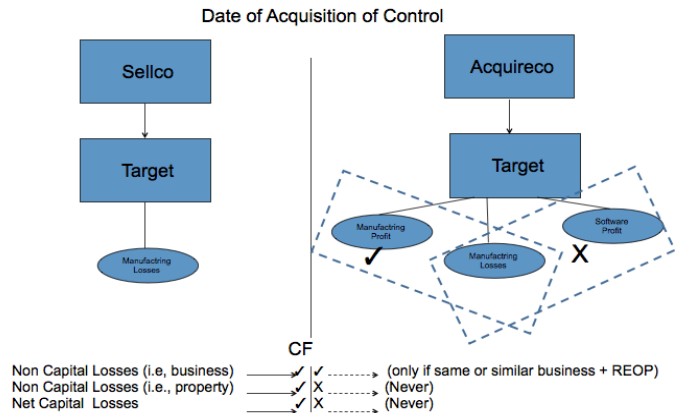
Step 3: If Depreciable property: ACB original + ½ (Gain)
 [No half year rule - 1100(2.2)]

Loss Balance	Tax Attributes of Asset (FMV=400 and ACB=40) Scenario 1		Tax Attributes of Asset (FMV=400 and ACB=40) Scenario 2	
	Net Cap. Loss Balance = (20) (before AOC)	FMV/POD = 400	New ACB = 400	POD = 240
Add: 111(4) loss = (80) (as a result of AOC) (see above)	ACB = (40)	New UCC 40 + 180 = 220	ACB = (40)	New UCC = 40 + 100 = 140
Net-Cap. Loss Balance = (100)	Potential Gain = 360 Tx. Cap Gain = 180		Gain = 200 Tx. Cap Gain = 100	
	Net-Cap Loss = (100)		Net-Cap Loss = (100)	
	Inclusion = 80*		Inclusion = Nil *	
	* Not optimal – tax leakage		* Optimal – no tax leakage	

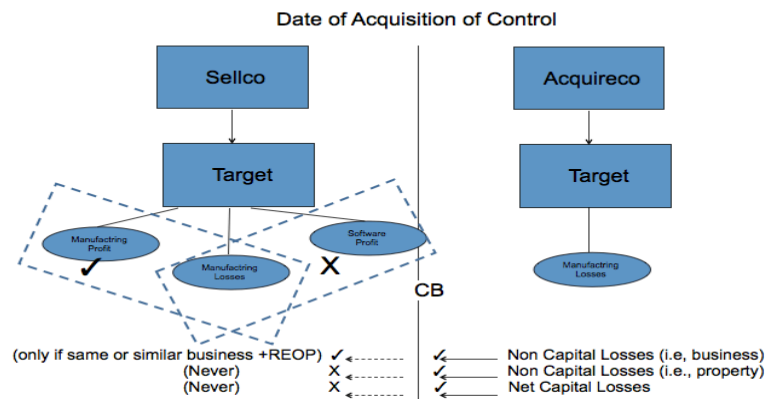
1.15. Non-Capital Losses/ Loss Streaming Rules - Paragraph 111(5)(a) restricts the carry-over of non-capital losses and farm losses incurred before the A/C [including those triggered/accelerated by virtue of these A/C rules - i.e., accrued loss on depreciable property, ECE, doubtful accounts] . They are deductible only:

- to the extent that they may reasonably be considered to result from carrying on a business [i.e., As a result, may not carryover property loss or allowable business investment loss];
- if the business in question was carried on by the corporation for profit or with a reasonable expectation of profit throughout the particular taxation year [i.e., Intended to discourage taxpayers from operating an unprofitable business in order to use losses] ; and
- losses may only be applied to the extent of the aggregate of the corporation's income from that business (i.e., the same or 'similar' business) Note: The same requirements apply to carry-back losses before an acquisition of control, of non-capital losses and farm losses incurred after an acquisition of control [i.e., paragraph 111(5)(b)]
- See Figures below and Appendix D.

A/C – CF of losses



A/C – CB of losses



1.16. Accrued Losses on Depreciable Property - Subsection 111(5.1) – Requires write-down of accrued terminal losses [only applicable to depreciable property] in the taxation year ending prior to the acquisition of control [i.e., may increase pre-acquisition non-capital loss balance].

Where UCC exceeds FMV

Step 1: Excess between UCC and FMV = Deemed CCA
 (reduce income for period or create a loss)

Step 2: New UCC = FMV

Step 1	Step 2
UCC= 100	UCC after AOC = 20
FMV=(20)	FMV after AOC = 20
Loss= 80 * increases pre-acquisition net-capital loss balance	Note: No accrued loss

- 1.17. Accrued Losses on ECE** - Subsection 111(5.2) requires accrued loss be recognized in respect of eligible capital property [ECE] in the taxation year ending prior to the acquisition of control [i.e., may increase pre-acquisition non-capital loss balance].

Step 1: Excess [ECE less $\frac{3}{4}$ FVM] = Deemed CEC taken
 (reduce income for period or create a loss)

Step 2: New ECE balance= $\frac{3}{4}$ FVM

Step 1	Step 2
CEC = 100	CEC after AOC=(20 x $\frac{3}{4}$)= 15
FMV=(20 x $\frac{3}{4}$)= 15	FMVafter AOC = 20
Loss= (85) *	Note: No accrued loss
*increases pre-acquisition net-capital loss balance	

- 1.18. Doubtful Accounts** - Subsection 111(5.3): Doubtful debts to be claimed as bad debts for the taxation year ending prior to the acquisition of control [i.e., may increase pre-acquisition non-capital loss balance].

- 1.19. Anti-Avoidance provision - subsection 111(5.5):** If main reason for acquisition of control is to trigger the recognition of accrued losses per above provisions, those provisions are not applicable

- 1.20. SR&ED – 37(1)(h), 37(6.1) and ITC – 127(9.1) and (9.2) :**

Paragraph 37(1)(h) and subsection 37(6.1) limit the carry-forward of expenditures on scientific research and experimental development made before an acquisition of control of a corporation in taxation years ending after the acquisition of control.

Subsections 127(9.1) and (9.2) limit the ability of a corporation to carry forward and carry back investment tax credits after an acquisition of control of the corp

- 1.21. Corporation become or ceases to a Canadian-Controlled Private corporation - 249(3.1):** If at any time a corporation becomes or ceases to be a Canadian-controlled private corporation (CCPC) 249(3.1) applies and treats the corporation of having a taxation year-end immediately before the time it becomes or ceases a CCPC. The new deemed year-end rule is also of particular relevance to the tax treatment of eligible dividends, including new subsections 89(4) and (8) that apply to include an amount in a corporation's general rate income pool or low rate income pool when the corporation becomes or ceases to be a CCPC.

Suggested Methodology:

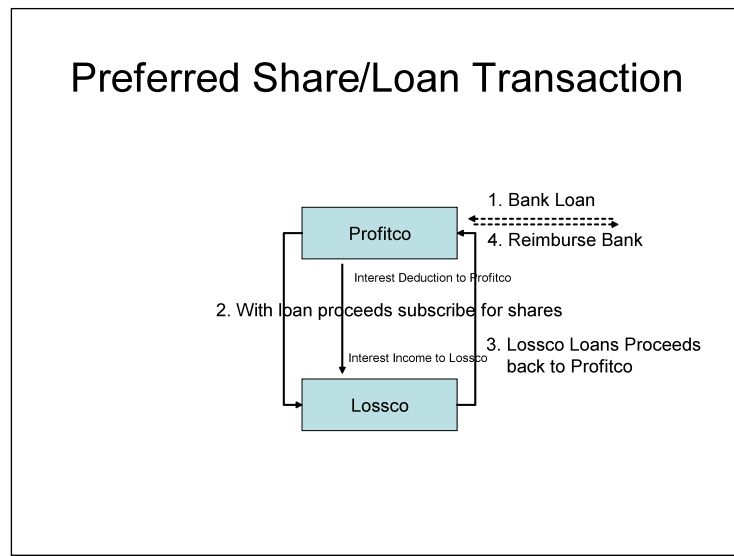
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|----|--|
| 1. | Deemed Year End with corollary consequences; |
| 2. | Write down of accrued losses that become part of the net-capital and non-capital loss pre-acquisition pool; |
| 3. | Determine net-capital and non-capital loss balance after no. 2 taking into account those that have expired (i.e., take into account acceleration in no.1 above); |
| 4. | Use Election to trigger capital gains or recapture to offset against above loss balances in order to increase (step-up or bump) cost of properties (i.e., to minimize tax consequences on future dispositions) in such manner there is no tax leakage (i.e., no additional tax triggered); |
| 5. | Re-determine cost of properties (i.e., ACBs, UCCs, etc.) |
| 6. | Determine Net Income (Division B) and Taxable Income (Division C); |
| 7. | With respect to non-capital loss, determine if losses can be streamed (i.e., same or similar business test)l and |
| 8. | If no. 7 is met, see planning tips below to “shift” or “transfer” losses in profitable entities. |

1.22. Planning – Loss Utilization: If no acquisition of control or acquisition of control and same business is operated, consider the following to use losses:

1. Amalgamation [lecture to follow]
2. Wind-Up of 90% owned corporation [lecture to follow]
3. Transfer Assets that produce income can be transferred to LOSSCO from Profitco

Other Planning Points – Preserving Losses and Loss-Consolidation Techniques

1. Do not claim CCA or reserves as discretionary and amend Discretionary Deductions - Information Circular 84-1
2. Preferred Share/Loan Transactions



3. **Selling Profitable Assets and Using Losses of an Affiliated company:** Transfer Asset from PROFTICO to LOSSCO on a tax deferred basis via section 85 to LOSSCO and sell it through LOSSCO to claim loss [i.e., must be affiliated, otherwise subsection 69(11) will ignore initial rollover and deem initial rollover at FMV]

2. Scientific Research And Experimental Development (SR&ED) and ITCs

2.1. Definition

Scientific research and experimental development (SR&ED) is defined in subsection 248(1) as follows:

scientific research and experimental development means systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis.

The following is excluded from SR&ED:

- market research or sales promotion,
- quality control, normal testing of products or processes,
- research in the social sciences or the humanities,
- prospecting, exploring or drilling for, or producing, minerals, petroleum or natural gas,
- the commercial production of a new or improved material, device or product or the commercial use of a new or improved process,
- changes of style, or
- normal data collection.

2.2. Incentives of SR & ED System

- Pool System in Section 37: Ability to deduct capital and current expenditures
- Investment Tax Credits: Reduces taxes payable dollar or for dollar and, in some instances, may be refundable.

Simplified Approach for CCPCs

Step 1: Calculation of section 37 pool (i.e., to be deducted in determining Net Income) based on rules outlined in subsequent pages.

<u>Current expenditures:</u>	XXX
.....	XXX
.....	XXX
<u>Capital expenditures:</u>	XXX*
.....	XXX
.....	XXX
Total SR&ED expenditures	<u>\$ XXX</u>

Steps 2 and 3: Calculate Expenditure Limit, ITC, Refundable ITCs

(a) Establish the Expenditure Limit: Formula: $(\$8 \text{ million} - 10A) \times [(\$40 \text{ million} - B) / 40 \text{ million}]$ where:

A = is the greater of \$500,000 and Taxable Income for previous year

B= If Taxable Capital Employed in Canada (TCEC) for previous year is less than 10 million, nil. If TCEC is greater than 10 million, least of [i] 40 million or [ii] TCEC less 10 million.

Note: If previous year taxable income is less than 500,000 and TCEC for previous year less than 10 million, expenditure limit will be 3 million.

Example – Expenditure Limit:

Previous year Taxable Income: 550,000
 Previous year TCEC: 12,000,000

$[\$8 \text{ million} - (10)(550,000)] \times [(\$40 \text{ million} - 2,000,000) / 40 \text{ million}]$
 $2,500,000 \times (38 \text{ million} / 40 \text{ million}) = 2,375,000$ of Expenditure Limit

(b) Determine if the CCPC is a qualifying corporation: A qualifying corporation (QC) as defined in subsection 127.1(2) as a corporation that:

- throughout the year was a CCPC; and
- whose taxable income for the immediately preceding taxation year including with the taxable incomes of all associated corporations does not exceed the business limit of \$500,000

(c) For CCPCs that is a qualifying corporation - ITCs and Refundable ITCs:

Nature	A	B	C = A x B	D	E = D x C
	Amount	ITC rate	ITC	Refundable ITC	
Current	XXX	35%	XXX	(100%)	XXX
Capital (Expenditure Limit – * Current claimed above)	XXX	35%	XXX	(40%)	XXX
Excess over Expenditure Limit	XXX	20%	XXX	(40%)	XXX

(d) For CCPCs that is not a qualifying corporation – ITCs and Refundable ITCs:

Nature	A	B	C = A x B	D	E = D x C
	Amount	ITC rate	ITC	Refundable ITC	
Current	XXX	35%	XXX	(100%)	XXX
Capital (Expenditure Limit – * Current claimed above)	XXX	35%	XXX	(40%)	XXX
Excess over Expenditure Limit	XXX	20%	XXX	(0%)	XXX

*Note for 2014: As indicated above, allowable current and capital expenditures in respect of SR&ED are fully deductible, and qualifying SR&ED expenditures are eligible for an investment tax credit. Budget 2012 proposes to include expenditures of a capital nature from eligibility for SR&ED deductions and investment tax credits. This measure will apply to property acquired on or after January 1, 2014, and to amounts paid or payable in respect of the use of, or the right to use, property during any period that is after 2013.

2.3. Rules - Section 37 and Part XXIX

General System and Advantages of SR&ED

- Costs are entered to a pool;
- Deductible costs may include current and capital [i.e., normally only CCA would be allowed];
- Can be deducted in the current year or future year [i.e., no time limit]; and
- SR&ED expenses are only deductible from income of a business carried on in Canada [Note - some expenses may be incurred outside Canada].

Detailed Rules - Determining the Section 37 Pool:

Step 1: Rules For Current Expenditures - (i.e., Qualifying SR&ED expenditure)

Category 1 - Directly Attributable

- All or substantially [90% or more according to CRA] of current expenditure attributable SR&ED in Canada, 100% of the expenditure enters in the SR&ED pool and must be paid within 180 days of the taxpayer's fiscal year end
- Salaries:
 - If employee spends time on SR&ED activities and others activities, prorate to determine attributable SR&ED activity;
 - Vacations are excluded\ignored;
 - Bonuses and profit based remuneration to specified employees (i.e., who hold 10% and more of the corporation or a related corporation – including non arms length people) are excluded\ignored
 - Salaries must be paid within 180 days the taxpayer's fiscal year end
- If the usage is less than 90 percent for SR&ED, the expenditure will still be deductible, but not as an SR&ED expenditure.

Category 2 - Overhead

- No 90% rule for overhead
- SR&ED related overhead includes labour, general and administrative costs (i.e., the cost of heat and light, and long distance telephone charges);
- They must be directly attributable to SR&ED;
- In order to be deductible, these costs would have not been incurred if it was not for SR&ED activities.

Note: Expenditures may be outside Canada on behalf of the taxpayer

If to difficult to determine, a proxy method is available but not as an SR&ED expense but as an ITC

Step 2: Rules For Capital Expenditures - (i.e., Qualifying SR&ED expenditure)

- Capital expenditures can be allocated to the SR&ED pool and written off in the year of acquisition if 90% or more used in SR&ED.
- Must be new equipment (i.e., used or refurbished equipment does not qualify) and must be used in Canada (i.e., may be purchased outside Canada in so far as it is used in Canada)
- Land and Building (including rents/leases) do not qualify except if building has special purpose.
- Otherwise, may not claim pool [Note: May claim as ITC if used 50% + but less than 90%]

Important Points

- Capital expenditures must be for SR&ED carried on in Canada in order to qualify for inclusion in the pool.
- If capital asset meets 90% test, can not claim CCA. However, CCA will be deemed to have been taken. As a result, there may be recapture. There may be capital gains too.
- If they do not meet the 90% test, may claim CCA (need to remove ITC as will be discussed).

Detailed Rules - Determining the ITC:

Step 3: Starting Point: Section 37 Pool

Step 4: Prescribed Proxy Method [Where Overhead is too difficult to determine under SR&ED]

- Determined as 65 percent* of “salaries and wages of employees” that are directly engaged in SR&ED carried on in Canada.

*60% starting in 2014

Disadvantage:

- An unlimited carry forward period lost and will contribute to the non-capital loss carry-forward balance that is subject to a 20 year limitation.

Step 5: Shared Used Equipment

- Capital equipment that does not meet 90 percent test, but + 50% percent for SR&ED purposes.
- One-half of the cost of such shared use equipment is eligible for an investment tax credit over a two year period [25% for first year, 25% for the second year]

- Amount of ITC is reduced from capital cost (taxation year after the year the credit is claimed) resulting only in net cost of asset being available for CCA

Step 6: SR&ED - Apply ITC Rates [refer to subsections 127(10.1) - 127(10.4)]

<i>Area</i>	<i>Qualified Property</i>	<i>SR&ED</i>	
		<i>CCPC</i>	<i>Non-CCPC</i>
<i>Gaspe and Atlantic Provinces</i>	<i>10%</i>	<i>35%</i>	<i>20%</i>
<i>Remainder of Canada</i>	<i>Nil</i>	<i>35%</i>	<i>20%</i>

i. Taxpayer other than CCPC

- Base ITC is 20%* of Qualified SR& ED Expenditures.
 *15% starting in 2014

ii. CCPC

Pre-2014:

- 35% of Qualified SR & ED Expenditures = Base ITC is 20%. + additional credit of 15% is based on the following formula:

2014 and afterwards:

- 35% of Qualified SR & ED Expenditures = Base ITC is 15%. + additional credit of 20% is based on the following formula:

Formula – Annual Expenditure Limit:

- Formula: $(\$8 \text{ million} - 10A) \times [(\$40 \text{ million} - B) / 40 \text{ million}]$ where:

A = is the greater of \$500,000 and Taxable Income for previous year

B= If Taxable Capital Employed in Canada (TCEC) for previous year is less than 10 million, nil. If TCEC is greater than 10 million, least of [i] 40 million or [ii] TCEC less 10 million.

Note: If previous year taxable income is less than 500,000 and TCEC for previous year less than 10 million, expenditure limit will be 3 million.

Example – Expenditure Limit:

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 $2,500,000 \times (38 \text{ million} / 40 \text{ million}) = 2,375,000$ of Expenditure Limit

Important Points

- Additional Credit of 15% [for a total of 35%] is available to a maximum as described above.
- Expenditure Limit: First \$ 3 million [for the additional 15% credit to reach a total of 35%] and must allocated among associated corporations [see SBD notes as same formalities]

- Qualified Property: Newly acquired depreciable property used in Canada and used in manufacturing and processing.
- Qualified SR&ED: Current and Capital Items per above including amounts for applied or basic research as well expended for developing new products or processes. Amounts may related to administration or maintenance of equipment.

Issues for previous and subsequent years

- Any unused ITC can be carried back 3 years and forward 20 years [prior to 2005, it was 10 years].
- If the ITC relates to SR & ED, the use of ITC will reduce the pool of SR & ED expenditures, if any, in the taxation year following the year the ITC is used.
- If the ITC relates to a capital expenditure, the ITC reduces the capital cost of an asset in the taxation year following the year in which the ITC is used.
- If the asset is disposed of, include the ITC in income inclusion per paragraph 12(1)(t) in the taxation year following the year in which the ITC is used.
- Any ITC earned in relation to deductible current expenditures, it is added in income the next year.

Step 7: Qualified Property (QP) in Atlantic Canada and/or Gaspé – 10%

- QP is a prescribed building, machinery or equipment;
- QP must be new;
- Must be used in M&P, oil and gas, mineral extraction; and logging, farming, fishing, grain storage or industrial mineral production

Salary & Wages of an Eligible Apprentice – 10%

- Individual who is employed in Canada;
- Trade must be prescribed in the first 2 years of apprentice contract;
- Registered with a federal, political or territorial government that certifies or licensed individual in a trade;
- Limited to first \$20,000 per each apprentice

Eligible Child Care Space Expenditures – 25%

- Child care spaces in a licensed child care facility for the use of the children of the taxpayer's employees;
- Limited to first \$10,000 per each space.

Step 8: Calculating the Refundable ITC (RITC) – Section 127.1

Applicable where corporation can't use ITC as in a loss position or nil tax payable.

		Refundable @40%	Refundable @100%	No Refund
CCPC other than Qualifying Corporation ⁸				
Current	ITC – 20%			✓
	ITC – 35%		✓	
Capital	ITC – 20%			✓
	ITC – 35%	✓		
Qualifying Corporation				
Current	ITC – 20%	✓		
	ITC – 35%		✓	
Capital	ITC – 20%	✓		
	ITC – 35%	✓		

Issues for previous and subsequent years

- RITC claimed on current SR&ED will reduce s.37 pool
- RITC claimed on capital SR&ED will depend:
 - if deductible – reduce s.37 pool
 - if capitalized – reduce cost/UCC
- RITC claimed on QP will reduce Cost of QP next year
- Any RITC earned in relation to deductible current expenditures is added in income the next year.

⁸ **Qualifying corporation (QC) as defined in subsection 127.1(2):**

A corporation :

- throughout the year was a CCPC; and
- whose taxable income for the immediately preceding taxation year including with the taxable incomes of all associated corporations does not exceed the business limit of \$500,000

3. Distribution of Corporate Surplus

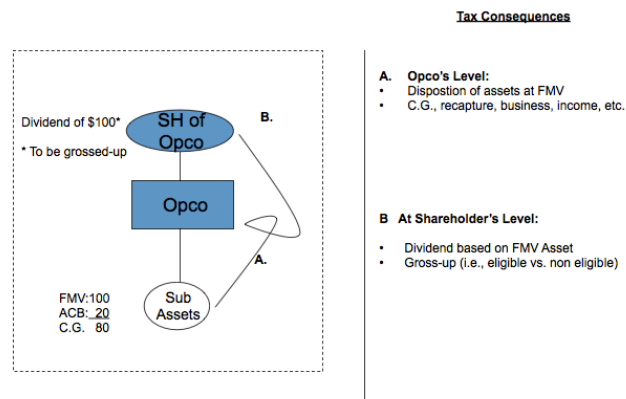
3.1. Cash Dividends

- Individuals and Trusts: Gross Up and DTC
- Corporations: No Gross-Up and DTC, inter-corporate dividends deductible per section 112, possible Part IV tax

3.2. Dividends in Kind

- For payer corporation: disposition of capital property which may trigger capital gain, capital loss, recapture or terminal loss
- For recipient:
 - ACB=FMV per subsection 52(2)
 - Individuals and Trusts: Gross Up and DTC
 - Corporations: No Gross-Up and DTC, inter-corporate dividends deductible per section 112, possible Part IV

Dividend in Kind



3.3. Stock Dividend

Step 1:

- Taxable dividend is based on the increase in the paid up capital (ie. stated capital for accounting and legal purposes) and NOT the FMV.
- Apply gross-up and tax credit procedures described above for individuals

Step 2

- The ACB of stock dividend shares is equal to the paid up capital

Example:

ABC Corp declares a stock dividend to Mr. A. The FMV of the stock dividend is \$200,000 and the increase in PUC is 100.

Mr. A is taxable dividend is $100 \times 1.25 = \$125$ [taxable on the increase in PUC] and claim a DTC. Mr. A's ACB of the stock option is \$100

3.4. Capital dividends – Capital Dividend Account (CDA) – 83(2)

Capital dividends are non-taxable to the recipient (other than if paid to a non-resident where Part XIII may apply). **Capital** dividends must be paid by a private corporation out of a tax account called a **capital dividend account (CDA)**. The CDA is a cumulative account. Its balance is calculated at any *particular* time. It is a fundamental component of the integration process.

Capital Dividend Account is defined in subsection 89(1) as follows:

- A. The non-taxable portion of capital gains *that exceeds* of the non-allowable portion of capital losses.

Note:

- Losses cannot exceed gains and consequently, no negative balance in this section affects the balances in the other four sections.⁹
 - Use historical inclusion rates at the time of gain.
- B. Capital dividends received from other private corporations [including through trusts and partnerships].
- C. The non-taxable portion on the sale of eligible capital property
- Refer to Appendix E for ACCO 340 reminder
- D. Generally, no longer applicable.
- E. Proceeds of a life insurance policy net of the adjusted cost base of the policy.

Aggregate of (A) through (E) is reduced by:

- F. Capital dividends which previously became payable by the corporation.

Excessive Elections – Part III tax

If elected amount of the capital dividend exceeds the balance in the capital dividend account, a penalty tax of 3/5 of the excess will be taxed to the corporation pursuant to Part III of the Act. [Note: The shareholders still receive the tax free dividend].

However, an election is available pursuant to subsection 184(3) which eliminates the penalty that the corporation has to pay. Rather, it must file an election in order for the dividend to be divided into separate dividends as described below:

1. The first dividend is the amount that the corporation should have paid as a capital dividend based on the proper balance.
2. The second amount represents the excess originally elected CDA and this will be treated as a separate *taxable* dividend.

⁹ Even though a negative balance will not affect the CDA balance at the time the dividend is paid, capital losses in excess of gains will reduce future capital gains.

3.5. Shareholder Equity and Deemed Dividends

Deemed Dividends Private Corporations

Amount Distributed	Dissection of Components	Tax Treatment
Example: \$100	Excess \$70	Taxable as a Dividend
	CDA \$10	Amount returned without tax incidence
	PUC \$20	Tax Free (i.e., Return of Capital)

3.5.1. Overview and Application in the following order per paragraph 84(6)(a):

- Subsection 84(1): PUC Increase
- Subsection 84(2): Wind-Up or Discontinuance of a Business
- Subsection 84(3): Redemption of Shares
- Subsection 84(4): PUC Decrease of Private Corporation Resident in Cdn
- Subsection 84(4.1): PUC Decrease of Public Corporation

3.5.2. Key Concept - Paid-UP Capital (PUC):

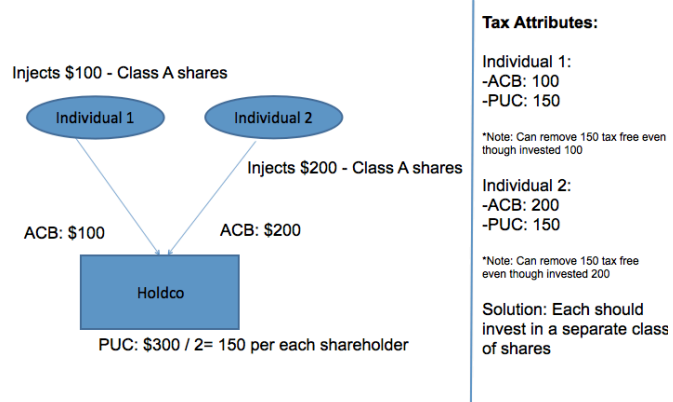
An investment per class of shares that can be distributed tax free to the shareholder.

It is calculated per class of shares and it is not necessary equal to ACB. The PUC of any class of shares is the amount invested in that class divided by the amount of outstanding shares.

PUC is a corporate concept (i.e., follows the corporation and not the shareholder) whereas ACB follows the shareholder.

Each shareholder should invest in a separate class of shares to avoid PUC averaging.

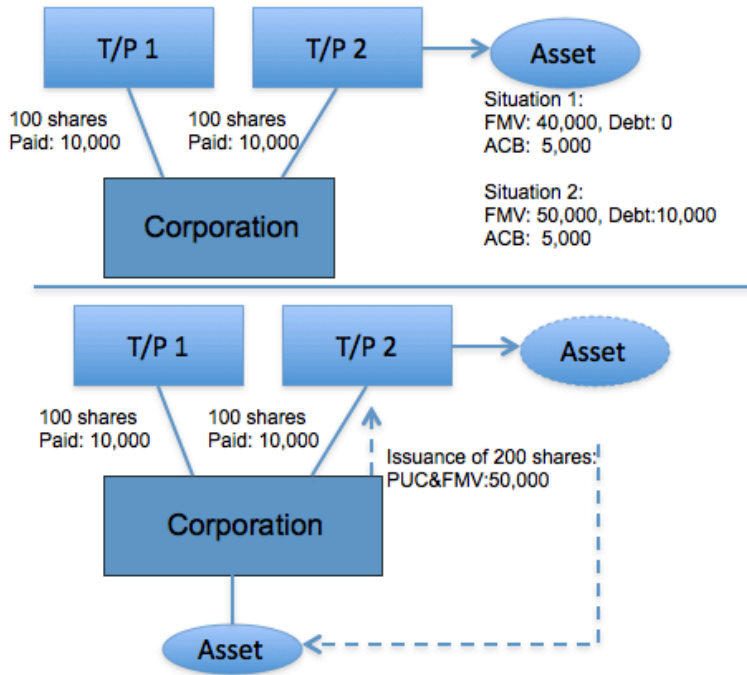
PUC Illustration



3.5.3.Subsection 84(1) - PUC Increase

<p>84(1) Artificial increase in PUC of a corporation resident in Canada</p>																					
<p>Deemed Dividend</p>	<p>Amount of increase in the PUC of the shares of a class</p> <p>Less:</p> <ul style="list-style-type: none"> • amount of increase in net assets • amount of decrease in net liabilities • amount of decrease in the PUC of the shares of any other class <p>Exceptions</p> <ul style="list-style-type: none"> • Stock Dividends • Shifts Between Classes • Conversion Of Contributed Surplus <p>The deemed dividend is distributed among the shareholders of the class after the increase in the PUC according to the number of shares that they obtain.</p> <p>Tax Consequences – Only one: 1. Deemed Dividend – 84(1)</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Increase in PUC:</td> <td style="text-align: right;">XXX</td> </tr> <tr> <td colspan="2">Less:</td> </tr> <tr> <td>• amount of increase in net assets</td> <td style="text-align: right;">XXX</td> </tr> <tr> <td>• amount of decrease in net liabilities</td> <td style="text-align: right;">XXX</td> </tr> <tr> <td>• amount of decrease in the PUC of the shares of any other class</td> <td style="text-align: right;">XXX</td> </tr> <tr> <td>Deemed Dividend</td> <td style="text-align: right;">XXX</td> </tr> <tr> <td>Less: CDA</td> <td style="text-align: right;"><u>(XXX)</u></td> </tr> <tr> <td>Taxable Dividend</td> <td style="text-align: right;">XXX</td> </tr> <tr> <td>Taxable Dividend reported by each S/H [based on their %]</td> <td style="text-align: right;">XXX</td> </tr> <tr> <td>Taxable Dividend x Gross-UP by each S/H</td> <td style="text-align: right;">XXX</td> </tr> </table>	Increase in PUC:	XXX	Less:		• amount of increase in net assets	XXX	• amount of decrease in net liabilities	XXX	• amount of decrease in the PUC of the shares of any other class	XXX	Deemed Dividend	XXX	Less: CDA	<u>(XXX)</u>	Taxable Dividend	XXX	Taxable Dividend reported by each S/H [based on their %]	XXX	Taxable Dividend x Gross-UP by each S/H	XXX
Increase in PUC:	XXX																				
Less:																					
• amount of increase in net assets	XXX																				
• amount of decrease in net liabilities	XXX																				
• amount of decrease in the PUC of the shares of any other class	XXX																				
Deemed Dividend	XXX																				
Less: CDA	<u>(XXX)</u>																				
Taxable Dividend	XXX																				
Taxable Dividend reported by each S/H [based on their %]	XXX																				
Taxable Dividend x Gross-UP by each S/H	XXX																				
<p>ACB Adjustment</p>	<p>Under paragraph 53(1)(b), the amount of the deemed dividend is added to the ACB of the shares.</p>																				
<p>Capital Gain or Loss</p>	<p>None.</p>																				

84(1) Example



Tax Consequences:

Deemed Dividend:

PUC Increase:	50,000
Net Asset Increase:	40,000
Deemed Dividend:	10,000

DD - T/P 2 (300/400):	7,500*
DD - T/P 1 (100/400):	2,500*

*To be grossed up depending if eligible or non eligible

ACBs:

ACB for T/P 1:	
- 10,000 + 2,500=	12,500:
ACB for T/P 2:	
-10,000 + 40,000 + 7,500=	57,500

Capital Gain for T/P 2:

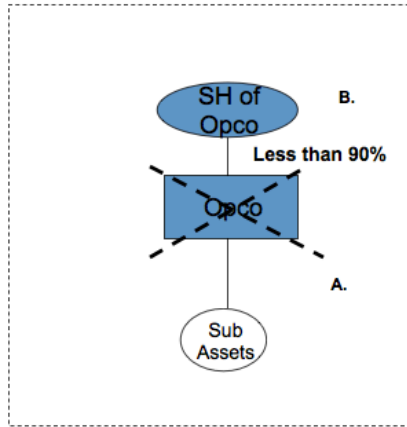
POD:	40,000
ACB:	<u>5,000</u>
C.G:	35,000
Amount previously taxed:	<u>(7,500)</u>
R.C.G:	27,500
T.C.G	13,750

3.5.4.Subsection 84(2) - Wind-up or Discontinuance of a Business

84(2) – Wind-Up or Discontinuance of a Business	Windups, reorganizations, or discontinuance of a business of a corporation resident in Canada
<p>Deemed Dividend</p> <p>Amount or value of the property distributed to the shareholders of a class Less:</p> <ul style="list-style-type: none"> reduction of the PUC of the shares of the class <p>The deemed dividend is distributed among the shareholders of the class according to the number of shares that they held immediately before the distribution.</p>	<p>Tax Consequences – Two types:</p> <p>1. Deemed Dividend - 84(2):</p> <p>[A]Amount of property value distributed XXX</p> <p>Less:</p> <p>PUC (XXX)</p> <p>[B]Deemed Dividend XXX</p> <p>Less:</p> <p>CDA (XXX)</p> <p>Taxable Dividend XXX</p> <p>Taxable Dividend per S/H [based on their %] XXX</p>
<p>Capital Gain (Loss)</p> <p>Per the definition of POD per paragraph (j), deemed dividend is excluded from POD</p>	<p>2. Capital Gain or Capital Loss</p> <p>[A] Amount of property value distributed XXX</p> <p>Less:</p> <p>[B] Deemed Dividend (XXX)</p> <p>Revised POD – S.54(j) XXX</p> <p>Less:</p> <p>ACB (XXX)</p> <p>Capital Gain (Loss): XXX</p>
<p>ACB Adjustment</p>	<p>Under paragraph 53(1)(b), the amount of the deemed dividend is added to the ACB of the shares.</p>
<p>Note with respect to denial of loss rules</p>	<p>Per paragraph 69(5)(d), the loss denial rules in subsections 13(21.2), 14(12), 18(15), 40(3.4) and 40(3.4) are not applicable.</p>

Partial Anatomy of an 88(2) Wind-Up and 84(2) Dissolution

Tax Consequences



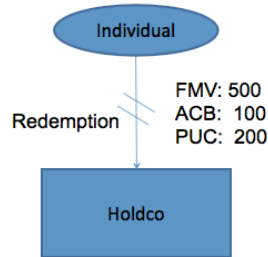
A. Opco's Level:

- Disposition of assets at FMV
- C.G., recapture, business, income, etc.
- Creation of CDA, RDTOH,
- Opco's Pays Tax
- Amount available for Distribution:
 - POD – Corporate Taxes + RDTOH

B At Shareholder's Level:

- Deemed Dividend:
 - Amount available for Distribution
 - Less PUC
- Capital Gain or Loss:
 - Amount available for Distribution
 - Less: Deemed Dividend

84(3) Deemed Dividend



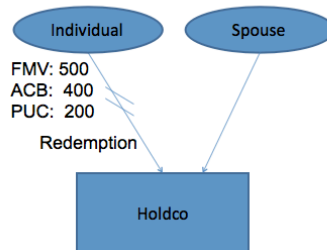
Tax Consequences:

Deemed Dividend:
 POD (FMV): 500
 PUC: 200
 D.D. 300 *

*Gross-Up

Capital Gain:
 POD: 500
 D.D. (300)
 R.POD 200
 ACB 100
 C.G 100
 T.C.G 50

40(3.6) and 84(3) Deemed Dividend



Tax Consequences:

Deemed Dividend:
 POD (FMV): 500
 PUC: 200
 D.D. 300 *Gross-Up

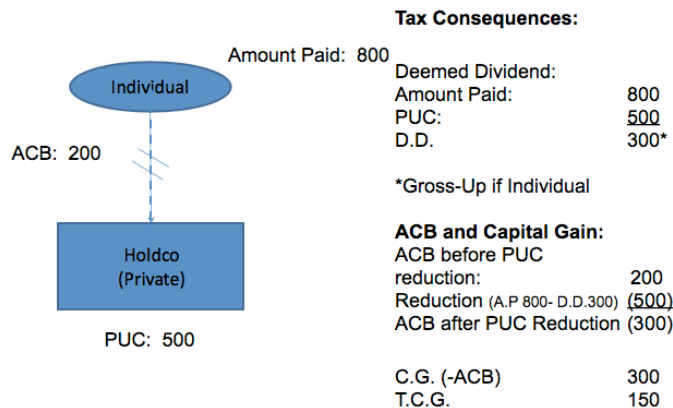
Capital Gain:
 POD: 500
 D.D. (300)
 R.POD 200
 ACB 400
 C.L (200)
 Deemed Nil -

Loss of 200 is denied as individual is affiliated with Holdco and would be added to his ACB (i.e., would need to conserve 1 share)

3.5.6.Subsection 84(4) – Decrease in PUC of Private Corporation Resident in Canada

84(4) – Decrease in PUC of Private Corporation Resident in Canada	Decrease in PUC of Private Corporation Resident in Canada
Deemed Dividend	<p><u>Deemed dividend [84(4)]</u></p> <p>[A] Amount paid XXX</p> <p>Less:</p> <p>Reduction in PUC (XXX)</p> <p>[B] Deemed dividend XXX</p> <p><u>ACB of shares</u></p> <p>ACB before the reduction in PUC XXX</p> <p>[A – B] Amount paid less 84(4) dividend (XXX)</p> <p>ACB after the reduction in PUC (XXX)</p> <p>ACB goes negative, then capital gain</p>
Capital Gain (Loss)	None, unless ACB goes negative, then capital gain
ACB Adjustment	<p>Reduction of the ACB of the shares according to 53(2)(a)(ii) for that amount received in the reduction of the PUC</p> <p>Note: If reduction in PUC without payment, no ACB adjustment</p>

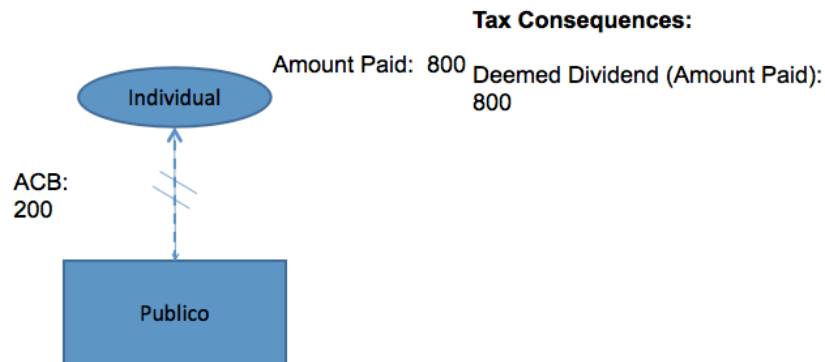
**Private Corporations
 84(4) Deemed Dividend**



3.5.7.Subsection 84(4.1) – Decrease in PUC of Public Corporation

84(4.1) – Reduction of PUC of a public corporation	84(4.1):Reduction of PUC of a public corporation
<p>Deemed Dividend</p> <p>Amount paid to shareholders for the reduction of PUC of the class of shares is considered a dividend EXCEPT where the amount may be reasonably considered to be derived from a transaction which occurred</p> <ol style="list-style-type: none"> 1. Outside the ordinary course of business; and 2. within the period that commenced 24 months before the payment <p>(i.e., a sale of a business unit in which the proceeds are not reinvested)</p> <p>will be considered a tax-free return.</p>	<p><u>Amount Paid</u></p>
<p>Capital Gain (Loss)</p>	<p>None, unless ACB goes negative, then capital gain</p>
<p>ACB Adjustment</p>	<p>None</p>

Public Corporations 84(4.1) Deemed Dividend



LECTURE 5: Chapter 15
Corporate Taxation and Management Decisions

Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

1. Advantages of Incorporation

- Limited Liability
- Allows to separate of business and personal activities
- May select year end (e.g., Jan. 31 versus Dec. 31). Opportunity for tax deferral;
- Tax savings [deferral - other than property income - and income splitting];
- Stabilization of income of individual through salary/ dividend payments
- which offers flexibility in timing (i.e., mindful that salaries have to reasonable per section 69, kiddie tax regarding dividends to minors, etc.);
- Use of a holding company for the operating company can defer Part I taxes on inter-corporate dividends (i.e., may be Part IV tax if dividend refund to connected payor corporation);
- Availability of RPP, DPSP in corp. (not available to owner of an unincorporated business);
- CGD on sale of shares if company is a QSBC;
- Deferral of CG on eligible SBC (44.1 – reviewed in ACCO 340);
- Estate Planning; and
- Foreign estate taxes can be avoided by placing foreign property in a Canadian corporation.

2. Disadvantages of Incorporation

- Unable to use losses of the corporate business against personal income;
- No personal tax credits in corporation;
- Donations in corporation are deductible & may result in less tax savings vs. 29% personal credit;
- Corporate Wind-up procedures are complicated;
- Other taxes for corporation (i.e., payroll tax, capital tax, etc.); and
- Legal and accounting costs, additional tax returns.

3. Integration and Deferral Possibilities

- Generally, no advantage to incorporate if will withdraw monies in the form of dividends to fund lifestyle.
- However, if do not need the monies, a deferral possibility may exist by retaining it in corporation.
- See tables below.

Illustration: Integration - Theoretical Model: All sources of Income

Legend		ABI eligible for SBD	ABI in excess of SBD	Interest	Capital Gain	Eligible Dividends	Non-Eligible Dividends
	Earned Directly:						
A	Amount Received	100,000	100,000	100,000	100,000	100,000	100,000
	Add: Gross-Up (25%)						25,000
	Gross-Up (38%)					38,000	
	Less: Non Taxable portion of CG (i.e., 50%)				50,000		
B	Taxable Income	100,000	100,000	100,000	50,000	138,000	125,000
	Tax at Individual Level:						
	Amount Subject to Tax (@45%)	45,000	45,000	45,000	22,500	62,100	56,250
	Less: DTC Non-Eligible Dividend - (Fed. 2/3 + Prov. 1/3) of Gross-Up						25,000
	DTC Eligible Dividend - (Fed. 13/23 + Prov. 10/23) of Gross-Up					38,000	
C	Net Tax	45,000	45,000	45,000	22,500	24,100	31,250
D=(B-C)	Net Amount Retained at Individual's level	55,000	55,000	55,000	77,500	75,900	68,750
	Earned via Corporation:						
	Amount Received	100,000	100,000	100,000	100,000	100,000	100,000
	Less: Non Taxable portion of CG (i.e., 50%)				50,000		
	Less: Inter-Corporate Deductible Dividends (i.e., ss.112(1))					100,000	100,000
E	Taxable Income:	100,000	100,000	100,000	50,000	0	0
	Corporate Tax on ABI:						
	Federal Tax - SBD @ 12%	12,000					
	Federal Tax - In Excess of SBD @ 20%		20,000				
	Provincial Tax - SBD @ 8%	8,000					
	Provincial Tax - In Excess of SBD @ 9.078%		9,078				
	Corporate Tax Investment Income:						
	Federal Tax @ 28%			28,000	14,000		
	ART @ 6 2/3%			6,667	3,333		
	Part IV - 33 1/3%					33,333	33,333
	Provincial Tax @ 12%			12,000	6,000		
F	Net Tax at Corporate Level:	20,000	29,078	46,667	23,333	33,333	33,333
G=(E-F)	Net Cash Available for Distribution	80,000	70,922	53,333	26,667	66,667	66,667
	Add: RDTOH			26,667	13,333	33,333	33,333
	Distributed to Individual (i.e., as a dividend)			80,000	40,000	100,000	100,000
	Add: Non Taxable portion of CG (i.e., 50%)				50,000		
H	Amount Received	80,000	70,922	80,000	90,000	100,000	100,000
	Add: Gross-Up (25%)	20,000		20,000	10,000		25,000
	Gross-Up (38%)		29,078			38,000	
I	Taxable Income	100,000	100,000	100,000	50,000	138,000	125,000
	Federal and Provincial Tax @45%	45,000	45,000	45,000	22,500	62,100	56,250
	Less: DTC Non-Eligible Dividend - Fed. 2/3 + Prov. 1/3	20,000		20,000	10,000		25,000
	DTC Eligible Dividend - Fed. 13/23 + 10/23		29,078			38,000	
J	Net Tax at Individual Level	25,000	15,922	25,000	12,500	24,100	31,250
K=(H-J)	Net Amount Retained	55,000	55,000	55,000	77,500	75,900	68,750

Illustration:
Integration - Tax Deferral Incidence of Retaining Income at Corporate Level

	ABI eligible for SBD	ABI in excess of SBD	Interest	Capital Gain	Eligible Dividends	Non-Eligible Dividends
Earned Directly:						
Amount Received	100,000	100,000	100,000	100,000	100,000	100,000
Add: Gross-Up (25%)						25,000
Gross-Up (38%)					38,000	
Less: Non Taxable portion of CG (i.e., 50%)				50,000		
Taxable Income	100,000	100,000	100,000	50,000	138,000	125,000
Tax at Individual Level:						
Amount Subject to Tax (@45%)	45,000	45,000	45,000	22,500	62,100	56,250
Less: DTC Non-Eligible Dividend - (Fed. 2/3 + Prov. 1/3) of Gross-Up						25,000
DTC Eligible Dividend - (Fed. 13/23 + Prov. 10/23) of Gross-Up					38,000	
Net Tax	45,000	45,000	45,000	22,500	24,100	31,250
Net Amount Retained at Individual Level	55,000	55,000	55,000	77,500	75,900	68,750
Earned via Corporation:						
Amount Received	100,000	100,000	100,000	100,000	100,000	100,000
Less: Non Taxable portion of CG (i.e., 50%)				50,000		
Less: Inter-Corporate Deductible Dividends (i.e., ss.112(1))					100,000	100,000
Taxable Income:	100,000	100,000	100,000	50,000	0	0
Corporate Tax on ABI:						
Federal Tax - SBD @ 12%	12,000					
Federal Tax - In Excess of SBD @ 20%		20,000				
Provincial Tax - SBD @ 8%	8,000					
Provincial Tax - In Excess of SBD @ 9.078%		9,078				
Corporate Tax Investment Income:						
Federal Tax @ 28%			28,000	14,000		
ART @ 6 2/3%			6,667	3,333		
Part IV - 33 1/3%					33,333	33,333
Provincial Tax @ 12%			12,000	6,000		
Net Tax at Corporate Level:	20,000	29,078	46,667	23,333	33,333	33,333
Net Cash Available for Distribution	80,000	70,922	53,333	26,667	66,667	66,667
Add: CDA				50,000		
Net Amount Retained at Corporate Level	80,000	70,922	53,333	76,667	66,667	66,667
Tax Deferral Advantage (Cost) of Retaining Income in Corporation	25.00%	15.92%	-1.67%	-0.83%	-9.23%	-2.08%

4. Corporate Decisions: Salary v. dividends - Case by case situation

- If below business limit, pay dividend to preserve integration
 - pay taxable dividends which trigger [i.e., eligible dividends first and, subsequently, non-eligible dividends] dividend refund where substantial RDTOH;
 - pay taxable dividends [i.e., eligible dividends first and, subsequently, non-eligible dividends]. Note: May be beneficial to elect out of CCPC status per 89(11) in order to claim eligible dividends (see GRIP and LRIP lectures for reminder or the particularities of the election)

		2013 Non Eligible Dividends	2014 Non Eligible Dividends	2013 and 2014 Eligible Dividends
A	Dividend	\$100,000	\$100,000	\$100,000
	Grossed Up Dividend	\$125,000	\$118,000	\$138,000
	Federal Tax @ 29%	\$ 36,250	\$ 34,220	\$ 40,020
	Provincial Tax @ 50% of Federal	\$ 18,125	\$ 17,110	\$ 20,010
B	Total Tax	\$ 54,375	\$ 51,330	\$ 60,030
	DTC – Federal [13 1/3% x 125,000] [11.00 % x 118,000] [15.02% x 138,000]	\$16,667	\$12,980	\$ 20,728
	DTC – Provincial	\$ 8,334	\$ 6,490	\$ 10,364
C	Total DTC	\$25,001	\$19,470	\$ 31,092
D=B-C	Taxes Payable	\$29,374	\$31,860	\$28,938
A-D	Net Cash Retained	\$70,626	\$68,140	\$71,062

- Tax Free Amounts of Eligible and Non-Eligible Dividends:
 - If single and no other source of income, may receive non-eligible dividend (i.e., generally from CCPCs below business limit) of \$35,553 or an eligible dividend of \$50,187 without incurring any tax liability (i.e., factoring in DTC and basic personal credit.)
 - For a married individual (i.e., presumption that spouse’s income is nil), one may receive a non-eligible dividend of \$49,527 or an eligible dividend of \$66,321 without incurring any tax liability.
- If CNIL, pay dividend to optimize CGD
- If above business limit, pay bonus or salary (as deductible) to extent of business limit rather than dividends (not deductible to the corporation).
- Consider compensation, if feasible and desired, that will give deduction to the payer corporation and that is not taxable or can be deferred by the recipient such as:
 - RPP (i.e., contributions made by employer not taxable to the employee per section 6.)
 - DPSP (i.e., contributions made by employer not taxable to the employee per section 6.)
 - Private Health Care Premiums (i.e., contributions made by employer not taxable to the employee per section 6.)

- RRSP: Earned income includes salary but not dividends
- Added Costs of Salary is CPP, EI and Payroll Tax.
- CPP, EI and Canada Employment Tax Credit: Salary is admissible but not dividends
- Consider Mix of salaries and dividends: If paying dividends and a portion of the individuals tax credit unused, top off with salary.
- If children above 18, consider income splitting.

5. Non taxable methods of distribution:

- Reduce PUC;
- Pay CDA

6. Income Attributed to a Shareholder

Shareholder Benefits - Subsection 15(1): A corporation confers a benefit of any kind on a shareholder. Some example of shareholder benefits are as follows:

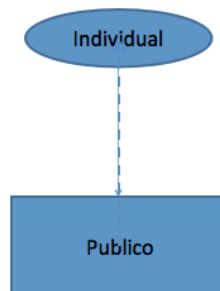
- The corporation pays various personal expenses of the shareholder such as trips, meals and entertainment, etc.
- A vacation home owned by the corporation is used by a shareholder for personal use.

Shareholder Benefits

Situation: Publico Pays 10,000 or personal expenses on behalf of individual

Individual:
-Includes 10,000 in income as SH benefit

Publico:
- 10,000 deduction is refused



Interest Free Loans – Subsection 15(2)

Instead of salaries, bonuses or dividends, interest-free or low-interest loans may be a way to try to evade tax. As a result, loans to the S/H are included in their income in the year indebted. However, the following exceptions apply:

- (i) Non-Resident Persons: Both the corporation and the shareholders have to be non residents
- (ii) Loans In Ordinary Course Of Business (i.e., Loan by a financial institution.)
- (iii) Repayment within one year after the end of the taxation of the corporation:

If loan is repaid within one year after the end of the taxation year of the corporation in which the loan was made or the indebtedness arose.

- (iv) Loans received as shareholders/employees: A loan received by a shareholder would not be included in income where :
 - the shareholder/employee owns less than 10% of the shares of the corporation;
 - it is used to purchase or construct a dwelling for personal use;
 - it is used to purchase treasury shares of the corporation or a related corporation; or
 - it used to purchase an automobile to be used in the performance of the duties of his office or employment

However, in order for these exemptions to apply, the following conditions must be met:

- the loan must be obtained because of the employment and not because of the number of shares held

- and -

- arrangements must be made for the repayment of the loan within a reasonable time.

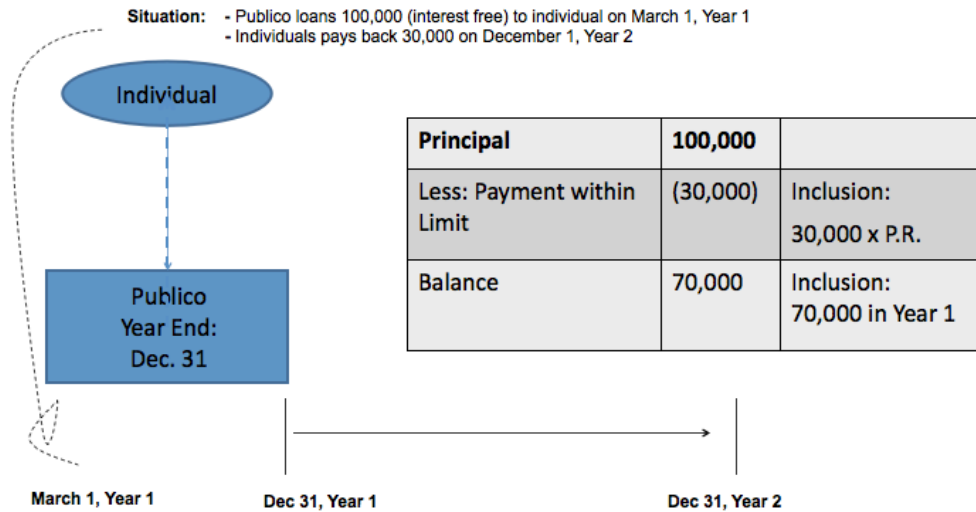
Repayment after one year: Deduction of loan inclusion per 20(1)(j) to the extent repaid

Interest Free Loans - Subsection 80.4: Benefit per prescribed rate (i.e., as with employment income)

Interaction 15(2) and subsection 80.4 - Methodology:

- If Loan and no reimbursement 15(2) Inclusion and no 80.4 interest benefit
- If Loan and reimbursement (i.e., including 20(1)(j)): 80.4 deemed interest benefit and no 15(2) inclusion:
- If Loan and partial reimbursement: 80.4 on portion reimbursed and 15(2) on non-reimbursed portion

Shareholder Loans



Repayment and 20(1)(j) deduction: Once the loan is included in income and the taxpayer decides to reimburse the loan subsequently (i.e., say in year 3 in the above example), the taxpayer will be able to deduct per 20(1)(j) the amount repaid (i.e., the \$70,000) in the year of reimbursement (i.e., year 3).

Prescribed Rates 2013:

	Taxable Benefits	Overpaid Taxes	Underpaid Taxes
Jan 1 to March 31	1%	3%	5%
April 1 to June 30	1%	3%	5%
July 1 to Sept 30	1%	3%	5%
Oct 1 to Dec 31	2%	4%	6%

LECTURES 6 and 7: Chapters 8 & 9

Non Arms Length Transactions, Inadequate Considerations, Attribution Rules and Deemed Dispositions

Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

1. Non Arms Length Transactions, Inadequate Considerations, Attribution Rules

1.1. Non Arms Length Person – Defined in Section 251 by virtue of section 252

- Person to person: A non arms length person is a person related by blood, marriage, common law relationship or adoption.
- Person to Corporation: Where a person or a related group control a corporation.
- Corporation to Corporation: Generally, controlled by the same person or group of people.

1.2. Inadequate considerations – Section 69 (General Rule)

Capital Property including Depreciable Property

Actual POD of Vendor	Deemed POD of Vendor	ACB of Purchaser	Reference
Greater than FMV	Actual POD	FMV	Paragraph 69(1)(a)
Less than FMV	FMV	Amount Paid	Paragraph 69(1)(b)
Gift	FMV	FMV	Paragraph 69(1)(c)

Depreciable Property:

Paragraph 13(7)(e)(iii) Applies where the transferor’s capital cost exceeds the proceeds of disposition

ACB of Property = Same as Vendor
 Less: [Difference between cost and POD] = Deemed CCA
 UCC = XXX

Note: Simply put, this means UCC will be equal to POD

Tax Attributes to Vendor: ACB=650,000, POD=400,000, UCC=300,000	Application of 13(7)(e)(iii) to Purchaser
	ACB = 650,000 * *Relevant for calculation future C.G
	Deemed CCA (650,000-400,000) =(250,000)
	UCC (POD)= 400,000 ** **Relevant for calculation of Recapture

Paragraph 13(7)(e)(i) Depreciable Property where POD of transferor exceeds ACB. :

$$\text{ACB} = \text{POD}$$

$$\text{UCC} = \text{ACB of vendor} + \frac{1}{2} (\text{POD} - \text{ACB of vendor})$$

Note:

Half Year Rule not applicable when purchaser claims CCA [see REG 1100(2.2)]

Tax Attributes of Asset (FMV=400, ACB=40, UCC=30)	
To the Transferor	To the Purchaser
FMV/POD = 400	New ACB = 400
ACB = (40)	New UCC 40 + 180 = 220
Potential Gain = 360 Tx. Cap Gain = 180	
UCC = 30	
Least of: POD = 400 ACB = 40 = (40)	
Recapture = (10)	

1.2.1. Exception to the General Rule: Transfer to Spouse, Common Law Partner – Section 73

- Section 73 provides a rollover (i.e., allows to defer disposition and tax-disposition at ACB or UCC) treatment to spouse (i.e., inherits ACB or UCC)
- Section 73 *automatically* applies UNLESS an election in the tax return not to have the provisions apply

1.3. Attribution Rules - section 74.1 and 74.2

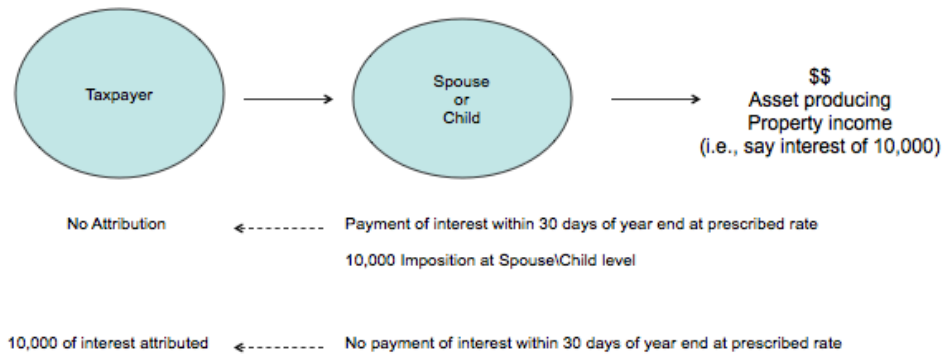
Type of Attribution	Type of Property	Tax Consequences	Exceptions – subsection 74.5	Other Points
Spousal (directly or indirectly or through a trust) – section 74.1	<ul style="list-style-type: none"> ▪ Transfer of Property ▪ Loan ▪ Does not apply to <i>business</i> income 	<ul style="list-style-type: none"> ▪ Income from property attributed back to transferor spouse ▪ Capital Gains and losses attributed back to spouse 	<ul style="list-style-type: none"> ▪ If consideration of at least FMV AND elected out of section 73 [ie. there must be a gain reported on a transfer between spouses as well a FMV consideration] ▪ If loan – interest charged at the prescribed rate and interest payable for the year was paid within 30 days after the end of the particular taxation year 	<ul style="list-style-type: none"> ▪ Applies to substituted property ▪ Does not apply to 2nd generation income (ie. income earned on attributed income) ▪ Does not apply where T/P [ie. the transferor] is not a resident of Cdn
Related individual under 18 including nephews and nieces (directly or indirectly or through a trust) – section 74.2	<ul style="list-style-type: none"> ▪ Transfer of Property ▪ Loan ▪ Does not apply to <i>business</i> income 	<ul style="list-style-type: none"> ▪ Income from property attributed back to transferor spouse ▪ Capital Gains and losses NOT attributed back 	<ul style="list-style-type: none"> ▪ If consideration of at least FMV no attribution rules ▪ If loan – interest charged at the prescribed rate and interest payable for the year was paid not later than 30 days after the end of the particular taxation year ▪ Does not apply to split income ▪ Income or loss will be ceased to be attributed to the transferor in the year in which the transferee has attained the age of 18. 	<ul style="list-style-type: none"> ▪ Applies to substituted property ▪ Does not apply to 2nd generation income (ie. income earned on attributed income) ▪ Does not apply where T/P [ie. the transferor] is not a resident of Cdn

1.4. Corporate Attribution Rules - section 74.4: see estate freezing lecture (i.e., last lecture)

Examples – Section 69 and Income Attribution Rules:

	To the Vendor					To the Purchaser		Imposition on the Revenue - Attribution		Imposition on the CG (say POD of 200 by the Purchaser) - Attribution	
	FMV	Actual POD	Tax POD	ACB	Gain (Loss)	Actual ACB	Tax ACB	Vendor's Hands	Purchaser's Hands	Vendor's Hands	Purchaser's Hands
Child 1	100	30	100	40	60	30	30	✓			✓ 170 (200-30)
Child 2	100	120	120	40	80	120	100		✓		✓ 100 (200-100)
Child 3	100	Gift	100	40	60	-	100	✓			✓ 100 (200-100)
Wife	100	120	40	40	-	120	40	✓		✓ 160 (200-40)	
Wife – Elect out 73	100	120	120	40	80	120	100		✓		✓ 100 (200-100)

Attribution – Loan



1.4.1. Non Applicability of Attribution Rules

- Marriage breakdown
- Contribution to a spousal RRSP
- Salary to spouse or children under 18

1.4.2. Avoidance Rules :

- Use of a Third Party to avoid attribution – subsection 74.5(6) & (7)
- Guarantee Payments – subsection 74.5(7) and (8)
- Use of Trust - subsection 74.5(9)
- If use attribution rules to reduce taxes – subsection 74.5(11)

1.4.3. Tax Liability

- Spouses are jointly & severally liable.

1.4.4. Subsection 56(4.1) - Non-Arm's Length Individuals including Children > 18

Conditions

- Loan or indebtedness to a non-arms length individual
- One of the main reasons for the loan or indebtedness was to reduce or avoid tax

Effect

- Attribute the income [not losses] to the lender

Exceptions

- Gifts
- Interest charged at the prescribed rates and paid within 30 days following the taxation year.

1.5. Split Income “The Kiddy Tax” – Section 120.4

- The Kiddie Tax is based on “split income” at the rate of 29%, the highest marginal rate of tax, and
- Applicable to children under the age of 18 at the end of the taxation year.
- Split income is defined as taxable dividends received on shares of private corporations, shareholder benefits or shareholder loans [does not include capital gains].
- Dividends remain eligible for the dividend tax credit but no other deductions or credits are allowed in computing a minor’s split income or the tax thereon.

2. Deemed Dispositions – Definition:

Per definition of Proceeds of Dispositions, there is a deemed disposition (no actual disposition but treated as a disposition for tax purposes) such as on:

- Emigration (Departing Cdn/Ceasing to be a resident of Cdn)
- Death
- Change of Use of property

2.1. Leaving and Entering Canada, Becoming a Non-Resident

2.1.1. Taxpayer entering Canada - paragraphs 128.1(1)(b) and (c)

- Deemed to have disposed and re-acquired assets at FMV immediately prior to immigrating to Canada;
- As a result, full-step in basis

2.1.2. Taxpayer leaving Canada – IT-221R3

According to IT-221R3, taxpayer is deemed to have departed Canada at the latest of the following dates [regardless on when that person actually departed]

1. the individual leaves Canada
 2. the spouse and/or dependants, if any, leave Canada
- or
3. the individual becomes a resident of another country

2.1.3. Deemed disposition of property – paragraph 128.1(4)

Departing taxpayers are deemed to have disposed all assets at FMV [thereby possible capital gain (loss) and recapture (terminal loss) other than the following property

- i. Canadian real estate, resource properties, and timber resource properties
- ii. property (including capital property, ECP, and inventory) of a business carried on in Canada by an individual, at the time of emigration
- iii. “excluded right or interest” including:
 - a. a salary deferral arrangement
 - b. an RRSP, RRIF, RESP, DPSP,
 - c. a stock option or mutual fund option
 - d. a retiring allowance
 - e. an annuity contract
 - f. Canada or Quebec Pension Plan and Old Age Security benefits
- iv. property of returning non-residents on which an election has been made to unwind the deemed disposition of a previous departure
- v. certain property of departing short-term residents (residents in Canada for less than 60 months during the 10-year period preceding the cessation of Canadian residence)

2.1.4. Security - Section 220(4.5) to 220(4.54)

- May result in a significant tax burden
- May be problematic as no actual disposition and therefore proceeds have not been received to pay the taxes
- Legislation allows taxpayer to provide security and pay tax when the property is actually sold.
- No interest will be charged.
- May elect to defer tax on \$100,000 of capital gains without posting security.

2.1.5. Filing Requirements

- Form T1161-02 must be filed where an individual departs from Canada and has assets greater than \$25,000 [i.e., Personal-use property of \$10,000 or less is excluded from this reporting requirement].

2.1.6. Short Term Residents - subparagraph 128.1(4)(b)(iv)

- If an individual that departs from Canada has resided in Canada for 60 months or less during the 10 years preceding his departure, the deemed disposition rules do not apply to assets:
 1. That were acquired through an inheritance;
 2. Belonged to him before he last entered Canada

3. Death of a Taxpayer [see Appendix F: Supplementary on Death]

General Rule - Deemed Disposition of all property – subsection 70(5)

Capital Property

Paragraph 70(5)(a) – For Deceased:

- Deemed Disposition at FMV immediately prior to death

Paragraph 70(5)(b) – For Beneficiary:

- Deemed to acquire property at FMV

Depreciable Property

Paragraph 70(5)(a) – For Deceased:

- Deemed Disposition at FMV immediately prior to death
- May trigger recapture, terminal loss, etc.

Paragraphs 70(5)(b) & (c) – For Beneficiary:

- Beneficiary: Deemed to acquire property as follows:

Where FMV of vendor exceeds ACB vendor - 70(5)(b)

ACB and UCC = POD of vendor – 70(5)(c)

Where ACB of vendor exceeds FMV vendor

$$\begin{aligned} \text{ACB} &= \text{ACB of Vendor} = && \text{XXX} \\ \text{CCA taken} &= (\text{ACB of Vendor} - \text{FMV}) = && \text{XXX} \\ \text{UCC} &= \text{FMV} = && \text{XXX} \end{aligned}$$

No application of half year rule for beneficiary - Reg. 1100(2.21)

Note: Same rules as with non-arms length – see previous tables/calculations

i. Exception #1: Automatic Rollover (Tax-free transfer) to Spouse/Common Law or Spousal Trust – subsection 70(6):

Conditions:

Automatic tax-free transfer to spouse [i.e., It overrides subsection 70(5)]:

1. the deceased taxpayer and spouse common law partner [including spousal trust if spouse is entitled to receive income before his/her death and no other than spouse can use the capital of the trust] must be resident in Canada immediately before his death;
2. the property transferred must be transferred following the death of a taxpayer; and
3. it can be shown that that property vests indefeasibly [absolute right to property] in the spouse, common-law partner or trust within 36 months after the death or within such longer period as is considered reasonable in the circumstances.

To the Deceased:

Non - Depreciable Property:	Disposition at ACB
Depreciable Property:	Disposition at UCC

Electing out of Spousal Rollover provision - 70(6.2)

In order not to have the spousal rollover rules applies, one must elect out of 70(6) and, as a result, there is a disposition at FMV [and not any value between FMV and ACB] .

ii. Exception #2: Other Property subject to Rollover Treatment - 70(9)

- Farm Property
- Shares of a Family Farm Corporation
- Interest in a Family Farm Corporation
- Must be given to a child. Child includes per subsection 70(10) :
 - a grandchild,
 - a great grandchild, and
 - a person who at any time before he attained the age of 19 years, was wholly dependent on the taxpayer for support and of whom the taxpayer had the custody at that time

4. Change of Use:

There are two types of change of use:

- 1) Personal to Business; and
- 2) Business to Personal

Rules

On a change of use, there will be a deemed disposition (no actual disposition but an incident for tax purposes that will be considered a disposition) for $POD = FMV$.

(i) Personal to Business

1. Deemed Disposition = $POD (FMV) - ACB =$ Capital gain or loss
2. If gain in #1 the UCC of purchaser = ACB of vendor + $\frac{1}{2}$ of gain, otherwise UCC of purchaser = FMV
Note: Same rules as with non-arms length – see previous tables/calculations
3. ACB of purchaser = FMV

(ii) Personal to Business – Subsection 45(2) Election

1. Election allows taxpayer to defer the deemed disposition.
2. The taxable capital gain on the property is deferred until the election is revoked or the property sold
3. In the event the property was converted from a principal residence to a rental [business], the property can continue to be designated as a principal residence for up to 4 years.

(iii) Business to Personal

1. Deemed Disposition = $POD (FMV) - ACB =$ capital gain or loss
2. Recapture or Loss
3. $ACB = POD (FMV)$

(iv) Business to Personal – Subsections 45(3) and 45(4) Elections

1. May make an election to defer capital gain but election is only available where the property becomes a principal residence of the taxpayer [subsection 45(3)].
2. No CCA must have been claimed any CCA on the property when it was used for business purposes [subsection 45(4)].

Overview of Rollover rules (i.e., tax deferred transactions)

Objective of Provisions:

- Defers Gain to the vendor
- Generally, tax continuity of the tax basis (i.e., ACB, UCC) of the vendor to the purchasing corporation.

Transfer of Property to a Taxable Canadian Corporation	Share-for-share Reorganizations	Combining Corporations
- Section 85 (Transfer of Property to a taxable Canadian Corporation)	Section 85.1: (Takeover where a large number of shareholders of a particular corporation exchange their shares for shares of another corporation) Section 86: (Reorganization of Capital – Share for Share Exchange) Section 51: (Exchange of Shares or Debt for Shares)	Section 87: Amalgamations Section 88: Wind-Ups

LECTURES 8 AND 9: Chapter 16
Rollovers under section 85,
Dividend Stripping per section 84.1,
Capital Gains Stripping per subsection 55(2)

Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

Section 85 Rollovers

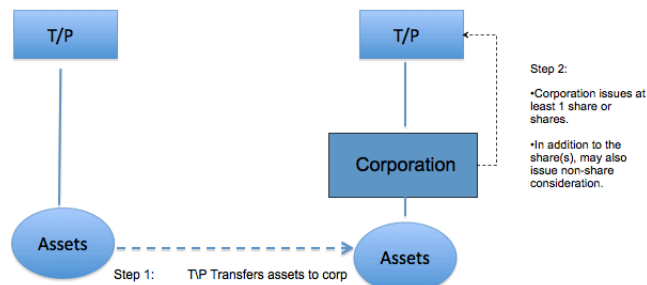
1. General

- Section 69 requires property to be transferred at FMV between persons not dealing at arm's length.

2. Section 85 Rollover

- No immediate tax/transfer at tax costs [ACB, UCC].
- May select value between certain ranges
- On transfer, must receive at least 1 share.

Section 85



3. Advantages versus Disadvantages

3.1. Advantages:

- Tax free transfer of property to corporation
- Incorporation of a business without tax incidence
- Take advantage of CGD by rollover business and selling
- « Cost Isolation » (See Appendix G) (i.e., beyond ACCO 440)

3.2. Disadvantages must be considered:

- Double Taxation:
 1. Disposition of shares of the shareholder
 2. Disposition of assets by the corporation received from shareholder
- Additional legal and accounting fees.
- GST, HST and provincial taxes
- No access to losses of the business

4. Eligible Persons [i.e., who can use the rollover provisions]:

4.1. Individual

4.2. Trust

4.3. Corporation

4.4. Partnership [use subsection 85(2)]

- 5. Transferee (i.e., the purchaser):** Must be a taxable Canadian corporation which is basically a corporation that is a "Canadian corporation" not exempt from Part I tax. A "Canadian corporation" is defined in subsection 89(1) as being a corporation that at the relevant time is resident in Canada and was either incorporated in Canada or resident in Canada throughout the period commencing June 18, 1971 and ending at that relevant time.

6. Eligible Property [i.e., Property which may rolled over]:

Subsection 85(1.1) contains a list of eligible property. If not listed, may not rollover. Property listed is as follows:

- a capital property
- a capital property that is a real property
- a Canadian resource property a foreign resource property
- an eligible capital property (ECP)
- an inventory except real property [i.e., Land held on account of inventory].
- a capital property that is a real property, or an interest therein or an option in respect thereof, owned by a non-resident other than a non-resident insurer and used in a business actively carried on in Canada [conditions set out in subsection 85(1.2) MUST be met]

7. Property where Section 85 should be not used [i.e., not to be rolled over]:

7.1. Property with no appreciation or a latent loss as there will be double tax on eventual sale of shares and assets [see above]. If the assets are still transferred, the rules in section 69 will generally apply and the loss may be denied per various stop-loss rule [see # 3 in step #4].

7.2. Account Receivable / Opt for section 22 election as an alternative

Accounts Receivable

No Election:

Tax Consequences to Vendor

- Previous year reserves must be included in income,
- On sale of the accounts receivable, the disposition will result in a capital loss in which $\frac{1}{2}$ is deductible [where FMV of receivable is less than carrying value].

Tax Consequences to Purchaser

- the purchaser will not be able to deduct reserve/bad debt as they were only included in the vendor's income and not that of the purchaser.

Section 22 Election:

Conditions for election

- All or substantially all (90%) of the assets of the vendor must be sold to the purchaser;
- Purchaser must carry on the same business as the Vendor
- Purchaser and vendor must make a joint election on form T2022

Tax Consequences to Vendor

- Any loss on the disposition of the receivables will be considered a business loss (100% deductible) rather than a capital loss (50% deductible);

Tax Consequences to Purchaser

1. The receivables retain their nature;
2. In the year of acquisition, the business loss of the vendor (computed above) will be added on to the purchaser's income (deemed inclusion);
3. The purchase may take a reserve at the end of the year as A/R deemed included in income.

7.3. QSBC shares: No benefit transfer to new corporation as can no longer claim CGD on those QSBC shares. No assurance that shares of the transferee corporation will qualify.

8. Forms and Filing Requirements - subsection 85(6) and (7):

Form T2057 must be filed no later than the earliest of the days that the transferor or transferee must file an income tax return in which the transfer took place

Transferor is:

- Individual: April 30 or June 15 [if carrying on a business] of the following year
- Corporation: six months after the end of its taxation year
- Trust or estate: 90 days after the end of its taxation year

Late Filing / Two conditions

1. Filed within 3 years following the deadline for filing the original election,
2. Must pay the penalty in subsection 85(8)¹⁰

¹⁰ This penalty is equal to the lesser of:

- $1/4 \times 1\%$ of the excess of the deferred gain on late election for each month or part of month late
- \$100 per month or part of a month not exceeding \$8,000

9. Detailed Mechanics of Section 85: Steps to be followed

STEP 1: SET UP TABLE AS FOLLOWS

1	2	3	4	5	6			
					Consideration Received			
					Non Share Consideration			
Property Transferred	FMV of Property Transferred	ACB of property transferred	UCC/CEC of property	Agreed Amount [Deemed POD] See step 3 below on how to compute	Note/Cash Issued	Debts Assumed	Shares Received	FMV Received

STEP 2: CONSIDERATION RECEIVED

1. For each property transferred, **transferor must receive at least one share** of the corporation of which asset is transferred to.
2. FMV OF PROPERTY TRANSFERRED [COLUMN # 2] = FMV RECEIVED [COLUMN # 6]
3. BENEFIT PROVISIONS – SUBSECTION 15(1)

 IF FMV OF PROPERTY TRANSFERRED [COLUMN # 2] IS LESS THAN FMV RECEIVED [COLUMN # 6] = NEGATIVE AMOUNT IS A BENEFIT AND IS INCLUDED IN INCOME
4. GIFTING PROVISION PARAGRAPH 85(1)(E.2)

 IF FMV OF PROPERTY TRANSFERRED [COLUMN # 2] EXCEEDS FMV RECEIVED [COLUMN # 6] = EXCESS IS GIFT AND ADJUSTMENT IS NEEDED IN STEP # 3

STEP 3: DETERMINE AGREED AMOUNT [A.A]: DEEMED PROCEEDS OF DISPOSITION FOR EACH PROPERTY TRANSFERRED AS FOLLOWS:

$$A.A. = A.A. \text{ gift} + A.A. \text{ base}$$

$$A.A \text{ gift} = \text{GIFT [DETERMINED UNDER 4 IN STEP 2]}$$

$$A.A. \text{ base} = \text{Amount determined below:}$$

Maximum Amount: FMV

Minimum Amount:

Greater of:

- i) Non Share Consideration

Hint:

If not given, and asked to maximize NSC, use amount determined in ii) below.

Where FMV is determined to be lesser amount in ii) below, NSC should FMV – 1.

- ii) Lesser of:
-FMV
-ACB
-UCC proportionate and not total [asset by asset – 85(1)(e.1)]**
-4/3 CEC BALANCE

Note: As nil is not an “amount” (i.e., at least \$1)

Based on above, A.A must be increased up to NSC for purposes of determining minimum amount (i.e., stated alternatively, NSC can not be greater than AA).

** Special Rule for Passenger (Luxury) Automobiles – 85(1)(e.4):
Deems A.A. to be UCC of the class immediately before transfer
(Reminder: each luxury vehicle is in a separate class 10.1 and capped at 30,000)

STEP # 4: DETERMINE TAX CONSEQUENCES OF DISPOSITION USING A.A. AND/OR THE TRANSFER

Calculate, where applicable, the following:

1. Capital Gain
2. Recapture
3. Capital Loss [other than depreciable property].

Loss where property is transferred to an affiliated person (see Appendix H) is denied:

OVERVIEW OF LOSS DENIAL PROVISIONS						
ITA Reference	Type of Property	Vendor	Purchaser	Loss	Treatment of Loss	Illustration
40(2)(g) Definition of superficial loss in section 54	Non-Depreciable property	Individual	Affiliated Person (see Appendix H)	Denied	Denied <u>loss is added to ACB of purchaser.</u>	See powerpoint slide for an illustration
40(3.3) and 40(3.4)	Non-Depreciable property	Corporation	Affiliated Person (see Appendix H)	Denied	Denied <u>loss is suspended and can be claimed by original purchaser in the year when the affiliated party disposes the property to an outside group.</u> there is a liquidation or become a NR	See powerpoint slide for an illustration
13(21.2)	Depreciable Property	Any taxpayer	Affiliated Person	Denied	The <u>loss is added to the same class of the Vendor and CCA can continued to be claimed by the Vendor.</u> No half year rule [REG 1100(2.2)]. <u>Loss is suspended until sale outside corporate group, liquidation or become N/R]occurs at which time may the unamortized terminal loss may be claimed by the original vendor.</u>	See powerpoint slide for an illustration
14(12)	Same as 13(21.2)	Same as 13(21.2)	Same as 13(21.2)	Same as 13(21.2)	Same as 13(21.2)	See powerpoint slide for an illustration

Non-Depreciable Property:

Common Conditions:

a) during the 61-day period commencing 30 days before and ending 30 days after the disposition, the transferor or an affiliated person acquires the same or an identical property

(b) at the end of the period, the transferor or an affiliated person owns the property.

Transferor is an individual - Superficial Loss - Effect:

Loss is denied per paragraph 40(2)(g) and added to ACB of purchaser per paragraph 53(1)(f)

Transferor is a corporation, trust or partnership - Loss suspension rules - Effect:

Loss is denied per subsection 40(3.3) and is suspended until one of the events in subsection 40(3.4) [i.e., sale outside corporate group, liquidation or become N/R] occur where at which time the original transferor may claim loss.

Depreciable Property:

All transferors - Terminal Loss - Partial Loss Suspension Rule:

- **Section 85 is N/A.**
- Loss is denied pursuant to subsection 13(21.2).
- In addition, pursuant to subparagraph 13(21.2)(e)(iii), the loss is added to the same class of the Vendor and CCA can continued to be claimed by the Vendor. No half year rule [REG 1100(2.2)].
- Loss is suspended until one of the events in subparagraph 13(21.2)(e)(iii) [i.e., sale outside corporate group, liquidation or become N/R] occurs at which time may the unamortized terminal loss may be claimed.

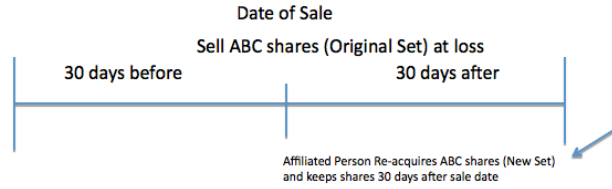
Eligible Capital Expenditure (ECE):

Transferor is a corporation, trust or partnership - Loss on ECE – Partial Loss Suspension Rule:

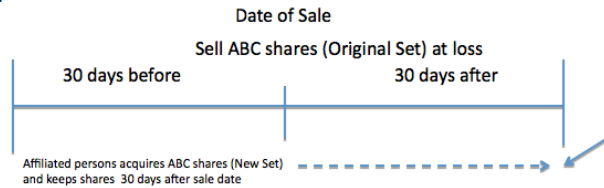
- same rules as depreciable property / refer to subsection 14(12) except N/A to individuals]

Common Conditions

Situation A:



Situation B:

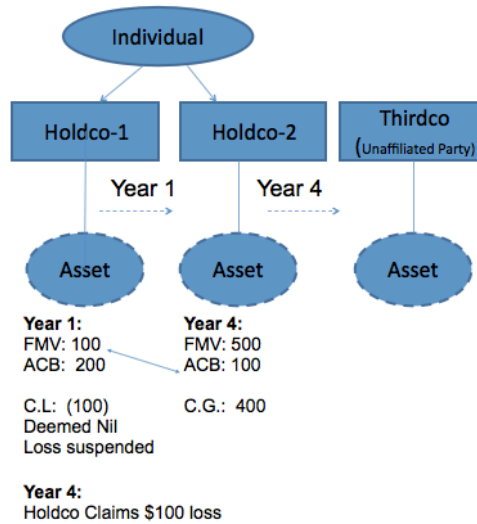


Superficial Loss – Example

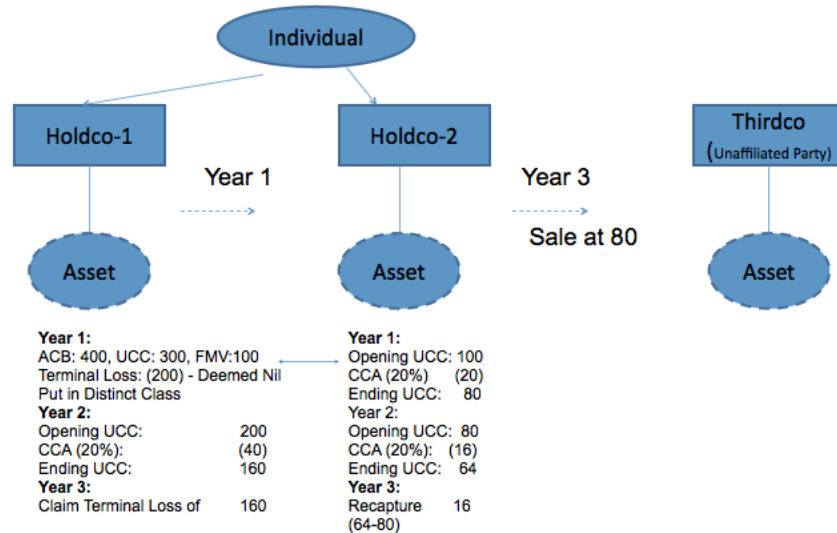
Example:

<ul style="list-style-type: none"> - Madame sells her shares to Monsieur Inc. - Loss is deemed nil to Madame and the amount is added to the ACB of Monsieur Inc. - Monsieur Inc. holds on to the shares for 30 days and sells them on the open market and claims the 100,000 loss - Monsieur Inc. applies the other GC (\$100,000) 	<ul style="list-style-type: none"> • Madame Shares of X Inc. POD: 1 000 \$ ACB: 101 000 \$ CL: (100 000) \$ 40(2)(g)(i) – Superficial Loss Nil 	<ul style="list-style-type: none"> • Monsieur Inc. Other GCs Shares of X Inc. PD 1 000 \$ ACB 100 000 \$ Price Paid 1 000 (FVM) Superficial Loss – 53(1)(f) + 100 000 [53(1)(f)] (101 000 \$) CL (100 000 \$) (100 000) \$ 	<ul style="list-style-type: none"> Gain (Loss) Nil
--	--	---	---

40(3.3) and 40(3.4): Corp. Disposing of Non-Depreciable property to Affiliated Person



13(21.2) and 14(12): T/P Disposing of Depreciable property or ECE to Affiliated Person



STEP # 5: DETERMINE ACB OF CONSIDERATION RECEIVED

1	2	3	A.A. Base + 15(1)
Non Share Consideration – 85(1)(f)	Preferred Shares – 85(1)(g)	Common Shares – 85(1)(h)	A.A base
Up to FMV of NSC but may not exceed A.A. base	A.A. base – Allocation to NSC May not exceed FMV	A.A. base – Allocation – NSC – Allocation of PS May not exceed FMV	1+2+3 should equal A.A. base [as determined in step 3]
Up to FMV OF NSC	Up to FMV OF PS	Up to FMV OF CS	15(1)

STEP # 6: DETERMINE TAX PUC OF SHARES RECEIVED:

LEGAL PUC OF NEW SHARES: FMV OF ALL SHARES = XXX

Less: subsection 85(2.1) reduction:

A-B x (C/A)

A= FMV OF ALL SHARES = XXX

B= A.A. – NSC = XXX

C = $\frac{\text{FMV OF CLASS}}{\text{FMV OF ALL SHARES}}$ = XXX = (XXX)

A= FMV OF ALL SHARES

TAX PUC [HINT: THIS SHOULD EQUAL A.A – NSC x FMV CLASS/ FMV ALL SHARES]

Important Notes:

- If 85(1)(e.2), need to go through long method and not hint method
- In internal section 85 rollover, no PUC reduction (see last lecture – estate freezes), may result in ss.84(1) or 84(3) deemed dividend (i.e., paragraph 29 of IT-291R3)

STEP # 7: DETERMINE ACB/UCC OF PROPERTY RECEIVED BY PURCHASER

Non-Depreciable Property:

Paragraph 85(1)(a): ACB of Property = A.A
 + loss added per paragraph 53(1)(f)

Depreciable Property:

Subsection 85(5): Applies where the transferor’s capital cost exceeds the proceeds of disposition
 ACB of Property = Same as Vendor
 Less: [Difference between cost and A.A] = Deemed CCA
 UCC = XXX

Paragraph 13(7)(e)(i) Depreciable Property where A.A of transferor exceeds ACB. :

ACB = A.A.
 UCC = ACB of vendor + ½ (A.A. – ACB of vendor)

Note 1: Half Year Rule not applicable when purchaser claims CCA [see REG 1100(2.2)]

Note 2: Same rules as with non-arms length – see tables/calculations on pages 69 and 70

STEP #8: ANOMALIES – 15(1) BENEFIT OR 85(1)(e.2) GIFT

Example – 15(1):

Property Transferred	FMV	ACB	AA	NSC	Shares
Shares	8,000	6,000	6,000	6,000	4,000

FMV Transferred	8,000
FMV Received	<u>10,000</u>

S/H Benefit - 15(1) (2,000) Include in Income

ACB of Property Received:

NSC	Shares	A.A base
6,000	Nil	6000
		15(1)
* Nil	*2,000	2,000

*[Up to FMV]

$$\text{PUC} = \text{A.A} - \text{NSC} = 6,000 - 6,000 = \text{Nil}$$

COST OF PROPERTY TO TRANSFEREE

A.A=6,000

Example – 85(1)(e.2)

Property Transferred	FMV	ACB	AA	NSC	Shares
Shares	8,000	6,000	6,000	5,999	1

FMV Transferred	8,000
FMV Received	<u>6,000</u>

85(1)(e.2) Gift 2,000 [Add to A.A]

$$\begin{aligned} \text{A.A} &= \text{A.A. gift} + \text{A.A. base} \\ &= 2,000 + 6,000 \\ &= 8,000 \end{aligned}$$

$$\text{POD} - \text{ACB} = 8,000 - 6,000 = 2,000 \text{ Capital Gain}$$

ACB OF Property Received:

NSC	Shares	A.A base (without gift)
5,999	1	6,000

PUC OF SHARES RECEIVED:

$$\text{A.A} - \text{NSC}: 8,000 - 5,999 = 2,001$$

COST OF PROPERTY RECEIVED:

A.A: 8,000

STEP # 9: “ERROR FILLED” AND “FIX IT” ROLLOVER:

1. DETERMINE ASSETS THAT ARE NOT ELIGIBLE FOR SECTION 85 ROLLOVER – APPLY SECTION 69 [FOR POD AND ACB]

PUC AND ACB – REMNDR

To Vendor:

If shares received

- PUC\ACB of property received: FMV of Consideration Received

If no shares received:

- ACB of property received: FMV of Consideration Received

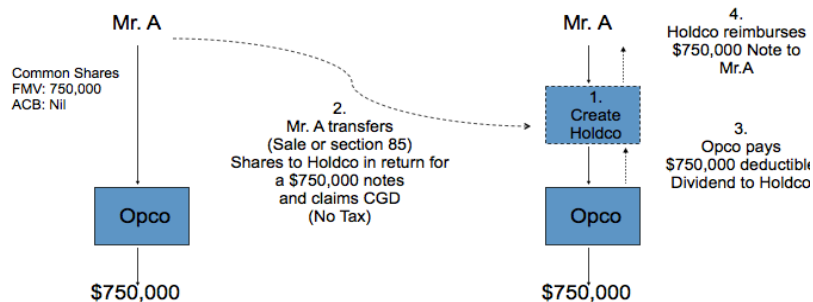
2. IF FMV TRANSFERRED = FMV RECEIVED = APPLICATION OF 15(1) OR 85(1)(E.2) AS DESCRIBED IN STEP 2
3. DETERMINE IF A.A. IS CORRECT. IF INCORRECT, RECALCULATE GAIN. IF LOSS, SEE BELOW.
4. CONSEQUENCE OF SECTION 22 ELECTION
5. WHERE LOSS APPLIES, APPLY STOP-LOSS RULES AS DESCRIBED IN STEP 4
6. IF SHARES TRANSFERRED, APPLICATION OF SECTION 84.1 MUST BE CONSIDERED BEFORE SECTION 85. [SEE NEXT LECTURE]
7. IF GOODWILL NOT TRANSFERRED= INCOME INCLUSIONS

Section 84.1 – Dividend Stripping

1. Purpose:

Section 84.1 converts a capital gain [usually where CGD used to secure tax free transaction or to take advantage lower capital gain rates] into taxable dividends

Section 84.1 - Illustration



Result: \$750,000 of Surplus converted in tax free capital gain

2. Conditions

Section 84.1 applies when all the following conditions are met:

- the shares transferred are capital property of the person disposing of them (the vendor)
- the vendor is not a corporation
- the vendor is resident in Canada
- the purchaser is a corporation
- the vendor and the purchaser do not deal at arm's length
- the corporation whose shares are sold is resident in Canada

-and-

- the corporation whose shares are sold is connected, within the meaning of subsection 186(4) [see previous lecture], with the purchaser corporation immediately after the transaction.

IMPORTANT NOTE:

If section 85 is used to transfer property, section 84.1 has precedence over section 85. In other words, the moment there is a rollover and shares are the property transferred [only shares], consider the application of section 84.1. If it is not applicable, then consider section 85. If assets other than shares are transferred, disregard section 84.1.

3. Detailed Mechanics

STEP # 1: ACB OF PURCHASER FOR PURPOSES OF APPLYING SECTION 84.1 (i.e., determine ACB for steps 2 to 3 only)

ACB vendor XXX

Less:

CGD claimed by T/P or related person (XXX)

ACB for purposes of subsection 84.1 XXX

STEP # 2: DETERMINE PUC FOR PURPOSES OF APPLYING SECTION 84.1

LEGAL PUC (FMV) = XXX

Less: PUC Reduction per paragraph 84.1(1)(a)

$$(A-B) \times (C/A)$$

A= LEGAL PUC (FMV) = XXX

B- Greater of

i. PUC old shares XXX

ii. ACB old shares [step 1] XXX

Minus NSC (XXX)

XXX (XXX) (XXX)

C = FMV OF CLASS multiply by XXX (XXX)

A = FMV OF ALL SHARE

TAX PUC XXX

HINT : RESULT SHOULD EQUAL :

GREATER OF I) PUC old shares or ii) ACB old	XXX	
LESS: NSC	<u>(XXX)</u>	
	XXX x <u>FMV CLASS</u>	
	FMV SHARES	

STEP 3: CALCULATE DEEMED DIVIDEND

The deemed dividend is computed using the following formula:

$$(A + D) - (E + F)$$

where

A = LEGAL PUC (FMV) of new shares

D = NSC received by the transferor

E = the greater of:
(i) PUC old
(ii) ACB old [step 1]

F = PUC reduction [see step 3]

HINT: DEEMED DIVIDEND SHOULD EQUAL:

NSC less the greater of the following amounts:

- PUC of the shares transferred
- ACB of the shares transferred

STEP 4: CALCULATE CAPITAL GAIN (LOSS)

POD [If section 85 rollover, use A.A]	XXX
Less: Deemed Dividend [computed in step 3]	<u>XXX</u>
POD revised – 54(k)	XXX
ACB without adjustment in step 1	<u>(XXX)</u>

GAIN (LOSS)

IF LOSS :

Step 1: Loss Reduction – subsection 112(3): Reduce by CDA

Step 2: If affiliated, loss is denied by virtue of paragraph 40(2)(g)

STEP # 5: DETERMINE ACB OF CONSIDERATION RECEIVED

If no section 85 rollover, ACB equals Amount Paid

If section 85 rollover, DETERMINE ACB OF CONSIDERATION RECEIVED

1	2	3	A.A. Base + 15(1)
Non Share Consideration – 85(1)(f)	Preferred Shares – 85(1)(g)	Common Shares – 85(1)(h)	A.A base
Up to FMV of NSC but may not exceed A.A. base	A.A. base – Allocation to NSC May not exceed FMV	A.A. base – Allocation – NSC – Allocation of PS May not exceed FMV	1+2+3 should equal A.A. base [as determined in step 3]
Up to FMV OF NSC	Up to FMV OF PS	Up to FMV OF CS	15(1)

STEP # 6: DETERMINE ACB OF PROPERTY RECEIVED BY PURCHASER

If no section 85 rollover, ACB generally equals Amount Paid [apply section 69]

If section 85 rollover, DETERMINE ACB OF PROPERTY RECEIVED BY PURCHASER

Non-Depreciable Property

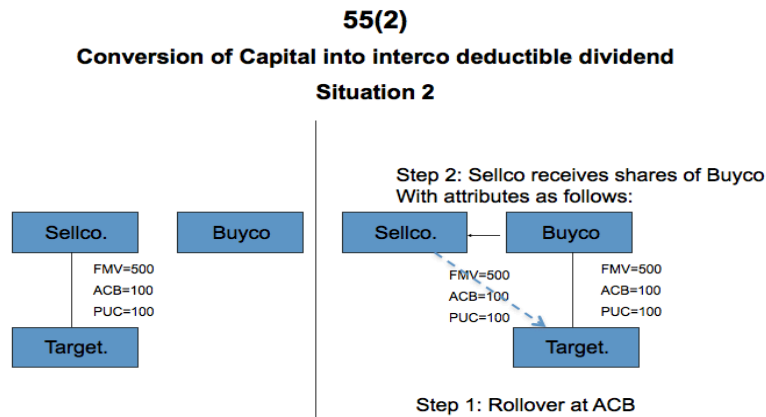
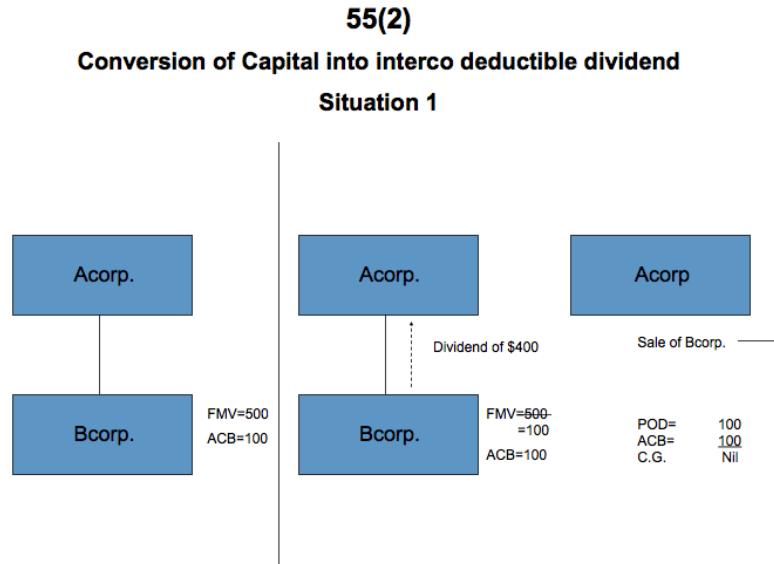
$$\text{Paragraph 85(1)(a): ACB of Property} = \text{A.A} + \text{loss added per paragraph 53(1)(f)}$$

Subsection 55(2) - Capital Gain Stripping:

1. Purpose

- Designed to prevent converting a capital gain into an inter-corporate tax free dividend

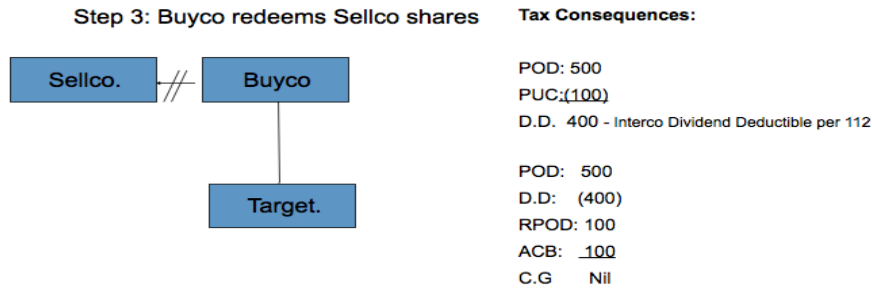
2. Problem



55(2)

Conversion of Capital into interco deductible dividend

Situation 2 – Cont'd



End Result:

- BUYCO has disposed of SELCO for a \$1,000,000 but has converted its \$1,000,000 capital gain into a \$1,000,000 tax free dividend
- In this example, the \$1,000,000 of inter-company tax free dividend would be converted into a capital gain pursuant to section 55

3. Conditions of subsection 55(2):

Subsection 55(2) is applicable where:

- Recipient is a taxable Canadian Corporation
- Receives taxable dividend
- Inter-corporate dividend deductible per section 112
- Purpose of dividend / result [84(3)] -> significant reduction of capital gain.

4. Exceptions to subsection 55(2):

- Part IV tax,
- safe income (i.e., similar to retained earnings),
- related party transactions and
- butterfly transactions

5. Effect of subsection 55(2):

If these conditions are present, the following rules apply to the dividend:

1. Paragraph 55(2)(a): The dividend shall be deemed not to be received.
2. Paragraph 55(2)(b): If corporation has disposed of the share, the dividend shall be deemed to be proceeds of disposition of the share.
3. Paragraph 55(2)(c): If corporation has not disposed of the share, the dividend shall be deemed to be a gain of the corporation in the year which the dividend was received.

6. Calculation

Actual proceeds of disposition.....		\$	XXXX
Add: Deemed proceeds of disposition:			
Dividend received	\$	XXXX	
Less: Safe Income and Amount of Dividend subject to Part IV ...		<u>(XXX)</u>	<u>XXXX</u>
Total proceeds of disposition.....			<u>XXXX</u>
Less: Adjusted cost base.....			<u>XXXX</u>
Capital gain.....		\$	<u>XXXX</u>

LECTURES 10 and 11: Chapter 17
Other Rollovers and Sale of Incorporated Business

Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

Share for Share Exchanges

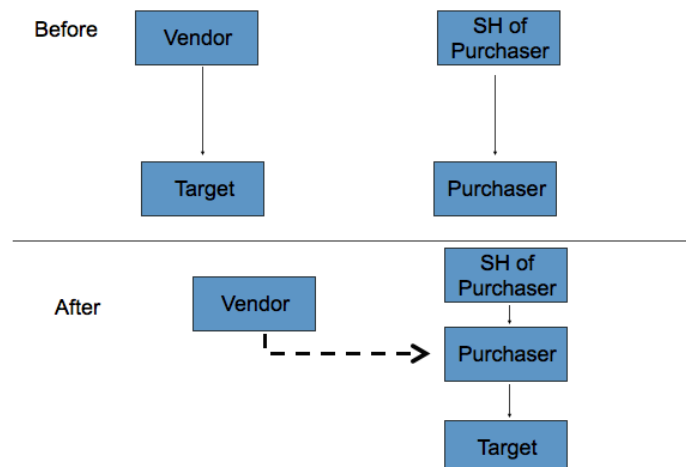
Section 85.1:

Section 85.1 provides for an automatic rollover [no requirement to file forms].

1. Conditions:

- There has to be a disposition by the taxpayer of shares of a corporation (Target) in exchange for newly issued shares of the purchaser (Acquirerco).
- The purchaser must be a Canadian corporation.
- The exchanged shares must be capital property of the vendor and has to be shares of a taxable Canadian corporation.
- The vendor and the purchaser must be dealing at arm's length immediately before the exchange.
- After the exchange, the vendor and persons whom do not deal at arm's length with the vendor, may not control the purchaser.
- No election per subsections 85(1) or 85(2).
- The vendor must receive shares of a single class of the purchaser.
- No non-share consideration.

Example Section 85.1
Share for Share Exchange



2. Tax Consequences

2.1. Tax consequences for the vendor

Vendor's POD

- $\text{POD old shares} = \text{ACB old shares}$

Vendor's ACB

- $\text{ACB new shares} = \text{ACB old shares}$

2.2. Tax consequences for the purchaser corporation

Purchaser's ACB of target shares

Lesser of:

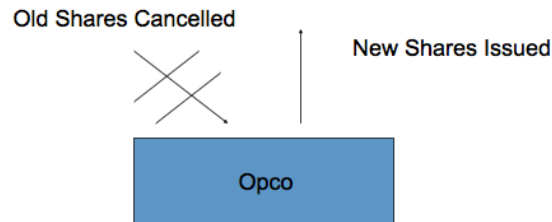
1. the FMV of the share of the target corporation immediately before the exchange
2. the PUC of the share of the target corporation immediately before the exchange

2.3. Paid-up capital of the shares issued by the purchaser corporation

- $\text{PUC of purchaser shares} = \text{PUC of exchanged shares}$

Section 86: Reorganization of Capital

Section 86 Reorganization of Capital



1. Conditions:

- All the shares of the class held by the taxpayer must be exchanged;
- The shares must be capital property of the taxpayer;
- The taxpayer must receive shares of the same corporation as consideration for the old shares.
- Section 85 must not apply to the transaction. [86(3)]
- There must be a *reorganization of capital* in that there is a substantial change to a corporation's capital structure either by way on amendment of the articles or constating documents of the corporation,

2. Use of Section 86:

- Estate Freeze [to be covered during a subsequent lecture] and passing of a business to a key employee

3. Detailed Mechanics

Step # 1: Determine if Benefit pursuant to subsection 86(2)

FVM transferred XXX
 FVM received XXX

 If +, then Gift XXX

Step # 2: ACB of Non Share Consideration – Paragraph 86(1)(a)

ACB of NSC= FVM	ACB of NSC= FVM
-----------------	-----------------

Step # 3: ACB of New Shares:

<p>*ACB of New Shares Lesser of 1. ACB of Old Shares – NSC * If shares of more than one class are received, the cost is allocated in proportion to the FMV, immediately after the exchange, of the shares of each class.</p>	<p>ACB of New Share = Lesser of: 1. ACB of Old Shares - NSC - Gift</p>
---	--

Step # 4: Determination of PUC

LEGAL PUC = XXX

Less: Paragraph 86(2.1)(a) [(A-B) x C/A]

A= Increase in PUC of issued shares [usually FMV] XXX

B=	PUC Old	XXX	
	Less: NSC	<u>(XXX)</u>	
		XXX <u>(XXX)</u>	
		XXX -> <u>(XXX)</u>	

C = increase in the PUC of the particular class
 [will be equal to A unless shares two classes of shares issued, if A disregard]

TAX PUC XXX

Hint: **Tax PUC will be equal to:**

PUC Old	XXX
Less: NSC	<u>(XXX)</u>
	XXX

Step # 5: Determine - Deemed Dividend per subsection 84(3)

	Amount Paid	=NSC + TAX PUC [per step # 4]	= XXX
Less:	PUC Old		= <u>(XXX)</u>
	Deemed Dividend		XXX

Step # 6: Capital Gain - No Gift

	Proceeds	=ACB new*+ NSC	= XXX
Less:	Deemed Dividend [per step 5]		= (XXX)
	Revised POD		= XXX
Less:	ACB		= <u>(XXX)</u>
	Capital Gain or Loss**		= XXX

Step # 6: Capital Gain - Gift

	Proceeds – Least of:		
	=NSC + Gift		
	=FMV Old Shares		= XXX
Less:	Deemed Dividend [per step 5]		= (XXX)
	Revised POD		= XXX
Less:	ACB		= <u>(XXX)</u>
	Capital Gain or Loss**		= XXX

* Note: ACB of the new shares = the cost of old shares less NSC

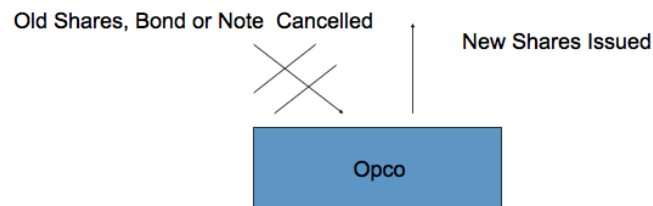
** Since POD can not be less than ACB, **no loss can be realized on disposition of shares** [see 86(2)(d)] except to the extent any costs incurred for purposes of disposition. If so, such loss may be suspended per the affiliated stop-loss rules.

Section 51 Conversions (i.e., not covered per Byrd and Chen):

1. Purpose:

Section 51 allows a taxpayer exercises the right to convert certain debt or shares of a corporation in exchange for shares of the share capital of the same corporation.

Section 51 Convertible Property



2. Conditions:

- exchanged property is capital property of the taxpayer;
- exchanged property is a share, bond, debenture or note of the corporation;
- the property received in exchange is shares of the same corporation.
- Section 85 or 86 is not applicable as they have precedence [subsection 51(4)]
- No non share consideration

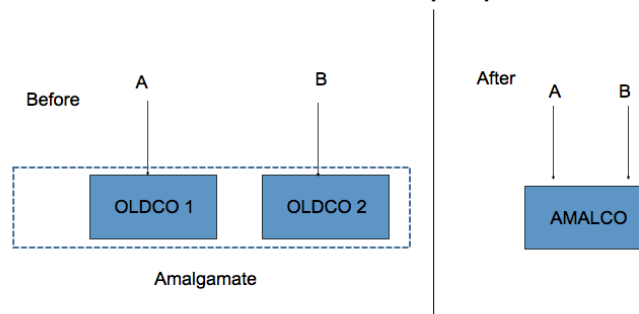
Section 87 Amalgamations:

1. Purpose

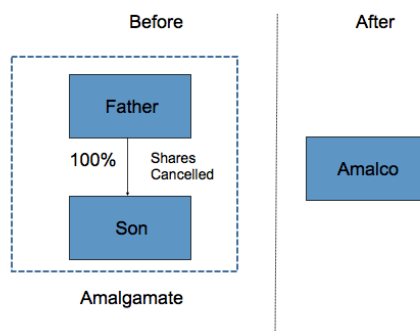
- Simplify structure
- Subject to the acquisition of control rules, allows one corporation to access losses and favourable tax attributes of another corporation .
- May allow for profitable company to access CCA of the capital assets of the unprofitable
- In an acquisition context, matching interest expense of PURCHASCO with income from operations of TARGETCO [i.e., leveraged buyout]

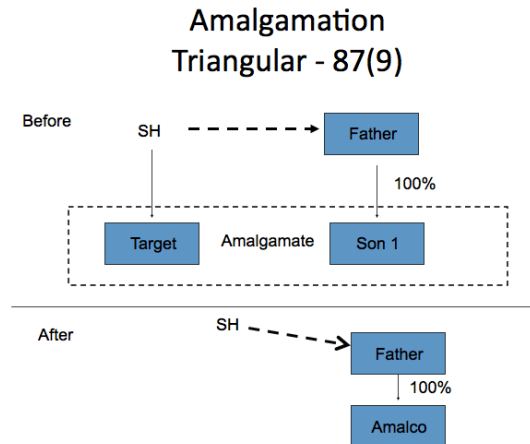
2. Types of Amalgamation:

Amalgamation Horizontal - 87(1.1)



Amalgamation Vertical - 87(11)





3. Conditions – Subsection 87(1)

- There must be a merger of two or more taxable Canadian corporations ("predecessor corporations")

Note 1: The expression "taxable Canadian corporation" is defined in subsection 89(1) and is basically a corporation that is a "Canadian corporation" not exempt from Part I tax. A "Canadian corporation" is defined in subsection 89(1) as being a corporation that at the relevant time is resident in Canada and was either incorporated in Canada or resident in Canada throughout the period commencing June 18, 1971 and ending at that relevant time.

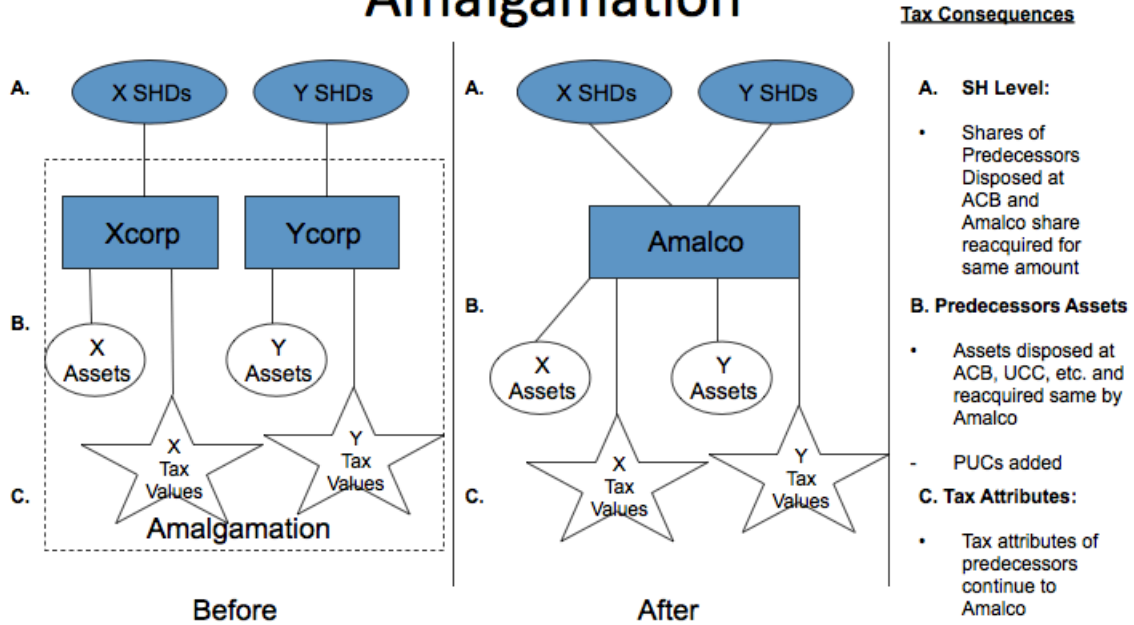
- One corporate entity ("new corporation") formed:
- all of the property (except amounts receivable from any predecessor corporation or shares of the capital stock of any predecessor corporation) of the predecessor corporations immediately before the merger becomes property of the new corporation by virtue of the merger;
- all of the liabilities (except amounts payable to any predecessor corporation) of the predecessor corporations immediately before the merger become liabilities of the new corporation by virtue of the merger; and
- all of the shareholders (except any predecessor corporation), who owned shares of the capital stock of any predecessor corporation immediately before the merger, receive shares of the capital stock of the new corporation because of the merger.

Note 2: The provisions of section 87, however, will not apply to acquisitions of property of one corporation by another corporation by means of the purchase of such property by the other corporation or as a result of the distribution of such property to the other corporation upon the winding-up of the corporation.

Note 3: The corporations seeking to amalgamate must be governed by the same law.

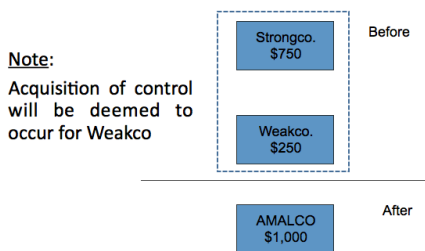
4. Detailed Mechanics:

Partial Anatomy of a Horizontal Amalgamation

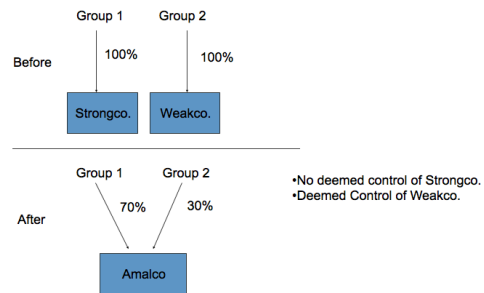


Step 1: Paragraphs 256(7)(b) deems that control of corporation is deemed not to have been acquired solely because of amalgamation unless paragraphs 256(7)(b)(ii) or (iii) apply [i.e. see AOC notes] Determine if Acquisition of Control: If so, apply acquisition of control rules.

Acquisition on Control Subparagraph 256(7)(b)(iii)



Clause – 256(7)(b)(iii)(B)



Step 2: Deemed Taxation Year end – Paragraph 87(2)(a) - Deemed taxation year end immediately before the amalgamation. It may choose any year end it wishes as long as it does not exceed 53 week. As a result, the following will occur:

- Additional financial statements and income tax returns for the stub year
- Instalments may have to be paid sooner
- Prorate CCA for new fiscal period
- Shareholder Loans [i.e., 15(2) and 20(1)(j)] will have to be repaid sooner,
- Unpaid remuneration and amounts [i.e., section 78] will be accelerated,
- Losses carry-forward per section 111 will be affected [i.e., 1 less year due to additional stub year]. R&D and ITCs pools will also be affected

Step 3:

- Rollover of assets at ACB or UCC.
- Inheritance of predecessor tax accounts by AMALCO as long as listed in paragraphs 87(2)(b) to (uu) [i.e., if not listed in those provisions, there will be no continuity as AMALCO is a new corp].

Particularities:

- i. UCC between unrelated companies
 - Half year rules applies
- ii. Amalgamation between Private and Public Corporation Paragraph 87(2)(ii)
 - If private corporation amalgamates with a public corporations, the new corporation will be public a corporation per paragraph 87(2)(ii) unless conditions in Regulation 4800(2),(3) and (4) are met [if there is an election in the return to deem Oldco not to be a public corporation and 90% of the issued shares were listed on a prescribed stock exchange, then, AMALCO will not be a public corporation] . As a result, there may be a loss of the SBD, CDA and RDTOH accounts.
- iii. Inter-company debts
 - Settled at their cost amount and no election is needed [see 80.01(3)].
- iv. GRIP - Applicable if Amalco a CCPC:

- If a predecessor was a CCPC, GRIP flowed through to Amalco. If a predecessor was non-CCPC, notional GRIP calculated and flowed through to Amalco.

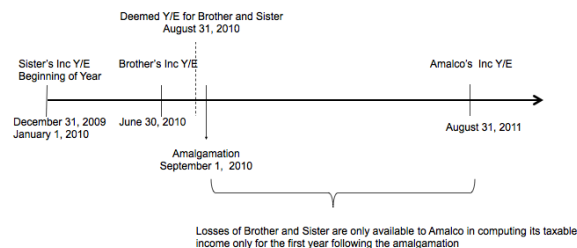
v. LRIP --Applicable if Amalco a non-CCPC:

- If a predecessor was a non-CCPC, LRIP flowed through to Amalco. If predecessor was a CCPC, notional LRIP calculated and flowed through to Amalco.

vi. Losses

- Subsection 87(2.1) states that amalgamated corporation is deemed to be the same corporations as predecessors for purposes of loss application of the amalgamated company.
- Therefore, allows flow through of non and net capital losses of predecessors to be carried through to AMALCO only if:
 - Would have been deductible by the predecessors if they had continued to exist; and
 - Predecessors had sufficient income to absorb such losses
- The predecessor's losses can be applied the first year following the amalgamation (i.e., the taxation year commencing the beginning of the day the amalgamation occurred)

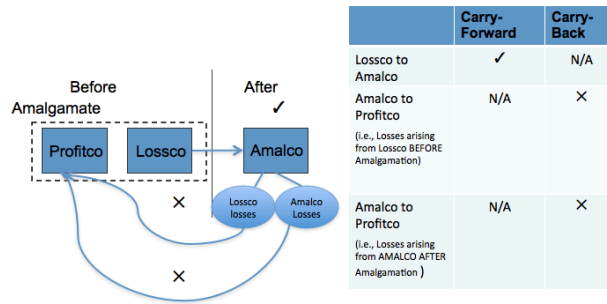
Amalgamation: Timing of Losses



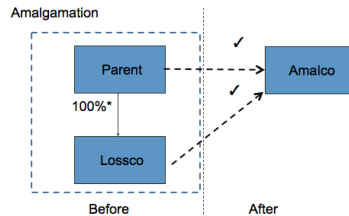
- Must take into account the remaining number years of carry-forward years of the predecessor;
- Short or 'stub' fiscal will age losses by 1 year and reduce carry-forward period;

- Amalgamation should take place 1 day after normal fiscal year end of predecessors to optimize loss utilization;
- Does not allow losses of AMALCO to carry back any losses to predecessors unless there is a vertical amalgamation.

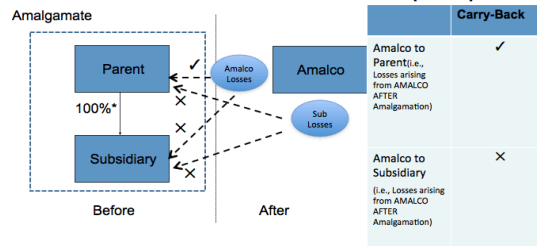
Horizontal Amalgamation Losses - subsection 87(2.1)



Vertical Amalgamation CF of Losses

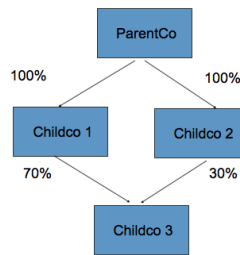


Vertical Amalgamation CB of Losses - subsection 87(2.11)



* Needs to be wholly owned as defined per subsection 87(1.4) – see next slide

Vertical Amalgamation
Losses - subsection 87(2.11)
Wholly Owned Subsidiary – 87(1.4)



* Childco 3 is a wholly owned sub of Parentco [and not a wholly owned sub of Childco 1 or 2] for purposes of 87(2.11) loss and not for the bump (topic to follow)

Step # 4: Position Of The Shareholders – Subsection 87(4)

POD old shares

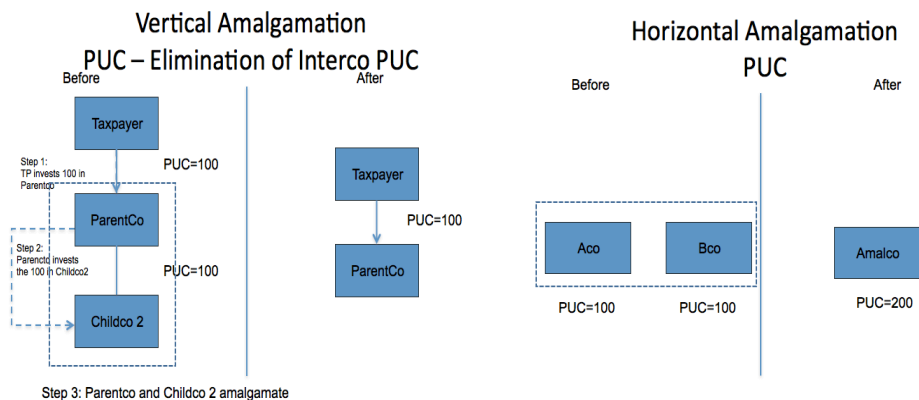
- $POD \text{ Old shares} = ACB \text{ Old Shares}$

ACB of new shares

- $ACB \text{ New Shares} = ACB \text{ Old Shares ONLY}$ if:
 - No Non Share Consideration is received
 - The original shares must be capital property of the shareholders and
 - Must not result in a deemed gift to a person related to the shareholders.

Note: If there is a vertical amalgamation [Parent Owns 100% of Subsidiary], the gain is computed per the provisions of the 90% + wind-up rules (i.e., see step 3 in 90+ wind-up lecture)

Step # 5: PUC of Amalco - Subsection 87(3)



- $PUC \text{ of Amalco is equal to PUC of Oldcos}$ [except inter-corporate PUC]

Step #6: If there is a Vertical Amalgamations [Parent Owns 100% of Subsidiary]

- Consider Bump: Discussed in subsection 88(1) windups – see next topic

Section 88(1): 90% ± Wind-Up:

1. Purpose

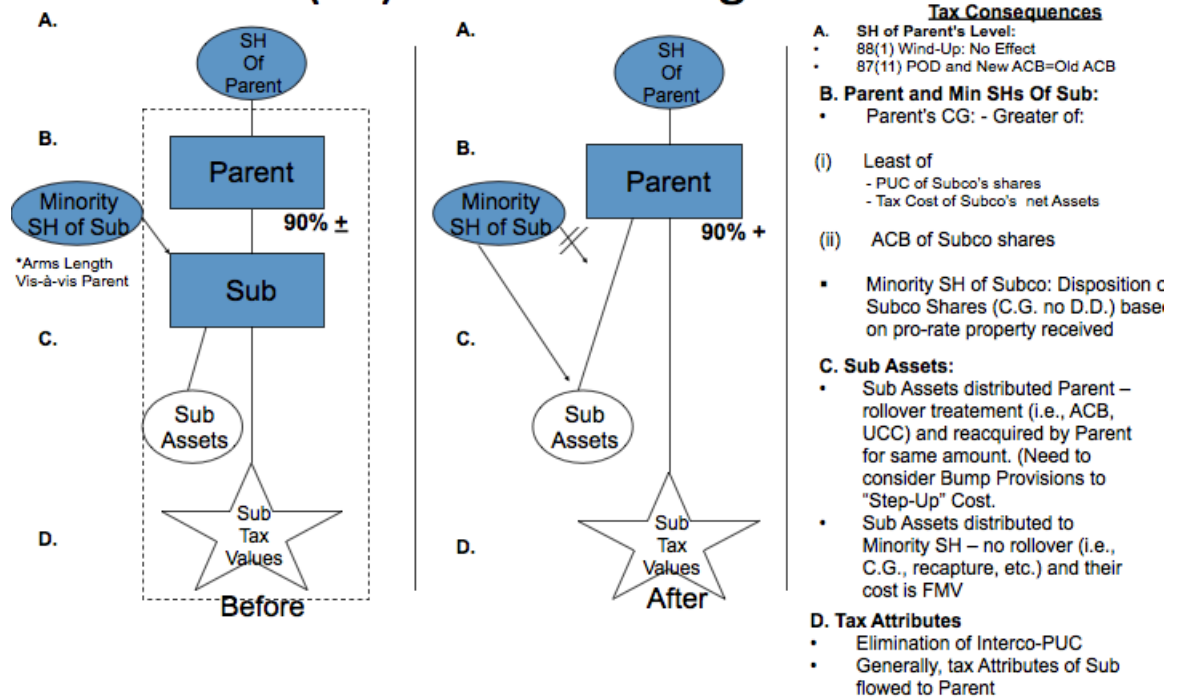
- Simplify structure
- Subject to the acquisition of control rules, allows one corporation to access losses and favourable tax attributes of another corporation .
- May allow for profitable company to access CCA of the capital assets of the unprofitable
- In an acquisition context, matching interest expense of PURCHASCO with income from operations of TARGETCO [i.e., leveraged buyout]

2. Conditions:

Tax Consequences to 90% ± wind-up [as described below] applies only if:

- Parent and Subsidiary are both taxable Canadian corporations
- At least 90% of the shares of each class of the capital stock of the subsidiary owned by the Parent
- Minority shareholders are dealing at arm’s length with parent

Partial Anatomy of an 88(1) Wind-Up or 87(11) Vertical Amalgamation



3. Tax Consequences

3.1. Parent - POD of shares in Subsidiary per Paragraph 88(1)(b)

Deemed POD - Greater of:

- i) Least of:
 - PUC
 - Net assets at cost (i.e., cost – debts other than inter-corporate debts)
- ii) ACB of the shares for the parent

Note/Planning: Reduce PUC without actual payment prior to Wind-up to ensure no capital gain

3.2. Minority Shareholders - POD of shares in Subsidiary per Paragraph 88(1)(d.1)

- Disposition at FMV of their shares and there will be a capital gain [no deemed dividend]

3.3. ACB of Minority Shareholders

- FMV of asset distributed (i.e., if possible, distribute assets with no gains)

3.4. POD of assets for the subsidiary

i. Assets Transferred to Parent – Paragraph 88(1)(a)

Under paragraph 88(1)(a), the subsidiary will be deemed to have disposed of the property transferred to the parent on winding-up at cost (i.e., ACB, UCC, nil for resource property etc).

ii. Assets Transferred to Minority Shareholders – Subsection 69(5)

Disposition at FMV per subsection 69(5)

3.5. ACB of parent of assets acquired

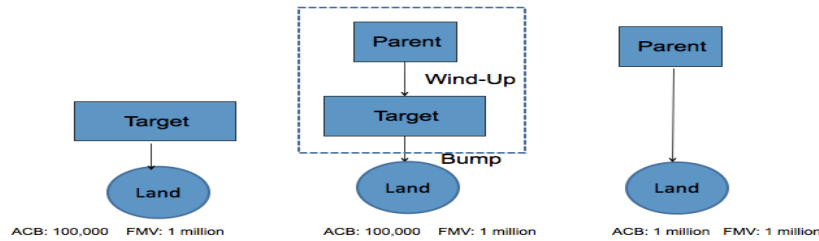
Paragraph 88(1)(c)/Other than depreciable property: Equal to POD of sub (i.e., it inherits the cost of the sub' assets)

Paragraph 88(1)(f)/Depreciable property:

ACB of sub = ACB of parent
= [CCA deemed taken]
UCC of sub = UCC of parent

3.6. “Bump” – Increasing ACB of non-depreciable property [88(1)(c) and 88(1)(d)]

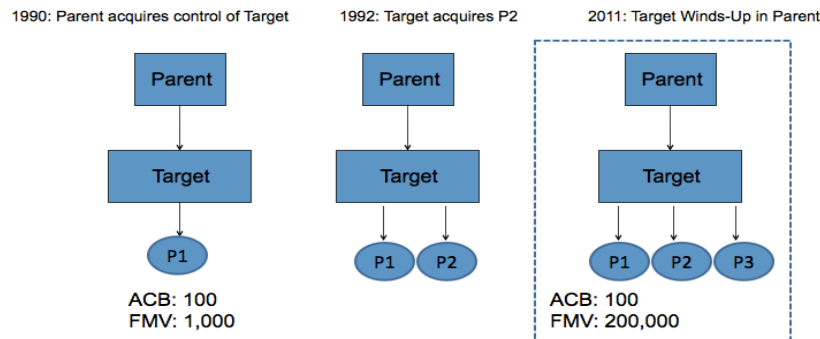
**Bump
 Conceptual Purpose**



Conditions:

- Property must have been owned by the sub at the time the parent last acquired control and owned continuously by the sub until the time it was distributed to the parent [i.e., if tier of affiliates, liquidate top tiers first as the asset must have owned by the sub since the parent last acquired control – see Appendix I] and the ACB of the property may be increased to its **FMV at the time the parent last acquired control**;

Bump



Property eligible for Bump: P1 can only be bumped to FMV of 1,000 (i.e., the FMV of the property the parent last acquired control of sub and not the the FMV at the wind-up date of 200,000). P2 and P3 can not be bumped-up as Target did not own when parent acquired control of target,

- Must be capital property.
- Must not be depreciable property [per paragraph 88(1)(c)(iii) includes option to buy depreciable property and leasehold interest in depreciable property – paragraph 88(1)(c.7)]
- Must not be property transferred to the parent as part of a butterfly reorganization [per paragraph 88(1)(c)(iv)]
- Must not be property acquired from the parent or from a person with whom the subsidiary did not deal at arm’s length [per paragraph 88(1)(c)(v) – i.e., the anti stuffing provisions]
- Must not be property subsequently disposed of by the parent as part of a series of transactions designed to sell certain assets of a corporation to a corporation with which it deals at arm’s length [per paragraph 88(1)(c)(vi) – i.e., the back door butterfly provisions]

Beyond
 ACCO 440

Calculation of the Bump:

Simply put, the net cost of assets of sub	{	Parent's ACB in sub		xxx
		Less: Cost of Property	xxx	
		Cash	xxx	
		Less: Debts (Other than Inter-co Debts)	(xxx)	
		Reserves	(xxx)	(xxx)
		Dividends from Subsidiary		(xxx)
		Less: Earnings from Sub - Post AOC		(xxx)
		Add: Losses from Sub - Post AOC		<u>xxx</u>
		Maximum Bump Available	xxx	

Note: Generally, can not have an 88(1)(d) bump where 88(1)(b) produces a gain to parent

Application:

1. Total Bump room may not exceed excess calculated above;
2. The ACB of the property may be increased to its **FMV at the time the parent last acquired control**;
3. Property per property basis; and
4. Parent must designate bump in its return

	ACB	BUMP	FMV of property owned at the time parent last acquired control of Subsidiary
Property A			
Property B			
Property C			
Maximum Bump Available per above calculation:			

3.7. Consequences to Subs / Attributes transferred to Parent

- No CCA allowed to subsidiary in year of liquidation as sub does not own asset at the end of the year.
- No deemed year end to the sub. It ends as usual until it ceases to exist [CRA will accept if it will be dissolved in the near future because of factors such as pending litigation. However, the latter statement does not apply to utilization of losses (see below) which requires dissolution).
- Per paragraph 88(1) (e.1) and (e.2), the tax attributes such as the reserves, CDA , RDTOH, ITC are transferred to parent. Note that unlike Amalgamation if sub is a public corporation and parent is private corp, it remains a private corporation [no equivalent of 87(2)(ii)]
- Inter-company debts are settled at their cost amount **if** an election is filed [see 80.01(4)] otherwise at FMV which may trigger debt forgiveness.

- GRIP - Applicable if Parent a CCPC: If sub was a CCPC, GRIP flowed through to Parent. If sub was a non-CCPC, notional GRIP calculated and flowed through to Parent.
- LRIP - Applicable if Parent was a non-CCPC: If sub was a non-CCPC, LRIP flowed through to Parent. If sub was a CCPC, notional LRIP calculated and flowed through to Parent.

3.8. Transfer of losses - Subsections 88(1.1) and 88(1.2)

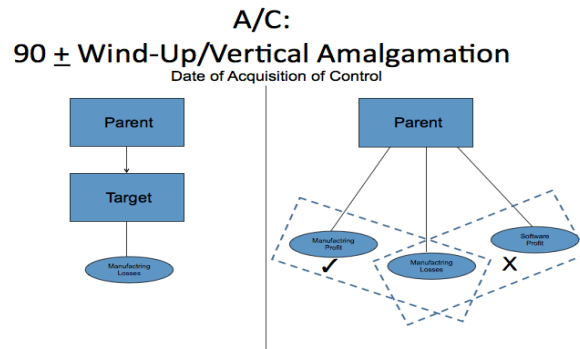
General Application

Losses (i.e., non-capital losses, net capital losses, farm losses, restricted farm losses and limited partnership losses) of sub are transferred to the parent.

Note: Losses of Parent unaffected [i.e., they can be applied - cf or cb - against income of the parent and no change in carry-forward or carry-back window]

Conditions for Usage

Subject to applicability of the A/C of rules:



Furthermore, losses of sub can be used only if:

1. not deducted by the subsidiary;
2. they would have been deductible by the subsidiary in its first taxation year commencing after the commencement of the winding-up [i.e., on the assumption that it would have had such a taxation and sufficient income]
3. Subsidiary is wound-up [i.e., dissolved – the CRA concession that it will be wound up shortly does not apply to this instance]

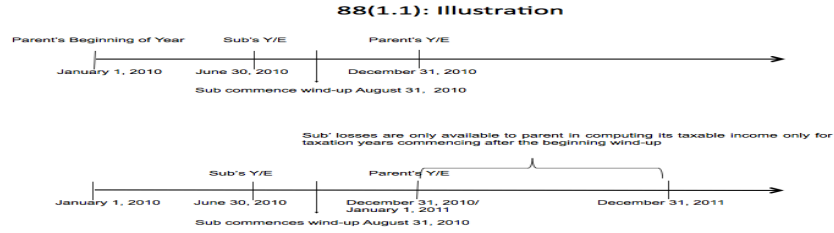
Timing of Losses:

- Losses of the sub are treated as the parent's losses in the same year in which the subsidiary incurred the loss.
- For instance, if parent has a taxation year end September 30th and subsidiary's taxation year is December 31st, any losses incurred by

subsidiary during the year end December 31, 2010 will be deemed to be a loss of the parent for it's year end September 30, 2011.

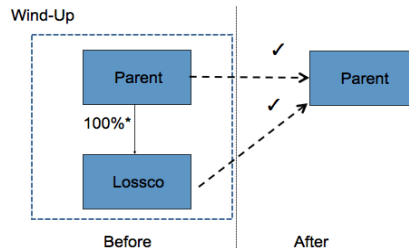
When the losses may be used

- Sub's losses may be applied against the parent's income for taxation years commencing after the commencement of the winding-up.

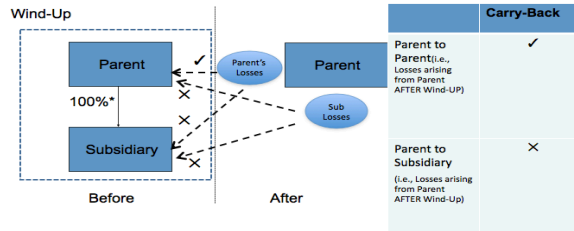


- As a result, the losses of the subsidiary may not be carry-back and applied to the parent's income prior to wind-up.

**Wind-Up
CF of Losses**



**Wind-Up
CB of Losses**



Loss Push Back\Restoration Rule:

- Paragraph 88(1.1)(f) permits the parent to treat the loss in its immediately prior year to calculate its taxable income for taxation years commencing after the wind-up.

Example of paragraph 88(1.1)(f)

	SUBSIDIARY Y/E - August 31	PARENT December 31, 2008	PARENT December 31, 2009
Subsidiary begins wind-up in October 2007 and incurs a loss.		The subsidiary's loss falls in parent taxation year ending December 31, 2008.	
The loss has been incurred in Subsidiary's year ending August 31, 2008.	X		
The subsidiary's loss falls in parent taxation year ending December 31, 2008.		X	
Sub's losses may be applied against the parent's income for taxation years commencing after the commencement of the winding-up			X
Paragraph 88(1.1)(f) permits the parent to treat the loss in its immediately prior year to calculate its taxable income for taxation years commencing after the wind-up.		X	

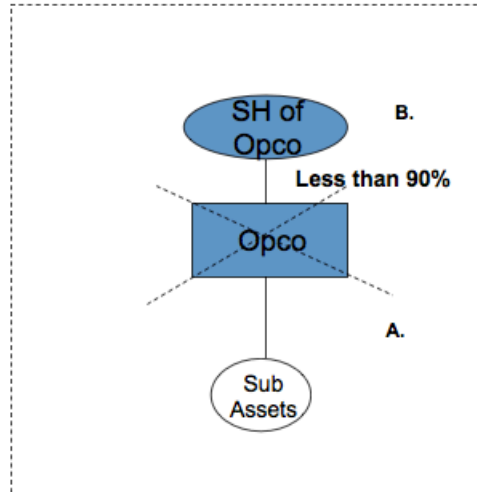
**AMALGAMATION versus 90%± Wind-Up
 COMPARISON**

	AMALGAMATION	WIND UP
Corporate Law	Must be same jurisdiction	No requirement to be same jurisdiction
Year-End	Oldcos: Year end before amalgamation Amalco: New taxation year and must select year end	Subs: No year end until dissolved Parent: Taxation Year continues as usual
Tax Accounts	Generally Flow-Through	Generally Flow-Through
CCA	Oldcos: May claim CCA. If short year, must prorate Amalco: May claim CCA. If short year, must prorate	Subs: No CCA in year of wind-up (i.e., as does not own assets). Parent: May claim CCA
Bump	Yes, but only where 100% owned	Yes, where the parent owns at least 90% of the shares of each class of the capital stock of the subsidiary
Losses	See Amalgamation lecture. Watch for aging of losses if short year.	See Wind-Up Lecture.

**Subsection 88(2): Other Wind-Ups [less than 90% or conditions of 88(1) not met]
-and-
Subsection 84(2) and Sale of a Business**

Partial Anatomy of an 88(2) Wind-Up and Dissolution

Tax Consequences



A. Opco's Level:

- Disposition of assets at FMV
- C.G., recapture, business, income, etc.
- Creation of CDA, RDTOH,
- Opco's Pays Tax
- Amount available for Distribution:
 - $POD - \text{Corporate Taxes} + RDTOH$

B At Shareholder's Level:

- Deemed Dividend:
 - Amount available for Distribution
 - Less PUC
- Capital Gain or Loss:
 - Amount available for Distribution
 - Less: Deemed Dividend

1. Seller's Perspective – Assets v. Shares:

The vendor of a business will favour selling shares over selling assets for the following reasons:

- A. Simple.
- B. Disposition triggers capital and possibility of claiming CGD
- C. Possibility of deferring by claiming reserve.
- D. If reinvested in QSBC shares, may defer part of gain per section 44.1.
- E. Sale of assets may result in business Income, capital gains (losses), recapture (terminal losses).

2. Buyer's Perspective:

Purchaser would like to purchase assets

- A. ACB of Assets will be FMV rather than at historical cost
- B. Recognize Goodwill and Claim higher CCA
- C. No need to acquire redundant assets [can pick and choose which assets he needs].
- D. Legal liability if shares acquired

3. Evaluating: Assets v. Shares

Alternative A: Sale of Share by Individual

Step 1: Calculate tax if individual disposes of shares [determine if eligible for, deferral/section 44.1, restrictive covenant election (i.e., see below and/or CGD)]

Step 2: Calculate Net amount available to S/H [POD less taxes in step 1]

Alternative B: Sale of Assets by Corporation and distribution of excess to S/H:

Recommendation: Set up Table as Follows:

Description	POD	ACB	Taxable Capital Capital Gain (Capital Loss)	Recapture (Terminal Loss)	Active Business Income	Aggregate Investment Income	CDA	RDTOH
Opening Balance								XXX
Cash	XXX							
Non Depreciable including Accounts Receivable – (no section 22 election)	XXX		XXX		XXX (i.e., Reserve for doubtful accounts of previous years)	XXX (i.e., the other half of the taxable capital gain)	XXX (i.e., the other half of the taxable capital gain)	
* For A/R, if section 22 election, sale will be on account of income.			(XXX)			(XXX) (i.e., the other half of the allowable capital loss)	(XXX) (i.e., the other half of the allowable capital loss)	
Dep. Property	XXX		XXX	XXX (i.e., Potential Recapture)	XXX	XXX (i.e., the other half of the taxable capital gain)	XXX (i.e., the other half of the taxable capital gain)	
				(XXX) (i.e., terminal loss)	(XXX)			
Goodwill	XXX				Cost x $\frac{3}{4}$ = XXX Less-CEC= <u>(XXX)</u> XXX Add: $\frac{1}{2}$ Gain <u>XXX</u> XXX		XXX (i.e., $\frac{1}{2}$ of gain)	
Balance:					XXX	XXX	XXX	
Liabilities	(XXX)							
Income Taxes: -ABI x Rate -AII x Rate	(XXX)							
RDTOH -Opening -AII x 26 2/3%	XXX							
Amount available for distribution	XXX							

Step 1: Sale of Assets : Calculate Capital Gains, Capital Losses, Terminal Losses, Recapture, Income on Disposition of ECE

Step 2: Calculate: Income Taxes at Corporate Level
RDTOH [notably Refundable Amount of Part 1]
Capital Dividend Account on sale of Assets

Step 3: Calculate Amount available for Distribution as follows:

	POD	
-	Income Taxes at Corporate Level	
+	RDTOH	

Note: Table above establishes steps 1 through 3

Step 4: Determine Deemed Dividend and Distribution of Dividend – 84(2) and 88(2)

	Amount Available for Distribution [Step #3]	XXX
Less:	PUC	XXX
	Deemed Dividend	XXX
Less:	CDA	XXX
	Taxable Dividend	XXX

Calculate Tax at S/H level

Step 5: Determine Capital Gain

	Amount Available for Distribution	XXX
Less:	Deemed Dividend	XXX
	Revised POD	XXX
Less:	ACB	XXX
	Capital Gain (Loss)	XXX

Calculate Tax at S/H level

Step 6: Calculate Net amount available to S/H :

	POD less taxes in step 4 and 5	
+	CDA	
+	PUC	

Recommendation: Choose highest between Alternative A and B

4. Restrictive Covenants:

What is it?

A non compete agreement (i.e., arrangement that restricts the capacity of the taxpayer to provide services or sell goods in some fashion).

General Rule

Include 100% in income per subsection 56.4(2) (i.e. other income in subdivision d) when received or receivable.

Exceptions

Employment - Paragraphs 56.4(3)(a) and (4)(a): If related past employment, 100% included in employment income. However, inclusion is only when received [i.e., not receivable as is in the case with the general rule]. Payor may deduct as salaries and wages.

Cumulative Eligible Expenditure - Paragraphs 56.4(3)(b) and (4)(b): If relates to the selling of intangible, vendor may treat as disposition of CEC: Purchaser will treat as acquisition of CEC (i.e., $\frac{3}{4}$ in pool and 7% deduction). Both vendor and recipient must agree and jointly elect.

Eligible Interest - Paragraphs 56.4(3)(c) and (4)(c): Eligible interest is an interest in active corporation or partnership. Thus, if vendor receives a restrictive covenant in conjunction with sale of an eligible interest (share, interest in a partnership, etc.) the amount received for the restrictive covenant is added to the proceeds of disposition, resulting in capital gain treatment (i.e., 50% included in income). However, purchaser will treat purchase as addition to cost of eligible interest.

LECTURE 12: Chapter 18 and Chapter 2
Partnerships and Returns & Payments

Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

Partnerships - Section 96 to 103:

1. Definition and Treatment - Income Tax Act

- Partnership is not defined in the Act.
- A partnership is not a person and, as a result, it is not a taxable.
- Rather, the partners are taxable.

2. Taxation of a Partnership – Subsection 96(1)

In computing the income of the partnership to be allocated to the partners, the Act deems the following:

- the partnership was a separate person resident in Canada;
- sources of the partnership do not lose their characteristics [i.e., business, dividend income, capital gain treatment, etc]

2.2. Fiscal Period

If partnership has any individuals partners:	December 31
All Corporate Partners:	Any FYE



2.3. Specific Treatment of Items

2.3.1. Remuneration

- Remuneration not deductible to partners; they considered a distribution. Other salaries are admissible.

2.3.2. CCA

- As the income of the partnership is calculated as if it were a person, CCA (may not create or increase rental loss), recapture and terminal losses are claimed at the partnership level.
- **As rental income includes CCA that is allocated to partners, individual partners must be mindful not trigger an aggregate loss on the rental property that they own personally.**

Note: Rent paid by the partnership to a partner is a deductible expense to the partnership and will not be treated as a distribution.

2.3.3.Dividends

- Dividends are NOT grossed up at the partnership level nor does the partnership claim the DTC.
- Rather, they are allocated to the partners. The dividends will retain their source and be grossed up and DTC are claimed at the partnership level.

2.3.4.Charitable gifts

- Not deductible by the partnership [i.e., add back if reconciling]
- Rather, partner may claim donation tax credit [limited to 75% of net income]

2.3.5.Political contributions

- Not deductible by the partnership [add back if reconciling]
- Rather, partner may claim political contribution tax credit.

2.3.6.Foreign tax credit

- Partners claim FTC.

2.3.7.Automobile provided to partner

- Standby charge and operating cost benefit will be calculated to the partner [i.e., similar to where a corporation provides an automobile to an employee]

2.3.8.Capital Gains and Losses

- Taxable capital gain and allowable capital losses) (i.e., after any potential claiming of capital gain reserves at the partnership level) are allocated to the partners;

3. Disposition of Partnership Interest

- Capital Gain Treatment = $POD - ACB$ [see below]

4. ACB of partnership interest

Acquisition Cost		XXX
Add: subsection 53(1)		
Net income for prior fiscal periods [if dividend, no gross-up]	XXX	
100% of of ECP	XXX	
100% of capital gain (i.e., not taxable portion)	XXX	
Capital Dividends	<u>XXX</u>	
	+XXX	+ <u>XXX</u>
Deduct: subsection 53(2).		
Losses for prior fiscal periods	XXX	
100% of terminal losses on ECP	XXX	
100% of capital losses	XXX	
Political Contributions	XXX	
Charitable Donations	XXX	
Capital Withdrawals and Distributions	<u>XXX</u>	
	-XXX	- <u>XXX</u>
ACB end		XXX

Returns and Payments – Individual and Corporation

1. Section 153: Employer Withholdings

Withholding on Employment Income.

To increase withholding: File form TD1

To reduce withholding: File form T1213

2. Section 150: Filing of tax returns

Paragraph 150(1.1)(b) exempts individuals [Note: Not applicable to corporations] from an income tax return except if any one of the following conditions is present:

1. Balance/tax owing;
2. Disposition of capital property
3. A taxable capital gain needs to be reported
4. Outstanding balance under the HBP/LLP

Individual not carrying on a business: April 30th of the following year

Individual carrying a business: June 15th

Inter vivos Trusts: 90 days from its year end

Corporation: 6 months from its year end

3. Section 156 and 157 Instalments:

3.1. Section 156 Instalments - Individuals:

Instalments¹¹ must be made on March 15, June 15, September 15th, December 15th if tax is payable:

- i. Greater than \$3,000 in current year and
- ii. Greater than \$3,000 in either one of the two preceding taxation years

Interest will be charged if late or insufficient.

Instalment Amounts

1. Forecast For Current Year

2. Amount For Preceding Year

3. CRA Formula Methodology:

- 1 & 2: Based on 2nd Preceding Year (Each Payment: 2nd Preceding / 4)
- 3 & 4: 50% (Preceding Year – Payments 1 & 2)

¹¹ The CRA will indicate to the taxpayer his instalment base.

Example:

2011: 48,000
2010: 64,000
2009: 40,000

Instalment Amounts

1. Forecast For Current Year $(48,000/4)=12,000$

2. Amount For Preceding Year $(64,000/4)=16,000$

3. CRA Formula Methodology:

- 1 & 2: Based on 2nd Preceding Year (Each Payment: 2^{nd} Preceding / 4)
10,000 each for Instalments 1 & 2 ($40,000/4=10,000$)
- 3 & 4: 50% (Preceding Year – Payments 1 & 2)
50% $(64,000 - 20,000)= 22,000$ for each Instalment 3 and 4

Total: $(10,000 + 10,000 + 22,000 + 22,000)= 64,000$

3.2. Section 157: Instalments for corporations

- i. CCPCs must pay any outstanding tax balance 3 months after its year end even though filing is 6 months after year end
- ii. Non - CCPCs must pay any outstanding tax balance 2 months after its year end even though filing is 6 months after year end.
- iii. If taxes payable are greater than \$3,000 in the current year and the preceding year, instalments must be made monthly and are payable at the end of the month
- iv. Interest will be levied where instalments are either late or insufficient.

4. Sections 233 and 162: Foreign Reporting Requirements

	Foreign Assets other than Foreign Affiliates, transfers or loans from a trust
ITA Reference	Section 233.3
Requirement to file	Persons or Partnerships whom own foreign property with a cost of \$ 100,000
Form	T1135,
Period	Years after 1997
Penalty to File a Return – 162(7)	\$25 per day for a max of 100 days (Cdn \$2,500)
Penalty to File a Return if done knowingly or with gross negligence – 162(10)	\$500 per month for a max of 24 months (Cdn \$12,000)
Penalty to File a Return if demand served by CRA – 162(10.1)	\$1,000 per month for a max of 24 months (Cdn 24,000)
Penalty for false statement or omission – 163(2.4)	Greater of: -24,000 -5% of the Cost of the property subject to the penalty
Main Exclusions	Foreign Affiliates, Property used in an Active Business, Personal Use Property, foreign property in RRSPs, RRIFs and pensions plans

5. Interest Payable/Refundable:

5.1. Section 161 : Interest Payable

CRA will charge interest if there is an outstanding balance or late instalments. Pursuant to paragraph 18(1)(t), the interest is not deductible.

5.2. Subsection 164(3): Refundable Interest

The CRA will refund interest per prescribed rate in REG 4301 at the latest of:

1. For all taxpayers, the date the overpayment occurred [applicable to all taxpayers]
2. If the taxpayer is a corporation, 120 days after the end of its taxation year.
3. If the taxpayer is an individual, 30 days following the day the return is due.
4. If taxpayer is an individual, the day the return is filed.

6. Sections 162, 163, 163.2, 238 and 239: Civil and Criminal Penalties

6.1. Section 162: Late Filing Penalties

i. Subsection 162(1) - First Offence:

5% penalty on the amount owing + 1% per month for up to 12 months of the unpaid tax balance

ii. Subsection 162(2) - Second Offence:

10% penalty on the amount owing + 2% per month for up to 20 months of the unpaid tax balance

6.2. Section 163: Penalties relating to Unreported income

i. Subsection 163(1): Unreported income on a subsequent occurrence

If taxpayer fails to report income and has been warned by the CRA of this failure, a penalty of 10% of the unreported income will result if omission occurs within 3 year

ii. Subsection 163(2): Gross negligence

Taxpayers who knowingly or under circumstances of gross negligence has made or participated in the making of a false statement or an omission in a return is subject to a penalty of up to 50% of the tax otherwise payable on this offence. The burden of proof lies with CRA.

6.3. Section 238 and 239: Criminal Offences

i. Section 238: Criminal Offenses

A fine between \$1,000 - \$25,000 may be levied or a taxpayer may be subject to a 12 month prison term for criminal offences. This penalty usually occurs under formal requirements to produce information and the taxpayer does not comply. The burden of Proof lies with CRA

ii. Section 239: Criminal Offenses

A fine of anywhere between 50% - 200% of the tax sought to be evaded and/or up to a 5 year prison term. This usually is imposed where there is substantial fraud and the taxpayer has demonstrated *mens area* [i.e., the wicked mind]. The burden of proof lies with CRA

Note:

Pursuant to paragraph 18(1)(t), the penalties are not deductible

6.4. Section 163.2: Third Party Civil Penalties

Third party civil penalties target tax advisors¹² whom make or participate in the making of false statements or omissions in circumstances amounting to ‘culpable conduct’¹³. The amount of the penalty is 50% of the tax evaded [to a maximum of \$100,000] + an additional penalty based on the advisor’s gross compensation in respect of a false statement.

7. Section 230 and Regulation 5800: Books and Records

Taxpayers must maintain “adequate” books & records including electronic records for a period of 6 years which may not be destroyed without CRA’s permission.

8. Section 152: Assessments & Reassessments

The CRA is obliged to assess the taxpayers’ tax return with “due dispatch” The CRA may reassess within the normal reassessment period which generally allows an assessment:

- i. 4 years from the date of the Notice of Assessment for Non-CCPCs;
- ii. 3 years from the date of the Notice of Assessment for CCPCs, individuals and trusts.
- iii. 6 years where there is a loss carry back

¹² Broadly defined and a tax advisor may included accountants, lawyers, employees and executives of corporations who make or participate in a false statement.

¹³ “Culpable conduct” means conduct by a tax advisor that is tantamount to intentional conduct, shows an indifference as to whether the tax law is complied with, or shows a willful, reckless or a wanton disregard for the law.

The CRA may also assess outside the normal reassessment period:

- i. Where the taxpayer waives the time limit [usually limited to items agreed to by the taxpayer and CRA] and may be revoked by taxpayer within 6 months after filing a notice to terminate the waiver.
- ii. Anytime the taxpayer has been grossly negligent [i.e., where penalty pursuant to 163(2) is applied]
- iii. Anytime the taxpayer has been negligent [i.e. see subsection 152(4)].

9. Sections 164 and 180: Objections & Appeals

9.1. Appeals to CRA

In the event a taxpayer disagrees with the Notice of Assessment/Reassessment, the taxpayer must file a Notice of Objection from the **later of**:

1. 90 days from the date of the Notice of Assessment. In specific circumstances, this can be extended pursuant to subsection 166.1(7).
2. For individuals and trusts only, 1 year from the date the return was due to be filed.

9.2. Court Appeals

Where taxpayer is not satisfied by the decision rendered by CRA's appeal branch, he can appeal to the Tax Court within 90 days. There are two procedures available:

- i. Informal Procedures:

Applies, generally, where:

1. the tax subject to appeal is no more than \$12,000; or
2. the income item subject to appeal does not exceed \$24,000.

Taxpayer's usually opt for informal procedure for the following reasons:

3. An individual can represent himself;
4. No court costs for the taxpayer.
5. Where the taxpayer is successful in his appeal, the Court can ask the minister to pay taxpayer's costs.

Nature of the Decisions

6. Not precedent setting and decisions are binding except where the Tax Court failed to observe a principle of natural justice then the decision can be appealed.

ii. General Procedures

1. Decisions are precedent setting as strict rules of interpretation are followed;
2. All taxpayers are required to be represented legal counsel;

10. Income Tax Returns: Adjustments Requested by the Taxpayer

Form T1-Adj must be filed where adjustments requested by the taxpayer.

11. Subsection 152(4.2), Subsection 220(3.1) and (3.2), Regulation 600: Fairness Package

- Subsection allows minister to reassess income tax return after the statute barred-period if results in refund [individuals and testamentary trusts only].
- Allows minister to cancel penalties and interest but decisions are up to the Minister's discretion and taxpayer's may not appeal.
- Taxpayer may only ask for a judicial review that the Minister exercised his discretion

12. Section 222 to 226, Section 231 and 232: Collection Procedures

Where taxpayer fails to pay outstanding sums, the CRA may:

- i. seize the taxpayers assets
- ii. Force debtor of taxpayer [i.e.. generally the employer] to make payments directly to CRA

Pursuant to section 158 of the ITA, CRA may collect immediately after a Notice of Assessment except

- iii. Not before a period of 90 days where no Notice of Objection is filed;
- iv. If no appeal is made before the Tax Court, not before a period of 90 days after an assessment is upheld by the Appeals branch of CRA;
- v. If appealed is made to the Tax Court , until the decision is rendered. Where the taxpayer loses his appeal, the amount is due 30 days after the decision;

Large corporations [i.e., 10 million + in capital] must pay ½ of the assessment immediately.

13. Legitimate Tax Planning, Tax Evasion, Tax Avoidance and GAAR:

Taxpayers may organize their affairs to pay as little tax as possible but the transactions carried out by taxpayers must not constitute tax evasion or abusive avoidance.

13.1. Tax evasion

The wilful act or knowing omission of an act that would result in criminal charges under subsection 239(1) (i.e., such as not reporting sales, claiming of personal expenses, maintaining false accounting records, or the destroying books and records).

13.2. Tax avoidance

Legal minimization of tax. An avoidance transaction is one that is undertaken solely or mainly to derive a tax benefit.

13.3. Section 245: General Anti-Avoidance Rules - (GAAR):

In some instances, it may be considered abusive and the CRA may apply the General Anti-Avoidance Rule found in section 245 of the Act.

Further to *The Queen v. Canada Trustco Mortgage Co.*, 2005 SCC 54, the approach to s. 245 of the Income Tax Act may be summarized as follows.

1. Three requirements must be established to permit application of the GAAR:
 - a. A tax benefit resulting from a transaction or part of a series of transactions (s. 245(1) and (2));
 - b. The transaction is an avoidance transaction in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a bona fide purpose other than to obtain a tax benefit; and
 - c. There was abusive tax avoidance in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer.
2. The burden is on the taxpayer to refute (1) and (2), and on the Minister to establish (3).
3. If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.
4. The courts proceed by conducting a unified textual, contextual and purposive analysis of the provisions giving rise to the tax benefit in order to determine why they were put in place and why the benefit was conferred. The goal is to arrive at a purposive interpretation that is

harmonious with the provisions of the Act that confer the tax benefit, read in the context of the whole Act.

5. Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient by itself to establish abusive tax avoidance. The central issue is the proper interpretation of the relevant provisions in light of their context and purpose.
6. Abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions.
7. Where the Tax Court judge has proceeded on a proper construction of the provisions of the Income Tax Act and on findings supported by the evidence, appellate tribunals should not interfere, absent a palpable and overriding error.

LECTURE 13: Chapter 19
Trusts and Estates

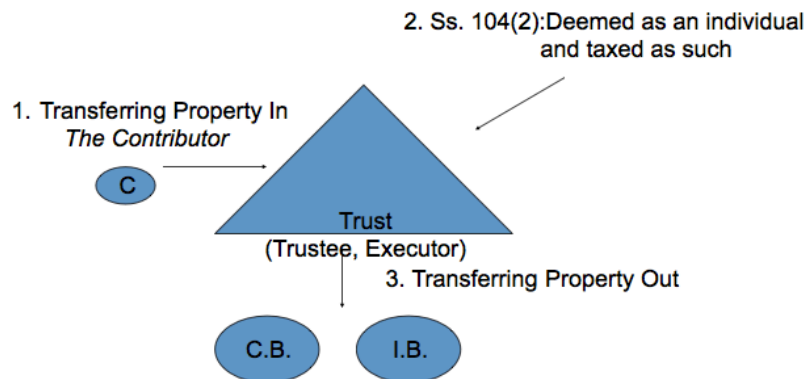
Instructor: Joseph Armanious, CPA, CGA, LL.M. Fisc.

1. Trusts – Section 104 to 108

A relationship where a person (i.e., the contributor\settlor) transfers property to a person or group of persons (i.e., the trustee) for the benefit of other people (i.e., beneficiaries.) In all provinces, other than Quebec, requires three certainties:

1. Certainty of intention;
2. Certainty of property; and
3. Certainty of beneficiaries.

Trust and the Players



1.1. Transferring Property In

General Rule:

Contributions are a disposition at fair market value per the definition of disposition in section 248 and/or the provisions of section 69.

Exceptions: The “rollover” trusts

- Spouse or common-law partner;
- Alter ego;
- Joint spouse or common-law partner;
- Qualifying Disposition Trust (Rollover of inventory); and

1.2. Classes of Trust

1.2.1. Testamentary Trust

- Created at death and, generally, provided in will; and
- Spousal trust & non spousal trust.

1.2.2. *Inter vivos* Trust

- Other than testamentary trusts and created during the life of an individual

1.3. Discretionary vs. Non Discretionary

1.3.1. Discretionary

- Trustee has discretion to amount, timing and type of distributions

1.3.2. Non Discretionary

- Trust deeds specifies amounts, timing and type of distribution

2. The Trust

2.1. Taxation

A. Tax Year :

- *Inter vivos* trust: Calendar year
- Testamentary trust: Choice of Taxation year end but may not exceed 53 weeks
- Filing: Within 90 days of year end

B. Taxation of the Trust

A trust is an individual [per subsection 104(2)] and taxed accordingly [per section 3] with adjustments described below [claim CCA, business expenses, etc at trust level].

Starting Point: Section 3

Add:

1. Deemed Disposition every 21 years for all trusts [except for rollover trusts described above].

Note/Planning: As a result, transfer property out in the 20th year [see transferring property out section]

2. Income deemed/elected to be retained in the trust [even in physically distributed] pursuant to subsection 104(13.1) and 104(13.2)]

Note/Planning: As losses don't flow through to beneficiaries [see beneficiary section], this is advantageous where the trust has losses in order to absorb losses.

Deduct:

1. Income payable to the income beneficiaries – subsection 104(6)

Note: Payable is defined in subsection 104(24) as paid or payable if beneficiary can enforce payment. It will be not be considered payable where:

- A beneficiary can only enforce payment of an amount of income by forcing the trustee to wind up the trust.
- The beneficiary's right to income is subject to the approval of a third party.
- Payment of income is at the trustee's discretion.
- The beneficiary has the power to amend the trust deed and must do so to cause the income to be payable.

2. Upkeep & maintenance costs of property of a life tenant - paragraph 104(6)(b)
3. Income for which a preferred beneficiary election has been filed - subsection 104(12)

Preferred Beneficiary Election: Income retained in trust, taxed in hands of beneficiary

Only applicable to beneficiaries

- Qualify for the disability tax credit; or
- Qualify as an infirm dependant over 17

Note/Planning:

Useful where beneficiary has very little income to take advantage of low rates but do not entrust beneficiary with income

C. Rate of Tax :

- 29% for inter vivos trusts
- Progressive rates for testamentary trusts [May lose testamentary status if contributions by living person]
- Where there are multiple testamentary trusts with same beneficiaries, may be taxed as one trust per subsection 104(2).
- AMT Applicable To Trusts but the \$40,000 exemption is only available to testamentary trusts

D. A trust is not allowed to claim personal tax credits or the CGD [other than spousal trusts] except the following:

- Donation tax credits
- Dividend tax credits
- Foreign tax credits
- Investment tax credits
- Political contributions tax credit

104(13.1) and 104(13.2) - Example:

Trust can not allocate losses. They are trapped in the trust.

As result, 104(13.1) and 104(13.2) allows the imposition of income in trust (in order to offset trapped losses) even though the amounts are actually paid to the beneficiaries.

		Trust
Income		100,000
Amount Paid to Beneficiaries – 104(6)	(100,000)**	
Amount Designated to be imposed in trust per 104(13.1) or 104(13.2)	100,000	0
Net Income of Trust		100,000
Loss Carrover Balance		(100,000)
Taxable Income of Trust		Nil

** Actual amount the beneficiary receives. However, the beneficiary is not taxed on the amounts as they are imposed in the trust.

104(18) – Example of Preferred Beneficiary Election

As an inter-vivos trust is taxed at 29% and the preferred beneficiary may possibly be taxed at lower rates, the election deems the amount to be received by the beneficiary and is accordingly taxed at the beneficiary’s level even though the amounts are retained in the trust for safekeeping.

		Trust
Income		10,000
Amount Paid to Beneficiaries – 104(6)	(10,000)*	(10,000)
Net Income of Trust		Nil

		Beneficiary
Income		10,000*
Net Income		10,000
Taxable Income		10,000
Tax @ 15		1,500
Less : Basic Personal Credit		(1,500) *Credit Capped
Tax Payable		Nil

* Physical Amount retained by the trust

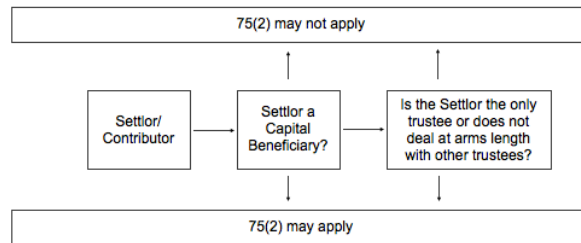
3. Taxation of Contributor/Settlor

- For property transferred to trust, deemed disposition at FMV unless rollover trust described above.
- Income attributed back per subsection 75(2) of the Act [see below]

75(2)

Attribution to Settlor:

- If the transferred property can revert to the settlor;
- If the settlor can determine the persons that will receive the transferred property; or
- The transferred property cannot be disposed of except with the transferor's consent



- Income attributed back per subsection per attribution rules in section 74.1 and 74.2 (i.e., see notes prior to midterm)

4. Taxation of Beneficiaries

4.1. General

- Income paid or payable per beneficiary is included in beneficiary's income per subsection 104(13) other than income retained by the trust per subsections 104(13.1) and 104(13.2);
- Income allocated under the preferred beneficiary election is also taxed in the hands of the beneficiary;
- The income attributed to the beneficiaries lose their source per subsection 108(5) except the following items which are listed from subsection 104(19)-(22):
 - Taxable Dividends [i.e., Gross up and claim DTC]
 - Capital Dividends [Tax Free]
 - Taxable Capital Gains [1/2 inclusion rate]
 - Foreign Source income

4.2. Split Income "The Kiddy Tax" – Section 120.4

- The Kiddie Tax is based on "split income" at the rate of 29%, the highest marginal rate of tax, and
- Applicable to children under the age of 18 at the end of the taxation year.
- Split income is defined as taxable dividends received on shares of private corporations, shareholder benefits or shareholder loans [does not include capital gains].
- Dividends remain eligible for the dividend tax credit but no other deductions or credits are allowed in computing a minor's split income or the tax thereon.

Section 120.4 - Kiddy Tax

Applicable to split income:

Split income defined in 120.4(1):
- includes taxable dividends and benefits conferred on a shareholder (directly or indirectly through partnerships and trusts)

Not applicable to:

1. Interest income
2. Capital gains
3. Split income received by a person over the age of 17

4.3. Sale of Interest

Income Interest:	Gain will be property income [usually cost of nil]
Capital Interest:	Gain or loss will be capital [may have a cost]

Matrix – Taxation of Contributor/Transferor, Trust and Beneficiary

	<i>Settlor/Transferor</i>	<i>Trust</i>	<i>Beneficiary</i>
Income subject to 75(2)	✓		
Income attributed back to transferor	✓		
Trust Income retained or where 104(13.1) or 104(13.2) elections made		✓	
Trust payable to beneficiaries or preferred beneficiary election made			✓

5. Transferring Property Out of Trust:

A. Rollover at cost [no tax implications] per subsection 107(2) unless distributed to:

- ◆ Individuals who are not beneficiaries in the following trusts - subsection 107(4):
 - Spouse or common-law partner trust
 - Alter ego trust
 - Joint spouse or common-law partner trust
- ◆ unless subsection 75(2) would have applied at any time – subsection 107(4.1);
- ◆ unless N/R where disposition at FMV (subsection 107(5))

6. Principal Residences and Trust:

- Generally, available where owned by trust and ordinarily inhabited by beneficiary.

7. Using a Trust – Why ?

- Income Splitting [Adult Beneficiaries]
- Control of property;
- Substitute of a will;
- Legal Reasons such as creditor protections; and
- Estate Freezes (i.e., see below)

8. Estate Freezing

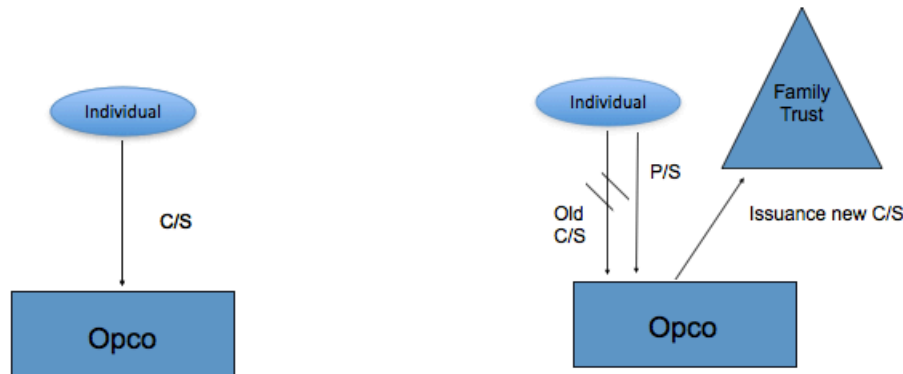
- Freeze value of shares [generally, by taking back preferred shares that are fixed in value (redeemable and retractable) and successors (i.e., children, grandchildren, spouse, etc) take back growth/common shares.

Estate Freezing

Methods:

- Internal Section 85 Freeze
- Section 86 Freeze
- Section 51 Freeze
- Holdco Freeze
- Direct Sale Freeze
- Reverse Freeze

**Estate Freezing - Illustration of:
Internal Section 85
Section 86
Section 51**



Internal Section 85, Section 86, Section 51 Freezes:

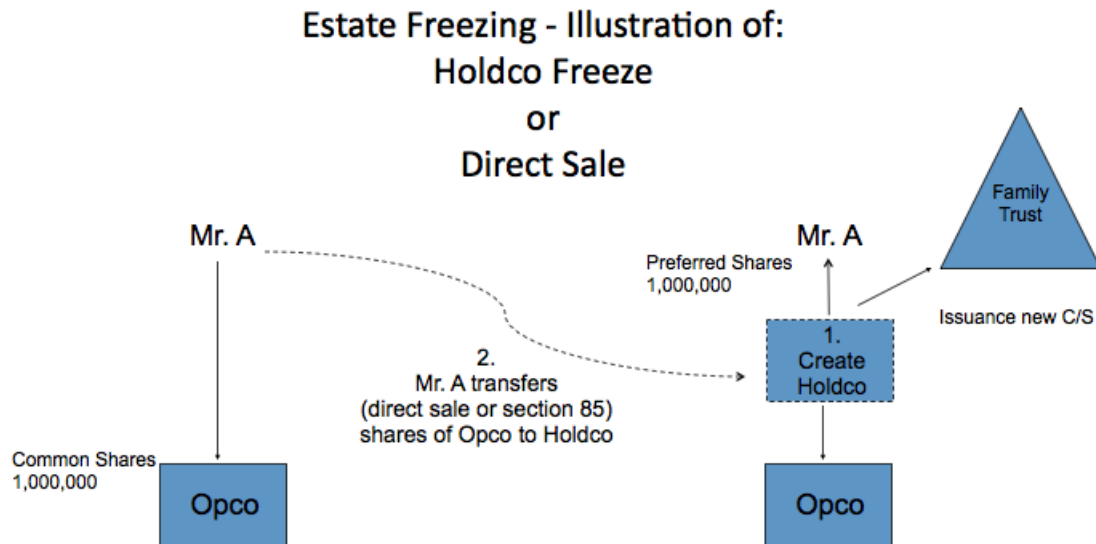
Internal Section 85 issue - No PUC Reduction in internal section 85 rollover resulting in 84(1) or 84(3) deemed dividend – paragraph 29 of IT-291R3 :

The formula in subsection 85(2.1) may yield anomalous results where the property transferred is shares of the corporation itself as described in 20 above. Consider the following situation:

- X, an individual, owns 5% of the issued common shares of Opco having a cost amount and paid-up capital of \$100,000 and a fair market value of \$600,000. In order to realize a capital gain and make use of the deduction available under subsection 110.6(2.1), X transfers the common shares of Opco to Opco in return for preferred shares of Opco having a fair market value of \$600,000. X and Opco elect under subsection 85(1) to transfer the shares at an agreed amount of \$600,000. Since X deals at arm's length with Opco, the corporate law of most jurisdictions will require Opco to add to the stated capital of the preferred shares issued to X an amount equal to the fair market value of the consideration received for their issue, i.e. \$600,000 being the fair market value of X's common shares of Opco. Since the increase in the paid-up capital of the issued shares of Opco as a result of the transfer does not exceed the cost to Opco of the common shares less the fair market value of any non-share consideration, subsection 85(2.1) will not apply to reduce the paid-up capital of the preferred shares issued to X. Consequently, as noted in ¶ 20, by virtue of subsection 84(1) 1, X will be deemed to have received a dividend of \$500,000.

Internal Section 85, 86, section 51 common issues:

- Subsection 74.4 may apply as subsection 84(9) deems there to be a disposition of shares. Even though there is no transfer of shares pursuant to section 51, paragraph 51(1)(e) deems that for the purposes of section 74, the exchange shall be deemed to be a transfer of the convertible property by the taxpayer to the corporation thereby making the attribution rule applicable (see next slides)
- Valuation Issues: Consideration Given = Consideration Received (i.e., to ensure no 15(1) or Gift) – Need to insert a Price Adjustment Clause



Section 84.1 concern:

Per section 84.1, a dividend may result from a non-arm's length sale of shares, if there is NSC. In order to avoid deemed dividend, NSC must not exceed the greater of the following amounts:

- PUC of the shares transferred
- ACB of the shares transferred

When the non-share consideration exceeds this amount, the excess is taxed as a dividend.

Valuation Issues:

Valuation Issues: Consideration Given = Consideration Received (i.e., to ensure no 15(1) or Gift)

– Need to insert a Price Adjustment Clause

Section 74.4 attribution rule concern: See next slides

Corporate Attribution Rules

Section 74.4 provides for attribution rules in this situation. Under subsection 74.4(2), the attribution rules apply where:

- property is loaned or transferred, either directly or indirectly, *by means of a trust* or by any other means
- The transaction is between an individual and a corporation
- one of the main purposes of the transfer or loan may reasonably be considered to be to reduce the income of the individual and to benefit a person who is a designated person (ie. wife and child) the corporation is not an SBC
- the designated person is also a specified shareholder of the corporation
- Applicable at any time (i.e., if “onside” year may be applicable where “offside” the following year);

Corporate Attribution Rules

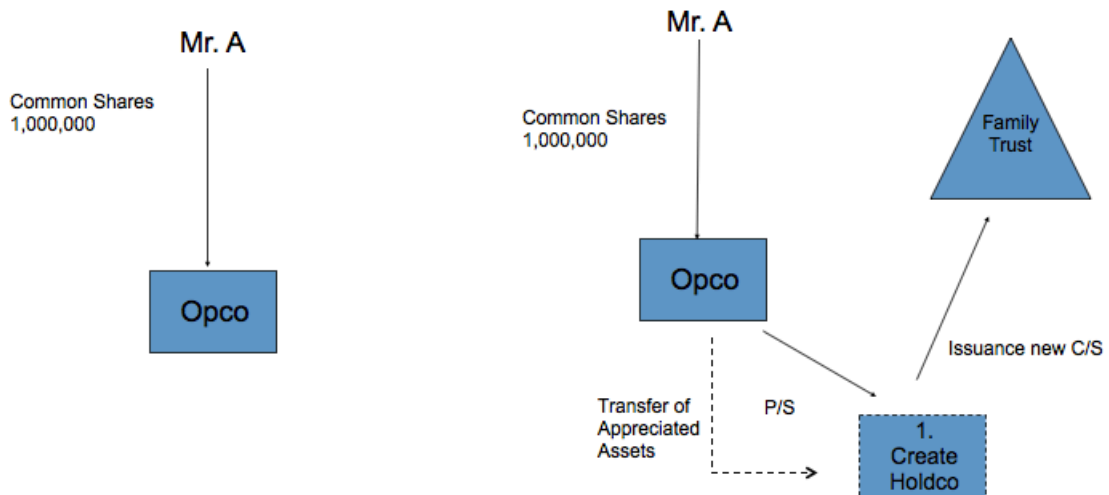
Income Inclusions

- Prescribed rate on “outstanding amount” (value of C.S. at time of freeze)
 - Minus: Interest received in respect of transfer
 - Minus: 5/4 of certain taxable dividend

In practice, not uncommon to see a section 74.4 “trust”:

- Minor Beneficiaries are not allowed income or capital until they become age of the majority

Estate Freezing - Illustration of: The Reverse Freeze



The Reverse Freeze:

Opco transfers some or all of its assets to Newco in exchange for Frozen Shares of Newco. Newco then issues common shares to the appropriate persons for nominal consideration. The reverse freeze has the advantage that section 74.4 is not applicable because assets are being transferred to Newco by a corporation, Opco, rather than by an individual, the Freezor.

Valuation Issues:

Consideration Given = Consideration Received (i.e., to ensure no 15(1) or Gift) – Need to insert a Price Adjustment Clause

APPENDIX A: RESIDENCY OF CORPORATIONS (ACCO 340 REMINDER)

i. Place of Incorporation – Deemed Resident [subsection 250(4) ITA]:

- a. Incorporated in Canada *after* April 26, 1965;
- b. Incorporated in Canada *prior* to April 27, 1965 and at any time in a taxation year after April 26, 1965 it was
 - resident in Canada (mind and management criteria – see below),
or
 - carried on business in Canada

INCORPORATED IN
CANADA



Carried on a business in Cdn
(even for one second)
OR
Mind and Management in Cdn
(see below)

Note: Once test is met in any year, it applies to all subsequent years

ii. Mind and Management [will usually apply where corporation is constituted outside of Canada]

The primary factors are the:

- Location of the board of director meetings [Note: This *is not the same* as where the directors reside];
- Day to day decision making is made.
- Location of books and records;
- Major business contracts are signed.

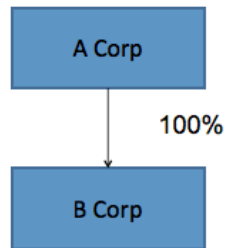
Note: Annual Test

APPENDIX B: ASSOCIATION

256. (1) Associated corporations : For the purposes of this Act, one corporation is associated with another in a taxation year if, at any time in the year.

(a) **one** of the corporations controlled¹⁴, directly or indirectly in any manner whatever, **the other**;

256(1)(a)



¹⁴ Two Types:

Control (Control in law – *de jure*): 50% + 1% of votes of the corporation

Controlled directly, indirectly or in any manner whatsoever (*De Facto Control*) defined in subsection 256(5.1): a corporation is considered to be controlled, directly or indirectly, in any manner whatever, by another corporation, a person or group of persons where the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation.

(b) **both** of the corporations were **controlled**, directly or indirectly in any manner whatever, **by the same person or group of person**¹⁵

256(1)(b)



¹⁵ Definition of "Group" - Paragraph 256(1.2)(a) "provides that "a group of persons in respect of a corporation means any two or more persons each of whom owns shares of the capital stock of the corporation."

Control by a Group - Paragraph 256(1.2)(b) reads as follows:

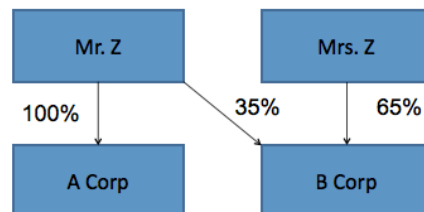
- (i) a corporation that is controlled by one or more members of a particular group of persons in respect of that corporation shall be considered to be controlled by that group of persons, and
- (ii) a corporation may be controlled by a person or a particular group of persons notwithstanding that the corporation is also controlled or deemed to be controlled by another person or group of persons.

Paragraphs 256(1)(c), (d), and (e) expand the scope of the associated rules by including:

Related persons [i.e., Generally family members and other corporations controlled by family members – see appendix 2] where there is a cross share ownership of 25% of any class of shares.

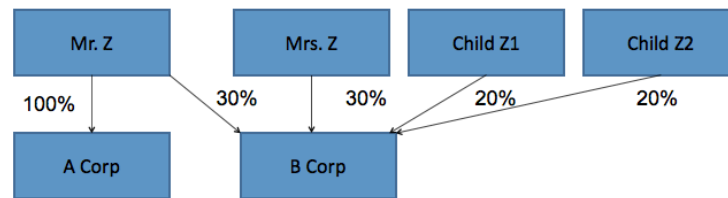
(c) each of the corporations was controlled, directly or indirectly in any manner whatever, **by a person and the person who so controlled one of the corporations was related to the person who so controlled the other**, and **either of those persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class**, of the capital stock thereof;

256(1)(c)



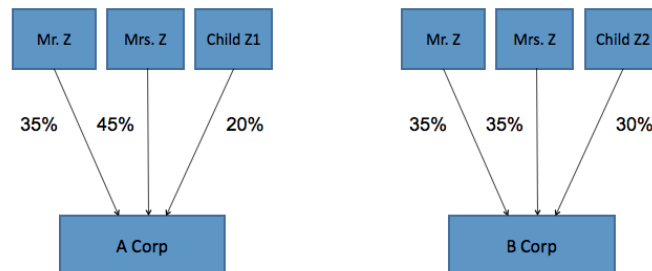
(d) **one of the corporations was controlled**, directly or indirectly in any manner whatever, **by a person** and **that person was related to each member of a group of persons that so controlled the other corporation**, and **that person owned, in respect of the other corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof**;

256(1)(d)



(e) **each of the corporations was controlled**, directly or indirectly in any manner whatever, **by a related group** and **each of the members of one of the related groups was related to all of the members of the other related group**, and **one or more persons who were members of both related groups, either alone or together, owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof**.

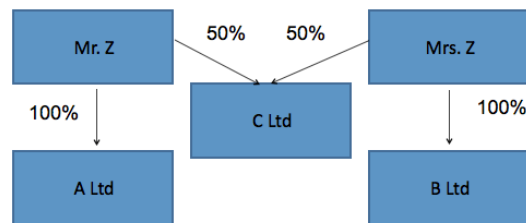
256(1)(e)



The rules in subsection 256(2) state that where two corporations would not otherwise be associated with one another unless they are both associated with a third corporation. In this case, they are deemed to be associated with each other.

This subsection also includes an election that can mitigate this rule. The third corporation can elect not to be associated with the other two corporations. As a consequence, the third corporation's annual business limit will be set at nil. However, the election will allow the other two corporations to be exempt from the association rules under

256(2)



Other Points - Deeming Rules :

Paragraph 256(1.2)(c) - The Fair Market Value Test:

One corporation is deemed to control another if it owns either more than 50 percent of the common shares of that corporation

- or -

owns shares (common and/or preferred) with a fair market value that exceeds 50 percent of the fair market value of all of the outstanding shares of that corporation.

Paragraph 256(1.2)(d) - Holding Companies: a shareholder of the holding corporation is deemed to own the shares of the held corporation in proportion to his interest in the holding corporation.

Paragraph 256(1.2)(e) - Partnerships: Look through rules as within holding companies.

Paragraph 256(1.2)(f) – Trusts: Look through rules as within holding companies.

Paragraph 256(1.3) - Children Under 18 - Shares owned at any time during the year by a child under 18 are deemed to be shares owned by each parent for purposes of determining associated companies.

Paragraph 256(1.4) - Rights And Options Requires rights to acquire shares be treated as though they were exercised for purposes of determining associated companies

Exceptions:

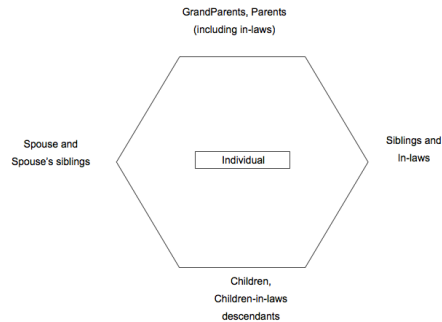
Subsection 256(1.1) - Specified Class Shares: This definition refers to non-convertible\exchangeable, non-voting shares that have a fixed dividend rate and redemption amount that can not exceed FMV at which shares were issued + unpaid dividends [i.e., preferred shares].

APPENDIX C:

Subsection 251(2) - Definition of “related persons”.

For the purpose of this Act “related persons”, or persons related to each other, are as follows:

1. Individuals connected by blood relationship, marriage or adoption [i.e., does not include uncles, aunts, nephews, nieces and cousins];



2. A corporation and
 - (i) a person who controls the corporation, if it is controlled by one person,
 - (ii) a person who is a member of a related group that controls the corporation,or
 - (iii) any person related to a person described in subparagraph (i) or (ii); and
3. Any two corporations
 - (i) if they are controlled by the same person or group of persons,
 - (ii) if each of the corporations is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation,
 - (iii) if one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation,
 - (iv) if one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation,
 - (v) if any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation, or
 - (vi) if each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation

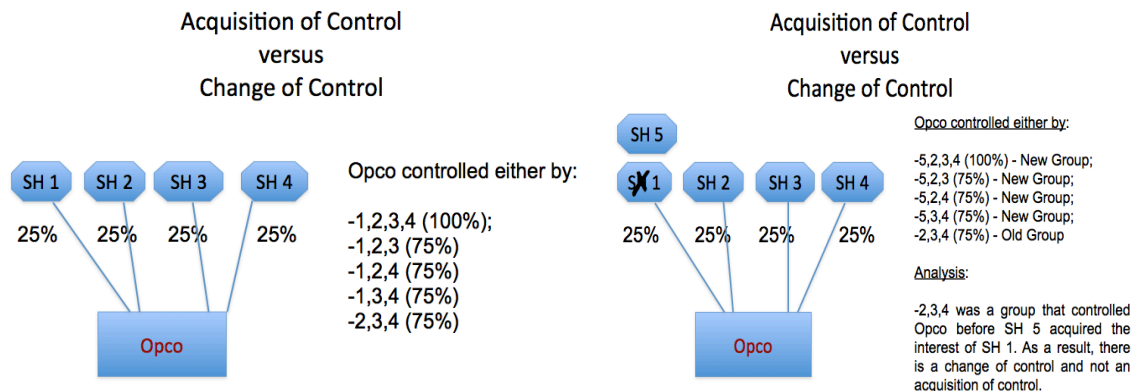
APPENDIX D: ACQUISITION OF CONTROL ISSUES

Acquisition of Control versus Change of control:

To determine whether there is an acquisition of control, the following analysis is required:

1. Determine all persons or groups that control the corporation **before** the acquisition (i.e., note that there may be more than one person or groups that control the corporation before the acquisition - simultaneous control);
2. Determine all persons or groups that control the corporation **after** the acquisition (i.e., note that there may be more than one person or groups that control the corporation after the acquisition - simultaneous control);
3. If any of the persons or groups that control the corporation in no. 1 are the same in no. 2, there is a change of control and no acquisition of control.

Consider the following example:



Similar Business:

At paragraph 14 of IT-302R3, the CRA's stated the following whether loss business is being carried on:

[...] non-capital losses and farm losses may not be carried forward to a post-acquisition of control year, if the loss corporation was not, throughout that post-acquisition year, carrying on "that business". Whether the corporation carried on "that business" is a question of fact. Factors to be considered in determining whether "that business" was being carried on include the following:

- (a) location of the business carried on before and after the acquisition of control,
- (b) nature of the business,
- (c) name of the business,
- (d) nature of income-producing assets,
- (e) existence of a period or periods of dormancy,
- (f) extent to which the original business constituted a substantial portion of the activities of the corporation in the allocation of time and financial resources.

In CRA document no. 9627815, the CRA stated the following regarding the similar criterion:

[...] in the context of subsection 111(5), it is appropriate to interpret "similar" as meaning "of the same general nature or character". Based upon this interpretation, paragraph 20 of IT-259R2 states that "the Department will interpret "similar business" in a reasonably broad manner. However, the Department's position that it will interpret the phrase "similar business" in a reasonably broad manner only applies where two businesses belong to the same service industry. We have reviewed our files with respect to positions previously taken regarding similarity of properties or services. The positions are as follows:

- (a) Systems software is similar to applications software, but neither is similar to computer hardware.
- (b) Trucking of sand and gravel is similar to trucking of poultry and lumber.
- (c) Mining and sale of metallurgical coal is similar to the mining and sale of other minerals.
- (d) The operation of a hotel which includes a restaurant and lounge is similar to the operation of a restaurant and lounge.
- (e) The operation of a hotel or motel with no restaurant, the operation of a restaurant, and the operation of a hotel or motel with a beverage room but no separate restaurant would be considered businesses similar to the operation of a hotel with a restaurant.
- (f) A prime rib restaurant is similar to a steak restaurant (even where the latter is operated in conjunction with a hotel).
- (g) The sale of fast-food chicken is similar to the sale of fast-food fish.
- (h) Staging of musical concerts in a stadium is similar to staging professional football, each being a kind of live entertainment.
- (i) Security equipment (including locks, fire detection equipment, intruder alarms, safes and fire-resistant cabinets and closed-circuit television) is similar to electro-magnetic labels developed for use in libraries, hospitals and retail establishments.
- (j) The manufacture of parts and major components for aircraft is similar to the design, manufacture and sale of aircraft.
- (k) The construction of single-family residences is not similar to the construction of residential or commercial rental buildings.
- (l) The leasing of land is not similar to the development and sale of land.
- (m) Structural steel is not similar to plastic and concrete sewer pipes.
- (n) Farm equipment is not similar to cars and trucks sold by a Ford dealer. (o) A funeral business is not similar to a hotel/tavern business.
- (p) The operation of a senior citizens home is not similar to the operation of a restaurant and tavern.

APPENDIX E: ECE (ACCO 340 REMINDER)

1. Cumulative Eligible Capital Expenditure – Section 14

An eligible capital expenditure (ECE) is an expenditure on account of capital for the purpose of gaining and producing income from a business.

ECEs include **goodwill, incorporation costs, licences, a customer list, or a franchise of unlimited duration** [do not confuse with franchises of a limited duration]

- ◆ One pool
- ◆ Enter $\frac{3}{4}$ into pool
- ◆ Rate is 7%
- ◆ Remove $\frac{3}{4}$ from pool
- ◆ No half year rule

1.1. Negative Balance

Any negative balance must be divided into two parts:

1. Lesser of:
 - Negative Amounts
 - Past CEC deductions
2. $\frac{2}{3} \times$ [Negative amount **minus** CEC deductions]
(i.e., should be equal to $(\text{POD}-\text{ACB}) \times \frac{1}{2}$)

The amounts calculated in 1 and 2 above are included in income.

SUMMARY OF ECE BALANCE

	CEC Amount	XXX
Add:	$\frac{3}{4}$ Acquisitions during the year	XXX
Less:	$\frac{3}{4}$ Dispositions	(XXX)
	Base Amount for CEC	XXX
	Deduct CECA (Base Amount x 7%)	(XXX)

CEC at the end of the year XXX

If – balance, include the following amounts in income:

1. Lesser of:
 - Negative Amounts
 - Past CEC deductions
 2. $\frac{2}{3}$ x [Negative amount **minus** CEC deductions]
(i.e., should be equal to (POD-ACB)* $\frac{1}{2}$)
-

1.2. Business Terminations

If business is terminated and there is a positive balance, this amount may be deducted from income.

APPENDIX F: SUPPLEMENTARY ON DEATH

1. Four Types of Returns

- i. Ordinary Return - Year Of Death:
- ii. Elective Return/Rights Or Things - Subsection 70(2):

Rights or things constitute amounts that are due but that have not been paid on the taxpayer's death.

- dividends declared but not paid on the date of death
- uncashed matured bond coupons
- unpaid salary, remuneration or commissions
- work in progress of a professional who elected to exclude work in progress in computing his income
- rent due but unpaid when the cash basis is used

Note that this is different than a periodic payment which constitutes amounts that have accrued but are not due at the time of death which must be included in the ordinary return of the deceased.

Rights and Things may also be transferred to the return of a deceased individual pursuant to subsection 70(3) and the recipient does not have to include until realized]. [Interesting Planning available this may lead to abusive results]

- iii. Elective Return/Business of Partnership Income for a Non Calendar Fiscal Year End – Subsection 150(4):
- iv. Elective Return/Beneficiary receiving income from a testamentary trust – Paragraph 104(23)(d):

2. Advantages of Multiple returns

- i. Application of Progressive Rates to each of the returns
 - Income Splitting
- ii. Personal Credits can be deducted in each of the returns as follows

Non-refundable tax credits that may be claimed on each return

- Basic personal credit
- Age credit
- Married credit
- Equivalent-to-married credit
- Credit for dependent aged 18 or over and mentally or physically infirm
- Informal caregivers' credit

Non-refundable tax credits that may be claimed on the different returns provided that the total amount claimed does not exceed the amount allowed if only one return were filed

- Credit for severe and prolonged physical or mental impairment
- Tuition
- Education credit
- Charitable gifts,

Deductions in computing taxable income and non-refundable tax credits that must be claimed on the return on which the associated income is reported

- Deduction for benefit derived from stock options
- Deduction for income exempted under a tax convention - 110(1)(f)
- Deduction for compensation received under an employees' or workers' compensation law
- Credit for pension income
- Tax credit for EI and CPP

3. Filing Deadlines - Paragraph 150(1)(b) and (d):

i. Regular Return For the Year of Death:

Death between January 1 and October 31 of a year:

Did not carry on a business:	April 30 of the following year
Carried on a business:	June 15

Death between November 1 and December 31

Did not carry on a business:	6 months after the date of death.
Carried on a business:	June 15

ii. Return for the taxation year preceding the death:

Did not carry on a business:	6 months after the date of death.
Carried on a business:	June 15

iii. Separate Returns:

- A separate return for income from “rights or things” is due on the later of:
 - one year after the date of death
 - 90 days after the date of mailing of any notice of assessment in respect of the income tax payable by the taxpayer for the year of death [subsection 70(2)]
- The separate return for business/partnership income and the separate return for trust income are due on the later of:
 - six months after the date of death
 - June 15 of the year following death

4. Special Situations involving Death

i. Retirement Arrangements

- The FMV of RRSP's and RRIF's must be included in deceased return unless transferred to a spouse

ii. Death Benefit

- Include in the recipients income.
- First \$10,000 received is exempt.
- Apply first to the spouse and the remainder to the other beneficiaries.

iii. Losses – subsection 111(2) and subsection 164(6)

Subsection 111(2):

- Net capital losses incurred in the year of death or carried over from preceding years may be deducted from the deceased taxpayer's other income in the year of death and in the preceding taxation year to the extent that they exceed the total CGD previously claimed.

Subsection 164(6):

- An estate may apply its net losses [i.e., capital losses in excess of capital gains + terminal losses] against the income of the deceased [capital gains first and then other income per subsection 111(2) but only in the year of death].

iv. Charitable Donations

- 100% net income limitation [rather than 75% for non-deceased taxpayers]
- May be carried back to immediately preceding year

v. Medical Expenses

- Medical expenses paid can normally be claimed for any 12 month period ending in the year to the extent they exceed a threshold amount .
- In the year of death, the time period is extended to the 24 month period prior to death.

5. Payment of Taxes – Subsection 159(5)

- May differ payment of taxes for 10 years [applicable for deemed disposition as well as rights and things]
- Interest is computed at the prescribed rates beginning when payment is due

APPENDIX G: SECTION 85 - MINIMIZING GAINS THROUGH « COST ISOLATION »

Mr. A owns 100 common shares of B. Corp with the following tax attributes :

POD : 1,000,000 ACB : 500,000

Mr. A would like to sell 50% of the company to Mr. C.

No Planning :

A straight sale (without planning) would entail the following tax consequences :

POD :500,000 (1,000,000 * 1/2)

ACB :250,000 (500,000 * 1/2)

CG : 250,000

Planning :

Mr. A could execute an internal rollover where he would exchange his 100 common shares of B. corp (i.e., agreed amount of 500,000) in consideration shares for 50 preferred shares of B. Corp with a FMV of 500,000 and 50 new common shares of B.Corp with a FMV of 500,000.

The ACB of the shares received by Mr. A from B.Corp. are determined as follows :

NSC	50 Preferred Shares	50 New Common Shares	AA
-	500,000	-	500,000

As a result, Mr. A could sell the 50 preferred shares (i.e., representing 50% of the company) and there would be no tax consequences as indicated below :

POD : 500,000 (i.e., being the FMV)

ACB : 500,000

C.G. Nil

APPENDIX H: AFFILIATED PERSONS

The definition of "affiliated persons" is set out in subsection 251.1(1). A taxpayer is affiliated persons with himself, his spouse, a corporation he controls, a corporation his spouse control, a corporation which is controlled by the taxpayer and his spouse. A taxpayer is **not affiliated** with his children.

The concept of affiliated important for the denial of certain losses.

The following losses are denied between affiliated persons:

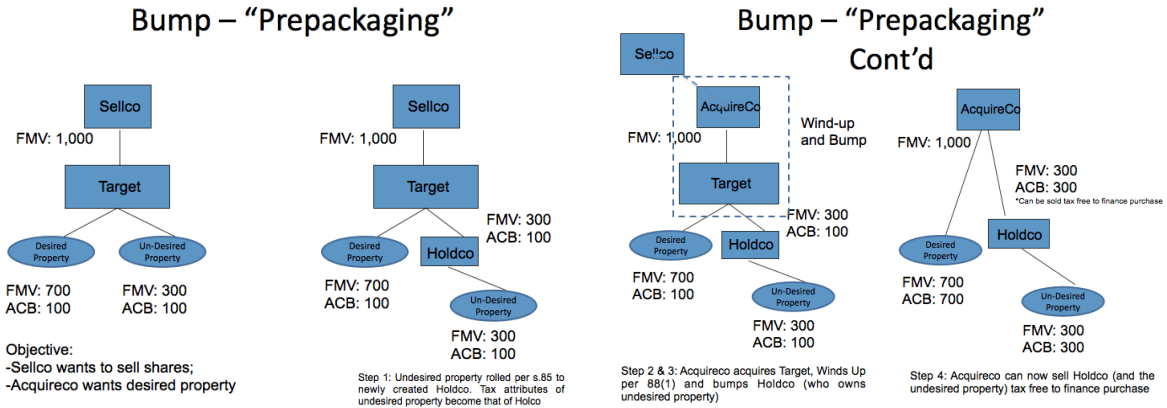
1. Individual transferring non-depreciable property to affiliated person – Paragraph 40(2)(g) by virtue of the definition of superficial loss found in section 54
2. Corporation transferring non-depreciable property to affiliated person – Subsection 40(3.3) and 40(3.4)
3. Redemption of shares and immediately after, taxpayer is affiliated with corporation – subsection 40(3.6)
4. Taxpayer transferring depreciable property to an affiliated person – subsection 13(21.2)
5. Taxpayer transferring ECE to an affiliated person – subsection 14(12)

The technical rules are as follows for individuals and corporations:

1. In the case of individuals, an individual is affiliated with his or her spouse or common-law partner.
2. A corporation is regarded as affiliated with
 - a. a person by whom the corporation is controlled,
 - b. each member of an affiliated group of persons¹⁸ by which the corporation is controlled, and
 - c. a spouse or common-law partner of a person described in (a) or (b).
3. Two corporations are regarded as affiliated corporations if
 - a. one corporation is controlled by a person that is affiliated with a person that controls the second corporation;
 - b. one corporation is controlled by a person that is affiliated with each member of a group of persons that controls the second corporation; or
 - c. each corporation is controlled by a group of persons, and each member of each group is affiliate

APPENDIX I: SUPPLEMENTARY BUMP USES AND ISSUES

Common Use of Bumps to Finance Purchase (i.e., Causes some parity between asset acquisitions and share acquisition):



Ordering Through a Chain of Affiliates:

